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UK rail operators brace themselves for shake-up

By Rose Jacobs and Mark Odell

The UK rail sector is preparing for a busy three years, with more than half the country's 19 franchises coming up for renewal.

This week the Department for Transport is expected to start the process when it sends out detailed information to the four shortlisted bidders for the contract to run the west coast mainline.



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The franchise linking London Euston to Birmingham, Manchester and Glasgow is one of the country's biggest and most lucrative, pulling in £753m (\$1.15bn) in revenues last year and £39.9m in pre-tax profits.

The stakes are high for Stagecoach, joint owner with Sir Richard Branson's Virgin Group of the west coast incumbent operator Virgin Trains.

But pressure is also bearing down on FirstGroup, the other London-quoted company on the shortlist, following recent signals from the government that it is looking to attract big foreign operators as part of a shake-up of the UK rail industry.

The two other shortlisted bidders – Keolis, a unit of France's SNCF, and Abellio, part of the Dutch state rail group – underscore this broader theme in the forthcoming round of refranchising, which has investors in UK transport groups on alert.

The 2010 takeover of Arriva by Deutsche Bahn gave the German state rail group about 10 per cent of the UK passenger rail network, while the Dutch and French state operators already have a foothold in the UK market through joint partnerships.

Abellio also won its first standalone contract late last year, a short, two-year deal to run the Greater Anglia rail franchise, beating out homegrown companies Go-Ahead and Stagecoach.

With an estimated £4bn in annual revenues at stake in the next eight franchises coming up for renewal, other state-controlled groups are circling. Renfe, the Spanish state-owned rail operator, and MTR, the Hong Kong-listed, government-controlled transport group, are also looking at opportunities.

Teofilo Serrano, chief executive of Renfe, said: "There are three new franchises being put out to tender in 2012 and we hope to be present in these processes."

Sir Richard Branson, Virgin Group founder recently railed against foreign companies' ability to bid for UK business while their own domestic markets were in effect shut to UK-based rivals.

But many in the industry, including Sir Brian Souter, chief executive of Stagecoach, believe the threat from foreign operators is overstated. He said last year: "We've all got big enough balance sheets. If we wanted to play the game, we could play it."

Other executives privately question how radical the government will be in its much-vaunted reform of UK rail, prompted by a report by Sir Roy McNulty into the cost structure of the industry published early last year.

It recommended sweeping changes, including longer, more flexible franchises that encourage greater investment and cost-cutting by the operator and closer co-operation with Network Rail, the infrastructure owner. Current franchises typically range from seven to 10 years; in contrast the renewal of the west coast franchise is expected to be for at least 15 years.

Changes the government is exploring include a change to the risk-sharing mechanism, to avoid a repeat of the fiasco surrounding the east coast franchise, which National Express walked away from in 2009 after passenger numbers badly missed expectations.

An official response to the report is expected from the DfT as early as this month. But the west coast franchise is expected to be exempted from any serious reform, in part because it has already seen significant investment over the past decade.

The outcome of the west coast competition may give investors a better feel for the seriousness of the threat from foreign operators. But the outcome of the government review and its impact on the next three franchise renewals, including Thameslink and Great Western, will have a greater bearing on the sector's competitive landscape.

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Coming down the track

UK rail franchises up for renewal

Route and current operator	Passenger journeys	Renewal	Shortlisted for new franchise
Intercity West Coast Virgin Trains	 27m ↑ = 5m Journeys	Dec 2012	Stagecoach, FirstGroup, Keolis, Virgin Trains, Serco & Abellio
Greater Western First Great Western	 84m	Mar 2013	FirstGroup
Essex Thameside c2c	 32m	May 2013	National Express
Great Northern/Thameslink First Capital Connect	 90m	Sep 2013	FirstGroup
Northern Northern Rail	 84m	Sep 2013	Serco & Abellio
Intercity East Coast East Coast	 18m	Dec 2013	Directly Operated Railways (government owned)

Source: Deutsche Bank