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FirstGroup

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West Coast rail franchise award stokes debate about foreign state operators

The awarded of the West Coast mainline railway franchise to a partnership between FirstGroup PLC (LON:FGP) and Italy's Trenitalia has stoked the debate about Britain's train companies being taken over by foreign state-owned firms.

With a succession of UK governments so resistant to returning the railways to state ownership, it seems quite a strange approach.

On Wednesday, FirstGroup and Trenitalia were announced as the winners of the Department for Transport's West Coast bid and will run West Coast services out of London Euston from 8 December 2019 to 2026.

The DfT also announced that the First Trenitalia joint venture will then run HS2 services through to March 2031.

Also this month, Abellio, the Dutch state-owned operator, took over from Stagecoach Group PLC (LON:SGC) on the East Midlands line, while National Express Group PLC (LON:NEX) two year ago sold out of its last UK train franchise, c2c, which it handed off to Trenitalia.

That means that only six out of 30 of UK rail franchises, including London underground and the not-yet operational Crossrail, do not have some sort of foreign owner.

This could be seven if you include Heathrow Airport as the owner of the Heathrow Express, but the airport is owned by a consortium of overseas investors, so we're not.

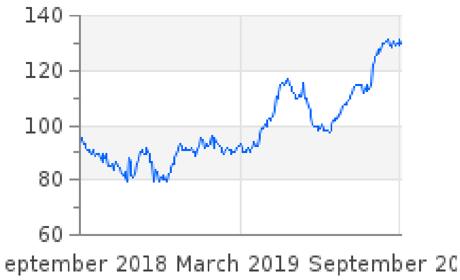
This will mean that 80% of the UK's train companies are at least partly foreign owned, up from 70% when the RMT union last researched the situation in 2017.

UK rail franchise Operator (country) c2c Trenitalia (Italian state) Chiltern Arriva/Deutsche Bahn (German state) Caledonian sleeper Serco (UK) Crossrail (from 2020/21), TfL Rail (currently) MTR (Hong Kong state) East Midlands Abellio (Netherlands state) Eurostar SNCF (French state), CDPQ (Canadian), SNCB (Belgian state) Gatwick Express Govia (UK-French state) Grand Central Arriva (Germany state) Great Northern Govia (UK-French state) GWR FirstGroup (UK) Greater Anglia Abellio (Dutch state) and Mitsui (Japan) Heathrow Express Owned by the (foreign owned) airport Hull Trains FirstGroup (UK) East Coast LNER (UK state) London Northwestern Abellio (Dutch), JR East and Mitsui (both Japan) London Overground Arriva (German state) London Underground TfL (UK state) Merseyrail Serco (UK) and Abellio (Dutch) Northern Arriva (German) Scotrail Abellio (Dutch) South Western Railway MTR (Hong Kong) Southeastern Govia (UK Plc-French state) Southern Govia (UK

Price: £1.32

Market Cap: £1.6 billion

1 Year Share Price Graph



Share Information

Code:		FGP
Listing:		LSE
52 week	**High**	**Low**
	134.5	**77.95**
Sector:		**Transport**
Website:		**www.firstgroup.com**

Company Synopsis:
FirstGroup plc is engaged in the provision of passenger transport services. It operates in four divisions: Bus, UK Rail, North America and Greyhound.

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Plc-French state) Stansted Express Abellio (Dutch state) Thameslink Govia (UK Plc-French state) TransPennine Express FirstGroup (UK Plc) Transport for Wales Keolis (French state) West Coast FirstGroup (UK) and Trenitalia (Italy state) West Midlands Railway Abellio (Dutch), JR East and Mitsui (both Japan)
What's behind the story?
The reason behind this is relatively simple: after the British Rail monopoly was broken up and privatised in the 1990s under John Major's government.

In short, the deep-pocketed overseas state operators battled to win the franchises, which were initially put up for tender on a lowest-cost wins basis.

Looking in the contracts, in several cases the overseas partner only has a relatively small stake, such as Govia, the joint venture partnership 65%-owned by Go-Ahead Group PLC (LON:GOG) and 35% by Keolis, which is 70% owned by France's state-owned SNCF.

But most are run by a single operator, as shown in the table above.

Train companies and Network Rail, represented by the Rail Delivery Group, of course argue that the public and the state have benefitted from franchising.

They say international rail companies "bring new ideas and innovation", increasing passenger numbers and with the railway system transformed from a £2bn a year cost to the taxpayer to a contribution of £200mln a year.

Franchise failures
However, the franchise system is not without its many critics.

Some point out that when in public hands, the East Coast main line returned over £1bn to the Treasury without hiking fares and had a strong record for passenger satisfaction and industrial relations.

The East Coast line is again in public hands as the franchise system can lead to over-optimistic projections by the companies in order to win.

Stagecoach and Virgin's struggling East Coast franchise had to be rescued and bought out last year, with the premature end enabling the joint venture to avoid paying up to £2bn into the public coffers.

"Awarding a complex contract for both the West Coast Partnership and HS2 services to First Group, a company with questions over its finances, is a gross error of judgement," said shadow transport secretary Andy McDonald said on Wednesday.

He noted that the government had cancelled the Southeastern rail franchise competition only last week, which he said was an admission that the "rail franchising process will not deliver for passengers or the taxpayer" and rather than being run in the interests of passengers was instead "ripping them off to line the pockets of profiteers and shareholders".

Passenger satisfaction?
Challenging the operators and government's assertion that the service has improved under the franchise system, recent research by independent passenger watchdog Transport Focus found that many passengers do not feel they are getting the train service they are paying for.

"This research underscores that passengers want a more reliable service that is better value for money and - whichever model is selected to run the system - that they want to know who is in charge of their railway," said Mike Hewitson, head of policy at the Transport Focus.

"For many, the issue of accountability - or a lack of it - coupled with a perceived lack of 'customer-focus' leads passengers to believe the system is based arounds the needs of the railway rather than their needs. This has to change."

Rail unions were also not surprisingly unimpressed.

Manuel Cortes, leader of the TSSA, said: "The person appointed by the government to oversee a root-and-branch review of our railways has already said franchising is not 'delivering clear benefits for either taxpayers or farepayers'.

"One has to ask what's the point of continuing with this broken system which only benefits privateers at our expense? Shapps is in danger of inheriting Grayling's failing tag."

Early arrivals or late departure?
The DfT maintained that the new contract award represented a move away from the old the franchise system, arguing that its use of a forecast revenue mechanism (FRM), designed to offer protection against shortfalls in estimated revenues, would use a to avoid a repeat of the issues seen last year at the East Coast franchise.

First Trenitalia expects to make annual profits of at least £50mln a year after paying back excess profits of about £1.6bn to the Treasury over the six years and four months of the contract.

The UK railway award system can often spring a surprise and the West Coast franchise award may not be a done deal yet.

This is because Stagecoach has brought a judicial review against the DfT over its bid for the franchise being disqualified over a lack of clarity on future pension liabilities.

There was also speculation that Hong Kong's MTR, which lost out in the final bid, was mulling a challenge of the franchise award.

"We will seek clarification from the Department for Transport about why we were unsuccessful," an MTR spokesman said.

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