

Market and revenue case

Central Railway is a Franco-British project that will extend the benefits of the Channel Tunnel to the North of the UK. It will reduce the cost of transporting goods to and from mainland European markets and directly create employment. Crucially, it will remove more than five million HGVs a year from UK roads.

Target market

Central Railway's target market is freight currently transported by lorry or container between the UK and mainland Europe via ports in France, Belgium and the Netherlands and the Channel Tunnel. In 2000 this market was 5.3 million units, including 1.1 million units carried by Eurotunnel's lorry shuttle service.

The volume of road freight in this target market grew by more than 6.6% a year between 1982 and 2000, nearly doubling every ten years. Key drivers of this growth include GDP, increased trade between the UK and mainland Europe and just-in-time manufacturing.

Although the market may well continue to grow at a rate of 5-6% a year, the company has assumed a more conservative growth rate. On this basis, the company's target market would reach more than 13 million units by 2015.

Market requirements

Cost will be the determining factor when hauliers decide whether to use Central Railway's services. Other factors, such as reliability, frequency and time savings are less important provided that:

- ◆ 90-95% on-time performance is achieved
- ◆ there are scheduled departures every 3-6 hours

- ◆ the service is as fast as available road/ferry or road/Eurotunnel options.

Hauliers have to make a mode transfer (from road to ferry or train) to cross the Channel. With Central Railway, they will be able to make this mode transfer earlier in the journey, (ie at a Central Railway terminal). Accordingly, the company's tariffs are set at levels aimed at ensuring that they will always be at or below competing road costs on relevant routes. Initially, the tariffs will be on average 16% lower than the overall cost of the equivalent slower and less reliable road/ferry and road/Eurotunnel options. The cost of the whole journey, including the road hauls before and after using Central Railway, will be on average 8% lower than other options.

These savings do not take into account of any increase in road or HGV costs. With a shortage of drivers pushing wages up, congestion, higher fuel costs, distance-based road charges for lorries likely to be introduced in the UK and France from 2005/6, drivers' working time restrictions and restrictions on the size of HGVs, it is likely that real road haulage costs will continue to rise.

The very competitive market puts heavy pressure on hauliers to reduce costs. As little as 1% difference in price often determines the choice of mode and routing. With hauliers' profit margins at 2-4%, it is difficult to see how they could reduce their margins further.

Market research

Central Railway commissioned Roland Berger & Partners, a top international transportation consultancy to assess the volume and growth of the UK-Continental Europe freight market and the share of that market that Central Railway could reasonably expect to capture. This research was updated in 2001 and a copy of the report is available on our website.

Projected market share

Based on this pricing strategy and assuming that Central Railway meets hauliers' service requirements, the company is likely to achieve a market share of 50%. This is a reasonable assumption given that similar services operating over similar distances in the USA achieve 60-80% market share.

Potential competitor reaction

The main threats to the company achieving its target pricing and market share are:

- ◆ failure to deliver the expected level of reliability
- ◆ ferry companies and/or Eurotunnel regularly undercutting Central Railway's tariffs.

The company is confident that, with the benefit of its own, purpose-built railway, it will consistently deliver on-time performance of 95% or more. Given the economic advantages of rail over road, especially for distances of 400km or more (even without a barrier like the Channel, or extreme road congestion on the M6 or M25), the company believes that, for most of the target routings, it will deliver its services at or below the cost of the lowest alternative.

Central Railway will be competing with the ferries and Eurotunnel's Shuttle service on both price and service. Cross-Channel ferry prices have halved in real terms since Eurotunnel opened in 1994, with

margins on these routes now much thinner. To compete with Central Railway, ferry companies would have to reduce their prices further and permanently.

Eurotunnel's highly successful lorry shuttle service reinforces the company's view that a fast, reliable rail service tailored to hauliers' needs can attract a large market share. It has achieved this at fares slightly higher than those charged by the Dover Straight ferry operators. Central Railway is an extension of this most successful aspect of the Channel Tunnel and will enable Eurotunnel to make more efficient use of existing capacity and increase its revenues substantially. In 2002 the tunnel was operating at approximately 50% of its capacity. Central Railway is the only realistic current proposal which could use some of this spare capacity, paying Eurotunnel fees of more than £500 million a year to do so.

For more detailed analysis of Central Railway's potential market see Roland Berger's Revenue Case in the Business Case section of our website.

What are the alternatives open to hauliers?

- ◆ *Continue to use road transport:*
Road traffic is expected to double in the next 20 years, which will lead to even more congestion on a road network that is already reaching saturation point in many areas. Clearly, carrying freight by road is going to take longer and cost more.
- ◆ *Switch to existing rail freight services:*
Currently less than 5% of UK-mainland Europe freight is transported by rail. Traditional rail freight services are of limited interest to international transporters, mainly because they tend to be slow and impractical. The opening of the Channel Tunnel has done little to increase the volume of international rail freight. Excluding that carried by Eurotunnel's lorry shuttle, about one million tonnes more were carried in 1996 than in the mid-1980s when train ferries were used.
- ◆ *Put lorries on trains running on existing railways:*
Few railways are able to carry HGVs as the structure gauges in the UK and France are too low for standard HGVs on flat wagons to go through them. This means that almost no RoRo traffic can use rail. Some rail operators get round this by offering a service which requires hauliers to invest in specialist road-rail equipment enabling their trailers to be carried by train. As this involves considerable investment and commitment from hauliers, its success is limited.

While every effort has been made to ensure the accuracy of the information contained in this document, no responsibility can be taken for errors or omissions made.

For further information about Central Railway please visit our website,
www.central-railway.co.uk
or contact us at the address below.