THE WAGONLOAD —
An important (and sustainable!) business for France…and Europe

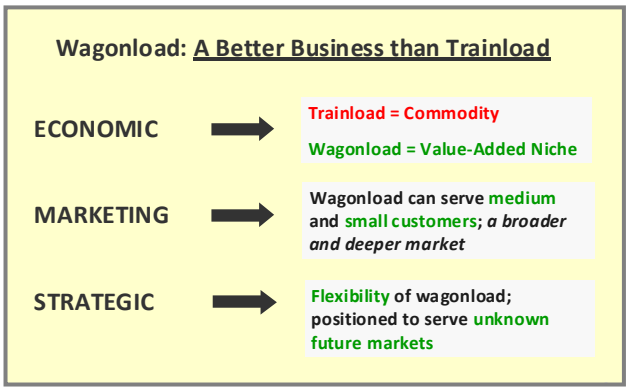
Henry Posner III, *Chairman*

First of all, I am an American in Europe and let me assure you that I know that Europe is not America, and I'm not here to tell you that you should become America; Europe is a passenger railway network that has freight, as opposed to the U.S. network which is a freight network that has passenger service.

Today I'll discuss two themes that keep coming up in the European context. The first one is the future of the wagonload, but equally important is the future of the trainload. In order to make efficient use of your time, I will present some specific ideas of what could be done to make the wagonload a better business, and in particular, why I think the wagonload is in fact a better business than the trainload business. Looking into the future, I see a bleak future for a block train oriented railway network and that bleak future is something you can already see in the UK, where there is no wagonload traffic. And then, we'll migrate to the roundtable format and get everyone's input from the panel and hopefully get good questions.

First I want to emphasize that everything being presented today are solutions that can be done within the existing framework of the European railways as they are right now.

To begin, I would like to present my view of how the wagonload business compares with the trainload business in three different ways: (1) economic, (2) marketing, and (3) strategic.

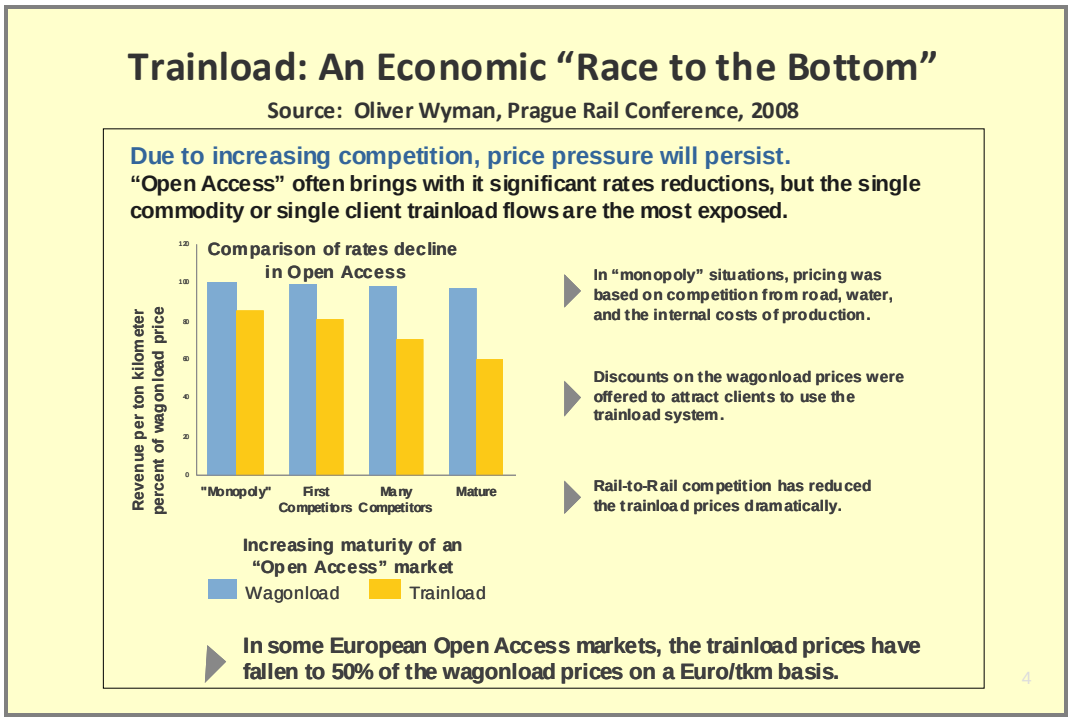


(1) From an economic perspective, the trainload is a commodity whereas the wagonload is a specialized value-added niche product.

(2) From a marketing perspective, the wagonload is a product which can serve medium and small customers. It is also a product which, if you can't generate a trainload of traffic, is still something that can be used to, among other things, take trucks off the highway.

(3) Third, and this is a topic that we don't often discuss in the USA, railways need to be positioned to serve the traffic of the future. If you are looking at where to invest your infrastructure dollars, keep in mind that ten years from now many of your major clients will have closed down and you'll be looking for new clients; this has certainly been our experience in the USA. So the railway has to be there for the traffic of the future, which no one is smart enough to predict. And the flexibility of the wagonload to meet that future demand is greater than the ability to build new lines to serve trainload customers that may or may not exist in the future. So from a strategic perspective, this is a very important point.

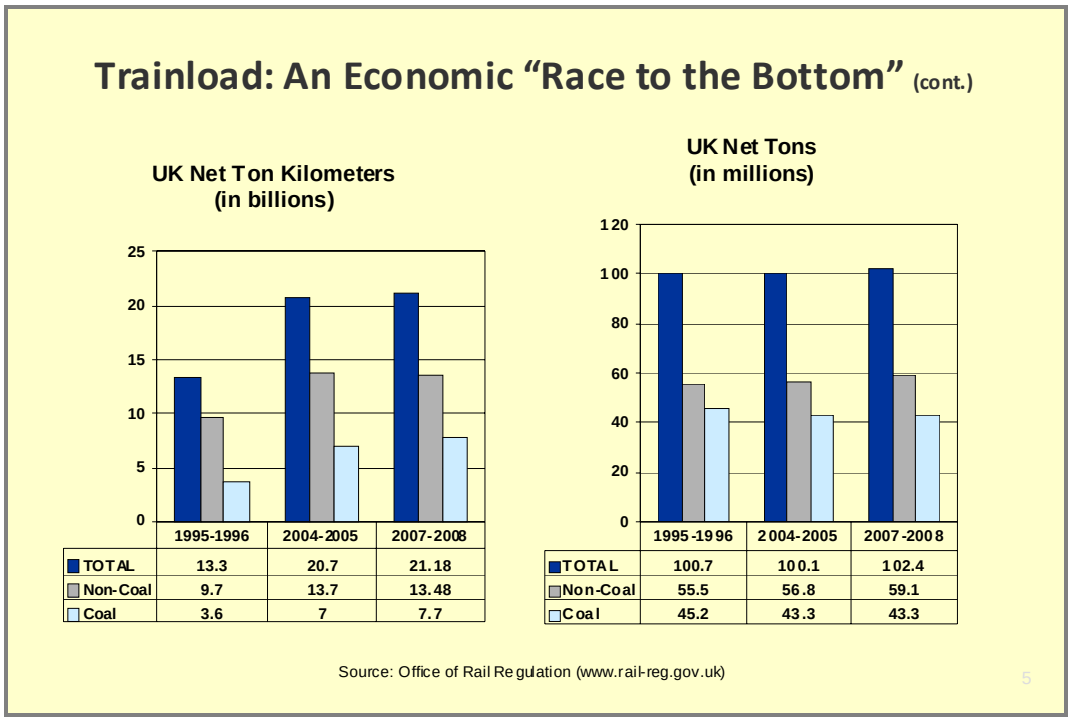
Like everyone else on this panel, I bring bias to this subject. But in an effort to reduce the amount of bias that I bring, I will present two slides containing data from other sources. I was told by some that the slide title "Trainload: An Economic Race to the Bottom" may be too strong, but others felt strongly that this point needs to be made. The point is that the trainload business is an economic race to the bottom which is not unlike the U.S. airline industry. Ultimately it's a commodity and the driver is price, and if you don't cut your costs (including your employees' wages) to the level that your competition will, you're going to lose the business.



This slide (above) is a public document from Oliver Wyman that was presented recently in Prague; and I think it encapsulates very well the European problem of liberalization—that in a trainload environment, the downward pressure on prices is relentless. What this table shows,

compared with wagonload, is the downward pressure on prices as new trainload operators come into the market. I think this is the best example that could be presented in terms of the revenue impact of the trainload's becoming a commodity.

Next, let's look at the UK and what happened from a volume perspective in a trainload environment. The statistics shown in this slide (below) come from the Office of Rail Regulation and what's interesting is that it shows 13 years of experience under liberalization.



The statistics that you hear the most from the UK are the statistics in the left graph—the dramatic increase in train-kilometers as result of liberalization; but what this does not tell you is that the main driver of the increase in train-kilometers was the collapse of the domestic coal industry. So this reflects nothing more than the fact that the domestic coal mines closed and they are importing coal, which moves a longer distance; it's got nothing to do with bringing new business onto rail, and the proof is in the right graph, which shows tons as opposed to ton kilometers. In 13 years of liberalization there has been no growth at all in rail traffic. In fact, the non-coal traffic actually decreased. This is a bleak future and this is the future that awaits a European network without wagonload.

Now let's discuss the wagonload "as is, where is." And by the way, I have a timer here and every 3 minutes I am going to remind you that I know this is Europe and not America!

There are institutional aspects to the wagonload business which I believe can be grafted into Europe that have nothing to do with loading gauge, signal systems, clearances or passenger congestion. It is really quite simple: if you make the product more reliable and faster, and create something that is not just more competitive with trucks, but a product that is actually more valuable to the customer, you can raise your prices. Everyone says that the wagonload is a high-cost business, which is true, but it is also a management-intensive business and it is a value-added business. So if you can improve your service, it is possible that you can command a higher price in the market, which in conjunction with efficiencies can make the wagonload a viable form of transportation. I would argue that this is not a cost problem but rather it is a combined cost problem and a revenue opportunity.

How Wagonload Can Be Profitable

- Reduced handlings = increased reliability, speed…
- …therefore lower cost, more valuable product
- More valuable product = higher revenue/wagon
- Lower costs also include asset utilization; risk sharing with asset owners, etc.
- Promote creation of, and full commercial integration with, short lines (and international connections)

To the extent that not every railway line is going to be viable, there is a third way, which is the Short Line. I know that in France there is movement toward the creation of short lines (OFPs), but I think that, unless there is full commercial integration of the short lines with the network carrier, it is going to be disappointing to all concerned. It is like being a commuter airline going to an airline hub that has no service to major cities; if you have a feeder system but no network to feed, you're wasting your time. By the way, this also applies to international traffic and Oliver Sellnick will discuss X-Rail, which is one of the real rays of hope in Europe these days.

It is also true that there are "soft" benefits to wagonload traffic and I'm sure most people would agree that saving the planet is a good idea. The problem is that we in the railway business don't get paid to save the planet. It makes us feel good, you can put bullet points in your annual report, and you may even want to put out a sustainability report (on recycled paper, of course!), but nobody is going to give you business because you are environmentally friendly. Nonetheless, the wagonload is a very environmentally-friendly product, especially in France where most of the haulage is electric and, in fact, most of the electricity is nuclear; you can't get greener than that. And from a congestion perspective, the wagonload business keeps a million trucks off the highways per year. Perhaps most importantly,

"Soft" Benefits of Wagonload

Environmental:	Most haulage **electric**
Congestion:	**500,000 wagonloads = 1,000,000 trucks**
Economic Development:	Platform for **regional growth**
Employment:	Thousands of **jobs**

it serves as a platform for regional growth because, again, no one knows the business of the future; our biggest business on the Iowa Interstate Railroad is ethanol, which did not even exist when we made our first investment in 1991. And of course there are thousands of jobs directly related to this business which is an important social consideration.

But rather than talk in generalities, let me present a case study; in particular, some ideas that could be applicable in France. I think it is important to bring the stakeholders together—SNCF as the network operator; the government, that sets the policy and the funding; and other stakeholders. Then you can take the business as it is right now and make incremental improvements ranging from service improvements to cost reduction to revenue growth, as I just described.

A Strategy for the Wagonload in France

- Partnership with SNCF, Government, others
- Stabilize the business through:
  - ✓ Service improvements
  - ✓ Cost reductions
  - ✓ Revenue growth

But the most important piece I think is the commercial integration, as I also mentioned before. For the international traffic, X-Rail is one answer; and for the domestic scene, short lines. Again, for short lines, not every one is going to be stand-alone profitable and there may well need to be some involvement from the public sector on a regional basis. In the USA, we have 600 short lines and each one is financed in a different way.

A Strategy for the Wagonload in France (cont.)

- Commercial strategy: work with rail connections to compete with trucks:
  - ✓ International: X-Rail
  - ✓ Domestic: Short Lines

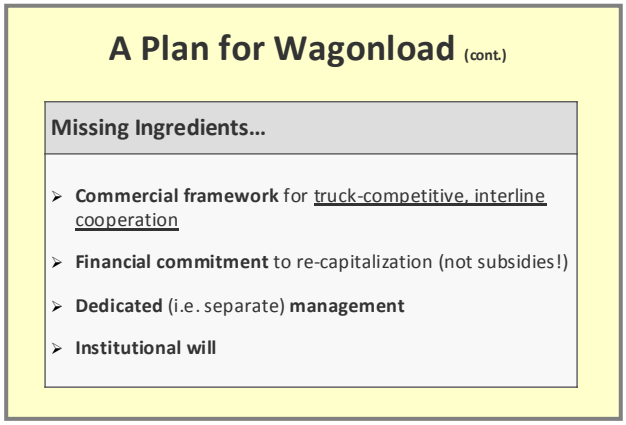
(For light density short lines, work with regional public sector as needed)

So in order to make the wagonload business a different type of business, a lot of basic ingredients need to exist. (Like Jacques said in his presentation before me, I too use the word "ingredients" because this is basically a recipe.) There is a broad and diverse base of customer support for the wagonload; the human capital exists–there are plenty of dedicated railway people who are really interested in the business and they like their jobs; and there are important physical assets that have disappeared in many other environments, such as private sidings. Wherever there is a private siding, you have eliminated the need to pay for trucking to go from the rail head to

A Plan for Wagonload

Basic Ingredients Exist…	…And Risk is (relatively) Low
➢ Customer Support ➢ Human capital ➢ Physical assets (including yards, private sidings)	➢ Diverse traffic base ➢ Defined competition (truck)

the customer, and usually it is two trucks per wagon plus the cost of transloading, etc. And as far as risk goes, it is a relatively low-risk business because the traffic base is diverse, and you know what the prices are going to be because they are set by the truckers. Unlike the trainload, it is not a "race to the bottom." In the wagonload business you simply need to price against truck competition.



However, there are ingredients missing in the wagonload as it stands today, and one of them I think is the commercial framework in which (1) railways work together to compete with trucks, (2) every carrier makes a profit, and (3) the customer sees one price. I wish I could give you a book or a document to show how this works, but unfortunately, it is not documented. All I can say is that we have been working in this environment for approximately 30 years in the USA, but no one has written it down. However, it is possible to graft that institutional knowledge into Europe because it is the same. You are competing against trucks, with multiple rail carriers involved in a relatively complex type of movement. Another thing that is necessary is that the business needs to be re-capitalized, but re-capitalizing the business is different than a subsidy. You also need a very focused type of management because it is a management-intensive business. And lastly, you need the institutional will to make it happen. If you have all of these things, it will be a reality instead of just my advice.

Thank you and I hope my comments will stimulate some very interesting questions.

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