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HIGH SPEED Italy

Ownership change heralds expansion at Italo-NTV



Photo: Gabriele Moschetto

Global Infrastructure Partners' surprise acquisition in February of Italian high speed open access operator Italo-NTV puts the business on course for further expansion, with an eye on market opening across Europe.

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Italo is now American. The world's first high speed open access railway undertaking was sold in February to Global Infrastructure Partners, an independent investor whose transport assets already include rail freight operator Pacific National in Australia, the Port of Melbourne and London's Gatwick Airport.

The acquisition came as something of a surprise, because Italo-NTV had been preparing for a listing on the Italian stock exchange. The plan had been to float up to 40% of the company's capital in an initial public offering, expected to take place at the end of February ahead of the Italian general election on March 4.

In the event, Italo-NTV — the new name combining the Nuovo Trasporto Viaggiatori title from the company's 2006 launch with the Italo brand selected for its services — was sold for €1·98bn plus debt of around €440m. GIP's positive evaluation of the business was surprising to many analysts, making it one of the biggest such acquisitions in the history of the rail sector.

Left: Italo-NTV Chairman Luca Cordero di Montezemelo and CEO Flavio Cattaneo launched the first Evo trainsets in comercial service in December 2017.

Right: Fig 1. Italo-NTV's EBITDA margin reached nearly 35% in 2014-17.

Far right: Fig 2. Italo-NTV can point to spectacular growth in the number of passengers carried, with traffic nearly doubling since 2014.

GIP had initially offered €1·9bn for 100% of the company, but after two days of negotiations increased its bid to €1·98bn. The value of the business, including debt, is thus around 11 times the estimated EBITDA for 2018 — which is higher than that of many airlines. It was not easy to calculate the company's net value because there are few direct comparators; this kind of open access high speed rail operation had not been attempted before.

Impact

Perhaps the most interesting question is what impact GIP's acquisition of Italo will have on the European railway market. In the last few years Europe's rail sector has been changing as competition is introduced to both the international and domestic markets. Some countries have led the way in demonstrating the importance of giving



consumers a choice. But while the benefits of competition are clearly evident in other industries such as aviation and telecommunications, true competition in Europe's passenger rail sector remains rare, especially in the long-distance segment.

Above: Italo-NTV is taking delivery of 17 Evo trainsets to augment its initial 25 AGV units.

> *'In Italy there are a number of longer-distance city pairs where aviation is losing market share to rail'*

The opening up of Italy's high speed passenger rail market took effect in 2012, when NTV launched its Italo services against incumbent national operator Trenitalia. NTV had been founded six years earlier with an eye to the forthcoming market liberalisation, and ordered 25 AGV trainsets from Alstom in 2008. However, the privately-owned company was faced with a long and difficult process obtaining the necessary safety licences and technical approval to operate its new fleet, and it was not until April 28 2012 that its first train carried fare-paying passengers on Italian rails.

Life for the new operator was not easy in the early years, with the slow build-up of traffic insufficient to generate an early return on the investment. However, the company has seen a significant turnaround in its fortunes, thanks to some far-sighted decisions taken by incoming CEO Flavio Cattaneo in 2015. These led directly to Italo-NTV reporting its first profit.

Strategy for profit

Faced with the need to reduce costs, Cattaneo felt that it was important to have a clear strategy to increase productivity, as well as adopting a much more aggressive pricing strategy. This generated benefits not only for the operator, which in 2017 achieved an average load factor close to 80%, but also for customers who were able to take advantage of some significantly lower fares.

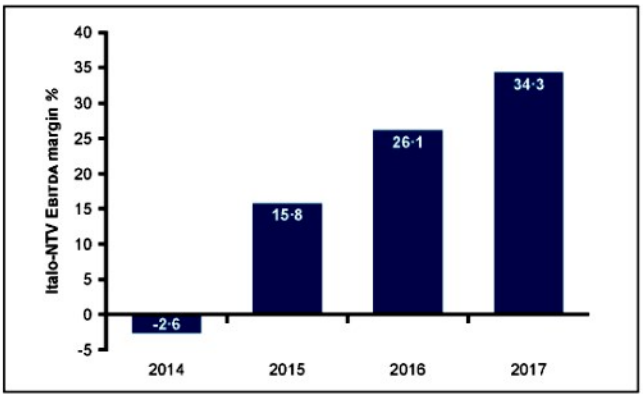
Once competition started, the benefits for travellers soon became very clear. The average yield per passenger-km in the Italian high speed sector fell by around 40%, and as a result of these cheaper fares the total demand shot up by no less than 90%. Both Italo-NTV and Trenitalia have sought to meet this demand by increasing the number of trains operated, which could be accommodated without the need for further construction of high speed lines.

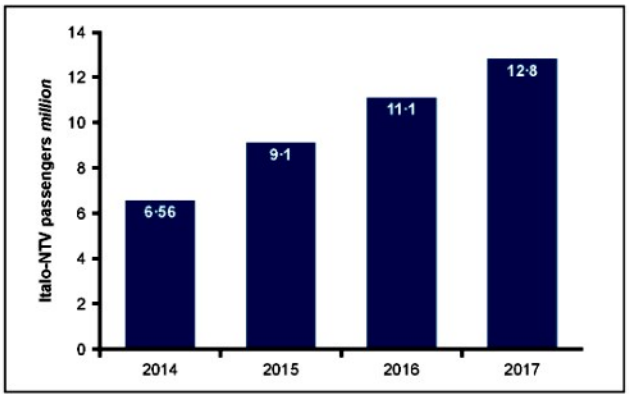
Italo's very competitive pricing strategy was supported by a revenue management and seat inventory system that allowed flexibility and ensured the ability to respond quickly to the market by defining new offers and prices. The impressive growth in demand was achieved despite a recession in the Italian economy — gross domestic product in 2017 was two points lower than in 2011.

By growing the market, NTV has been able to keep its fares at a very competitive level, with an average yield per passenger-km well below the norm for established high speed rail operators. Italo's yield in the first half of 2017 was around 7·5 euro cents (€0·075). This is not very different from the average yield achieved on China's high speed lines and is around 30% lower than the figure reported by Renfe Operadora for its AVE services in Spain. In comparison with Japan it is less than half of the average yield achieved by JR East, and it is probably 60% lower than the average yield for the Thalys services linking France with Belgium, the Netherlands and Germany. However, thanks to the operational efficiencies, the increased ridership generated an EBITDA margin of 34·3% in 2017 (Fig 1).

Recapitalisation

As part of the 2015 changes, the company decided to recapitalise in order to raise funding to buy additional trainsets. This would allow the operation of more





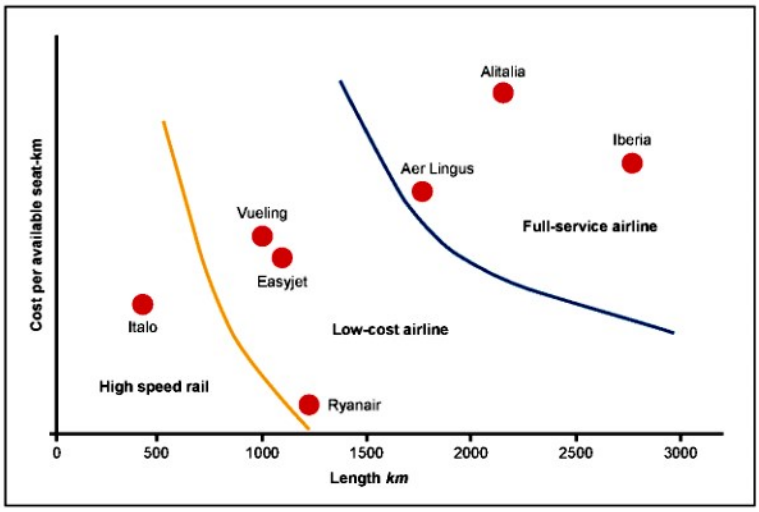


Fig 3. The cost per available seat-km for Italo-NTV services compares favourably with low-cost and full-service airlines.

frequent services and more routes, helping to increase its share of the business market in particular. It is important to understand that in the high speed rail business, frequency is a key driver of success in terms of achieving a higher yield.

A key element in the business strategy was a review of the long-term train maintenance contract with Alstom. An improvement in trainset productivity was essential to achieve the higher service frequency, and thanks to the changes, Italo-NTV was able to step up the number of daily services operated by its 25 AGVs from 48 in 2014 to 56 in 2016.

To pave the way for further expansion, Italo-NTV decided to order more trains, placing firm contracts with Alstom for a non-tilting Pendolino derivative now branded as 'Evo'. It is buying 17 sets, which will bring the combined fleet to 42 by the end of 2019, and the company holds an option for a further five. The first four of the new trains were put into service on December 7.

This combination of running more services between more cities and an aggressive pricing strategy allowed the company to nearly double the number of customers in just three years. The Italo fleet had carried 6·56 million passengers in 2014, but the annual ridership figure shot up to 12·8 million in 2017 (Fig 2).

Air-rail market shift

The productivity improvements drove down the cost per available seat-km to a lower level than that of many low-cost airlines, which has been essential to support the low-yield pricing policy. Significantly, Italo-NTV is not itself a low-cost carrier as it offers a wide choice of services across the entire market sector. Wi-fi and an entertainment portal are available on all trains, while passengers travelling with the higher priced Club Executive tickets have access to dedicated Italo lounges at six major stations.

A comparison between the high speed rail and aviation sectors demonstrates how efficient Italo-NTV has been in comparison with both low-cost and full-service carriers (Fig 3). Italo's cost per available seat-km is less than half of that for some of the full-service carriers, which helps to explain why rail has been able to gain such an important share of the domestic inter-city market.

The reduction in the cost per available seat-km also makes the train more competitive over longer routes. Historically, high speed rail was able to compete with the plane on journeys of 3 h or 3½ h, but in Italy there are a number of longer-distance city pairs where aviation is losing market share to rail (Fig 4). Examples include Milano – Napoli (4 h to 4 h 30 min), Torino – Roma (4 h 20 min) and Torino – Napoli (over 5 h). The airlines have been losing market share on all three routes since the completion of the north-south high speed rail corridor in December 2009 (RG 1.10 p26), although the shift became much more evident after Italo entered the market (Fig 5).

The launch of Italo services in 2012 forced Trenitalia to make changes to its offering. A range of product innovations was introduced, including 50 new Frecciarossa 1000 trainsets for its premium high speed services, which compete head to head with the AGVs. Rail now dominates the most important domestic route linking Roma with Milano. Market share has increased consistently over the last few years and now stands at 75%, with the two operators each providing two trains/h for much of the day.

Now, the delivery of the new trains leaves Italo poised to enter further markets. East-west services on the Torino – Milano – Venezia route launch on May 1.

Why GIP entered the market

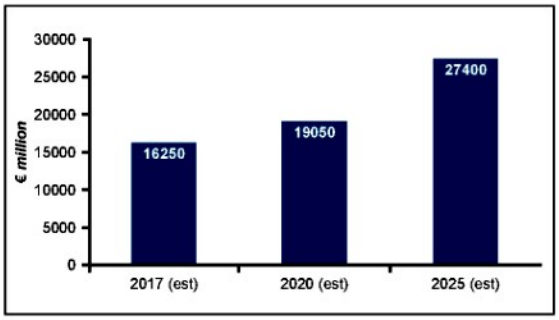
In order to understand why an infrastructure fund like GIP has acquired a passenger train operator there are five aspects to consider:

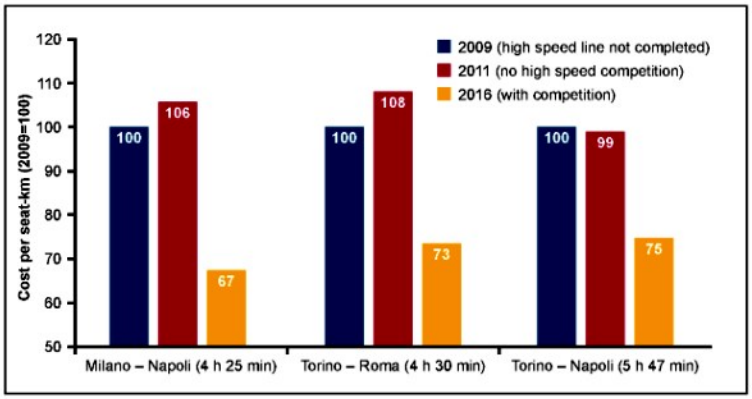
- the EBITDA margin of Italo-NTV is similar to that of the utilities sector;
- regulation of the business will remain stable for the next four years, as will the level of access charges for using RFI's infrastructure;
- the European market for rail passenger services will be opened up further in the next few years;
- the increase in fleet size will permit the operation of even more frequent services, as well as entering additional markets;
- it will be not easy for a third operator to enter the Italian high speed market because of the established dominance and frequency of Italo and Frecciarossa services.

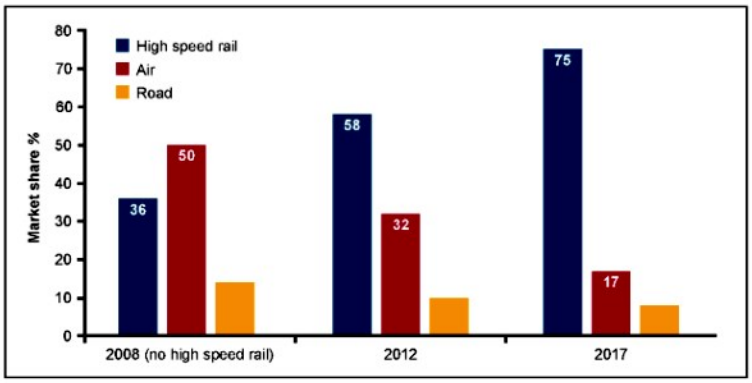
Once the Fourth Railway Package comes into effect, the Italo business model could be replicated in other European markets, as Italo-NTV Chairman Luca Cordero di Montezemolo

Below and right: An Evo trainset calls at Bologna Centrale on a Napoli – Verona working. Delivery of further sets will allow the introduction of a Torino – Milano – Venezia service from May 1.









suggested to Reuters earlier this year. Target markets include Spain, Germany and the UK, where Italo now holds a pre-qualification questionnaire passport from the Department for Transport, enabling it to bid for rail franchises. Other countries may also be of interest if genuine competition is permitted.

In 2017 the European market for high speed rail was worth around €16bn, and this figure is expected to grow to €27·4bn by 2025 (Fig 6). While Italo now has a 35% share of the high speed market in Italy, that amounts to less than 3% of the European total. So with some strategic developments elsewhere it is conceivable that the company could double its share of the European market over the next few years.

Above: **Fig 6. Estimated value of the high speed rail market in Europe 2017-25.**

Above right: **Fig 4. Reducing the cost per seat-km was a key factor in taking market share from the airlines on routes with journey times of well over 4 h.**

Right: **Fig 5. Comparison of airline and high speed rail market share on the Roma – Milano route.**

Success criteria

Looking at the key elements of success for Italo, it is possible to identify a number of factors that have shaped NTV's short history. First, company founder Giuseppe Sciarrone became the first CEO in 2006 and stayed in the role until 2013. His vision and drive helped to create the company from scratch and launch a successful business. He was followed as CEO by Flavio Cattaneo, who took a 5·1% stake in Italo-NTV as part of the recapitalisation. Cattaneo's efforts to drive an impressive turnaround and create a really strong global business case have been instrumental in the company's success.

The third element was the commitment of the shareholders, among whom was Chairman Luca Cordero di Montezemolo. Crucially, he believed in the business at a time when the company was faced with financial challenges. He and several of the other major shareholders continued to invest through a difficult period in order to enhance the performance of the company.

Finally, the depth of knowledge among the company's management was a vital contributor to the eventual success. Their knowledge and understanding of the rail sector gave Italo-NTV the ability to steadily improve its efficiency.

All of this suggests that there is a good potential for Italo-NTV to expand further over the next few years. Both di Montezemolo and Cattaneo have agreed to stay in post following the sale to GIP, to lead the company through the transition to new ownership and continue the service expansion programme. Looking ahead, the new owner is strong enough to support further expansion and continue the success story — not just in Italy, but also at the European level. ■



Below right: **Both Italo-NTV and Trenitalia provide booths at Milano Centrale where high speed passengers can make last-minute bookings or reservation changes.**

