Selective European Transportation Equipment Fund ("SETEF")

a sub-fund of the

A&P Selective Investment Fund S.C.A., SICAV-RAIF

Growth and modal shift of freight and river transport in Europe

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Executive summary

Unlike real estate, transport equipment assets such as railcars and river barges are mobile: they offer the constant **ability to be moved to areas where they are most needed**, rather than stay idle and unutilised in a fixed geographical area, if economic conditions dictate.

They are considered essential and robust assets, with **a low risk of obsolescence and long-life span**. They are standardized assets, exhibiting very **low disruption risks**, that **have no current replacement risk** as means of transporting goods. However, they require specific logistics and management expertise, extensive infrastructure, and high-quality maintenance capabilities organized and operated in a highly regulated market. This means that the **barriers to entry are very high**.

At present, the European fleet is very old, 56% or 400,000 freight wagons are over 30-years old and need urgent replacement. There is also limited manufacturing capacity for new equipment, which also needs to be addressed. The age structure combined with the limited manufacturing capacities means that there **is a large procurement gap** present in the market and demand for the newest assets is high. This structural imbalance is **supportive of the high levels of utilisation** with good stability of the per diem rental prices. **Stable rental prices with robust utilization levels provides investors with a resilient cash flow with built-in inflation protection**, which predictability is sustained by long-term rental contracts across a diversified mixture of high-quality customers. The high levels of diversification amongst the customer base also provide **a balanced mix of lease type, renewal terms and inflation hedge re-pricing opportunities**, which in turn leads to **revenue protection and revenue stability with long term visibility of cash generation**.

Most importantly is that transporting goods over long distances, using equipment such as freight wagons and river barges, **vastly reduces the carbon footprint**. With the climate change initiatives and the EU's European Green Deal to reduce carbon emissions and be carbon neutral by 2050, **it is an industry of the future, with winds in its sails** contributing to the stability of the leasing revenue pool.

CO_2 output for different modes of freight transport:

Source – Professor Alan McKinnon Professor of Logistics, Kuehne Logistics University, Hamburg Professor Emeritus, Heriot-Watt University, Edinburgh / Touax Group

In this paper, we aim to illustrate why there is resilience and stability in the returns of a long-term investment in freight wagons and river barges.

We will look specifically at the environmental benefits, the outlook, the historical market share and most importantly the historical levels of utilisation and lease prices (details of which can be found in appendix i of this paper).

Market stability & growth outlook

2021 was the "European Year of Rail". This is based on the intention that rail travel & transport in general must become more attractive and the rail share of total freight transport must be expanded to achieve the goals of the European Green Deal.

EU27 Greenhouse gas emissions targets are aiming to:

- Reduce 2030 transport GHG emissions (target should be the emission of 2008 reduced by 20%)
- 2050 transport GHG emissions target should be the emission of 2008 reduced by 70%

Combined, the targeted modal shift and the organic modal growth are expected to be very well supported by a series of structural changes as well as political, environmental, economic, and technological tailwinds, present today and in the future.

Demand will be primarily driven by:

(i) incumbents shifting their business models to be more sustainable, including using more carbon friendly modes of transport, such as rail and rivers, and

(ii) new market entrants utilising rail and river transport to also reduce their emissions and / or,

(iii) industries being attracted to rail and river transport due to better efficiencies and cost reduction.

We believe there are four possible scenarios that could play out over the next 10 years which are:

(i) a **worst-case scenario**, where no modal shift takes place and there is status quo between the % share of the various transport flows,

(ii) a **base case scenario**, where the modal shift is only influenced by European GDP growth,

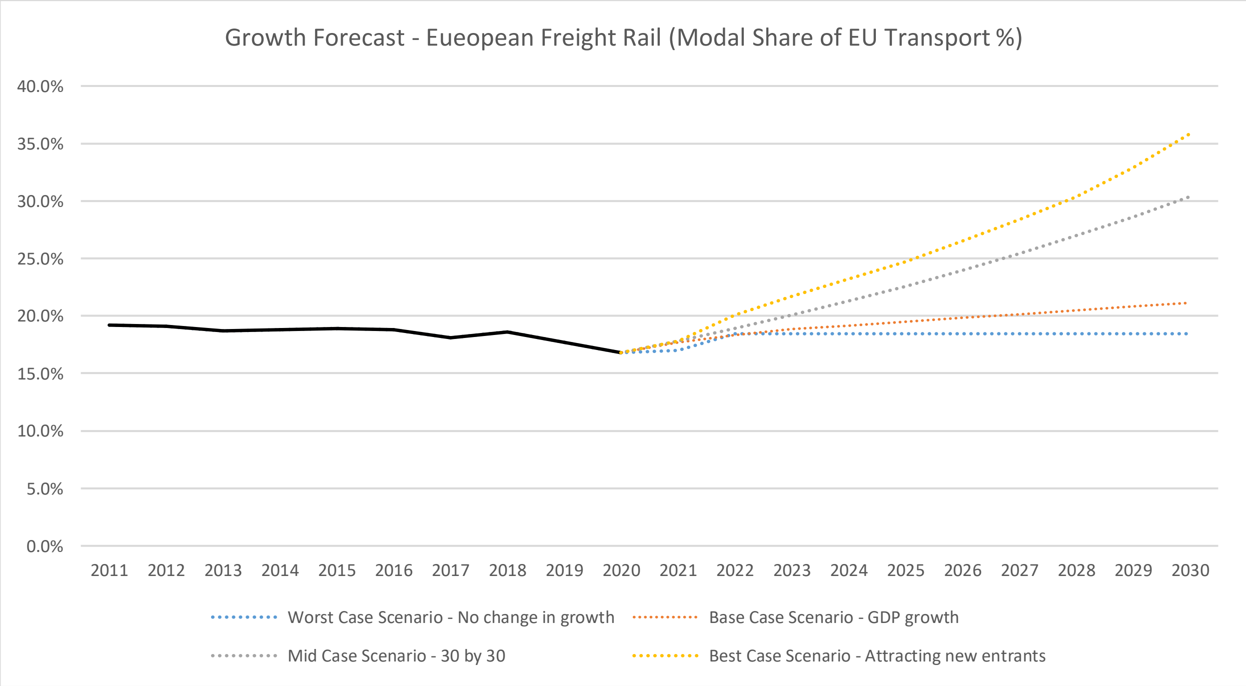
(iii) a **mid-case scenario**, where the EU's ambitions are realised and rail's share is increased by 30% as incumbents increase their modal share of rail and river transport; and finally,

(iv) a **best-case scenario**, where the EU's modal shift objectives are achieved and the attractiveness of rail and river transport, as an alternative form of transport, brings in new industries.

It is our opinion that the share of both rail and river transport flows will increase beyond the mid-case scenario and into the best-case scenario.

We will aim to explain why we believe this to be the case, why we are embarking on our project and launch a series of investment funds **to raise a total of EUR 2.4 bln of equity** from institutional shareholders **investing in EUR 6.0 bln of transportation equipment assets**, of which **3.6bln or 60% will be in new equipment**.

That will help capture this growth potential and be at the forefront of the EU's climate change initiatives over the next two decades whilst providing a stable and recurrent financial return.



Sources:
Advisors & Partners LLP model & estimates.
https://www.eea.europa.eu/data-and-maps/indicators/transport-emissions-of-greenhouse-gases-7/assessment/
https://www.statista.com/statistics/267898/gross-domestic-product-gdp-growth-in-eu-and-euro-area/

Environmental considerations

Freight transport represents almost 10% of all CO_2 emissions in Europe. This is mainly caused by our heavy reliance on trucks. 75% of the entire freight sector is using road networks. The result of such high road usage is already noticeable today. Each year, a driver spends on average 120 hours in traffic jams and 50,000 people die prematurely because of air pollution and road accidents. (1)

Since 1990, railway energy consumption has improved by 37% per transport unit (2)

- While the rail sector carries 8% of the world's passengers and 7% of global freight, it uses only 2% of total transport energy, proving its exceptional energy efficiency credentials;
- Rail freight is responsible for just 3% of emissions for freight transport; (3)
- Whereas a lorry requires approximately 2.214 megajoules (MJ) of energy expenditure per kilometre to move 1 ton of goods, a freight train only needs 0.295 MJ. (4)

By 2030, freight transport is expected to grow by 30%. According to some measurements, this is roughly the size of the entire German freight transport market, or an additional 1 million trucks added onto European roads[(5)].

If nothing changes, the impact on our environment and society will be considerable and potentially very dangerous from a social and environmental perspective.

One 38-tonne truck emits 62g of CO_2 per tonne / kilometre.
1 million trucks will emit an additional **62 tonnes** of CO_2 per / tonne kilometre.

We urgently need a modal shift and reduce road usage….

The expected freight transport growth of 30% by 2030, will urgently need to be shifted away from the roads and onto the underutilized railways and inland waterways. Freight transport by rail and the inland waterways are much more climate-conscious and safer modes of transport than road and now offer a higher degree of interconnectedness with new infrastructure projects completed or underway; new technologies are being developed, such as digital automatic coupling (DAC), that offer more efficient operations.

Road versus rail and river transport…

Transport by rail [(6)]:

- Has 12 times less external cost for society
- Emits 9 times less CO_2 emission
- Emits 8 times less air pollution
- Uses 6 times less energy
- Has 85 times fewer casualties

Transport by river [(7)]:

- Emits 4 times less CO_2 emissions
- Uses 4x less fuel consumption
- Uses 9 times less energy

Sources:

1. *https://lineas.net/en/modal-shift*
2. *The IEA-UIC Railway Handbook on Energy Consumption & CO_2 Emissions, 2016 Edition*
3. *The IEA-UIC Railway Handbook on Energy Consumption & CO_2 Emissions, 2016 Edition*
4. *InRoll AG Jahresbericht, 2018, p11.*
5. *https://lineas.net/en/modal-shift*
6. *Rail Freight Forward – "30 by 2030: Towards a Better Transport Mix for Europe's Future"*
7. *Touax Group*

Historical market share

The freight transport market with its fleets of trucks, freight locomotives, wagons and river barges are an important economic sector for Europe. Its impact on the environment and society is often underestimated but significant: an estimated 275 million tons of CO_2 emissions and 50,000 premature deaths/fatalities are caused each year [(1)].

The current European modal split is 75% road freight, 18% rail freight and 6% for inland waterways (chart 1) and if this ratio between the three modes persists, the annual CO_2 emissions are expected to increase by circa 80 million tons by 2030, severely endangering the attainment of the Paris 2030 goals [(1)].

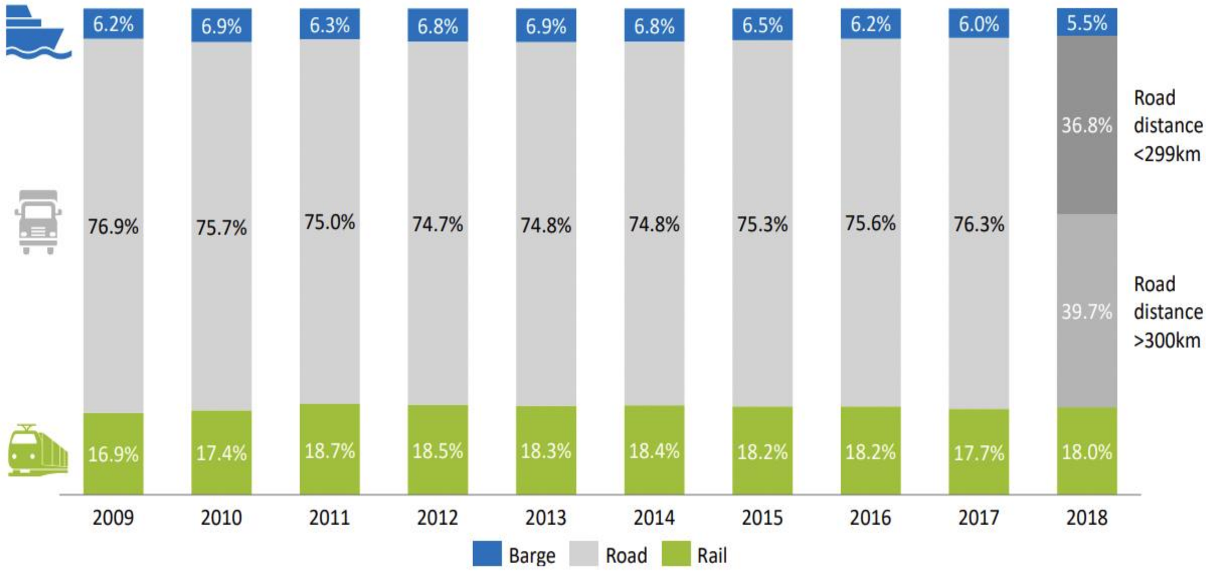
Existing road congestion will further worsen with an expected economic loss of 1% of GDP per annum and the number of fatalities and additional premature deaths due to air pollution will cause significant societal costs [(1)].

Today, huge volumes of goods are transported across the continent. There is an opportunity to focus on the largest and longer distance flows and put interventions in place to shift these volumes which are more suited to freight rail. Major flows move from / to Spain and Portugal, across France to countries in Central and Northern Europe, particularly Germany, Belgium, and the Netherlands. More than 40 billion tkm of road freight move across France per year, with an average transport distance of over 500km—this distance is the sweet spot for rail and river transport, yet only 5 per cent is on rail. Capturing 50 per cent of this traffic would boost freight rail modal share in France by 5.5 percentage points, from 8.7 per cent to 14.2 per cent [(2)].

For long-distance journeys (road distances over 300kms), Rail is attracting new industries due to its performance, reliability, new transportation concepts and interconnectedness with other modes of freight transport. One of the main benefits of rail freight is that only a few individuals are responsible for moving vast quantities of goods. For the equivalence of 40 to 60 trucks, only one locomotive driver is needed. With just a few individuals, large quantities of goods can be transported from point A to point B over long distances. Hence, shippers can save large sums of money. The same can be said of river transport that river barge (2,500 tonnes) can replace 65 (38-tonne) trucks [(2)].

Rail freight transport has six times lower energy consumption compared to road transport; this translates into six times lower external costs. It also produces nine times less CO_2 emissions with 85 times fewer casualties.

Chart 1 – Historical Modal Market Share 2009 - 2019



Source: https://uic.org/IMG/pdf/2020_report_on_combined_transport_in_europe.pdf

Chart 1 provides historical insight on the modal share of freight transport from 2009 to 2018. The ratio between the three modes has remained largely consistent and without any significant tailwinds to drive a modal shift, would likely remain the same going forward.

The Rail Freight Forward ("RFF"), a coalition of European rail freight companies that are committed to drastically reduce the negative impact of freight transport on the planet and mobility, has set bold ambitions to increase freight rail's modal share from current levels to 30% by 2030 (3) and through the European Commission's European Green Deal, reduce overall carbon emissions by 50% by 2030.

Achieving these ambitions would see freight rail volumes grow by around six per cent a year in tonne-kilometres (tkm). (2)

[1] *Sources: freight forward European rail vision 2030, Touax Group 2019*
[2] *Source: McKinsey & Co – bold moves to boost European Rail Freight – 2021*
[3] *https://www.railfreightforward.eu/sites/default/files/downloadcenter/rff_cer_position_paper.pdf*

Market structure of freight rail and river transport

It is important to understand the market structure of freight rail and river transport operations. One of the historical factors prohibiting capital and investment into rail and river transport was the complexities of operational leasing and for rail, in particular, the difficulty to operate the Entity in Charge of Maintenance (ECM) functions, which are complex, intensive and highly regulated. Operating the equipment along the waterways and rail corridors also requires extensive infrastructure to be in place, in the form of workshops, warehouses and personnel. For rail, this needs to be in accordance with the Office for Rail Regulations (ORR). The ORR regulations, 18A(2) and 18A(3) require an ECM to ensure that the vehicles for which it is responsible are safe to run on mainline railways. These complexities mean that the rare knowledge, skills and experience are concentrated amongst a small number of incumbents. Financial investors simply do not have the skill set, experience and certification to manage and maintain the equipment, therefore it is necessary to partner with an operating company, that does.

We have summarised below some of the key characteristics of both rail and river transport:

Strategic assets

With over **215,000 km of rail infrastructure** organized across 11 rail corridors in 23 countries and over **37,000 kilometres of waterways** that connect hundreds of cities and industrial regions, the European rail and river infrastructure network **is a long term strategic and essential asset for the European transport industry**. The interoperability between maritime ports, road networks and infrastructure development supporting rail and river transport is not easily decommissioned and replaced due to the strategic and integrated nature of maintaining and operating the rolling stocks and river barge fleets within the overall supply chain and lack of alternatives. Halting investment in rail and river transport would lead to facilities shutting, skilled jobs being lost, multi-national companies moving into other sectors or overseas and SMEs struggling to find work. **These assets have no replacement risk for the foreseeable future.**

Long term investment

Rolling stock is considered to be a robust asset with a long lifespan of more than 36 years. River barges can operate for up to 50 years and the useful life and value of the assets can be influenced and extended with experienced operators of the equipment. Both assets are widely considered to have a low level of obsolescence due to the lack of moving parts and are not self-powered. They are also very standard assets with much of the infrastructure designed around them.

Strong barriers to entry

Limited manufacturing and maintenance capabilities are a strong barrier to entry in a highly regulated industry (for rail) , with significant infrastructure requirements and engineering and technical expertise needed. Investors need to partner with an operating company to access the infrastructure and skillset to operate these assets.

Low-risk business model

Lessors do not take any usage risk within the lease contracts. As above, there are also very limited disruption risks as there is no foreseeable technology to replace the role of rail and river in the transport sectors. Credit risk exposure to the end users (the Lessees) is also reduced by having a diversified experienced customer base of high credit quality that can easily reposition the rolling stock to locations of higher demand as opposed to a real estate investment.

Stable revenue stream

Lease revenues display stable income streams organised through long-term operating rental contracts of between 4 to 6 years for freight wagons and up to 10 years for river barges, with a diversified customer base of high-quality customers across a range of industries. Due to the long-term lease contracts, the lease revenues are less impacted by short - or medium-term events over the market cycles.

Predictable cash flows

Predictable cash flows are backed by (i) Hardy utilisation rates throughout the economic cycle; (ii) Medium to long term lease contracts; (iii) Strong re-lease / renewal rate amongst end-users; and (iv) Lease rates increasing steadily throughout the lifetime of a railcar; (v) Limited contract termination risk due to high switching costs and operational risks related to logistic issues versus marginal cost savings of the lease rental rates; and (vi) Long-term visibility of cash flows enabling a very stable and recurrent yield to shareholders.

Key drivers and growth opportunities

There are several key drivers, or tailwinds, that are expected to assist in the modal shift and potential growth opportunities for both rail and river transport.

Government Action

The European Union has set a bold ambition to reverse the decline and accelerate the share of goods transported using rail and river networks. **The EU has plans to help double freight rail's modal share by 2030** [(1)]. Achieving this ambition would see freight rail volumes **grow by around six per cent a year in tonne-kilometres (tkm).** [(2)]

Freight rail is responsible for less than 0.5% of transport-related greenhouse gas emissions[(3)]. EU initiatives such as the European Year of Rail in 2021 help to promote rail as an alternative mode of transport.

[1] *https://www.railfreightforward.eu/sites/default/files/downloadcenter/rff_cer_position_paper.pdf*

[2] *(Source: McKinsey – January 2022)*

[3] *(Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2528)*

Environmental Action

The environmental and CO_2 benefits of rail and river transport over other modes of transport are actively driving a modal shift to rail and creating a dynamic alternative to other forms of transport. This is particularly so for goods transported over longer distances (300 km). European initiatives such as the European Green Deal provides the action plan to halve carbon emissions by 2030 and be carbon neutral by 2050, as well as ease the congestion of major road connections and improve road safety.

Infrastructure financing & development

Many infrastructure projects across Europe require an effective and environmentally friendly way of transporting goods and waste products, either by rail or via the inland waterways on barges. Such projects, amongst others, include the Connecting Europe Facility (CEF) (2014 – 2020), the Trans-EU Network for Transport (TEN-T) and the 30 Priority Projects (https://ec.europa.eu/inea/ten-t/ten-t-projects/projects-by-priority-project), the development of the North Sea – Mediterranean and Atlantic Corridors, the Seine-Nord Europe Canal Project, the Grand Paris Project (Europe's largest building project) and the new High Speed 2 (HS2) railway project in the United Kingdom. These projects will only encourage an increase in overall demand over the mid to long term.

Fleet replenishment (procurement gap) – Freight rail

The European rail fleet is very old with circa 400,000 wagons over 30-years old [(1)]. and in need of replacement. The replacement of old equipment and the procurement of new equipment creates continuous investment opportunities for investors with long-term stable capital that can fill this procurement gap.

The demand and increased use of containers in intermodal transport sectors are a driving force behind new fleets. This has more than compensated for the losses in bulk cargo transport in the sector. It is expected that the intermodal sector will grow more than 1.7x as fast as gross domestic product over the next decade and will thus account for most of the transport volume which is expected to increase by more than 2.5% per annum[(2)].

[1] *Source: Touax Group*

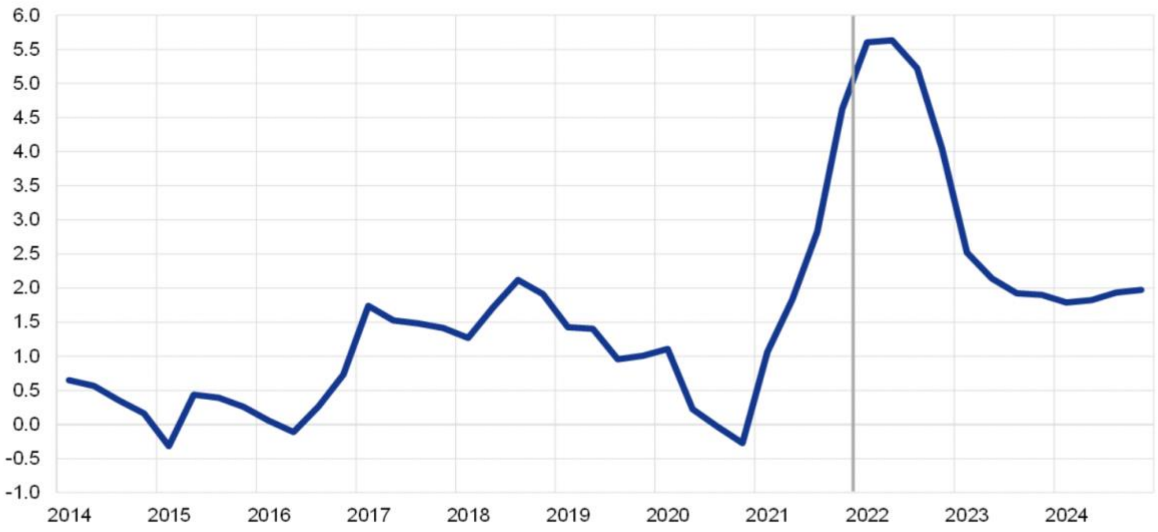
[2] *Source: SCI Verkehr, KFW IPEX-Bank*

Inflation

The war in Ukraine has led to further spikes in energy prices, which will keep headline inflation very high in the coming months. Eurozone inflation was 5.1% in January, 5.8% in February and 7.4% in March. Thereafter, inflation is projected to ease back towards its target. Inflation is set to average 5.1% in 2022, 2.1% in 2023 and 1.9% in 2024. (1) Headline inflation reached 7.4% in April 2022 and is projected to remain elevated over the coming quarters (see the below chart). (2)

Euro area HICP

(annual percentage changes)



Note: The vertical line indicates the start of the projection horizon.

[1] *Source: https://www.ecb.europa.eu/pub/projections/html/index.en.html*
[2] *Source: EC Eurostat Statistics & European Central Bank*

Inflation is being driven mainly commodities prices, and in particular by energy price inflation, which rose to around 32% in February, mostly on account of higher gas and electricity tariffs. These two components are also expected to sustain energy inflation at high rates over the year. By contrast, the contribution from fuels is expected to fade away in 2022 owing to base effects and an assumed downward-sloping profile of oil prices. Electricity and gas tariffs recorded large month-on-month increases, with prices being reset for the new year in many countries, and further increases are expected in the year as the surge in wholesale gas futures prices caused by the war in Ukraine is gradually passed on to consumers (although base effects imply some declines in annual inflation rates later in the year).

Headline inflation is expected to decline in the second half of the year on the back of large negative base effects and an assumed downward-sloping profile of oil prices.

In general, rising inflation may have an overall positive impact in owning and leasing of transport equipment. However, both market timing and navigating any changes in inflation by SETEF's investment team is critical in determining the performance and investment returns of the assets.

Rising inflation may positively impact the re-sale value of the assets, as rising inflation may increase the underlying prices of the raw materials used to manufacture the equipment, i.e., (steel, iron ore and prices of the wheel sets etc.

Rising inflation may positively impact the per diem lease prices at the point of renewing existing lease contracts or negotiating new lease contracts with customers.

Rising inflation may negatively affect the manufacturing price of new equipment as raw material prices rise and may impact the procurement costs of new equipment.

Interest rates

Lease rentals are typically a reflection of the weighted average cost of capital (WACC) of the lessor, which it has built or ordered the equipment and is then rented to the lessee on long term operating leases.

Rail wagons being long-life items (c. 36 years) they generate cashflow over a long period of time and thus tend to be financed on a long-term basis.

The debt element of the WACC will consequently be based on long term interest rates, which broadly and slowly follow the trajectory of short-term interest rate with a time lag. Think of a sea wave with its amplitude generally decreasing as it progresses. Central banks only act on short term interest rates, then the market adjusts the long-term portion of the interest rate curve depending in its risk perception of the future.

Historically, there was a strong relationship with lease rates and long-term portion of the interest rate curve. **Short term fluctuations** of interest rates, in either direction, did not strongly correlate with per diem lease prices.

There are several reasons for this:

i) The shorter-term cost of money does not impact lease prices as contracts' duration is typically around 4 – 6 years in length, so is broadly immune to short term fluctuations in interest rates.

ii) Changes in regulatory costs and bad debt provisions might cause the lessor to change their pricing structure, irrespective of changes in the cost of funds.

iii) Specific contract terms in the lease agreements such as milage and whether the ECM (Entity in Charge of Maintenance) functions are carried out by the lessor or lessee, will also have a larger impact than cost of funds.

Longer term directional changes in interest rates may have a greater impact on per diem lease prices as the interest rate trend may overlap with the renewal of the lease contracts thus providing the opportunity for the lessor to recalculate the per diem lease price, by factoring in prevailing interest levels. Generally optimising WACC.

Given that all equipment lessors will be subject to the same interest rate tide effect at any point of time, the increase in rates will not jeopardise the competitive position of one given lessor, also because the competitive position is mainly driven by commercial, maintenance and repositioning terms, which are of utmost importance to the industrial end-user.

A key factor to consider is that the bank base rate of interest sets the short-term interest rates between the commercial banks and the central bank. Changes in interest rates mainly have an immediate effect on variable interest credit facilities, such as overdraft facilities. Finance companies offering loans that have a fixed interest cost can't simply adjust the interest rates they charge their customers to reflect any changes in the bank base rate during the term of the agreements. Generally, lending to customers looking to finance part of their capital equipment assets will be on a fixed term basis. On average finance companies will lend either on a 3-to-5-year fixed term basis, after which a balloon payment or refinancing takes place. Any refinancing will take into consideration the anticipated average bank base rate that will apply for the term of the new credit facility.

Innovation & technology

New technologies being incorporated into rail freight transport will help to further drive costs lower and improve operational efficiencies.

Recent technological advances include digital automatic coupling technology. Digital Automatic Coupling ("DAC") is seen as the key technological development in Europe for Freight Rail as it is an enabling technology for the full automation and digitisation of rail freight transport. Digital automatic coupling speeds up the formation of freight trains and will make both longer and heavier trains, which in turn increases the capacity and quality of rail freight, thereby contributing to the transport transition from road to rail. It is expected that DAC will open the door to comprehensive automation and digitalisation of rail freight. The capacity of shunting yards and trans-loading stations can therefore be increased significantly. The introduction of DAC signifies a digital revolution for freight transport on the railways.

The introduction of a European Rail Traffic Management System (ERTMS) and electronic interlocking will increase the efficiency of the infrastructure. This efficiency potential is considerable because it has been inadequately harnessed until recently.

Evolving market structure (leasing vs owning, private vs public ownership)

Lastly, the market structure is also shifting towards the leasing model vs owning equipment. This structural shift has only been accelerated with the onset of the COVID-19 pandemic, as operators restructure their balance sheets and free up working capital for their core business, by selling non-core assets such as rolling stock. This structural change creates good investment opportunities for shareholders. Secondly, there is a trend towards more private ownership and entrepreneurship. Since 2007 new EU regulations, Government-owned operators are in decline with a shift towards private ownership. This privatization is driving competition and stimulating business (1).

[1] *Source: Market Research.com*

Growth in demand for rail and river transport

We have previously discussed the favourable tailwinds that will help drive future growth and contribute towards increasing the supply side of the equation by replacing old and developing new fleets of equipment whilst encouraging the modal shift from road use. It is equally important to assess the future demand for environmentally friendly modes of transport.

Growth in demand will come from two areas:

- **Organic growth driven by climate initiatives**, where incumbents need to evolve their business models to incorporate sustainability and climate change initiatives. Customers that view climate change as an integral part of their business model will seek to ensure that all parts of the value chain are compliant, and this will include transport shifting from road to rail and river transport will help achieve their target ambitions.

- **New customer industries,** by attracting new industries into using rail and river transport, either from an environmental perspective or through better efficiencies in using the rail and river networks.

SETEF will have access to a very diversified customer base, across four main industrial groups. Most, if not all will be conscious of climate change and the EU's ambitions to reduce carbon emissions and improve mobility safety. These incumbent users of rail and river transport will be looking at their business models to see how they can do more to support rail and river transport and support the demand for shifting more goods away from using roads to the railways and inland waterways.

In the table below, we have listed some of those customers who have publicly announced their main climate change objectives, to further demonstrate their commitment and the subsequent demand for environmentally friendly freight transport. Such initiatives will help drive transport climate neutrality and contribute to the modal shift of goods transported on road to railways and inland waterways.

Climate Change Initiatives – Key customers driving demand

Company	Main Climate Change Objectives	Source
Danone One Planet. One Health	Danone has committed to achieving zero net emissions by 2050	https://www.danone.com/impact/planet/towards-carbon-neutrality.html
ArcelorMittal	Arcelor Mittal has announced a plan to reduce its emissions by 30% by 2050	https://corporate.arcelormittal.com/media/press-releases/arcelormittal-sets-2050-group-carbon-emissions-target-of-net-zero
Solway investment group	Solvay aims to reduce its carbon emissions by 1 million tonnes by 2025	https://www.solvay.com/en/sustainability/climate
Volkswagen Konzernlogistik	Cut CO2 emissions in Europe by an average of some 17 tons per vehicle by 2030 and be Net carbon neutral by 2050 at the latest	https://www.volkswagenag.com/en/news/2021/04/way-to-zero--volkswagen-presents-roadmap-for-climate-neutral-mob.html
Tata Steel	Target to reduce steelmaking emissions in Europe by 30-40% by 2030	https://www.tatasteeleurope.com/corporate/news/tata-steel-helps-guide-global-steel-industry-on-its-path-to-net-zero
BASF The Chemical Company	25 percent reduction in CO2 emissions already by 2030, and target of net zero CO2 emissions globally by 2050 and Investments of up to €4 billion planned by 2030	https://www.basf.com/global/en/media/news-releases/2021/03/p-21-166.html
Ford Go Further	Ford Motor Company intends to achieve carbon neutrality globally by 2050, while setting interim targets to address climate change challenges more urgently, power all its manufacturing plants with 100 percent locally sourced renewable energy by 2035	https://media.ford.com/content/fordmedia/fna/us/en/news/2020/06/24/ford-expands-climate-change-goals.html#:~:text=annual%20Sustainability%20Report.-,Ford%20is%20the%20only%20full%20line%20U.S.%20automaker%20committed%20to,such%20emissions%20with%20carbon%20removal
babcock trusted to deliver	Babcock's "PlanZero40 commits" to ambitious Science-Based Targets in line with a 1.5°C limit to global warming and to delivering Net Zero within our own operations (Scope 1 and 2 emission) by 2040	https://www.babcockinternational.com/wp-content/uploads/2021/08/Babcock-International-Group-PLC-PPN0621-Carbon-Reduction-Plan.pdf
Puma	Between 2017 and 2030 Puma aims to reduce the Carbon Footprint of our own operations (Scope 1 and 2) by 35% (absolute reduction) and the Carbon Footprint of our Supply Chain (Scope 3)	https://about.puma.com/en/sustainability/environment/climate
Aditya Birla Group	Reduce carbon emissions to net zero by 2050	https://www.adityabirla.com/media/stories/birla-carbon-mission-net-zero-carbon-emissions-by-2050#:~:text=In%20August%202021%2C%20the%20company,redefine%20standards%20for%20the%20sector.
Rhenus Logistics	Neutralize the carbon emissions of all of its less-than-container-load (LCL) products by 2030	https://www.adityabirla.com/media/stories/birla-carbon-mission-net-zero-carbon-emissions-by-2050#:~:text=In%20August%202021%2C%20the%20company,redefine%20standards%20for%20the%20sector.
DB Schenker	DB Schenker wants to make its transport activities in European cities emission-free by 2030	https://www.dbschenker.com/pt-en/about/press-center/global-stories/emission-free-by-2030
inovyn An INEOS company	INOVYN is measuring and pushing sustainable development across four key areas: responsible care, carbon neutrality, circularity and value to society	https://www.inovyn.com/about/sustainability

Driving demand through attracting new industries

There is an opportunity to attract new customers to rail and river transport by expanding market share in some industries, such as the paper and pulp, and battery industries.

Today, around 300 million tons of wood are produced in the EU, and most of this is transported by truck over short distances to factories and production sites. According to a recent study, by McKinsey, at least 20 per cent is transported over longer distances, of 250 to 400 km, for which rail would be more suitable. Capturing these flows could potentially add 14 to 15 billion tkm to rail's modal share.

Another possibility could be to capture new European customers that produce batteries for electric vehicles. An average battery weighs around 300 to 500 kg for a mid-sized car. Given current production levels of around 20 million cars per year—and the fact that production of combustion engines will likely cease by 2040—this industry has the potential to add demand for around 5 billion tkm of freight rail per year.

Both wood and batteries are suitable for rail and are often located in specific regions. Putting these industries' logistics and supply chains on rail would require some targeted investments, including the establishment of sidings or direct access points to the rail network; measures to fully optimize last-mile management, and a high level of service to bring both reliability and flexibility to cater to clients' needs.

Source: https://www.mckinsey.com/industries/travel-logistics-and-infrastructure/our-insights/bold-moves-to-boost-european-rail-freight

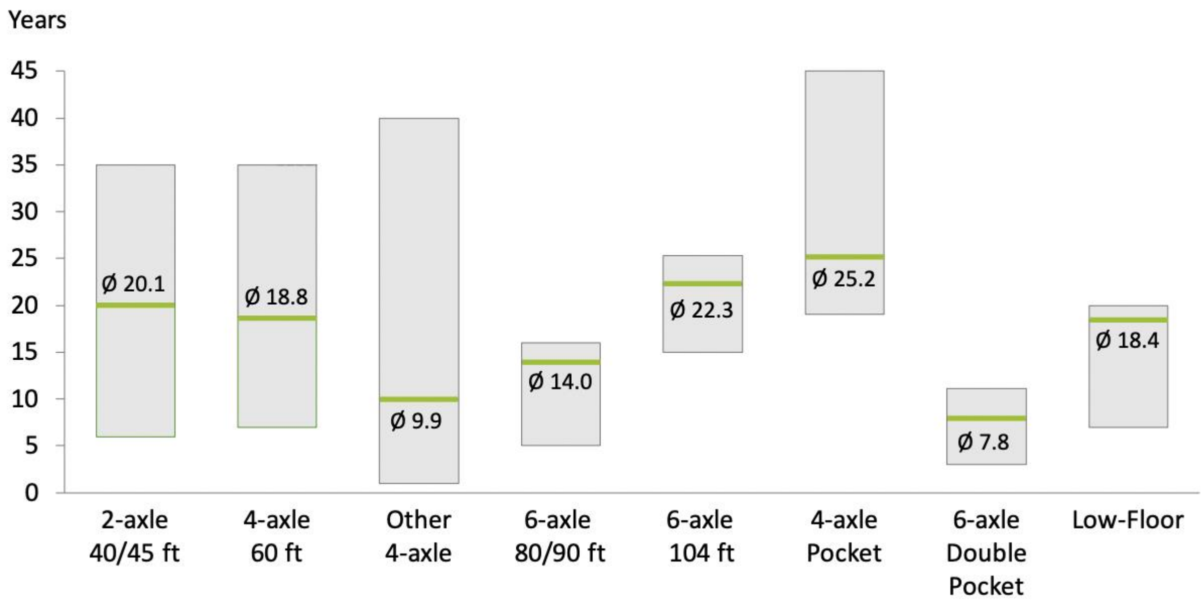
SETEF's strategy impact on European freight transport

The European Union has set ambitious targets to decarbonize the transport sector shifting as much as 30 per cent of road freight to other modes of transport, such as rail or waterborne transport by 2030 and to increase this to more than 50 per cent by 2050. These ambitions will help to drive a greener, more digitalised, and robust transport system with built-in resilience to withstand future crises. However, to achieve these ambitions and double rail freight modal share, the volume of goods transported would need to increase from circa 420 billion tkm to over 1000 billion tkm a year-on-year increase of 6.1%.

European fleet size:

The European Centralised Virtual Vehicle Register (ECVVR) indicates that there are 712,265 cars registered in Europe in 27 countries + The United Kingdom, Switzerland, and Norway, of which **400,000 (56% of the total fleet) are over 30 years old and need replacing**. Rebalancing the age structure of the European fleet is of major importance to achieving the European Union's objectives, as a large proportion will urgently need to be replaced, particularly within the largest growth sector, the intermodal, container, and swap body sector.

Age structure of European intermodal fleet by wagon type:



Source: BSL Transportation Analysis (sample includes about 2/3rd of total intermodal fleet in 2017

Manufacturing of new builds

There are around 20 specialist manufacturers in Europe and the total capacity output is circa 13,000 wagons per year, which represents a small fraction of the overall fleet size. **Estimates put the replenishment rate at just under 2% per annum, which is about 35% of the targeted CAGR growth rates that are needed to achieve the objectives to increase rail's modal share from 18% to above 30% by 2030.**

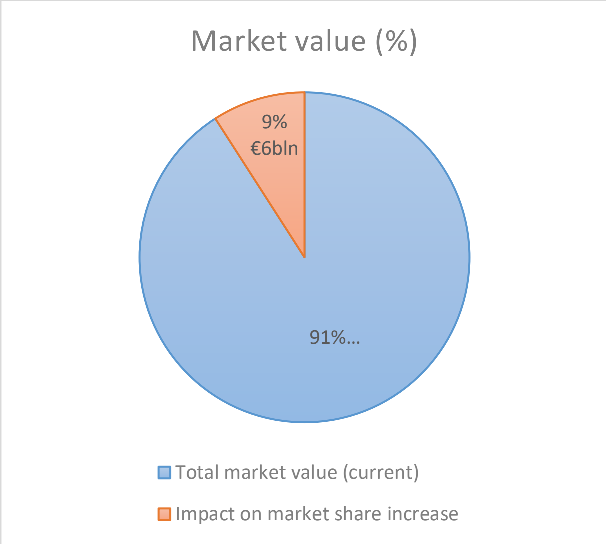
There is an urgent need to plug this procurement gap and SETEF will seek to dynamise its cash generation by taking advantage of this expected increasing demand for transport equipment.

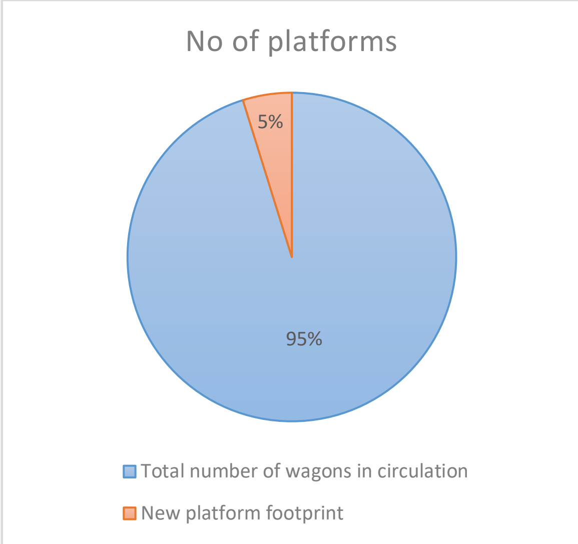
The long-term strategy of A&Ps funds, the first of which is the Selective European Transportation Equipment Fund, is to provide long-term capital to the sector to plug this procurement gap and capitalise on the rising demand in the modal share of rail freight, in particular.

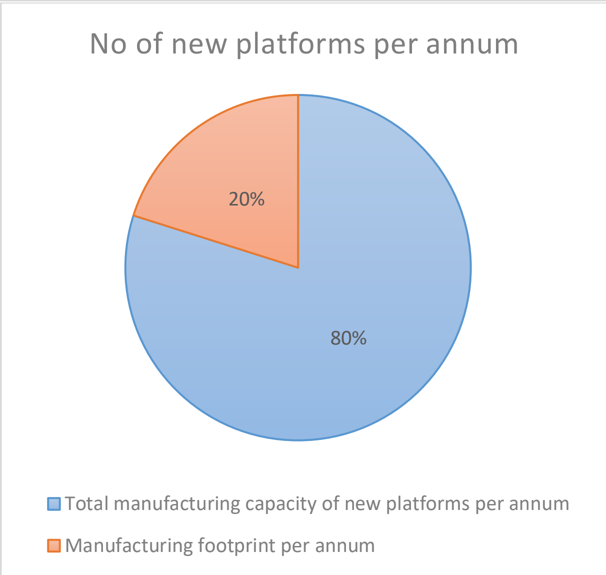
Strategy impact (10-year time horizon) 2022 - 2032

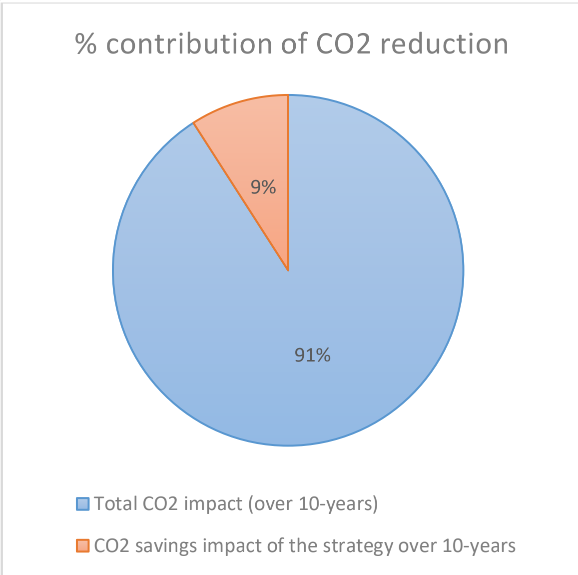
The long-term strategy for SETEF and its successor funds is to contribute towards increasing the modal share of the freight rail market, in line with the EU's ambitions. SETEF and its successor funds' 10-year plan is to raise a total of EUR 2.4 bln from shareholders which will translate into an investment of EUR 6.0bln of equipment (new and used), of which 3.6bln (60%) will be in new equipment.

The strategy will have a positive growth impact by (i) increasing the overall market share of freight rail; (ii) increasing the market share in new equipment; (iii) increasing the manufacturing capacity and replenishment rate; (iv) increasing CO_2 savings.









To develop the market there needs to be new capital inflows to help boost the increase in new builds and market development.

Key drivers for future market development and fleet investment:

- number of manufacturers and capacity volumes,
- technical developments in both road and rail,
- new technologies to improve efficiency and cut costs,
- key environmental factors,
- railway infrastructure development and workshop capacities,
- the interconnectedness between different modes,
- developments in the regulatory framework.

Sources: Rail freight transport in the EU: Still not on the right track, European Court of Auditors, 2016*, Eurostat, goods transported dataset 2003-2020, McKenzie* – January 2022

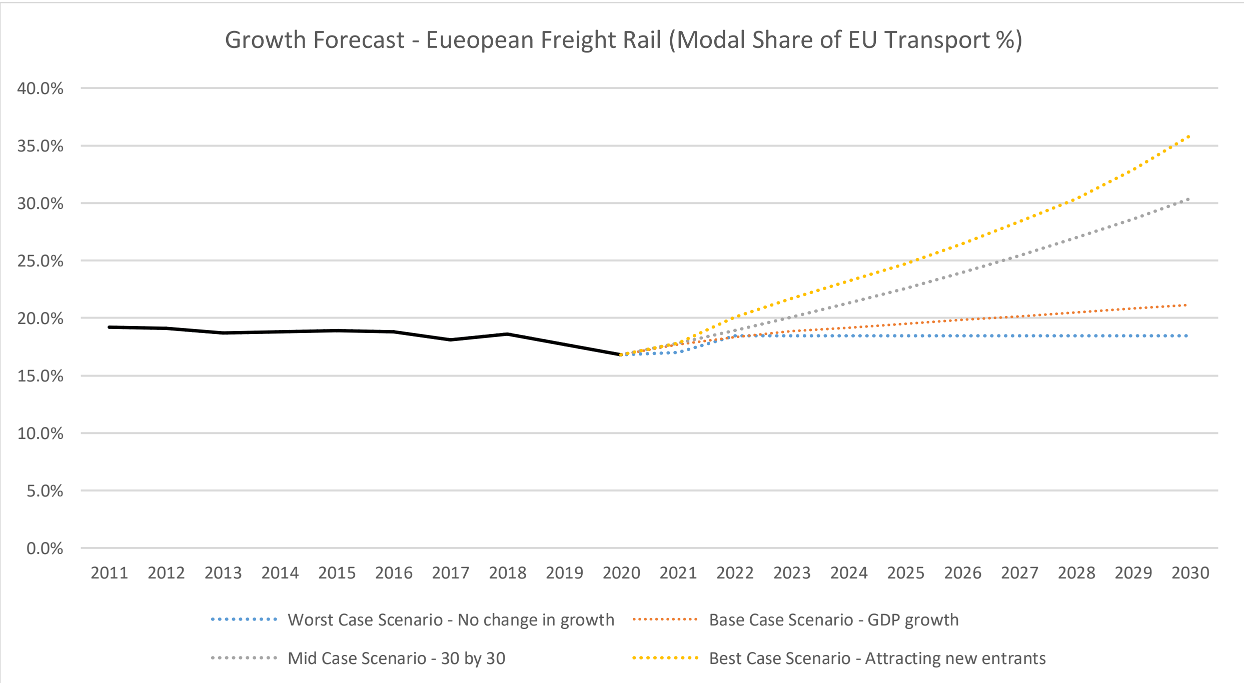
Conclusion

First and foremost, the growth of supply will be driven by plugging the procurement gap and the urgent need to replace Europe's ageing fleets (56% or circa 400,000 wagons are more than 30-years-old). Plugging this procurement gap, with no modal shift from road to rail and inland waterways and no GDP growth is in our opinion **the worst-case scenario as a minimum**.

Freight Transport is correlated to GDP growth. More GDP growth means more transport flows. So predictably, if the modal share of rail and river transport remains the same, the only growth would be linked to increasing GDP. It does not allow for any change in the modal makeup between road, rail, and river transport. This is our **base case scenario**.

Both the EU's and RFF's ambitions are to increase rail's modal share from 18%, as it is today, to 30% by 2030 (30 by 30). These ambitions, along with the other key growth drivers (tailwinds) mentioned earlier, will help achieve the targeted modal share of 30% by 2030. Demand is driven by the necessity for the end users of the equipment dramatically reduce carbon emissions or be carbon neutral by 2030, as evidenced in the various sustainability initiatives that these companies are incorporating into their business model. **We expect this target to be achieved and is our mid case scenario**.

Finally, the environmental agenda does not only affect incumbent users of rail and river transport. It is reasonable to assume that other heavy users of road transport will be attracted to using alternative modes of transport such as rail and river transport. This could be driven by similar sustainability initiatives or being attracted to rail and river transport for cost and efficiency improvements or both. Attracting new market entrants will further increase rail and river modal share. For example, as mentioned earlier in this paper, capturing a 20% share of wood transported across Europe would add circa 15 billion tkm to rail and shifting the transport of car batteries to rail would add a further 5 billion tkm. Together these would further increase rail's modal share by a further 5.5% based on the 2020 modal share for rail. **This is our best-case scenario**.



Sources:
Advisors & Partners LLP model & estimates.
https://www.eea.europa.eu/data-and-maps/indicators/transport-emissions-of-greenhouse-gases-7/assessment/
https://www.statista.com/statistics/267898/gross-domestic-product-gdp-growth-in-eu-and-euro-area/

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Appendix i – Sustainability case studies – Danone, Arcelor Mittal, Solvay

We have prepared three detailed case studies and provided a further summary table of some of our customer base to illustrate the level at which our customers are going to ensure they are aligned with the European Green Deal and climate change initiatives.

Danone

Citizens today want companies to take a leading role in combatting climate change. Danone is determined to help lead an industry-wide transition to a low-carbon economy; this is why we pledged in our 2015 Climate Policy to become carbon neutral by 2050 across our full value chain. Our zero net carbon commitment means that we are responsible for the carbon emissions from the farms where we source our ingredients to the facilities that manage packaging once our products are consumed.

Danone's strategy to achieve carbon neutrality is based on the following pillars:

- reducing emissions,
- transforming agricultural practices to sequester more carbon in the ground,
- eliminating deforestation from our supply chain, and
- offsetting the emissions that remain.

Current progress and next steps

		2017	2018	TARGET
CLIMATE CHANGE				
Reduction in CO_2 emissions intensity on Danone's full scope (g of CO_2 eq/Kg products sold)[1]	SCIENCE BASED TARGETS	10.5%	15.6%	50% by 2030
Absolute reduction on Danone's scope 1 and 2 CO_2 emissions[1]	SCIENCE BASED TARGETS	9.7%	20.3%	30% by 2030
Renewable electricity		18%	34%	100% by 2030

Danone is part of RE100 — a collection of the companies that have committed to using 100% renewable electricity. We are aiming to reach 50% of renewable electricity by 2020, and 100% by 2030.

Source: https://www.danone.com/impact/planet/towards-carbon-neutrality.html

Arcelor Mittal

ArcelorMittal ('the Company') today announces a group-wide commitment to being carbon neutral by 2050, building on the commitment made in 2019 for its European business to reduce emissions by 30% by 2030, and be carbon neutral by 2050.

"If the world is to achieve net zero by 2050 it will require all parts of the economy in all regions of the world to contribute. As the world's leading steel company, we believe we have a responsibility to lead the efforts to decarbonise the steel-making process, which today has a significant carbon footprint.

ArcelorMittal has identified two low-emissions steelmaking routes, both of which have the potential to lead to carbon-neutral steelmaking:

- The Hydrogen-DRI route, which uses hydrogen as a reducing agent. A demonstration plant in Hamburg, where ArcelorMittal owns Europe's only operational DRI-EAF plant, is currently planned with a targeted start-up in 2023.
- The Smart Carbon route is centred around modifying the blast furnace route to create carbon neutral steelmaking through the use of circular carbon - in the form of sustainable biomass or carbon containing waste streams - and carbon capture and use (CCU) and storage (CCS). ArcelorMittal is well advanced on constructing several commercial-scale projects to test and prove a range of Smart Carbon technologies. Start-up target for key projects is targeted in 2022.

While both routes have the potential to deliver carbon-neutral steel by 2050, we believe that Smart Carbon can deliver results sooner, and make a meaningful contribution to CO_2emissions reduction this decade, while industrial scale production from the Hydrogen-DRI route is unlikely to be significant before 2030 due to the current high costs.

The Company has also previously outlined the policy framework environment it believes is required for carbon-neutral steelmaking to become a reality, which includes:

1. A global level playing field which avoids the risk of carbon leakage through mechanisms such as green border adjustments
2. Access to abundant and affordable clean energy
3. Policies which support the development of the necessary clean energy infrastructure
4. Access to sustainable finance for low-emissions steelmaking, and
5. Policies which accelerate the transition to a circular economy.

ArcelorMittal will set out further detail in support of its 2050 net zero target in its second climate action report, which is anticipated to be published before the end of 2020.

ArcelorMittal is a member of the Energy Transitions Commission (ETC) and is an active member of the ETC's Net Zero Steel Initiative underway in partnership with the World Economic Forum. ArcelorMittal is also actively engaged with the Science Based Targets Initiative (SBTI) to define an achievable SBT for the steel industry considering the two distinct routes in operation today.

Source: https://corporate.arcelormittal.com/media/press-releases/arcelormittal-sets-2050-group-carbon-emissions-target-of-net-zero

Solvay

"At the service of the planet to curb emissions worldwide"

Every year an increasing amount of scientific literature emerges confirming Intergovernmental Panel on Climate Change (IPCC) forecasts: the global temperature is constantly rising, and a growing number of climate-related events underline the need for concrete actions. Through Solvay One Planet, we put our expertise at the service of the one planet we share, and pledge to curb our emissions worldwide. To protect the climate and biodiversity, we aim to reduce the environmental impact of our operations at planetary scale by 2030. We will reduce CO_2 emissions worldwide by working closely with our suppliers and customers to find sustainable solutions aligned with global trends. Today, our Sustainable Portfolio Management tool assesses that €1.6 billion of our sales come from solutions that reduce our customers' overall climate impact.

Contributing to the UN SDGs

Striving for ambitious climate goals by 2030

-30% GHG emissions worldwide

-14% in 2021 vs 2018

100% coal phase out

-18% in 2021, vs 2018

-30% pressure on biodiversity

-24% in 2021, vs 2018

Laying the groundwork for a carbon-neutral future

We have accelerated the rate at which we reduce emissions and aligned our trajectory with the "well below 2°C temperature increase" goal outlined in the 2015 Paris Agreement. In 2020, we took this a step further by committing to reduce our greenhouse gas emissions in line with the expectations of the Science Based Targets initiative (SBTi*) within 2 years. In 2021, Solvay announced its plan to target carbon neutrality before 2050 and raised its 2030 GHG emissions reduction target to -30% (from -26% initially).

The Group targets carbon neutrality before 2050 for scopes 1 & 2 and has committed to SBTi in 2020. Its scope 3 targets shall at least meet the 2C criteria of SBTi. A strategic initiative has been launched to spur transformative progress with its suppliers in 2021. The Group will continue its effort in that direction beyond 2030 within its 2050 neutrality vision.

Meeting carbon neutrality in the future requires investments in innovation today. We will focus our efforts on maximizing electrification and clean energy, such as solar power and sustainable biomass use across our plants, as well as facilitating process innovations. Furthermore, the infrastructural, regulatory, and macroeconomic levers enabled by public policies will be a critical component in our investment decisions in order to achieve our ambitions. Partnerships with authorities and other stakeholders will be key drivers towards an affordable and competitive transition to cleaner energy across our entire value chain.

In addition, we apply an internal carbon price of €100 per metric ton CO_2 equivalent on all our greenhouse gas emissions, in order to integrate climate-related challenges into our investment decisions.

Source: https://www.solvay.com/en/sustainability/climate

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