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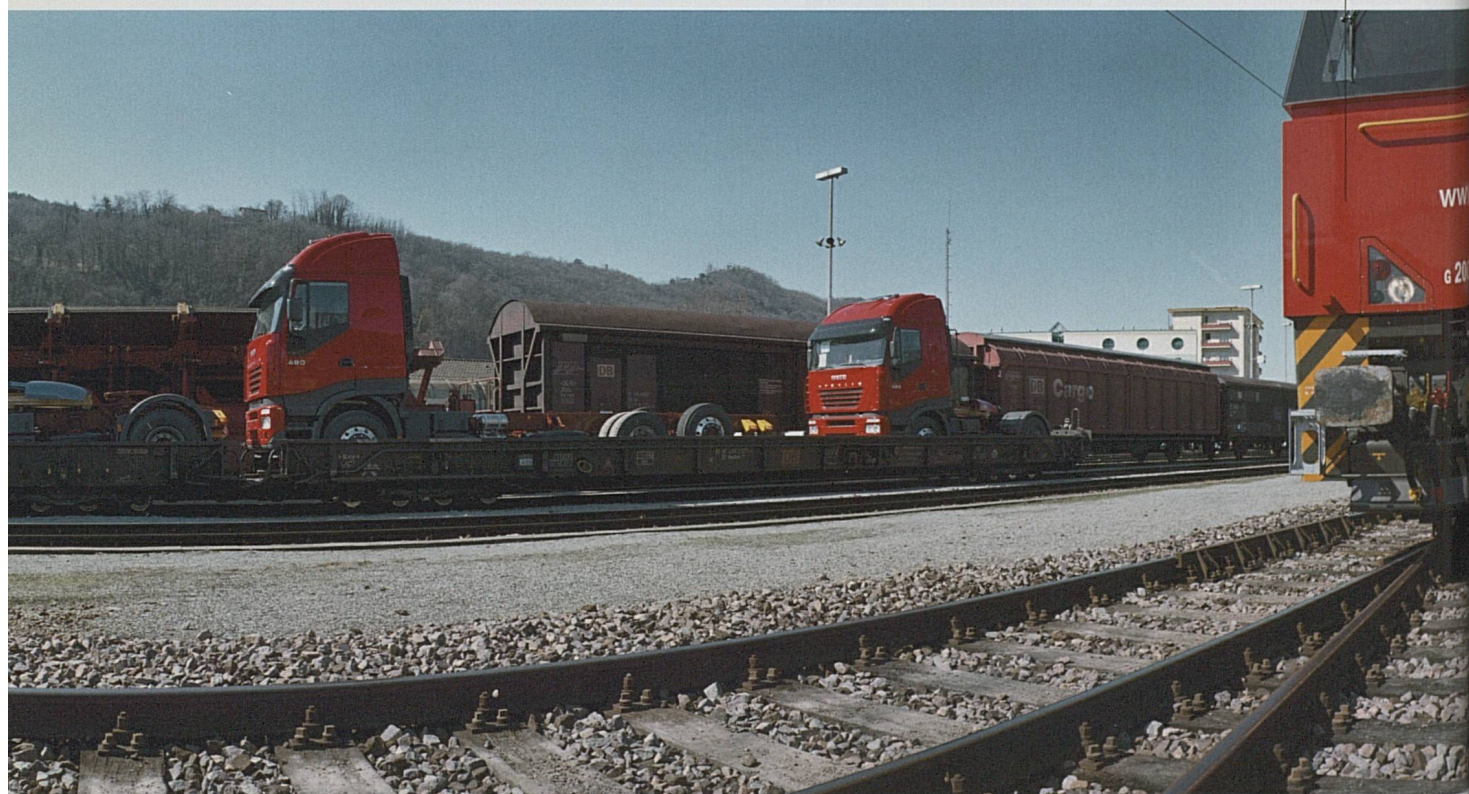
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Chiasso marshalling yard



Investments in the future. International rail freight calls for great flexibility, not least with regard to rolling stock. SBB Cargo operates modern Am 840 class diesel locomotives (pictured here) for non-electrified routes in Italy. But that's just one example. SBB Cargo invests large sums in fleet renewal: for Swiss-Italian traffic alone, it has ordered 39 state-of-the-art electric freight locomotives for a total of CHF 210 million.



Teamwork. SBB Cargo's logo has recently been joined, to the north and south, by those of its two subsidiaries – Swiss Rail Cargo Köln in Germany and Swiss Rail Cargo Italy. These two companies will operate as suppliers on the European market. The volume of freight is now being built up steadily so that SBB Cargo can operate a high-capacity through service between the major economic regions of Germany and northern Italy.

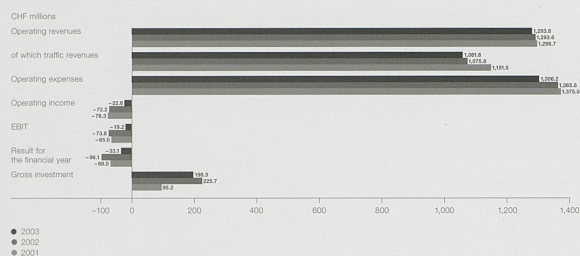
High performance. SBB Cargo posted total carryings of 9.94 billion tonne-km in 2003 (up 2.1%) despite an adverse business climate. Liberalisation of the European railfreight market has resulted in fierce competition. While SBB Cargo has lost traffic within Switzerland (and hence also in transalpine border-to-border business), it has gained market share on the international north-south routes.

Regular-interval freight. Innovation in rail freight: as of the new timetable in December 2003, SBB Cargo introduced a system of regular freight trains between Zurich and Sion and Sion and Samedan (east routes). As with the clockface passenger services, there are fixed times. This lowers costs and raises productivity – and forms a basis for strong growth on these routes.

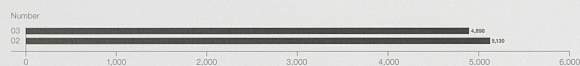
Turning the corner. As of the December 2003 timetable change, SBB Cargo implemented the first phase of its New Wagonload Service. Together with strict cost management, this changeover – the biggest in the railfreight time table for decades – is making a major contribution to improving SBB Cargo's financial results. In 2003, the loss for the financial year was reduced to CHF 33.1 million, 65.6% less than in 2002.

Economic integration. Bright prospects: by entering the Italian market on 15 December 2003, SBB Cargo became Europe's first freight railway in the key north-south corridor to offer a single-source solution featuring all-in train scheduling and management – Swiss quality and precision included. In doing so, it is meeting customers' actual needs.

Freight traffic in brief¹.



Employees².



¹ By segment. Group income and expenses not eliminated.
² Average workforce in full-time equivalents, including subsidiaries.

Strategic objectives, Freight Traffic, European market: exploiting opportunities for growth on the heavily-used routes between Benelux/Germany and Italy. Strong growth with high productivity. Swiss market: growth with new products, increased productivity.

SBB Cargo operates over 2,300 freight trains daily – an annual total of 9.9 billion tonne-kilometres – serving its customers on a network comprising over 675 delivery points, 600 loading points and 2,450 sidings. In doing so it reduces traffic on Switzerland's roads and in Europe's north-south corridor by over 20,000 truck journeys a day.

On target.

In the past year, SBB Cargo turned around its business, reducing the 2002 loss by 65.6% from CHF 96.1 to 33.1 million. It has thus made great strides towards achieving the targeted positive result. Despite a persistently difficult economic climate, traffic rose slightly in 2003. [With the launch of pilot operations in Italy and the implementation of the new wagonload service in Switzerland, SBB Cargo has initiated two key projects.](#)

At 9.94 billion tonne-kilometres (2002: 9.73 billion), freight traffic edged up by 2.1% despite the persistently sluggish economy. At 54.8 million tonnes, the volume of goods transported was virtually unchanged from the previous year (down 0.3% from 54.9 million). Traffic revenues of CHF 1.062 billion (-1.3%) were slightly below the year-back figure of CHF 1.076 billion. Thanks to the growth in turnover, the restructuring measures and strict cost management, SBB Cargo improved its operating result by 68.7% to CHF -22.6 million against the background of a slight (0.8%) fall in operating income to CHF 1.284 billion and a more significant (4.4%) drop in operating expenses. Earnings before interest and tax (EBIT) improved by 74% to CHF -19.2 million. This is reflected in a significantly better result for the year. The annual loss was reduced by 65.6% compared with the previous year and totalled CHF 33.1 million (previous year: CHF 96.1 million). Thus SBB Cargo reached an important milestone on its way to the positive result targeted for financial year 2005.

Increase in traffic in spite of recession and line closure.

Both the persistently weak economic situation in 2003, in which freight transport consolidated at a low level, and the dynamics of the liberalised rail freight market are reflected in traffic performance. While SBB Cargo lost market share to competitors in domestic traffic (and also in transalpine traffic from border to border), it gained market share in traffic outside Switzerland. Overall, the company saw an increase of 204 million tonne-km (+2.1%) in traffic performance, in spite of the economic slump.

Losses due to closure. The total closure of the Monte Olimpino II tunnel south of Chiasso for months on end meant that the company incurred losses estimated at CHF 10 million in revenue from traffic to and from Italy. The tunnel was closed completely due to water damage from the end of November 2002 to 5 May 2003, and until 7 August 2003 only one track was open. As a result, traffic was lost to the Brenner route and to road competition.

The volume of freight hauled from the Basel Rhine ports has plummeted. Because of persistently low water levels and the resulting higher shipping rates, the shippers' first priority was to reduce existing warehouse inventories. Only in a few cases did they select the all-rail option for freight originating at North Sea ports. Although Swiss Rail Cargo Köln was able to profit from this situation by operating a total of 236 special services for chemical and petroleum customers, the overall result was a loss of CHF 15 million in revenues.

Results for the individual traffic sectors.

The individual traffic sectors give the following picture:

- Export traffic continued to decline, dropping to 0.56 billion tonne-kilometres (–21.8%).
- Transit traffic decreased 4.6% to 5.02 billion tonne-km.
- Import traffic increased 1.0% to 1.31 billion tonne-km.
- Domestic traffic increased 2.2% to 2.4 billion tonne-km.

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In international traffic, the subsidiary Swiss Rail Cargo Köln (SRCK) was in operation for its first full calendar year and was able to increase traffic performance by 492 million tonne-km to five times the previous level. The success of the German expansion was also reflected by the revenue figure for the year under review, which increased from the previous year's CHF 3.6 million to CHF 34.3 million. With these results, SBB Cargo more than made up for the loss of traffic to its competitors in domestic traffic. For the first time, SBB Cargo also transported a modest amount of freight in Italy.

Traffic performance.

(in millions of net tonne-kilometres)	2003	2002	Change
Domestic traffic	2,403	2,351	+2.2%
Exports	557	712	–21.8%
Imports	1,308	1,295	+1.0%
Transit	5,017	5,261	–4.6%
Abroad (D/I)	651	113	+474.5%
Total	9,936	9,732	+2.1%

Development of client sectors. When sales are broken down according to industrial sector, we find that business decreased in the following areas: agriculture (below-average grain and sugarbeet harvests), construction (loss of clay traffic to competitors), chemical & petroleum, iron & steel (low water levels in the Rhine and losses to competitors), timber/paper (lower demand for paper) and postal service (customer's internal optimisation). Traffic increases were posted by the commerce sector (more shipments for supermarkets, new product "Cargo Domino") and by intermodal transport – the latter in continuation of a longstanding trend.

Transalpine traffic on the Gotthard and Simplon routes.

The decline in transalpine traffic reflects the growing competition in railfreight and the five-month closure of the Monte Olimpino II tunnel. Its closure cost SBB Cargo about 1 million net tonnes in transalpine traffic. As it has had a de facto monopoly of the Gotthard route until now, SBB Cargo loses market share in Switzerland, whereas it gains market share abroad (Germany and Italy). The downturn in tonnage is offset by an increase in the average distance travelled, as a single railway company (competing against other companies) is now increasingly responsible for the entire route. In particular, SBB Cargo has lost traffic in the "mixed-freight" wagonload segment as well as a few block trains. This trend will continue in the years to come. The Rollende Autobahn (Rola) piggyback segment saw a continuation of the trend away from the Gotthard and towards the Lötschberg-Simplon route, whose infrastructure is more suitable for this type of traffic. This has been associated with a change of operator from SBB Cargo to RAlpin, a company which uses BLS Cargo traction within Switzerland. Unlike the Gotthard route, the Lötschberg-Simplon route has been upgraded to accommodate trucks with a corner height of up to 4 metres.

Transalpine traffic.

(in millions of net tonnes)	2003	2002	Change
Wagonload traffic	7.48	8.61	-13.2 %
Unaccompanied intermodal traffic	11.07	11.19	-1.1 %
Rollende Landstrasse (piggyback)	0.70	0.87	-19.3 %
Total	19.25	20.67	-6.9 %

Market entry in Italy.

In December 2002, SBB Cargo decided to form its own subsidiary in order to enter the North Italian market. At the same time, the joint "Transalp" project with FS Trenitalia Cargo was discontinued.

Swiss Rail Cargo Italy s.r.l. (SRCI) was formally established at the end of January 2003. The big day came just under a year later: on 15 December 2003, Swiss Rail Cargo Italy began pilot operation with its first train from Chiasso to Monza-Lecco in northern Italy. SBB Cargo is the first European railway company capable of scheduling and operating freight trains between Germany and Italy and taking responsibility for end-to-end transport. SBB Cargo will begin regular operation in Italy in mid-April 2004 with additional trains departing from Chiasso.

A major challenge. The creation of the Italian subsidiary in such a short time was a major challenge for all employees involved. Important milestones were the legal formation of Swiss Rail Cargo Italy on 29 January 2003, licensing as an Italian railway undertaking on 26 March 2003, and the granting of the safety licence (Certificato di Sicurezza Cesifer) on 27 November 2003. SBB Cargo exerted great effort in training personnel – locomotive drivers, vehicle inspectors, and shunting personnel. The industry needed more time than expected for delivery and approval of the locomotives. SBB Cargo was able to secure the launch by purchasing Rail Italy, a small Italian industrial railway.

By developing Swiss Rail Cargo Italy, SBB Cargo intends to bring the quality and punctuality of rail freight traffic with northern Italy up to a level comparable with Switzerland. The goal is to make rail traffic attractive again for customers in the large northern Italian market and to continue to promote a shift in traffic from road to rail. In order to be closer to its customers, SBB Cargo re-opened its sales office in Milan at the end of 2003.

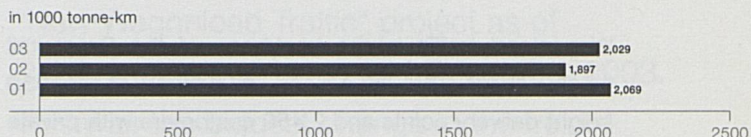
Competition...

In the second half of 2003, the SBB Cargo subsidiary was already operating about 90 trains per week on the Rhine route in Germany. This shows that SBB Cargo has successfully entered the German market. Customers can now choose between several options for this route: they can book their shipments either with SBB Cargo and its subsidiaries, or with other railways active in the liberalised railfreight business.

This new model is beginning to prevail over conventional cooperative arrangements, which did not achieve the desired quality. A single railway company takes responsibility for the shipment along the entire route and guarantees customers punctuality and cross-border reliability.

This development has considerable implications for the railway companies. The DB Cargo Group will lose its dominant position on the German Rhine-Ruhr route (Cologne-Basel). SBB Cargo will be among the winners on this route and will gain market share here. At the Gotthard end, the situation is exactly the opposite: here SBB Cargo will lose up to one third of its traffic to competing railway companies and will have to cede its dominant position. In northern Italy, a number of new companies are emerging on the market in addition to FS/Trenitalia Cargo and Ferrovie Nord Cargo. The Rail Traction Company, which operates on the Brenner route, played a pioneering role, with SBB Cargo following on at the end of 2003. The DB Group is also working towards market-entry in Italy.

Net tonne-kilometres per personnel unit.



... and cooperation.

SBB Cargo is continuing to handle import and export traffic and a portion of its north-south services in cooperation with Railion (DB Cargo) and Trenitalia Cargo. The wide-ranging cooperation with SNCF Fret and Rail Cargo Austria (ÖBB) has been extended. New partners are being acquired in addition to these traditional partners. Since April 2003, for example, Ferrovie Nord Milano (FN Cargo) has been operating trains for SBB Cargo on the Chiasso-Desio route, and additional routes have been established since then.

In October 2003, SBB Cargo and ERS Railways BV, formed a cooperative arrangement in order to improve the quality of railfreight services on the routes between Rotterdam and northern Italy. ERS is a joint venture of the globally active shipping companies Maersk Sealand and P&O Nedlloyd.

Restructuring of wagonload traffic.

Wagonload traffic is the backbone of the Swiss rail freight service. Through a close-knit network of over 650 freight delivery points and 2,450 customers with private sidings, SBB Cargo delivers over 1.2 million freight wagons per year. In 2002, wagonload traffic accounted for a loss of about CHF 36 million in SBB Cargo's income statement. Further savings were no longer possible with the previous production system.

Given this situation, SBB Cargo examined two possible options. The "re-dimensioning" option involved slashing the number of delivery points and thereby saving at least CHF 70 million. With the "optimisation" option, SBB Cargo proposed modifying the structure of regional production, thereby reducing peak loads in the morning and the evening.

Nationwide service retained.

In June 2003, Cargo decided in favour of the second option. The company felt it was important for wagonload traffic to remain a nationwide service. SBB Cargo is saving a total of CHF 29.5 million with the optimisation option. The nationwide service has been retained and will continue to be implemented through the "team station" concept. However, the number of these stations has been reduced from 120 to 43. The teams have been enlarged and now handle a greater catchment area.

Biggest timetable change in decades. SBB Cargo launched the first phase of its "New Wagonload Traffic" project as of the timetable change in mid-December 2003. This was the biggest change in the freight train timetable in decades. Thanks to painstaking preparations, it was accomplished smoothly and with no major problems. A large number of customers were involved in the changeover and played an active role in it. This close cooperation was instrumental in the project's success. The second phase of the project will begin in July 2004. It will include the preliminary work for utilising shunting locomotives with remote radio control systems.

Optimisation of wagonload traffic requires investments in the marshalling yards in Lausanne and Biel/Bienne and in several team stations. SBB has already given the go-ahead for the expansion and modernisation of the Lausanne yard. The expanded facilities will be available by the end of 2006.

Capital investment.

SBB Cargo has made major investments in upgrading its freight locomotive fleet and has ordered a total of 39 locomotives at a cost of about CHF 210 million for cross-border traffic between Switzerland and Italy.

At the end of February 2003, SBB approved an outlay of CHF 9.7 million for three diesel locomotives for non-electrified routes. The supplier is Vossloh Locomotives. The first two Am 840 locomotives have been in operation since December 2003, and the third will follow in early 2004.

On electrified routes, dual-current locomotives that can operate on both the Swiss and Italian systems are being deployed. Siemens Switzerland is supplying 18 dual-current Re 474 locomotives from the Eurosprinter family. Delivery will begin in June 2004. The purchase price is CHF 99 million. Bombardier Transportation is supplying 18 dual-current Re 484 locomotives from the Traxx family. The purchase price for these locomotives, which are scheduled for delivery as of December 2004, is also CHF 99 million.

SBB Cargo has continued to renew its freight wagon fleet. Delivery of flat wagons for transporting Cargo Domino swap-bodies has begun, as has the delivery of 200 modern sliding-wall wagons and 270 Cargo Domino containers of three different types. A new order was placed in the year under review for an additional 400 sliding-wall wagons. All the new freight wagons are equipped with low-noise synthetic brake pads.

Overall, SBB invested CHF 169 million in new rolling stock in the year under review.

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Locomotive upgrades.

The conversion of a further 12 Re 420 locomotives equipped for cross-border working (on the German and Swiss systems) was carried out at the Bellinzona Industrial Works. The new class designation is Re 421. The Bellinzona plant has also retrofitted three Re 420 locomotives with cab air-conditioning. After completion of the test phase, a larger number of locomotives of types Re 420, 430 and 620 will be similarly converted.

Improved safety thanks to derailment detectors.

SBB Cargo was able to complete a project in which 623 freight wagons for the transport of chemicals and petrol were retrofitted with derailment detectors at a cost of CHF 1.3 million. The retrofitting of an additional 1,000 wagons for hazardous goods transport has been approved and is now in preparation.

Basel-Nord gateway.

SBB Cargo has purchased a plot of land measuring some 1000 by 180 metres in the northern part of Basel that was once part of the former German Railways marshalling yard. A gateway for intermodal transport will be built on this 13.7 hectare site and is due to be completed in 2008. The facility will make it possible to receive intermodal trains and reconsolidate them. In contrast to a classic marshalling yard where rail wagons are shunted around, at this site powerful crane systems will be used transfer switch containers and swap bodies. The gateway will also be used for road/rail transshipment for the Basel region, replacing the existing Basel-Wolf container transshipment site.

Clockface timetable for transalpine freight.

When the timetable was changed on 15 December 2003, SBB Cargo introduced a "systematised timetable" on the Gotthard and Simplon routes. As with the regular-interval timetable for passenger services, most SBB Cargo trains now run on a clockface pattern. With this system, SBB Cargo can cut costs and increase productivity. The systematised timetable system lays the foundation for further growth along these routes.

Skillift principle. The new timetable's mode of operation is simple. Based on a principle like that of a skillift, the locomotives on the North-South routes run at regular intervals around the clock. The arriving freight loads are no longer assigned permanently to specific trains but – to put it simply – are hooked up to the next departing locomotive and sent on their way. SBB Cargo is thus able to reduce considerably the unproductive downtimes for both locomotives and drivers forced to wait at the border for trains that are delayed.

SBB Cargo estimates that in 2004 approximately 80% of the trains on the north-south routes will run at fixed intervals. The other 20% will be trains still operating outside the regular-interval system. As they require considerably more resources to transport the same quantity of goods, they will gradually be integrated into the new system.

Customer satisfaction falls slightly.

Customer satisfaction fell below the year-back level and averaged 7.32 points on a scale of ten (previous year: 7.47 points). The rating varied according to the importance of the customer group: while smaller customers gave SBB Cargo a significantly worse rating, satisfaction among major customers (who account for 74% of sales) stabilised at the year-back level of 7.4 points. The deterioration in the small-customer sector was due mainly to rigorous invoicing of all add-on services and to errors in invoicing for wagon demurrage. Both factors caused a significant rise in complaints, which could not be dealt with in the desired timeframe. The sales team was rated more highly, especially in terms of professional expertise and reliability. The Customer Service Center in Fribourg was also given a higher rating.

Improved punctuality in domestic traffic. The punctuality of freight trains remained high. Overall, 90.7% of the trains were on time (i.e. arrival within 30 minutes of the scheduled time). In domestic traffic, which is traditionally more punctual, the percentage was even higher: 94.1% of trains (up from 93% in the previous year) reached their destination within this time margin.

Headcount down. The average workforce of SBB Cargo, including its subsidiaries, decreased by 232 full-time jobs compared with the previous year and totalled 4,898 full-time positions by the end of the year. The reduction of 251 jobs in Switzerland resulted on the one hand from early retirements in 2002 which only worked through to the figures in the year under review and, on the other hand, from two new projects: New Wagonload Traffic and Passaggio (simplification of border formalities). In contrast, the average workforce abroad was increased by a total of 19 jobs at the subsidiaries Swiss Rail Cargo Köln (+5) and Swiss Rail Cargo Italy (+14). This trend – a falling headcount in Switzerland but rising staff numbers abroad – will continue in the years to come. In the year under review, personnel expenses were reduced by a total of CHF 44.8 million.

In order to increase the percentage of women employed by the company, SBB Cargo introduced a number of equal opportunity programmes. Among other things, a mentoring programme for women in management positions was introduced.

Outlook.

In 2004, SBB Cargo will push ahead with the development of its Italian subsidiary, Swiss Rail Cargo Italy, so that it can handle major freight services as of December as planned. The build-up of Swiss Rail Cargo Köln will also be continued, and SBB's expertise on the north-south routes will be strengthened.

The aggressively competitive policies of DB Cargo and its Swiss partner BLS Cargo will have consequences for SBB Cargo. SBB Cargo is expecting to lose a large portion of its existing transalpine traffic to this competitor. The stiffer competition will also result in falling rates.

Deterioration in the operating climate. As of 1 January 2005, the performance-based heavy goods vehicle tax (LSVA) will be increased. Because the weight limit for goods vehicles on the domestic road network is set to be raised from 34 to 40 tonnes at the same time, resulting in a significant productivity gain, the operating climate for domestic rail transport will worsen dramatically in the heavy goods segment.

In domestic traffic, the federal government's programme of spending cuts will put additional pressure on wagonload traffic. The train path subsidies, which serve to compensate for the productivity gains accruing to 40-tonne trucks, are set to be eliminated early. This poses a threat to the nationwide domestic freight service, which was optimised last year.