The Bournemouth-Swanage Motor Road and Ferry Company

(Incorporated by Act of Parliament 31 July 1923)

Application to Increase Certain Toll Charges

February 2020

Contents

1 BACKGROUND AND HISTORY OF THE COMPANY

1.1 The Company was set up under the provisions of The Bournemouth-Swanage Motor Road And Ferry Act 1923. This Act established a legal obligation to provide and maintain a more direct means of transport between Swanage and Bournemouth than had existed before that time.

1.2 Subsequent Acts in 1928, 1956 and 1986 changed and modified provisions governing the Company's powers, its ability to raise finance, regulate its business in general and to collect tolls for the maintenance and improvement of the undertaking.

1.3 Toll charges are currently regulated by the Transport Charges & c (Miscellaneous Provisions) Act, 1954, as amended by The Bournemouth-Swanage Motor Road And Ferry Act 1986 to provide for the day-to-day running costs of the company, items of capital replacement, and a reasonable return on the investment.

1.4 History

1.4.1 The Company, established by The Bournemouth-Swanage Motor Road and Ferry Act 1923, began operating the present service in July 1926. The Toll Schedule and Charges permitted then were as agreed by Parliament and formed part of the 1923 Act.

1.4.2 There was a proposal to replace the ferry, or Floating Bridge, with a fixed bridge of steel girder construction in 1929. However, the Private Bill necessary failed to win the support of Parliament and was consequently not proceeded with either then or since.

1.4.3 A larger, diesel-electric powered vessel replaced the steam-driven ferry in 1958. This vessel was itself replaced by an even larger, diesel-hydraulic powered craft, the "Bramble Bush Bay" (currently in service) in January 1994.

1.4.4 Originally the Company's shares were quoted on the London Stock Exchange; this ceased when a property company acquired a majority shareholding in the early 1960's and the Company became an asset of the parent company. In 1983 the Company was purchased by Silvermist Properties (Residential Developments) Limited (formerly called Silvermist Properties (Chelmsford) Limited), (SMP). In 1995 the Group was re-structured to give a much clearer division of its activities with the Ferry Company and SMP becoming direct subsidiaries of a new holding company, Fairacres Group Limited.

1.4.5 When taken over by SMP the whole of the ferry undertaking was in a badly run down condition, having been grossly neglected for many years by its previous owners.

1.4.6 An indication of the poor condition and inadequate management of the operation may be gauged by the fact that a Closure Notice had been served on the Company by the Health & Safety Executive, the reason for this being the rectification and repair of dangerous and unsafe equipment and the installation of proper fire-fighting and life-saving apparatus. In the view of the Health & Safety Executive, the ferry was unsafe for both the staff and the public and was not permitted to operate until the various matters had been attended to and the dangerous faults corrected.

1.4.7 The foregoing illustrates the very low level of care and maintenance that had been applied to the ferry by its previous owners. The same neglect had also affected all the Company's premises and other facilities.

1.4.8 Since 1983 there has been a huge investment in the undertaking. This has ranged from replacing vermin-infested timber huts, the then offices of the undertaking, with purpose designed conventional brick buildings, providing a supply of both mains electricity and water, all of which had to be brought to site over a distance of some three miles, and the provision of proper sanitation and heating. Concurrently and subsequently to the above-mentioned works, the slipways at North and South Haven were widened (to accommodate a larger vessel), new tollbooths were constructed, complete with traffic barriers, an automated toll collection system and a roundabout at the ferry end of the road allowing safer turning of vehicles.

1.4.9 The number of crossings within the framework of the various operating hours has increased under the current ownership, as have the number of operating hours, thereby compounding the effect to give a better service. The high point of this almost continuous investment and improvement programme was the placing of the order for the new ferry "Bramble Bush Bay" in 1992 and culminated in a complete rebuild of both slipways in 2008.

1.4.10 Since 1983, and aside from the original purchase price, the present owners have ploughed back over £7.5million into the Company. The main items of investment are as itemised in the previous paragraphs. This investment secured the future of the Company, it has reversed the gross neglect and mismanagement of earlier years, it will ensure a first class service for present and future users and, not least, it has secured the employment locally of 27 permanent staff and an additional 6 seasonal employees.

2 GENERAL NOTES REGARDING THIS APPLICATION

2.1 There are two sets of projections included in the appendices to this application. The first set shows the current and following 12 years on the basis that no increase in tolls is made. The second (for the same time period) assumes that this application is successful and toll charges are increased. The two scenarios have only been included so that the necessity for an increase in tolls can be clearly demonstrated.

2.2 The suggested toll increases are set out fully in Appendix 8 and are summarised below.

CLASS OF TRAFFIC	Current Maximum Toll Chargeable - £	Proposed Maximum Toll Chargeable - £
Pedestrian (Sandbanks to Shell Bay)	1.00	1.50
Pedestrian (Shell Bay to Sandbanks)	Nil	Nil
Pedal or motor cycle	1.00	1.50
Passenger vehicle ≤ 17 persons (cars & light vans)	4.50	6.75
Passenger vehicles > 17 persons (coaches)	9.00	13.50
Goods vehicles > 3,500kg & ≤ 20,000kg (trucks)	9.00	13.50

As set out in Appendix 8, the Directors have increased cash tolls wef 01 April 2020 by only between a 5% & 5.56% increase on the last approved Maximum Tolls Chargeable (MTC) amounts set under the last Toll Revision Order made in February 2015. This represents less than half the rate of inflation since that point in time. Tolls for motorbikes, bicycles & pedestrians have not increased since November 2009.

Thereafter cash tolls are shown to grow at an assumed 3% rate of inflation (Appendix 1, Section 1.21) and the Directors undertake (after the initial rise assuming this application is approved) to limit cash toll increases to inflation. This will be calculated by using the initial uplifted cash toll charges (those shown in

Appendix 8 as wef April 2020) as a starting point. Tolls for any given financial year will then be determined according to the preceding January's RPI figure (using the January 2020 RPI All Items Index 'basket' figure of 290.6 as a base point for all future calculations) and will be rounded down to the nearest 5p. This pricing strategy will eradicate the inconsistent toll increases experienced by passengers in the past.

2.3 The cost of Sandbanks Ferry Ticket Card (SFTC) Passes (advance purchases previously known as book tickets) are currently discounted by between 10% and 24% depending on the amount bought and class of traffic compared to cash tolls. Under the these proposals, the Ferry Company will freeze the current charges for all vehicles and apply greater levels of discounts from the MTC for advance purchases until they reach 26% & 30% respectively to the Indexed Cash Toll, which (in Appendix 8) is shown to be from 1st April 2021. Bulk purchase costs for bikes, motorbikes & pedestrians are shown not to rise (in the same way) until at least 2025, in an effort to promote more environmentally friendly transport usage.

The Company is committed to ensuring that SFTC Pass prices remain at those higher levels of discount. These pricing strategies reduce the burden on 'greener' and regular customers, even more so for those unable to purchase larger quantities in advance.

2.4 The Directors obtained an independent professional estimate of the replacement cost of the ferry (Appendix 11) in March 2019. Allowing for actual inflationary increases to date and assumed inflation rates for the future (Appendix 1, Section 1.21), the forecast cost (excluding delivery) for a like for like Diesel Hydraulic replacement will be £12.8m in 2032. This is when the Directors are advised it would be prudent to be in a financial position to replace the current ferry.

2.5 Section 3.1 of this application shows that, in order to be in a position to replace the ferry in 2032; the Company would have to transfer an average £426k per annum to the ferry replacement reserve in the current and following 12 years. The required value of the ferry replacement reserve at 31 March 2032 should be the projected replacement cost of the ferry of £12.8m, less borrowings that can currently be up to £5m.

In the No Toll Increase scenario transfers are made to & from the replacement reserve after paying out a reasonable level of dividend to the shareholders (see section 3.3) and the 31 March 2032 target is not met.

In the case of this application being approved the projected shortfall will be only £3.81m at 31 March 2032 after transfers are made only to (& not from) the replacement reserve and before paying out less than reasonable levels of dividends. In these circumstances therefore the shortfall would have to be found by seeking additional funding, which as can be seen in the letter from the Company's Bankers (Appendix 12) would have to be by way of a loan from the Parent Company.

The Company has received a written undertaking from its Parent Company (Appendix 13) setting out its commitment to ensure the necessary funding is in place at the requisite time.

2.6 The Company has not paid dividends for over 2 years and will not be in a position to do so until 2021. Dividends proposed for the twelve year period thereafter (Appendixes 2 & 4) average a mere 6.1% pa with no increase in tolls and a less than reasonable 4.3% with an increase. As can be seen at Appendix 5 the rates of return developed in this application are less than comparable industry averages.

2.7 A factor affecting the operation every other year is the refit work carried out to the ferry in order to achieve the high standards of service expected. As a result, the vessel is out of action for between two and nine weeks and there is a corresponding drop in income in the financial years concerned. A further impact on profits in those years is the cost of this refit itself.

The next refit is in the financial year ended 31 March 2021. Therefore, in the financial years ending 31 March 2021, 2023, 2025, 2027, 2029 and 2031 lower levels of income (and hence profits) are forecast than in the intervening financial years.

Future refits will involve a Major refit every four years in the financial years ending 31 March 2023, 2027 and 2031. A Minor refit is scheduled in the financial years ending 31 March 2021, 2025 and 2029.

The estimated costs of a Major refit as at 31 March 2019 is £946k and a Minor refit £315k. The ferry is expected to be out of service for six to nine weeks during a Major refit and two to three weeks during a Minor refit.

3 REASONS FOR THE APPLICATION

3.1 Replacing the Ferry

3.1.1 In order to maintain the high standards of service and reliability expected, the Directors are advised that it will be necessary to be in a position to replace the ferry by 31 March 2032 at which time it is projected that the replacement cost of the ferry will be £12.8m (see section 2.4).

3.1.2 The ferry replacement reserve at 31 March 2019 was £2.6m. Therefore, in order to be in a position to bring the ferry replacement reserve to the projected amount of £12.8m to be in a position to replace the ferry in 2032, total transfers per annum will need to average £426k in the current and following 12 years. This is only possible in some of the years if a less than reasonable levels of dividends are paid. The shortfall in the ferry replacement reserve would have to be found by seeking additional funding at the time the ferry is replaced.

3.1.3 It is the Directors' responsibility to retain existing & attract future investment in the Company. To do this they must ensure that the owners receive a satisfactory level of return on their investment (see section 3.3). The application of the future dividend policy set out in section 2.6 goes some way toward this; however it does mean that the target replacement reserve for the ferry will not be met (see section 2.5) unless this Application is approved.

3.1.4 As can be seen in Appendix 4, the proposed dividends represent an average annual return of just 4.3% of the Company's net asset value over the next twelve years if the application is approved and the average Return on Investment (Profits After Tax as a percentage of Total Net Assets) is a mere 6.2% per annum.

3.2 Shortfall in Cash Vs the Value of the Ferry Replacement Reserve

3.2.1 An examination of the projected balance sheets of the company at each financial year end show that appropriate investments (represented by the cash funds on hand) do not match the value of the Ferry Replacement Reserve. As at 31 March 2019, cash on hand in the balance sheet was £2.109m compared to the replacement reserve value of £2.566m. This is a shortfall of £457k.

3.2.2 A shortfall will arise as the company's cash on hand will fluctuate dependent upon the daily working capital requirements of the business. In addition, the transfer to the Ferry Replacement Reserve is an appropriation of profit and not a cash transfer (the cash available being the profit for the year adjusted for non revenue amounts such as corporation tax paid; dividends paid; fixed assets bought and sold; and changes to debtors, creditors and stocks).

3.2.3 If this application is successful, the forecast cash on hand will rise to £8.894m at 31 March 2032 (see Appendix 9.2). This is a reduced cash deficit of just £91k compared to the projected value of the ferry replacement reserve at that time of £8.985m.

3.3 **Ongoing Ability to Provide a Reasonable Return on the Investment**

3.3.1 The Ferry Company's 1986 Act recognises that the operation of the ferry service should provide "reasonable return" to the Company's owners.

3.3.2 As there are no set guidelines, what constitutes "reasonable" will always be subjective. Registered investment advisor Ibbotson and Associates analyse long-term performance of stocks, bonds, treasury bills and inflation. Arithmetic average annual return on 100% bonds investments, which would be deemed low-risk, is calculated at 6.1%. It is the Directors' belief that, bearing in mind the Company's assets are not as readily convertible into cash, along with the business risks attached to running such an operation, a higher return on investment should be expected than that achievable through investing in bonds.

3.3.3 The tables at Appendix 4.1 and 4.2 show the forecast returns on investment and dividends for the next twelve years, following a two year period without the Company paying any dividends.

3.3.4 Appendix 4.1 shows the situation if no toll increase is granted. The average Return on Investment (Profits After Tax as a percentage of Total Net Assets) for the forecast period covering the twelve financial years ending 31 March 2021 to 2032 would be 3.5%. Conversely, Appendix 4.2, demonstrates that if tolls are increased, the average return on investment rises to 6.2%

3.3.5 From the owners' perspective, dividends received represent their true return on investment, and the above rates of return without a toll increase are less than that achievable through investment markets.

3.3.6 It is quite clear from these statistics that, in order for the operation to provide a reasonable return to its owners in future, an increase in toll charges is necessary.

3.3.7 A further way to assess whether the Company's return on investment is reasonable is by way of comparison with other companies in similar industries.

3.3.8 Using data from www.riskdisk.com, Appendix 5.1 compares the Company's actual and forecast returns with other companies in similar industries. While RiskDisk gives different ratios that are relevant to measuring returns, the closest of these to the financially accepted measure of "return on investment" is Profit before Tax as a percentage of Shareholder's Funds.

3.3.9 When comparing the Ferry Company's Profit before Tax as a percentage of Shareholder's Funds to those of the companies within SIC code 6120 'Inland Water Transport' (Appendix 5.2) and SIC code 6110 'Passenger Sea and Coastal Water Transport' (Appendix 5.3), the return achieved by the company has not once met the median point in the past and does not ever in the future, even with a toll increase.

3.3.10 While other ratio comparisons have not been summarised graphically, the data table at Appendix 5.1 shows that the Company's Profit Before Tax as a percentage of Sales is much more favourable than other companies in similar industries. It also shows that the company's Sales as a percentage of Total Assets is much lower than these companies. This would suggest that the Company is more effective at controlling its costs and generating profits from the resources it purchases. At the same time, it requires a much larger investment to generate revenue than other companies in similar industries.

3.3.11 Appendix 5.4 (assuming no toll increase) shows in graphical form four ratios covering actual data from 2013 to 2019, and forecast data from 2020 to 2032, that clearly demonstrates a downward trend. Appendix 5.5 however shows the same ratios but for the forecast data assuming an increase in the toll rates (as applied for) which results in a slowly increasing trend being clearly visible across the time period, for all the ratios.

4 CONCLUSION

4.1 The Directors cannot predict future traffic volumes but have assumed them to remain static in the forecasts based on average historical traffic volume data (see Appendix 7.3 that shows the trend to be fairly constant) which has proven to be very accurate in preparing previous forecasts.

4.2 The Company has two main objectives:

- From a public service point of view, to be able to provide and maintain a safe, reliable and cost effective ferry service.
- To provide a reasonable return on the investment to its owner.

4.3 To realise the first objective, it is necessary to replace the ferry when needed and for the new ferry to be of a more modern and efficient design than the present with an even lower environmental impact. This is achieved through the owner's on-going reinvestment in the ferry company and the value of the ferry service itself.

4.4 Using the ferry has a positive environmental impact and saves money for motorists. On the assumption that the average motor vehicle journey is from Bournemouth to Swanage, a saving of at least 12 miles is achieved by using the ferry. Based on HMRC approved mileage rates of 45p per mile the average cost saved using the ferry is £5.40. In an average non refit year, there are 788,000 motor vehicle crossings saving over 9m road miles pa which is equivalent to a saving in excess of £4m pa in motoring costs. The corresponding CO2 impact on the environment has not been calculated, neither have the savings to the Local Highway Authorities.

4.5 This application clearly demonstrates that the Company cannot provide for the future replacement of the ferry and generate a reasonable return if tolls are not increased.

4.6 A common perception may be that this operation is a low risk business. From an investor's perspective, this may well be the case when it is compared to certain other businesses and industries. But this does not mean it is risk-free. Moreover the current owners manage the risk through responsible ownership and on-going re-investment.

4.7 In view of the foregoing, the Directors feel that this application for an increase in toll charges is therefore fair and reasonable.