

3 - Ongoing ability to provide a reasonable return on investment

The above is covered by appendix 3.3 in the ferry company's application for a fare increase. The ferry company admits that this is a contentious subject as there is no definition of what a reasonable return is. The appendices 4.1 and 4.2 show the forecast returns on investments and dividends, they calculate the returns on the basis of profit after tax (PAT) for calculating the return. Most calculations of return on investment utilise profit before tax (PBT). The use of PAT works for the benefit of the applicant as it shows a lower rate of return.

This inconsistency is confirmed by 5.1 where database RiskDisk.com uses the comparator of PBT in its' statistics as admitted by Ferry company.

Para 3.3.5 States that the dividend received represents the true return on investment. I take issue with this comment. The Dividend received by the owners is not the only return. As owners of the company they benefit from transfers to the FRR. It represents part of the Shareholders Funds albeit supposedly for the ferry replacement. It increases the net worth of the company for the long term and the benefit of the shareholders.

Para 3.3.9 refers to comparing the Ferry company returns with SIC code 6120 "Inland Water Transport" and SIC code 6110 "Passenger Sea and Coastal Water Transport". Reference to the Internet shows that these codes are incorrect. The correct codes should be 5010 and 5030. The Codes quoted by the applicant refer to "wired telecoms activity" and "wireless telecoms activity". We should seek clarification as to which statistics are included in the appendix 5.1.

I obtained financial data for the companies in SIC 5010 and 5030 from Experian. Of the 195 companies under these headings only 34 had lodged financial data at Companies House. They include very large operations such as P & O and Stena, cruise lines, Island Ferries and excursion companies, Bicycle hire, Port Management, back to back charter companies. It is well known that SIC codes are not accurate or policed by the ONS or Companies House.

It is questionable as to whether these sectors are the true comparative. According to Wikipedia there are 15 Chain Ferries operating in the UK.. They can be split as follows:

- 2 incorporated by Act of Parliament.
- 1 exempt from filing detailed accounts.
- 2 owned by private individuals.
- 1 Community Trust
- 2 owned by Public Houses.
- 7 owned by Local Authorities or County Council.

None of the above are available as a comparator in the above SIC groups as their financial results are not on public record. The sample obtained are not comparable to a Chain ferry. By the very virtue that a Chain Ferry is still attached to the land that make it a much lower risk operation. You do not need to be a Master Mariner to operate it, and it is a low tech vessel with almost tractor technology for propulsion. It is often described as a floating bridge. A better comparative would surely be a toll bridge, tunnel or some other infra structure project. This return would be around 4- 6%.

It is interesting that the majority of the major Chain Ferries are in public ownership as they are considered part of the essential infra structure.

The ferry company states that its return on capital employed at 7.8% is far below those in the comparative group. However the comparative group is not representative. This is once again overlooks the fact that the asset value of the ferry company is grossly overstated. In Shareholders Funds of approximately £16M is included a Revaluation Reserve of £12.5M. The ferry company is seeking a return on the revaluation of various assets . The main one is the road for which they paid no money to acquire the land upon which it sits, but merely had to bear the cost of putting down the tarmac surface. The valuation also includes the value of the right to receive the income from the road. This is introducing an element of circularity into the process and is inappropriate.

The original cost of the Land, roads and slipways is £138,977. Gerald Eve has valued them in total at £12.370M. An uplift of in excess of £12M. Shareholders funds also includes £3M of cash at bank which represents the FRR. It is unreasonable to expect a commercial return upon cash held to replace the ferry. Adjusting the road valuation to replacement cost of say £3M and removing the cash at bank from the calculation of return, we end up with a 17.8% return. This exceeds the median return of 14% stated in the application which is in itself inappropriate as previously stated. Including an element of risk for the ferry 6% would be appropriate on true capital employed.

In Para 3.3.10 the Applicant admits that they earn a higher PBT as a % of Turnover than other companies in the comparison group. The Application fails to show that it is 6 times higher (600%) higher. There is no information provided. The Ferry company shows between 40 -50% for this ratio. Research shows the comparatives are between 6 – 8%. The Applicant justifies this by dubious statements that the SFC are efficient and control costs. The plain fact is that the existing Tolls charged are far higher than required to cover the costs incurred in the operation. The fare tariff sought is driven by the scale of the dividend which is as much as 25% of revenue. However the transfer to FRR is also a return to the Applicant. True earnings are 40 – 50% of Turnover.

In summary the existing fare tariff for the next few years is sufficient to replace the ferry eventually, if a suitable loan to equity structure is planned for. At the same time reasonable dividends can be paid to the owners to reflect the true value of the investment in the Ferry. See Appendix MT3.