IN THE MATTER OF THE APPLICATION TO INCREASE TOLL CHARGES ON THE BOURNEMOUTH-SWANAGE FERRY LINK

FINANCIAL STATEMENT PROVIDING UPDATING INFORMATION AND RESPONSE TO VARIOUS PROPOSALS – DECEMBER 2020

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1 Introduction

This report has four sections:

- Section A provides updating information to the Inspector in relation to the Ferry's economic position since the time of the filing of the application. Section A also seeks to address some of the queries that have been raised in relation to the assumptions in the Ferry Company's original application.
- Section B then considers the proposals that have been advanced by the Consortium, and explains that while there is much of merit in the general proposal, equally there are revisions that would be required.
- Section C sets out a revised Application, which seeks to implement many of the Consortium's suggestions but also addresses some of the issues arising from those. Importantly, this revised Application seeks to ensure that charges for local residents regularly taking their car onto the Ferry do not increase more than inflation, by ensuring charges for bulk tickets are at, or less than, inflation.
- Section D considers the National Trust's proposals. These are considered un-workable as they suggest a solution for a single year rather than an increasing income scenario to at least keep track with rising expenditure for the period to 2032. While the Ferry Company considers that the NT's proposals are not workable in practice, it has nevertheless sought to address the concerns by ensuring that regular car users do not face greater than inflation increases in tolls (see above, Section C). In this manner, in real terms they will not face an increase in tolls.

SECTION A: UPDATING FINANCIAL INFORMATION

1 Basis of Turnover Projections

1.1 The last 'normal year' was the year ended 31 March 2018. This was a non-refit year without any significant outages. The turnover projections are based on the five 'normal' years prior to 31 March 2018.

1.2 The year ended 2019 was affected by an extended refit with complications; 2020 by drive shaft failure and Covid-19; and 2021 by Covid-19.

1.3 Traffic volumes over the last 10 years have been:

Year	Pedestrian	Cycle	Car	Goods	Bus/Coach
2009/10	**167,747**	**95,697**	**793,532**	**2,350**	**11,078**
2010/11	161,458	99,250	726,796	2,009	11,464
2011/12	**165,548**	**109,850**	**812,926**	**2,040**	**13,813**
2012/13	140,418	86,336	673,546	1,505	11,978
2013/14	**144,809**	**111,397**	**765,437**	**1,741**	**12,080**
2014/15	137,310	111,617	713,241	1,684	10,764
2015/16	**138,850**	**115,394**	**744,785**	**1,475**	**11,965**
2016/17	137,301	122,957	700,522	1,415	11,617
2017/18	**148,446**	**118,484**	**724,102**	**2,035**	**11,898**
2018/19	150,150	115,289	536,088	2,129	9,184
2019/20	98,372	74,572	391,480	1,554	7,400

Emboldened years were not refit years. The average car volume for the period 2010/11 to 2017/18 was 732,669 (taking 4 full years, 2 full refits years and 2 interim refits).

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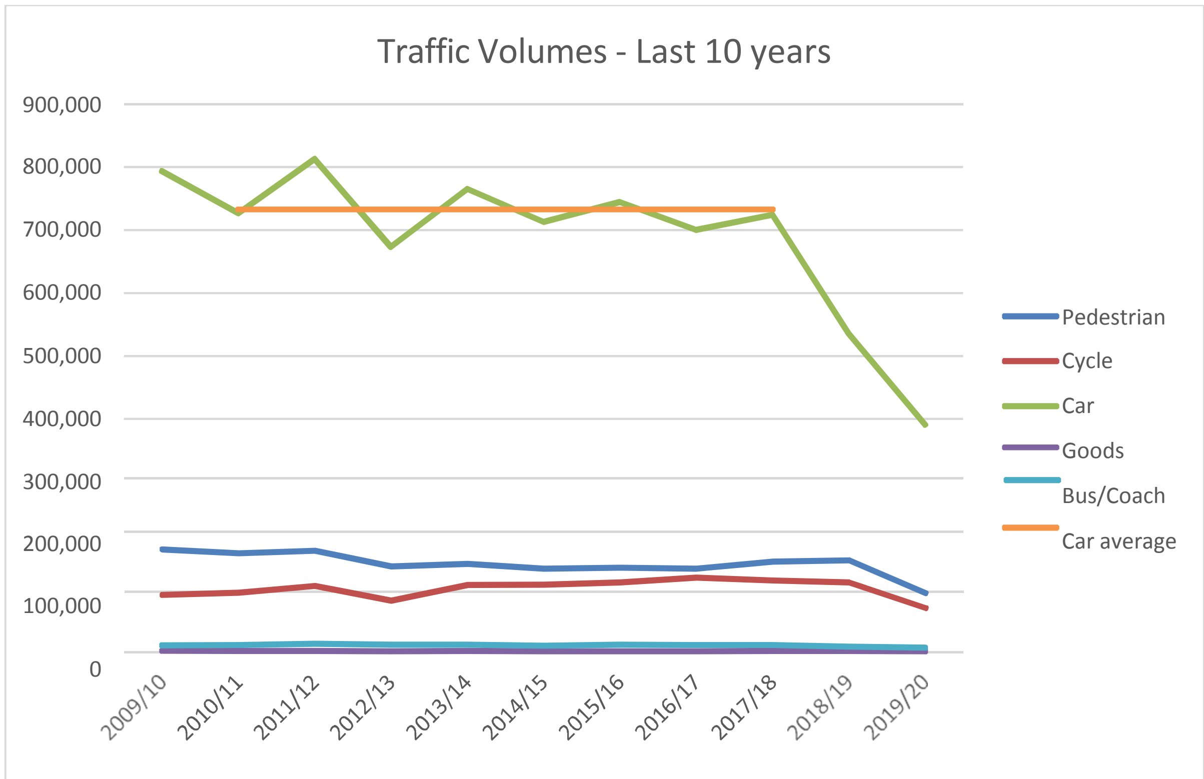
Graphically this is displayed as:



1.4 Assuming traffic volumes from October 2020 return to previous levels, traffic volumes compared to 2018 are down by the following percentages:

Class	2019	2020	2021 (estimated)
A – Pedestrian	1%	-34%	-25%
B/C – Cycle	-3%	-37%	-19%
F – Car	-26%	-46%	-29%
G – Goods vehicles	5%	-24%	5%
Coach	-23%	-38%	-25%

The resulting income reduction compared to 2018 is:

Class	2019	2020	2021 (estimated)
A – Pedestrian	5,604	(34,356)	(24,238)
B/C – Cycle	2,202	(49,952)	(25,404)
F – Car	(636,610)	(1,320,443)	(806,774)
G – Goods vehicles	7,676	(20,614)	4,043
Coach	(1,291)	(2,600)	(1,682)
Total	(622,419)	(1,427,965)	(854,055)

2 Financial projections v Actual & Expected results for the two years ending 31 March 2021

2.1 Fall in projected income

2.1.1 The financial projections prepared and submitted with the application in January 2020 were before any impact of Covid-19. As such, they are prepared on a 'normal operations basis'. At the time of the Inquiry, operations are not back to normal levels and there is every expectation that we will see further lockdown and associated measures into the new year.

2.1.2 The company prepares its financial statements to 31 March each year. Covid-19 affected the results for the last month of the year ended 31 March 2020 and has affected the results for the present financial year to date. If further restrictions are placed on the local economy, it is probable the results of the year ending 31 March 2022 will also be impacted.

2.1.3 In the revised proposal (see Section C) the projections have been updated for the actual results for the year ended 31 March 2020. The original prediction had a profit after tax of £995,328. This compares to the audited accounts profit after tax for the year of £705,658, a reduction of £289,760.

2.1.4 The projections for the year ending 31 March 2021 predicted a profit after tax (assuming an increase) of £941,926. The management accounts to 30 September 2021 together with an extrapolation to 31 March 2021 suggest a profit before tax of £248,299 assuming the business has now returned to more normal conditions (this will be subject to any further Covid-19 related lockdowns in the early part of 2021). Deducting a provision for tax from the forecast result gives a possible profit after tax of £181,588 – a fall of £760,338 on the original projections

2.1.5 The total losses of income of £1,050,098 across the year ending 31 March 2020 and the year ending 31 March 2021 will directly reduce any dividends payable to shareholders. This means that the dividend forecast for the year ending 31 March 2021 of £429,601 cannot and will not be paid and that forecast for 31 March 2022 of £990,807 will not be fully paid (see comments below regarding Ferry Replacement Reserve). As has been noted elsewhere no dividends were paid in respect of the financial years ending

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31 March 2019, or 31 March 2020.

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2.2 Ferry Replacement Reserve (FRR)

2.2.1 Following the last increase application, the company policy towards payment of dividends and ring fencing the FRR changed.

2.2.2 The company policy towards the FRR is set out in accounting policy note 1.13 and note 12 in the published audited accounts for the year ended 31 March 2020.

2.2.3 Since the last public inquiry, the directors have revised their dividend policy. They will now only consider payment of a dividend when the FRR together with the maximum loan finance the company may obtain, exceeds the predicted ferry replacement cost.

2.2.4 In order for the FRR to increase to meet the anticipated cost of the new ferry, allowing for loan finance, at 31 March 2020 the FRR would need to have been £3,728,178 (per audited accounts).

2.2.5 Due to the reduction in profit after tax for the year ended 31 March 2020 insufficient profits were available to meet this requirement. At 31 March 2020, the FRR amounted to £3,357,762 a shortfall of £370,416, despite no dividend having been paid to the shareholders for the preceding financial year.

2.2.6 A further increase in the deficit is forecast for the year ending 31 March 2021 as the projections estimate the FRR will need to be £4,243,622 .This would be an increase in the reserve by 31 March 2020 of £885,860, however profit of only £181,588 is forecast (see 2.1.4). Nonetheless, once there is a return to normal conditions (following Covid-19 lockdowns, and the rollout of the vaccine) it can be seen from the projections that the FRR targets will be achieved in subsequent years, in good time for the proposed purchase of the replacement ferry. In any event, following the change in company policy, the FRR will be put first, before any consideration of dividend payments.

3 Inflation

3.1.1 The forecasts were prepared at a time when the forecast RPI was 3%.

3.1.2 RPI has been used by the company for the following reasons:

- HM Government use it for other transport services – Rail Fares
- It has been in accepted use for a considerable period
- It is widely used
- In September 2019 the then Chancellor, Savid Javid advised the UK Statistics Authority it would continue to be used by HM Government until at least 2025, and would continue to use it until 2030, subject to the outcome of a public consultation to be held in the future. This was in light of the fact that '*RPI is embedded across the economy'.*
- In the November 2020 Spending Review, the Chancellor Rishi Sunak confirmed that RPI would continue to be used by HM Government until 2030, by which time CPIH and RPI would be effectively merged. HM Treasury's consultation response noted the use of RPI to determine rail fares, many regulated utilities and many private financial initiative contracts (among others).

3.1.3 There is an ongoing economic argument that CPI (or CPIH when owner occupied housing costs are included) is a better measure than RPI. The RPI uses an arithmetic average of price changes whereas the CPI uses a geometric average, which makes the CPI/CPIH mathematically more precise allowing it to capture the effects of changes in consumer spending patterns in response to inflation or deflation. RPI is generally a higher figure than CPIH which is generally higher than CPI. The RPI is an older measurement of inflation that is still published and widely used because it is used to calculate cost of living and wage escalation this does not mean CPI is always low - CPI averaged 1.74% in the UK during 2019 but in 2011 CPI averaged 3.85% and it was more than 7% in 1990/1991.

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3.1.4 The original proposal included an average inflation at 3% per annum until 2032. This is higher than the present RPI and CPI rates but lower than forecast rates (The June 2020 Government forecast for the UK economy forecast RPI of 1.2% and CPI of 0.7%. The consumer and marketing website statista.com predicts RPI of 3.1% and CPI of 1.6% for 2022).

3.1.5 Forecasting inflation over the next 12 years is not an exact science and will always be subject to debate. Looking back over the last 12 years, the average price changes suggest that for a cash deposit to keep pace with inflation it had to grow at an average of 2.6% per annum.

3.1.6 If the forecast (with toll increase) is amended to an inflation rate of 2.6%, profit after tax will increase by £635,471. This is still less than the fall in profits for 2020 and 2021 when comparing the original proposal and resulting actual results.

4 Dividends and return on investment

4.1.1 No dividends were paid during the years ended 31 March 2019 and 2020. They are also not going to be paid for 2021 and unlikely to be paid in 2022 (it is already clear that the full dividend will not be paid; whether a reduced payment is feasible after full contributions have been made to the FRR will depend on future financial conditions, including how quickly normal conditions return with the rollout of the Covid-19 vaccination).

4.1.2 The projections (were the application to be successful) forecast total dividends payable over the 12 years commencing 1 April 2020 of £7,662,653 - an average dividend each year of £696,605. This equates to an average return on net assets (average net assets forecast to be £18.18m over the period) of 3.51%. It is already clear that the first year of dividends will be reduced (after three years of no dividend payments). If the Covid-19 impact lasts into 2021 the average return may reduce further.

4.1.3 The question that is asked is what is a reasonable rate of return? The simple answer is, it depends on your appetite for risk. Investing in a small private company is naturally more risky than investing in a balanced managed stock market portfolio.

4.1.4 You can get 0.25% a year (Virgin Money) from an easy-access cash ISA (as at 7 December 2020), or, according to MoneySavingExpert, 1.14% if you are willing to tie you cash up for three years. According to the Credit Suisse Global Investment Returns Yearbook 2020, global stock markets have delivered a real return of 7.6%, versus 3.6% for bonds over the past decade. UK returns averaged 6.4% in the years between 1970 and 2019, but just 2.7% since the beginning of this century. That compares to 4.5% and 4.2% for gilts.

4.1.5 The conclusion is that a return of at less than 5% is very low given the following factors:

- Difficulties increasing income
- Significant capital investment

- Fixed operating profile and expenses

- Restricted access to external financial support including banks

- Lack of Government grants, funding and support

SECTION B: CONSIDERATION OF THE CONSORTIUM'S PROPOSALS

5 The Consortium Proposal makes a number of beneficial suggestions:

- It recognises that the company must raise tolls to provide for a replacement ferry in due course and accepts that without a toll increase, the company will not be in a position to achieve this objective
- The proposal seeks to achieve the same level of total income sought as set out in the company's original submission in order to be able to fund the new ferry
- The proposed pricing model is clear for ferry users and promotes environmentally friendly travel
- The proposal removes the annual inflation linked increase to provide greater clarification and future transparency for (particularly) regular users.

5.1.2 However, the proposal does not address a number of key issues which reduces its impact and the ability for the company to generate the income the proposal suggests is achievable:

- The proposal fails to take into account the income reductions in alternate years due to essential maintenance work and the bi-annual ferry refit. This results in the ferry being out of operation for 6 weeks in every four years and for 2 weeks in every four years i.e. 2023 – 6wks; 2025 2 wks; 2027 – 6 wks; 2029 2 wks etc.
- The proposal puts forward an increase of £1.00 in the car ticket price from 1 April 2021 to £5.50 and then stepped at a slower rate thereafter. The company considers this initial substantial increase will be unsustainable and likely to detract usage. It further offers little encouragement for customers to purchase book tickets.
- The proposal is purely focused on income streams but only uses data from a single year as its starting point. The company proposal takes an average of several preceding 'normal' (i.e. not refit years or those without exceptional outages) as its basis for its income projections.

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SECTION C: REVISED PROPOSAL

6 The company has prepared revised proposals that take into account the consortiums toll increases.

7 This updated proposal is prepared on the same basis and formats as the company's original proposal with the following changes/updates:

- Appendix 8, which sets out the annual tolls effective from 1 April each year for all years to 2032 has been updated to acknowledge the consortium toll proposals.
- The cash & book ticket charges for pedestrians and bikes have been frozen at the current levels in all years to 2032.
- The discount rates for books of tickets for motor vehicles are further enhanced and better the consortium proposal. The company now proposes an increase in discount rates. With discounts of 28% for books of 10 and 32% for books of 50 tickets from 1 April 2021. This results in increases lower than inflation; that is to say real-term reduction in costs.
- Likewise the consortium proposal of an initial increase of £1 (from £4.50 to £5.50) for motor car cash tolls has been reduced to £0.50 which is considered to be a more sustainable rise. There are then small incremental uplifts in tolls in the ensuing years until the Maximum Toll Chargeable is reached.
- The same principals for book tickets and cash tolls have been applied to goods vehicles, buses and coaches which are double the tolls charged for cars.
- The resulting changes in income adjust the transfers to/from the ferry replacement reserve and reduce the dividends payable to investors. The company retains its policy of ensuring the ferry replacement reserve builds up to the required amount prior to payment of dividends but consequently, the return to investors falls to an average of 2.96% compared with an average of 3.51% in the original submission.

8 An additional appendix is included (appendix 8a). This illustrates the how the proposed bulk ticket prices after the increased discount rates being applied will increase at a rate lower than inflation thus benefiting the end user at all times during the period to 2032. As noted above, this means that the real

cost of these tickets decreases.

SECTION D: CONSIDERATION OF NATIONAL TRUST'S PROPOSALS

9 The National Trust proposal has been considered. Unlike the company proposal and that of the consortium, the National Trust proposal is lacking in certain respects:

- It is not clear how the percentage rates for local and regular users have been calculated. To the company's knowledge, no such surveys exist thus the rates used are subjective and are likely to be inaccurate.
- The proposal does not make it clear who benefits from the local rate of £2. The present discounted ticket regime benefits all regular users whether they live in the vicinity, are tourists on holiday who wish to make many crossings or others from further afield who use the ferry often enough to wish to purchase a book of tickets. The NT's proposal does not factor in the additional administrative cost of vetting all users purchasing bulk tickets and ensuring they are only being used by the purchaser.
- It is not clear how long a period the local rate toll of £2.00 and regular toll of £4.50 will be effective and when they will be increased. If it is being proposed that the toll prices remain set until 2032, this will result in decreasing profitability of the company as it will be subject to the usual market forces pushing up prices for its wages, salaries and other expenditures. Is the National Trust suggesting that the tolls remain static, wages and salaries of the workforce should also remain at the same, 2020 level? As profitability declines, the company will take longer to build up the ferry replacement reserve (it may end up with a deficit) and any return to investors will be negligible.
- The proposal fails to consider the different classes of user. The flat rate would appear to apply across all users meaning bus and HGV users would benefit whilst foot passenger and cyclists would be disadvantaged.
- The proposal alludes to the possibility of peak and off-peak tolls during the course of the day but does not try to assess the impact of this. It appears to be based on anecdotal accounts. It is suggested that this will be impractical from an administrative and management point of

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view.

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