

The Bournemouth-Swanage Motor Road and Ferry Company

(Incorporated by Act of Parliament 31 July 1923)

Application to Increase Certain Toll Charges

January 2018

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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 restructured 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. 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.
- 1.4.9 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 next nine years on the basis that no increase in tolls is made other than the approved increase due on 1 April 2018. The second shows the next nine years assuming that this application is successful and toll charges are increased in addition to the approved increase. The two scenarios have been included so that the necessity for an increase in tolls can be clearly demonstrated.

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

CLASS OF TRAFFIC	Current toll £	Maximum Toll Chargeable (to be implemented 1 April 2018) £	Proposed Toll Chargeable (not implemented until FYE 31 March 2022) £
Pedestrian (Sandbanks to Shell Bay)	1.00	1.00	2.00
Pedestrian (Shell Bay to Sandbanks)	Nil	Nil	Nil
Pedal or motor cycle	1.00	1.00	2.00
Passenger vehicle ≤ 17 persons (car)	4.30	4.50	6.00
Passenger vehicles > 17 persons (coach)	8.60	9.00	12.00
Goods vehicles ≤ 3,500kg (cars)	8.60	9.00	12.00
Goods vehicles > 3,500kg & ≤ 20,000kg (trucks)	8.60	9.00	12.00

2.3 The cost of ticket books are currently discounted by between 10% and 25.58% depending on the class of traffic compared to cash tolls. As set out in Appendix 8, the Directors have phased the cash toll increases for all classes of traffic across each year. In the case of bulk tickets for motor cars and goods vehicles the rates of discount will remain (by up to 27.66%) until 2021 to mitigate the effect of increases in base price, thus keeping the annual increases roughly in line with the RPI rate in appendix 1, section 1.2.1.

2.4 The Directors have obtained an independent professional estimate of the replacement cost of the ferry. Allowing for actual inflationary increases to date and assumed inflation rates for the future (Appendix 1, Section 1.21), the forecast cost will be £10.669m in 2026. This is when the Directors are advised they should be in a position to replace the ferry.

2.5 Section 3.1 of this application shows that, in order to be in a position to replace the ferry in 2026; the Company would have to transfer an average £970,841 per annum to the ferry replacement reserve over the next 9 years. The required value of the ferry replacement reserve at 31 March 2026 should be the projected replacement cost of the ferry of £10.669m. In both scenarios (with or without a toll increase), transfers are made to the replacement reserve after paying out a reasonable level of dividend to the shareholders (see section 3.3). Based on the projections and the proposed increase in tolls, the 31 March 2026 target will not be met. The projected shortfall will be £961k at 31 March 2026. In these circumstances therefore the shortfall would have to be found by seeking additional funding at the time the ferry is replaced.

2.6 Dividends proposed for the nine year period are set to increase by no more than 2.99% per annum, which is less than the forecast rate of inflation. If the increase applied for is approved, the dividend increase has been factored in to maintain actual dividends as a percentage of total net assets at below 5.2%.

2.7 A factor affecting the operation every other year is the major refit work carried out to the ferry in order to maintain the high standards of service provided by the operation. As a result, the vessel is out of action for between five and seven weeks and there is a corresponding drop in income in the financial year concerned. A further impact on profits is the cost of this refit, which has averaged in excess of £330k for the last six years. The last refit was in the financial year ended 31 March 2017. Therefore, in the financial years ending 31 March 2019, 2021, 2023 and 2025 lower levels of income (and hence profits) are forecast than in the financial years ending 31 March 2018, 2020, 2022 and 2024 and 2026.

Future refits will involve a major refit every four years in the financial years ending 31 March 2019 and 2023. A mini refit will be scheduled in the financial years ending 31 March 2021 and 2025.

The estimated costs of a full refit as at 31 March 2017 is £500k and a mini refit £250k. The ferry is expected to be out of service for six weeks during a full refit and two weeks during a mini refit.

3 REASONS FOR THE APPLICATION

3.1 Replacing the Ferry

3.1.1 In order to maintain the high standards of service achieved under the present ownership, the Directors are advised that it will be necessary to be in a position to replace the ferry in approximately 9 years.

3.1.2 It is projected that the replacement cost of the ferry in 2026 will be £10.669m (see section 2.4).

3.1.3 The ferry replacement reserve at 31 March 2017 was £1.931m. Therefore, order to be in a position to bring the ferry replacement reserve to the projected amount of £10.669m to replace the ferry in 2026, total transfers per annum will need to average £970,841. This will not be possible in some of the years if a reasonable level of dividend is also to be paid. The shortfall in the ferry replacement reserve would have to be found by seeking additional funding at the time the ferry is replaced.

3.1.4 It is the Directors' responsibility to ensure that the owners receive a satisfactory level of return for their investment in the company (see section 3.3). The application of the 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). As can be seen from Appendix 4.2, the proposed dividends represent an average return of between 4.5% and 5.2% of the Company's net asset value if the application is approved.

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 2017, cash on hand in the balance sheet was £1.553m compared to the replacement reserve value of £1.931m. This is a shortfall of £378k.

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 £9.613m at 31 March 2026 (see Appendix 9.2). This is a cash deficit of £94k compared to the projected value of the ferry replacement reserve at that time of £9.708m but significantly below the expected cost of replacing the ferry of £10.669m in 2026.

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 nine years.
- 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 financial years ending 31 March 2018 to 2026 would be 5.85%
- 3.3.5 Conversely, Appendix 4.2, demonstrates that if tolls are increased, the average return on investment rises to 8.85%
- 3.3.6 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.
- 3.3.7 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.
- 3.3.8 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.
- 3.3.9 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.com gives five 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.
- 3.3.10 When compared to the companies within SIC code 6110 'Passenger Sea and Coastal Water Transport' (see Appendix 5.3), the return achieved by the company has not met the median point. Even with a toll increase, the return is only forecast to reach the current median point in one of the next nine years and this is only during a non-refit year.
- 3.3.11 The graph at Appendix 5.2, comparing the Company's data with the companies within SIC code 6120 'Inland Water Transport', shows the Company's return to be below the median point. Again even with a toll increase, the return is forecast to only reach the median point in one of the next nine years.
- 3.3.12 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.
- 3.3.13 Appendix 5.4 shows in graphical form all five ratios covering actual data from 2013 to 2017, and forecast data from 2018 to 2026, assuming no toll increase, showing little improvement. Appendix 5.5 shows the same ratios but for the forecast data assuming an increase in the toll rates and a slowly increasing trend can be seen across this time period, for all the ratios.

4 CONCLUSION

- 4.1 If this application should be successful, the Directors will phase the increases such that the maximum allowable toll will not come into effect until 1 April 2021.
- 4.2 The Directors cannot predict future traffic volumes but have assumed them to remain static in the forecasts based on the last six years' traffic volume data (see Appendix 7.3 which shows the historic trend to be fairly constant).
- 4.3 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.
- 4.4 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 a lower environmental impact. This is achieved through the owners' on-going reinvestment in the ferry company and the value of the ferry service itself.
- 4.5 Using the ferry has an environmental impact and saves money for motorists. On the assumption that the average motor vehicle journey is from Bournemouth to Swanage, a saving of 12 miles is achieved by using the ferry. Based on HMRC approved mile rates of 45p/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 around 9.456m miles equivalent to saving £4.255m motoring costs. The corresponding CO2 impact on the environment has not been calculated.
- 4.6 This application clearly demonstrates that, in the medium to long term, the Company cannot provide for the future replacement of the ferry and generate a reasonable return if tolls are not increased.
- 4.7 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.
- 4.8 In view of the foregoing, the Directors feel that this application for an increase in toll charges is therefore fair and reasonable.

APPENDIX 1: ASSUMPTIONS WITHIN THE FORECASTS

1 PROFIT AND LOSS ACCOUNT FORECASTS

1.1 Income

1.1.1 The income projections have been based on actual income for the year to 31 March 2017 ("the base year"). As this was a mini refit year, the ferry was out of service for 2 weeks. Therefore the base income figures are stated by annualising the 31 March 2017 actual amounts as if there was no refit.

1.1.2 Appendix 8 provides details of the phased toll increase, as well as the rate of discounts applicable to books of tickets. The forecast income for each passenger category has been arrived at by dividing the total income for that category by the present toll and multiplying it by the new toll. For refit years, income has also been decreased as noted in point 1.1.5 below.

1.1.3 The maximum chargeable cash tolls for passenger vehicles, goods vehicles and cycles have been phased in across five years. In the case of bulk tickets for motor cars and goods vehicles the rates of discounts will increase (by up to 27.66%) until 2026 to mitigate the effect of increases in base price, thus keeping the annual increases roughly in line with the RPI rate in appendix 1.2.1. below.

1.1.4 The proposed maximum toll rates detailed in section 2.2 (page 5) are the maximum toll rates being applied for in this application.

1.1.5 Appendix 7.1 shows the actual monthly traffic volumes for the six years to 31 March 2017. Averages have been calculated of the three financial years to 31 March in this period in which a refit occurred (i.e. 2013, 2015 and 2017) and the three non-refit years (2012, 2014 and 2016) – see Appendix 7.2. This data was then used to calculate how monthly traffic volumes differed for an average refit year compared to an average non-refit year (also shown in Appendix 7.2). This data showed the pattern of income across a refit or a non-refit year. It was used to arrive at the annual income figures, whereby forecast monthly income in a non-refit year was increased by the average percentages calculated. For a mini refit year it is assumed the reduction in traffic volumes during the refit period will be one third that in a major refit year.

1.1.6 Appendix 8 gives detailed workings regarding current and proposed tolls by class, as well as forecast income by class and also by category of passenger, before taking account of fluctuations arising in non-refit years.

1.2 Expenditure

1.2.1 In general, expenditure has been forecast using the base year figures, and increased by 3.6% per annum. This is reasonable bearing in mind the most recent data obtained from HM Treasury's website (*Forecasts for the UK Economy: A comparison of independent forecasts, June 2017*). In this report, the average forecast RPI (from 20 forecasts) was 3.9% for 2017 and 3.3% for 2018, with the highest being 4.9% for 2017. The 3.6 % used is in line with the average of the 2017 and 2018 RPI averages and so, considering recent press reports, is likely to be an accurate prediction of future RPI. The Summary Profit and Loss accounts (Appendices 2.1 and 2.2) show the rate of increase for each expense in the column "Annual Increase".

1.2.2 Ferry Harbour Dues increase every 5 years, at a rate of 3.6% per annum compounded. The next increase is due in the year ended 31 March 2023.

- 1.2.3 The base cost for ferry repairs and maintenance (excluding the cost of refits) has been arrived at by taking an average of the annual costs incurred in each of the last five financial years and increasing this figure by 3.6% per annum compounded to arrive at future projected costs.
- 1.2.4 The costs of the most recent ferry refits were £587k in the financial year ended 31 March 2013, £654k in 2015 and £215k in 2017. The cost of a refit includes the costs of removing the ferry from the chains, towage to and from the ship repair yard, classification survey fees, docking and mooring charges and professional fees. With the introduction of a new pattern of ferry refits, it is calculated that the base cost of a major refit is £500k and a mini refit £250k. These amounts have been increased by 3.6% per annum compounded to arrive at future refit costs for the financial years ending 31 March 2019 and biennially thereafter.
- 1.2.5 Major repairs to the slipways were carried out in the financial year ended 31 March 2015. Due to the major repairs, it has been assumed that only future annual slipways repairs and maintenance will arise, with no exceptional costs. The base cost for slipway annual repairs has been arrived at by taking an average of the annual costs incurred in each of the last five financial years (excluding the exceptional costs for the year ended 31 March 2015) and increasing this figure by 3.6% per annum compounded to arrive at future projected costs.
- 1.2.6 Depreciation has been calculated in accordance with the Company's accounting policy for depreciation, as recorded in its audited financial statements. No additions have been included and hence only the buildings and their revaluations will be subject to depreciation after financial year ending 31 March 2019.
- 1.3 Other Income
- 1.3.1 Other Income has been calculated using a base figure of £35,451, from financial year ended 31 March 2017, increased by 3.6% per annum.
- 1.4 Dividends
- 1.4.1 £3,675 of the dividend declared relates to non-equity preference shares.
- 1.4.2 Dividends on equity shares have been calculated using a base figure of 43p per share, from the financial year ended 31 March 2017 dividends. Dividends have been increased at a maximum rate of 2.99% which is below the RPI rate in 1.2.1.
- 1.5 Calculation of Transfers to the Ferry Replacement Reserve
- 1.5.1 The Directors are advised that it will be prudent to be in a position to replace the ferry in approximately 9 years.
- 1.5.2 Allowing for cost rises over the next 9 years, it is projected that the replacement cost of the ferry in 2026 will be £10.669m.
- 1.5.3 Therefore, with the value of the Ferry Replacement Reserve at 31 March 2017 standing at £1.931m, the Company would have to transfer £8.738m (an average of £971k per annum) over the next 9 years to be on target to replace the ferry in 2026. This will not be possible in some of the years if a reasonable level of dividend is to be paid to the owners and given the commitment of biennial re-fit expenditure to maintain the quality and safety of the service.

1.5.4 The calculations at the foot of Appendices 2.1 and 2.2 show the transfers made to this Reserve and the resulting cumulative shortfall or surplus. The opening shortfall is £5.366m.

2 CASH FLOW

2.1 Corporation tax is paid quarterly. The payments are based on the estimated profits for the financial year. The first payment in respect of a given financial year is seven months after the start of that year.

2.2 Dividends are paid in the financial year in which they are declared and relate to.

3 BALANCE SHEET FORECASTS

3.1 Fixed Assets

3.1.1 It is the Company's policy to revalue its fixed assets periodically. The last revaluation was on 31 March 2015. The forecasts are based on that last revaluation, as the directors are of the opinion that the current valuation is not dissimilar to the last valuation.

3.2 Deferred Tax

3.2.1 Deferred tax has not been calculated for future years as any change does not affect cash and is assumed to be immaterial in the context of total net assets.

3.3 Reserves

3.3.1 The Directors do not consider the ferry replacement reserve to be a distributable reserve, although in years where the company has a deficit on the profit and loss account after dividends, a transfer out of the ferry replacement reserve to the profit and loss account is required.

3.3.2 A proportion of the depreciation charge for the ferry relates to the revaluation noted above. In order that distributable reserves are not affected by this revaluation, this proportion of the depreciation charge is written back from the Revaluation Reserve (thereby reducing its value) to the Profit and Loss Reserve. For the nine years shown in these forecasts, this amount is approximately £133k per annum until the ferry is fully depreciated.