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| Report |
| PTE area bus operator profitability analysis |
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| October 2014 |

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# Introduction

This briefing paper summarises the current financial position of the largest bus companies operating in PTE areas and the wider city regions and compares their performance with that of their London and non-metropolitan counterparts. Our analysis covers all active bus companies employing at least 100 employees. We estimate there to be 122 companies which meet this criterion, representing approximately 90% of Great Britain’s bus industry turnover (see figure 1). Bus companies which operate into PTE areas from the surrounding region have been classed as PTE companies, regardless of the proportion of their operation which is within the metropolitan boundary.

**Figure 1. A breakdown of the companies involved in the analysis**

|  |  |  |
| --- | --- | --- |
| **Area** | **Number of companies** | **Turnover in most recent year (£000s)** |
| PTEs | 22 | 1,364,300 |
| GB exc. London and the PTEs | 85 | 2,277,941 |
| London | 15 | 1,707,664 |
| **Total** | 122 | 5,349,903 |

We have used published accounts from operating companies and our work does not take into account the financial results of owning groups. We would note that the performance of a given operating company can differ significantly from the aggregate performance of the UK bus division of its owning group. The financial performance of bus companies can vary significantly from year to year, in particular as the result of network expansion/contraction, acquisitions, large scale investment and changes in accounting practice. Our analysis therefore covers both financial performance during the latest year for which accounts are available (either 2012/13 or 2013/14) and the past five and ten years.

Section two provides a brief explanation of the key financial indicators, which we refer to throughout the paper. Section three summarises our key findings. Sections four, five and six then look at bus companies’ financial performance by area during the latest available year, and over the past five and ten years. Section seven compares the performance of metropolitan area bus companies within each of the major owning groups. Section eight lists the top ten PTE bus operating companies by average operating profit over the last ten years.

# Definitions

In this report we refer to a number of financial indicators, which are defined below. Unless indicated, these indicators are expressed as a percentage of turnover, although they could equally be expressed in absolute terms.

**EBITDA –** Earnings before interest, tax, depreciation and amortization. This is often used by analysts as a proxy for net operating cash flow, effectively the amount of money generated by the day to day operation of the business, which is available to pay for longer term investments, finance and to reward shareholders. This indicator can be used, for example, to assess for how much longer (or whether) a bus company can continue to operate with its existing fleet (i.e.: without investing in new vehicles).

**Operating profit**. A more useful indicator than EBITDA, this is a measure of the amount of money left over once the business has paid for all its expenses but before interest and tax due or owed are taken into account. Because the decision of how much money to borrow or lend is at the discretion of management, this indicator provides a fairly robust measure of the intrinsic profitability of a given operation.

**Profit before tax**. This equals operating profit plus or minus any interest owed/due. Because companies can artificially suppress operating profit margins by lending out some of their retained profits there is a case for looking at after tax profit as well. In the case of metropolitan bus operators, this indicator is often greater than operating profit, which reflects the fact that many companies have indeed lent considerable amounts of money from past surpluses.

**Profit after tax.** This equals profit before tax minus corporation tax due on positive earnings.

**Dividends.** This isthe share of after tax profits which the operating company decides to pay back to shareholders. Once this money is paid out it is no longer available for the company to invest in its business. Dividends can, on occasion, exceed after tax profits, if the company decides to dip into past earnings.

**Retained profit**. Thisis the amount of money left over to be used by the business once dividends have been paid. If the company decides to return more dividends to shareholders than the after tax profit made in a given year, then this indicator would be negative.

In this report, we largely focus on changes in **operating profit**, effectively the money made from bus operations once all relevant costs (including long term costs such as fleet acquisition) have been taken into account. This is likely to give the most comparable benchmark of profitability across bus companies and will be easily recognised by those in the industry. However, given the large proportion of interest payments received by many bus companies in PTE areas, there is a good case for also looking at after tax profit when investigating the performance of individual companies.

# Key findings

1. Average operating profits have been consistently higher in PTE areas than elsewhere.

* In the latest available year, PTE bus operating profits were 8.1%, compared to 4.1% in London and 7.5% elsewhere in England
* Over the past ten years, PTE bus operating profits were 8.5%, compared to 3.7% in London and 6.4% elsewhere in England

1. Despite a steep dip in profits at the start of the recession, PTE bus companies have been quick to recover. However, the past three years have seen a slight reduction in profit margins, possibly as the result of cuts in central and local government funding. Despite this, average operating profit margins over the past five years have been considerably higher than over the previous five (9.4% compared to 7.3%).
2. Over the past ten years, bus company turnover in PTE areas has increased by almost 50%, compared to a 40% increase in RPI inflation. This has been achieved despite a drop in passenger numbers of 12.7% in metropolitan areas.
3. Whilst the level of profit in PTE areas is relatively high little of this is invested back into the business. Over the past ten years, PTE bus company dividends have been, on average, 7.5% of turnover compared to after tax profit of 8.8% of turnover.
4. Bus operators in PTE areas are earning significant revenue through interest payments, possibly from intra-group loans. This suggests that, in some cases, money has in the past been taken out of profitable PTE companies to be reinvested in other parts of the business. This means that, alongside high dividends, a lot of retained profits have subsequently flowed out of PTE bus companies. This is also one way in which companies can artificially suppress operating profit margins and one reason to also look at pre-tax profit margins (which include interest).
5. Taking the past ten years into account, the list of most profitable PTE bus companies is topped by Stagecoach in Tyne and Wear (Busways) with an average operating profit margin of 18.8%. Midland Red (Stagecoach in Coventry and Warwickshire) takes second place and First West Yorkshire takes third place with profit margins of, respectively, 15.8% and 15.6%. National Express (West Midlands travel) comes fourth with 11.3%. All other PTE bus companies have had average operating profit margins below 10%.
6. Only three PTE bus companies (out of a sample of 22) have failed to make a positive operating profit over the past ten years: Diamond (West Midlands), Yorkshire Traction (Stagecoach in Barnsley) and Arriva NorthWest (mainly operating in the area between GM and Merseyside).

# Latest available year

Focusing on accounts from the most recent year available (see figure two), it is apparent that profits were considerably higher in PTE areas than in London for all measures. For example, using operating profit, PTE areas had much higher profit levels than bus companies in London (8.1% compared to 4.1%). The comparison to the national average on this measure was much closer, with a national figure of 7.5%.

**Figure 2. Average bus company profitability by area – most recent year available (as % of turnover except where stated)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Area** | **Turnover £000s** | **EBITDA** | **Operating Profit** | **Pre-tax profit** | **Post-tax profit** | **Dividends paid** | **Div as % of post-tax prof** | **Retained Profit** |
| CENTRO | 362,914 | 13.5 | 7.9 | 7.5 | 6.0 | 4.3 | 77 | 1.8 |
| Mersey-travel | 151,528 | 10.2 | 7.2 | 8.2 | 6.2 | 0 | 0 | 0.1 |
| NEXUS | 182,880 | 16.6 | 12.5 | 13.1 | 10.3 | 7.5 | 73 | 2.8 |
| SYPTE | 197,006 | 8.1 | 1.2 | 3.8 | 3.7 | 4.5 | 121 | -0.0 |
| TfGM | 264,611 | 17.0 | 11.0 | 13.9 | 11.4 | 11.5 | 101 | -0.2 |
| WYCA | 205,361 | 14.7 | 8.3 | 11.7 | 9.4 | 0 | 0 | **9.4** |
| **PTE average** | 1,364,300 | 13.7 | **8.1** | **9.7** | 7.8 | 5.0 | 64 | 2.8 |
| **GB exc. London and PTEs** | 2,277,941 | 13.9 | **7.5** | 7.3 | 5.7 | 2.6 | 46 | 3.1 |
| **London** | 1,707,664 | 7.6 | **4.1** | 3.0 | 2.3 | 2.1 | 91 | 0.2 |

Our figures show that pre and post-tax profit levels are often higher than operating profit. This is unusual as it implies that many companies, particularly in PTE areas are making a substantial amount of money outside of their direct operations as a bus company. This is largely coming from interest received on past loans, possibly to other parts of the operating group (though not enough information is disclosed in company accounts to verify this hypothesis).

One argument often made by transport owning groups is that robust profits are the sign of a healthy business and that profits are necessary to fund future growth. However, our analysis shows that whilst the level of profit is relatively high in PTE areas, the majority of this is not invested back into the business, with the level of dividends paid to shareholders being almost double the national average and two and a half times the London average.

In the latest year of accounts, WYCA has a very high level of retained profit. This is because no companies paid dividends in the last year. As the following sections will show, this is not the trend for the area, with the ten year average dividends being at the high end for the sample.

# Ten-year trend

In discussing profitability it’s common to focus on the latest available year since this is seen as the most relevant indicator of operator behaviour and market conditions. However, a one-year analysis can be skewed by one-off evens or accounting decisions and may, in some cases, be a poor proxy for a business’s steady state performance. We therefore show average financial indicators for the last ten years for which data is available in figure three.

**Figure 3. Average bus company profitability by area - ten year averages (as % of turnover except where stated)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Area** | **Turnover (£000s)** | **EBITDA** | **Operating Profit** | **Pre-tax profit** | **Post-tax profit** | **Dividends paid** | **Div as % of post-tax prof** | **Retained Profit** |
| Centro | 3,139,898 | 15.5 | 10.2 | 10.7 | 8.3 | 6.3 | 76 | 2.0 |
| Mersey-travel | 1,296,711 | 7.9 | 2.7 | 5.3 | 4.6 | 2.7 | 59 | 1.9 |
| Nexus | 1,405,722 | 15.5 | 9.5 | 15.0 | 12.6 | 11.5 | 91 | 1.0 |
| SYPTE | 1,590,855 | 10.6 | 3.7 | 7.4 | 6.4 | 7.1 | 112 | -0.7 |
| TfGM | 2,358,426 | 15.4 | 9.6 | 12.1 | 9.5 | 8.8 | 92 | 0.7 |
| WYCA | 1,891,365 | 17.3 | 11.4 | 15.3 | 11.2 | 8.8 | 79 | 2.4 |
| **PTEs** | 11,682,977 | 14.3 | 8.5 | 11.2 | 8.8 | 7.5 | 85 | 1.3 |
| **GB excluding London and PTEs** | 18,292,521 | 13.1 | 6.4 | 8.5 | 6.9 | 5.5 | 80 | 1.5 |
| **London** | 13,911,425 | 7.4 | 3.7 | 4.9 | 4.0 | 3.8 | 95 | 0.2 |

This analysis largely confirms that bus operators in PTE areas are earning high levels of profits when compared to other areas of the country and paying high levels of dividends. It’s also worth noting that, with the exception of Merseyside, bus companies have shown consistently high profits in PTE areas over this period. Profits have been 32% larger than elsewhere in England outside London and more than twice the level observed in London. While bus companies in PTE areas have been generating high levels of profit, of which 85% has been paid back to the shareholders as dividends.

As with the most recent year’s accounts, pre and post-tax profit margins are again considerably higher than operating profit, more so in PTE areas. This implies that bus companies have been loaning out a proportion of their earnings for some time.

There are two PTEs, SYPTE and Merseytravel, where bus operators have made profit levels that are below the national average. The level of profit made for the other PTEs is substantially above the national average on all measures. Operating profit is highest in Centro and WYCA, 10.2% and 11.4% respectively.

**Figure 4. Operating profit over time by area type**

Figure four shows that the level of operating profit made each year has been higher that in London or in non-PTE areas for almost all of the last ten years.

From the low point seven years ago, PTE operating profit levels increased rapidly, moving away from the national and London average. However, there has been a fall in the average operating profit in PTEs over the last two years, bringing the amount of profit earned closer to the national average, but still considerably above the London figure.

# Five-year trends

Having explored the most recent year and the ten years trends, this section breaks the last ten years down into two blocks of five. The figures taken combine the most recent five years together i.e. 2009-2013 and the five previous years 2004-2008[[1]](#footnote-1).

**Figure 5. PTE-wide financial analysis**

Outside PTE areas, EBITDA and operating profits have increased in the past five years. However, pre/post-tax profits have decreased. This suggests that companies are earning less additional income outside of the direct business, such as interest gained on loans. This makes sense as the recession will have had an impact on operating profits and reduced the amount of money which could be loaned out. Operating profit is not above both pre-and post-tax figures further highlighting this point. The level of dividends paid in the most recent five years has almost halved from the period before, which has helped to increase retained profit from a negative figure to over 2%.

The results are broken down into the different PTEs below. It is clear from the graphs that there is not a single trend for PTE areas as a whole.

**Figure 6. Centro financial analysis**

For Centro, the level of profit has been reduced over all of the measures in the most recent five years when compared to the first five. The level of dividends has also decreased whilst the amount of retained profit has been increased. Despite this, profit levels are still high for Centro.

**Figure 7. Merseytravel financial analysis**

Operating profits have increased significantly in MerseyTravel for the most recent five years, which is reflected in increased pre and post-tax profit. The only measure to decrease is the level of dividends being paid, which has reduced to none in the last five years, with the level of retained profit subsequently rising. Dividends have only been paid for two of the last ten years, so it is not possible to say whether this is a more recent trend or just part of a longer cycle.

**Figure 8. NEXUS financial analysis**

Operating profits for NEXUS have increased to 10.4% from 8%, whilst pre and post-tax profit levels have more than halved. This suggests substantially less additional income/interest has been received on top of the turnover from bus operations. The level of profit earned across all measures is still high compared to a PTE average.

The level of dividends paid has decreased massively, but is still considerably above average. Despite this, the level of retained profit has decreased. It appears that companies in Nexus are very profitable but retain very little of this money.

**Figure 9. SYPTE financial analysis**

Profit levels have increased on all of the indicators for SYPTE. However, the level of profit is still below many of the other PTEs. Dividends paid out to shareholders have been reduced which has in turn helped to increase the level of retained profit. The figure for the previous five years was exceptionally low, with the company giving out more money than it made.

**Figure 10. TfGM financial analysis**

Profit levels have increased across all of the different measures for TfGM. The greatest increases have been in operating profits and EBITDA. The level of dividends taken out of the companies has reduced, but is still very high compared to other bus operations.

There has been a big change in the level of retained profit, going from a negative figure to an above average amount. This reflects the increased profit levels and lower level of dividends paid.

**Figure 11. WYCA financial analysis**

Profit levels have increased across all of the different measures for WYCA. Despite this, the level of dividends paid has decreased, but is still considerably high. The level of retained profit has increased sharply. This is due to First West Yorkshire not paying any dividends in the most recent year. Had this occurred, there would have only been a marginal increase in retained profit.

**Figure 12. London financial analysis**

London has seen a reduction in all categories of profit in the most recent five years, and the level of dividends has been halved. The level of retained profit is very low. Despite this, bus companies in London have invested significant resources in their fleets and depots, providing the highest quality of service in the country. This implies that much of this past investment is reflected in steady state levels of depreciation and amortisation.

Profit levels in London are half those in the PTE areas. Through having tighter control on the bus networks, profit levels have been controlled whilst maintaining a very high standard of service and encouraging investment.

**What do the five year trends show us?**

* EBITDA and operating profit are up considerably in most PTEs over the last five years. This suggests that the bus operations of PTE companies are healthy and are generating more profit than the previous five years. The level of income from other areas of the business, for example interest received from loans, has decreased, meaning that some other profit measures have decreased.
* There has been particularly large increases in TfGM and WYCA for the most recent five years. Whilst the level of retained profit has increased during this time, very large dividends are being taken out of companies in these PTEs.
* Dividends are on average down across the PTEs. Despite this, they are still high compared to national and London figures.
* Over the last five years, bus companies in PTEs have made an average operating profit of almost 10%. Nationally this is 7% and in London it is around 3.5%.

# How the three largest operators behave across PTE areas

The following section explores the profit levels of operators across PTEs. The section focuses on the three main operators, Arriva, First and Stagecoach, as they are all present in the majority of PTEs.

Operating profit has been selected as the indicators for this section. This allows the analysis to focus purely on the profitability of the operations[[2]](#footnote-2).

**Figure 13. Operating profit of the big companies in PTE areas**

Both First and Stagecoach have seen reductions in operating profit over the last three years. Arriva has seen the reverse, with an increasing trend for the last six years.

The report now looks at the operators in more detail to see how their different companies act across the PTEs.

**Figure 14. Operating profit for Arriva companies in PTE areas**

The operating profit levels of the Arriva companies is closely grouped into two categories – one at around 3-4% (Midlands, Merseyside and West Yorkshire), and one at 10-12% (Manchester and Northumbria). Four different companies have made at some stage in the last ten years, with Arriva North West making a loss over eight years.

The average profit level for the group has recovered well in PTE areas from the recession where it dropped to 0%. Operating profit earned in the most recent years has now surpassed the level earned at the start of the ten year period.

**Figure 15. Operating profit for Stagecoach companies in PTE areas**

There is a wide variance in profit levels for Stagecoach companies, with no real trends emerging. There is a cluster of companies earning between 2-7% operating profit, however, the spread of companies is from over 20% to below -5%.

The average operating profit of the group in PTE areas is just under 10%, having decreased from 15% a couple of years ago. The level is now just above that at the start of the ten year period. This demonstrates a strong recovery from the recession, with only one company, the Yorkshire Traction Company making a loss.

**Figure 16. Operating profit for First bus companies in PTE areas**

Over the last two years there has been a significant fall in operating profit of all First bus companies in PTE areas. Before this, profit levels had been running at between 10-15%. Operating profits are still high in West Yorkshire, running at 10%, although this is down from over 20% a couple of years ago.

Having recovered from the recession, the group operating profit level has reduced significantly to below 5%. Only one company is making a loss, First South Yorkshire, at almost -10% operating loss, which is skewing the group average downwards.

# Top 10 profit making companies over the last ten years

The table below lists the top ten profit making companies by operating profit over the last ten years. The also shows, for each of these companies, what proportion of turnover flowed out of the company as dividends and what proportion was retained by the company.

The list is topped by Stagecoach in Tyne and Wear (Busways) with an average operating profit margin of 18.8%. Midland Red (Stagecoach in Coventry and Warwickshire) takes second place and First West Yorkshire takes third place with profit margins of, respectively, 15.8% and 15.6%. National Express (West Midlands travel) comes fourth with 11.3%. All other PTE bus companies have had average operating profit margins below 10%.

If we look instead at pre-tax profit margins (i.e.: taking into account interest payments), First West Yorkshire tops the table, which suggests the company may have used a considerable proportion of past earnings for intra-group loans. This seems to have also been the case at Midland Red (Stagecoach), First Manchester, East Midland Motor Services (Stagecoach) and Arriva Merseytravel.

**Figure 17. Top 10 profit making companies over the last ten years**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Company** | **PTE** | **Operating profit (%)** | **Pre-tax profit (%)** | **Dividends paid (%)** | **Retained profit (%)** |
| Busways (Stagecoach) | NEXUS | **18.8** | 18.5 | 10.6 | 3.2 |
| Midland Red (Stagecoach) | Centro | 15.8 | 18.5 | 14.5 | -0.2 |
| First West Yorkshire | WYCA | 15.6 | **20.5** | 11.9 | 3.1 |
| West Midlands Travel (Nat Ex) | Centro | 11.3 | 12 | 6.3 | 3 |
| First Manchester | TfGM | 8.6 | 10.5 | 7.3 | 0.6 |
| East Midland Motor Services (Stagecoach) | SYPTE | 8.2 | 10.3 | 7.7 | 0.8 |
| Arriva Midlands North | Centro | 7.7 | 7.6 | 2.6 | 3.5 |
| Arriva Merseyside | Merseytravel | 7.7 | 9.2 | 2.6 | 4.2 |
| Arriva West Yorkshire | WYCA | 6.1 | 5.9 | 4 | 1 |
| Go North East | NEXUS | 5.6 | 6.3 | 5.6 | -0.8 |

1. Where the 2013 figures are not available it combines 2008-2012 figures. [↑](#footnote-ref-1)
2. A number of companies appeared to receive significant sums of other money and interests, making the pre and post tax profit levels higher than the operating profit. This has been removed to allow a focus purely on operations, but it must be recognised that tax and any interest owing is still to be paid on top of the figures that are quoted. [↑](#footnote-ref-2)