

Financial performance of Arriva

Introduction

1. Arriva plc is a UK-based transport organization with bus and train operations in the UK, Denmark and the Netherlands, bus operations in Italy, Portugal, Spain and Sweden and train operations in Germany. It also operates a vehicle rental business and a bus and coach distribution business in the UK. Operating profit¹ in the year to 31 December 2003 was £115 million on continuing turnover of £1.6 billion.² Net assets as at 31 December 2003 were £472 million.³
2. Arriva plc's UK bus operations account for almost half of the group's operating profit on almost 40 per cent of the group's turnover.⁴ Other significant operations are the UK trains operations and the international operations, earning over one-fifth of the group's operating profit each. The vehicle rental and bus and coach distribution operations are less important, and only generated 14 per cent of operating profit on less than 10 per cent of group turnover.⁵
3. Arriva plc's wholly-owned subsidiary, APS, is the holding company for a number of bus subsidiaries providing services in the North-East of England, the North-West, the South-East, Yorkshire, the Midlands, Scotland and North Wales. APS is also a significant operator in the London area. It has some 7,000 vehicles and 17,000 employees, and is the third largest operator of bus services in Great Britain, after FirstGroup and Stagecoach Group. Net assets as at 31 December 2003⁶ were £396 million.
4. All Arriva plc's bus operations are held under APS. The main bus operating company in each region is a direct subsidiary of APS and each main bus operating company in each region, in turn, has one or more operating subsidiaries.
5. ATS is a direct subsidiary of APS and Arriva East Herts & Essex Limited is a direct subsidiary of ATS. Together, ATS and Arriva East Herts & Essex Limited are operated as Arriva the Shires & Essex (Arriva) and are reported on jointly for management information purposes. In the year to 31 December 2003, Arriva generated operating profits of £[x] million on revenues of £[x] million. Return on capital employed⁷ was [x] per cent.

Organization

6. Arriva is divided into nine operating units identified by its depot profit centres, which are Aylesbury, High Wycombe, Watford, Hemel Hempstead, Hitchin/Stevenage, Ware, Harlow, Debden and Luton.

¹Operating profit is profit from continuing operations excluding goodwill amortization and exceptional items.

²Discontinued operations relate to the motor retail business which was sold in July 2003.

³Source: Arriva plc published report and accounts for the year ended 31 December 2003.

⁴Figures relate to performance for the year ended 31 December 2003.

⁵Excluding the intra-group element of their operations.

⁶From draft accounts prepared 10 August 2004.

⁷Calculated as EBIT divided by capital employed. Capital employed is total assets (excluding intangibles) less current liabilities.

7. Arriva's five depots in Hertfordshire are operated as four profit centres: the Stevenage and Hitchin depots are operated together as a single profit centre. The depot at Stevenage is held on a lease which expires in 2007 (although Arriva has the ability to terminate the lease early, in 2005), and the depot at Hitchin is freehold.⁸ The Ware, Hemel Hempstead and Watford depots are the remaining three depots, each run as separate profit centres. The Ware and Watford depots are freehold and the Hemel Hempstead depot is held on a lease which expires in 2015. Central overheads are not recharged directly to each depot. Balance sheets and cash-flow statements are not produced at depot level.
8. Table 1 summarizes the capacity and current utilization (by number of buses) of each of the depots in Hertfordshire.

TABLE 1 Capacity and utilization at Arriva's Hertfordshire depots

	<i>Capacity</i>	<i>Utilization</i>
Stevenage	()
Hitchin		
Ware		
Hemel Hempstead		
Watford		
Total		

Source: Arriva.

9. Arriva's bus operations include 1,567 employees and a total fleet of 617. The Hitchin/Stevenage depots comprise [X] employees and a fleet of [X] buses.

Financial performance

10. Table 2 shows the financial performance for the Hitchin/Stevenage depots for the five years ended 31 December 1999 to 2003. This information is taken from the management accounts.⁹

⁸See paragraph 37.

⁹The management accounts do not include full provision for pension cost.

TABLE 2 Financial performance for the Hitchin and Stevenage depots, 1999 to 2003

	1999	2000	2001	2002	2003
Revenue					
On-bus revenue					
Off-bus revenue					
Concessionary fares					
Scholars' term tickets					
Tenders					
Contracts					
Private hire					
Operating revenue					
Other revenue					
Total revenue					
Expenditure					
<i>Direct operating costs</i>					
Drivers costs					
Net fuel cost					
Tyres					
PSV depreciation					
PSV insurance					
Road and operating licences					
Other traffic costs					
Total					
<i>Engineering direct costs</i>					
Material costs					
Wage costs					
Other costs					
PSV servicing staff					
PSV insurance recoveries					
Total					
<i>Other</i>					
Depot staff costs					
Non-PSV vehicle costs					
Building overheads					
Other overhead expenses					
Total					
Total expenditure					
Net profit					
Profit margin (%)					
EBITDA					
EBITDA margin (%)					

Source: Arriva.

11. On-bus revenues comprised [X] per cent of operating revenues in 2003 with revenue from tenders comprising [X] per cent of operating revenues. Revenue from contracts relates to income from other organizations such as colleges and some key employers, where Arriva provides bus services for pupils/employees to travel to and from the organizations' sites.
12. Between 1999 and 2003 total revenue increased by [X] per cent. On-bus revenue [X] during the same period, whilst revenue from tenders [X]. Off-bus revenue has [X] over the same period.
13. Direct operating costs have increased by [X] per cent between 1999 and 2003. In 2003, drivers costs were [X] per cent of total costs.¹⁰ Arriva management told us that the average was [X] per cent, which means that increases in wage rates have a substantial effect on profit, in circumstances where wages are under pressure due to

¹⁰Total costs (comprising direct operating, direct engineering, and other costs) were £[X].

the proximity of Hertfordshire to London. Drivers costs increased by [%] per cent between 1999 and 2003 whereas total costs only increased by [%] per cent. As a result of all this, operating profit margins have dropped sharply, from [%] to [%] per cent. This is in line with HCC's assertion that transport costs have increased at a rate greater than the rate of inflation in recent years. Arriva's EBITDA margins compare favourably with Sovereign's (see Appendix C) although they have declined in line with falling profit margins.

14. From the management accounts for Arriva for the six months to June 2004, Hitchin/Stevenage is operating slightly above budget, with operating profits of £[%] on revenues of £[%] million.
15. Arriva regularly measures its operational performance against budgeted figures and may implement measures at depot level, such as additional fare increases and cost reductions. It also measures its operations on a large number of non-financial key performance indicators directed more at service levels, such as levels of customer comments, staff turnover, keeping to the timetable, insurance claims costs, and the first-time pass rate for MOT tests.
16. Table 3 shows revenue and costs by route for the year ended 31 December 2003 for the Hitchin and Stevenage depots. The total revenue of £[%] million for the Hitchin/Stevenage profit centre is split roughly [%] between commercial and tendered services, although the commercial services are relatively more important in terms of contribution and profits generated. There are fewer commercial routes than tendered routes operated from these two depots. Variable and semi-variable costs make up a high proportion ([%] per cent) of total costs, with fixed costs only accounting for [%] per cent of total costs.

17. There are 11 commercial routes, of which [X] (the [X]) make up almost [X] ([X] per cent) of the revenues from commercial services. Although revenue from the commercial services comprises roughly [X] total revenues, the commercial services generate [X] ([X] per cent) of total contribution and a similar proportion of profit ([X] per cent).
18. Of the commercial routes, only [X] not contribute to fixed costs¹¹ ([X]) and only [X] are loss-making ([X]). Route [X] is not significant in terms of revenue, passengers carried, hours or miles operated, relative to the other commercial routes, whereas route [X] generates the most revenue of all 11 commercial routes, carries almost a [X] of total commercial passengers and operates almost a [X] of total commercial mileage. Route [X]. Route [X] is not significant in terms of revenue, passengers carried or miles operated, relative to the other commercial routes. It runs [X].
19. Overall, the commercial services generate a profit of £[X] and a margin of [X] per cent.
20. There are 23 tendered routes, of which only [X] generate over [X] per cent of tendered revenues each ([X]). The remaining routes comprise a long tail of revenues, with [X] routes generating less than 5 per cent of tendered revenues and [X] routes generating between 5 and 10 per cent of tendered revenues each.
21. All the tendered routes generate positive contribution, although almost a [X] ([X] routes) do not cover allocated fixed costs. Of these [X] routes, [X] are particularly poorly performing, with margins (based on losses divided by revenue) less than -5 per cent: the [X]. Of these [X] routes, the only significant route is the [X] which generates [X] per cent of tendered revenues.
22. Although the tendered routes generate roughly [X] of the total revenues for the two-depot profit centre, they only generate [X] ([X] per cent) of total contribution and a smaller relative proportion of profit ([X] per cent).
23. Overall, the tendered services generate a profit of just over £[X] (£[X]) and a margin of [X] per cent.
24. Table 4 shows further detail and analysis enabling comparison of each of the same routes for the same profit centre for the same period. Over [X] of passenger journeys in 2003 were made on commercial services, although the hours operated, miles travelled and daily PVR¹² were split roughly [X] between commercial and tendered services. Nine out of the 23 tendered services do not require additional vehicles and the daily PVR is zero. Eight of these services do not have any fixed costs allocated to them.¹³

¹¹Fixed costs are allocated to each route on the basis of peak vehicle requirement (PVR) and relate to depot costs. Reference to 'contribution' is to a contribution towards depot costs, ie contribution to overheads particular to the depot.

¹²In respect of commercial services, bus days is calculated as PVR multiplied by 250. For some tendered services the same calculation is made, although this is not the case for all the tendered services.

¹³One service, the [X], does have fixed costs allocated to it despite its PVR being listed as zero. This is because the route PVR changed during the year and ended the year with a PVR of zero.

TABLE 4 Hitchin and Stevenage: all routes, 12 months to 31 December 2003

<i>Route no</i>	<i>Route description</i>	<i>Passengers</i>	<i>Hours</i>	<i>Miles</i>	<i>Daily PVR</i>	<i>Bus days</i>	<i>Contribution/PVR</i>	<i>Contribution as % of revenue</i>	<i>Rev/mile</i>	<i>Cost/mile</i>	<i>Rev/op hour</i>	<i>Rev/PVR/day</i>
Commercial services												
	✂											
Subtotal commercial services												
Tendered services												
	✂											
Subtotal tendered services												
Other and withdrawn services												
Total all services (Hitchin and Stevenage)												
	✂											

Source: Arriva.

25. On average, contribution per PVR for commercial services is [%] per cent more than that of those tendered services which have a PVR. Revenue per mile and revenue per operating hour are marginally [%] for commercial than tendered services, although revenue per PVR per day is [%] on commercial services (£[%]) than on tendered services (£[%]).
26. At the bottom of Tables 3 and 4 the figures and analysis for route [%] are shown. This limited stop service is operated [%] out of the Ware and Harlow depots ([%] buses PVR [%]). Although this route is not operated out of Hitchin or Stevenage, it is included in Tables 3 and 4 to allow easy comparison with the other Arriva routes examined, and included in the overall analysis as it overlaps with a number of Sovereign's routes (see Appendix F).
27. Route [%] is a very significant route for Arriva in Hertfordshire, generating just over £[%] million revenue in 2003 and profits of £[%] (compared with the Hitchin/Stevenage depots which generated £[%] million revenue and profits of £[%] in 2003). The profit margin is [%] per cent, which is just under the average profit margin produced by Arriva's commercial services out of Hitchin and Stevenage.
28. As it requires only eight buses a day, it enjoys the [%] revenue per PVR (£[%]). Being a long-distance, express service, it is not surprising that it operated a large mileage in 2003: [%] per cent of the mileage operated by all the commercial services out of Hitchin and Stevenage. Resulting from this high mileage are lower revenues and costs per mile than the commercial services.
29. Table 5 shows summary financial performance of the other three depots in Hertfordshire and is included as a comparison to the Hitchin/Stevenage depots.¹⁴

¹⁴The figures for the [%] service, operated partly out of Ware, are included in the figures for Ware in Table 5.

TABLE 5 Summary financial performance of Arriva's other three Hertfordshire depots, 12 months to 31 December 2003

	Ware	Hemel Hempstead	Watford
<i>Revenue</i>			
Commercial			
Tenders—HCC			
TfL			
Other—misc and withdrawn			
Total revenue			
<i>Costs</i>			
Variable			
Semi-variable			
Total running costs			
Contribution			
Fixed costs			
Profit			
<i>Profit margin</i>			
Passengers			
Hours			
Miles			
Daily PVR			
Bus days			
Contribution/PVR as % of revenue			
Rev/mile			
Cost/mile			
Rev/op hour			
Rev/PVR/day			

Source: Arriva.

30. The other three depots in Hertfordshire generate [X] times as much revenue in total as the Hitchin/Stevenage depots, [X] of which comes from the Watford depot, and they are more profitable than the Hitchin/Stevenage depots.¹⁵
31. The Watford depot generates [X] as much revenue (with [X] the PVR) as the Hitchin/Stevenage depots whereas the Hemel Hempstead depot is a [X] Hitchin/Stevenage. The Ware depot generates slightly [X] revenue and operates [X] vehicles.
32. Hitchin/Stevenage generates [X] per cent of revenue from commercial services, the same as Hemel Hempstead and Ware, whereas the Watford depot generates nearly [X] its revenue from commercial services, with [X] of its revenue derived from TfL contracts.
33. Contribution and profit margins are [X] at these three depots than at Hitchin/Stevenage: contribution and profit margins produced at Hemel Hempstead are [X] and [X] per cent respectively. Broadly, the revenue measures shown in Table 5 are [X] favourable at the three depots than at Hitchin/Stevenage. Revenue per PVR per day is [X] at the Hitchin/Stevenage depots (£[X]) than at the other Hertfordshire depots ([X]).

¹⁵The Watford depot is materially different to the Stevenage/Hitchin, Ware and Hemel Hempstead depots in the scope of its operations because a substantial proportion of revenue is generated from operating London bus services under contract for TfL.

Vehicles

34. The Hitchin/Stevenage depots operate with a [x]%-vehicle fleet, made up of [x] midibuses and [x] single-deck buses. Arriva depreciates these types of bus to zero over a maximum of 15 years. However, once the bus has reached the end of its useful economic life, whether this is sooner or later than 15 years, it is offered to other Arriva companies and then outside the group if there are no offers within the group.
35. Arriva has stated that, in the last decade or so, with the introduction of the low-floor, easy-access buses, second-hand prices for older, non-easy-access buses (which can be used on commercial services until 2012) have reduced considerably. Arriva told us that it had made losses on disposal of buses in three of the last four completed financial years.
36. Buses are procured by Arriva Bus & Coach Limited, an Arriva group company which specializes in providing vehicles to group operations. The buses are then refinanced through independent finance companies, by means of hire purchase or finance lease, so the bus operator's profit does not reflect the interest charge which would be reflected if the buses were on operating lease.

Other inter-company transactions

37. It is Arriva plc group practice that all freeholds and long leaseholds are held by an Arriva investment company and are leased on full repairing terms to the relevant operating unit at a rent equal to [x] per cent a year of capital value.
38. There are a small number of company cars and vans (40 at present) which are rented from Arriva Vehicle Rental Limited.

Grants

39. Arriva stated that it had only received grants in the period up to 2003 in minimal amounts for the purchase or fitting out of buses with additional special features (for example, LPG-powered buses).