Information relevant to the counterfactual analysis

Introduction

1. This appendix includes several sections that provide detailed reference material for a number of the issues discussed in the Counterfactual section of the provisional findings. Whilst information flows where necessary from section to section, each section can be viewed as independent. The appendix includes the following sections:

   (a) review of Scottish Citylink absent the joint venture including:

   (i) company level review of its financial position;

   (ii) profit and loss account forecast for 2005;

   (iii) profit and loss scenario modelling for 2006;

   (iv) our critique of the profit and loss scenario model for 2006;

   (v) the relationship between Scottish Citylink and Braddell;

   (vi) restructuring options considered by Scottish Citylink; and

   (vii) the main parties' model of the effect on contribution of various Saltire Cross route reconfiguration options;

   (b) review of individual overlap routes and route groups:

   (i) Edinburgh–Glasgow (Motorvator and Scottish Citylink 900 service); and

   (ii) the Saltire Cross (megabus and Scottish Citylink's trunk route services);

   (c) effect on Scottish Citylink of an exit of Motorvator;

   (d) Saltire Cross overlap service frequencies;

   (e) Saltire Cross overlap passenger shares;

   (f) third party views on sustainability of competition on the Saltire Cross; and

   (g) subcontractor views on entry.

Scottish Citylink absent the joint venture

Scottish Citylink: company level financial position

2. Table 1 shows the extent [✂]. Turnover is reported [✂] £13,931,000 to £[✂] and statutory account operating profit from £1,053,000 to £[✂]. The method used by the parties to calculate 2005 results is set out in paragraphs 7 and 8. The reported change in revenue and operating profit in 2005 followed a three-year period when, although turnover was increasing, operating profit was decreasing. In this period

(2002 to 2004), the statutory accounts' operating margin fell from 12.0 to 7.6 per cent. [✂]

TABLE 1 **Scottish Citylink summary performance, 2002 to 2005**

				£'000
	2002	*2003*	*2004*	*2005**
	Actual	*Actual*	*Actual*	*Parties' forecast*
Scottish Citylink				
Turnover†	13,118	13,493	13,931	
Direct costs				
Gross profit				
Gross margin (%)		✂		
Overheads				✂
Operating profit (management accounts)				
Adjustments				
Operating profit (statutory accounts)*	1,575	1,356	1,053	
Operating margin (%)	12.0	10.0	7.6	

Source: Scottish Citylink statutory and management accounts, and Scottish Citylink budgets.

*2005 figures are based on a combination of actual and budgeted figures.
†Statutory account figures.

3. The Scottish services of megabus and Motorvator overlapped on limited parts of Scottish Citylink's entire route network. Motorvator only operated between Edinburgh and Glasgow (one part of Scottish Citylink's commuter route group) and megabus only operated on the Saltire Cross (trunk routes). Table 2 shows revenue and contribution based on the three route groupings that Scottish Citylink used to segment its network (commuter, trunk and rural) for the 12-month period[1] prior to the joint venture compared with the preceding 12 months.[2]

4. There are a number of data issues relating to the allocation of revenue and passengers to flows and double counting of passengers (see Appendix J). These issues could lead to revenues and thus contribution being understated by around 10 per cent and passenger numbers being overstated.[3] However, allocation issues should not affect any period-on-period comparison as we understand the numbers have been collated in the same manner for all periods.

[1] 12-month period is based on 13 accounting periods commencing with period 6 and ending with period 5.
[2] The analysis does not include all routes operated by Scottish Citylink, or revenue streams, [✂].
[3] [✂]

TABLE 2 **Scottish Citylink performance by route type**

	Year (13 periods) ended September 2004 AP6, 2003/04–AP5, 2004/05	*Year (13 periods) ended September 2005 AP6, 2004/05–AP5, 2005/06*	*Change*	*Percentage change*
Commuter				
Passengers				
Revenue (£)				
Mileage				
Subcontractors' costs (£)				
Contribution (£)				
Trunk				
Passengers				
Revenue (£)				
Mileage				
Subcontractors' costs (£)				
Contribution (£)				
Rural	✂			
Passengers				
Revenue (£)				
Mileage				
Subcontractors' costs (£)				
Contribution (£)				
Overall				
Passengers				
Revenue (£)				
Mileage				
Subcontractors' costs (£)				
Contribution (£)				

Source: Scottish Citylink route data.

5. Table 2 shows:

   (a) *Commuter routes.* These comprised predominantly the Glasgow–Edinburgh and Glasgow–Glasgow Airport routes. Stagecoach operated only on the Edinburgh–Glasgow route via firstly megabus and then Motorvator. [✂]

   (b) *Trunk routes.* These comprised the routes between any of Glasgow, Perth, Dundee, Inverness, Aberdeen and Edinburgh excluding Glasgow–Edinburgh. [✂][4]

   (c) *Rural routes.* There were few overlaps with Stagecoach services. [✂]

6. The contribution as set out in Table 2 is before BSOG. Table 3 shows contribution after the allocation of BSOG. The BSOG value per route type has been calculated on the basis of Scottish Citylink's BSOG revenue for the last audited year[5] [✂]. The [✂]p per mile figure has been applied to the total mileage per route type and does not distinguish between applicable and non-applicable mileage. It is therefore an estimate of the effect of BSOG on each route type. It indicates that, after BSOG is applied, it is likely that the trunk routes are still unprofitable at the contribution level. This, however, is only an approximation.

[4] [✂]
[5] 1 February 2004 to 31 January 2005.

TABLE 3 **Route type contribution and BSOG**

Year (13 periods) ended September 2005
AP6, 2004/05–AP5, 2005/06

	Mileage	*BSOG [✂] £*	*Contribution (after direct costs) £*	*Other direct costs [✂]*	*Revised contribution £*
Commuter					
Trunk			✂		
Rural					

Source: Scottish Citylink internal data/CC calculation.

Scottish Citylink's 2005 profit and loss calculation

7. The parties, in calculating the 2005 results, have used a combination of actual and budgeted figures because they consider that, for the purposes of modelling the counterfactual, it would not be appropriate to use actual figures from the joint venture's management accounts. They argued that, after the joint venture was completed, the business was subject to significant restructuring (including restructuring of staff and management and the timetable changes of November 2005) that are liable to have affected both the cost and revenue amounts in the profit and loss account. Therefore, the parties consider that Scottish Citylink's own forecasts made prior to the joint venture (which have been used by the parties to forecast most revenue and cost positions) are more reliable indicators of the firm's performance in periods 9 to 12 of 2005 had the joint venture not occurred.

8. In particular, the parties calculated costs and revenues for periods 9 to 12 were arrived at as follows:

(a) Evaluated revenues are based on route costing data. For periods 9 to 11, actual revenues from the route costing data was used. For period 12, ie the first full period where the consolidated timetable was in place, the actual revenue had to be adjusted.

(b) All other revenue and cost items were taken from Scottish Citylink budget forecasts. For the majority of items, budget forecasts for financial year 2005 from the Scottish Citylink management accounts were used. For a limited number or revenue items, the figures come from a quarterly update forecast for the second half of FY2005. Such update forecasts were prepared on a quarterly basis to account for new market developments (forecast update data was used where this differed from budget data).

Profit and loss scenario modelling for 2006

9. On the basis of the 2005 forecast the parties considered several scenarios for 2006. [✂][6,7] The assumptions for scenarios 1 and 1a are set out in Table 4 and the assumptions for scenarios 2 and 2a are set out in Table 5.

[6] [✂]
[7] [✂]

TABLE 4 **Parties' model scenarios 1 and 1a assumptions**

Scenario		*Assumptions*
1	Evaluated revenue	✄
	Hire charges	
	Other	
1a	Evaluated revenue	
	Hire charges	
	Other	

Source: Scottish Citylink/Stagecoach modelling.

[✄]

TABLE 5 **Parties' model Scenarios 2 and 2a assumptions**

Scenario		*Assumptions*
2	General	✄
	Evaluated revenue	
	Hire charges	
	Other	
2a	Evaluated revenue	
	Hire charges	
	Other	

Source: Scottish Citylink/Stagecoach modelling.

10. The scenario outcomes are set out in Table 6.

TABLE 6 **Parties' scenario outcomes**

£'000

	2005	*2006 Scenario 1*	*2006 Scenario 1a*	*2006 Scenario 2*	*2006 Scenario 2a*
Scottish Citylink					
Turnover					
Direct costs					
Gross profit					
Overheads					
Operating profit/loss			✄		
Depreciation					
Cash operating profit/loss					
Adjustment for concessionary scheme*					
Operating profit/loss					
Depreciation					
Cash operating profit/loss					

Source: Scottish Citylink/Stagecoach modelling.

*[✄]

11. [✄]

12. [✄]

13. [✂]

14. [✂]

15. [✂]

16. [✂][8]

Our critique of the model

17. Being a completed transaction the discrete figures for revenue and costs for Scottish Citylink, absent the joint venture, are not easily obtainable for the period following the joint venture. In particular, [✂]. In addition, the model takes no account of any potential route reconfigurations which could have been undertaken by an independent Scottish Citylink and the effect these would have had, absent the joint venture, on revenue and costs both in the period to December 2005 and future periods. A separate model was produced by the parties analysing the effect on contribution of various Scottish Citylink route reconfigurations on the Saltire Cross, further details of which are set out in paragraphs 40 to 44 of this appendix.

18. The 2006 forecast scenarios are based on only one year of competition between the parties. The parties stated that 'given the very short period of competition between megabus and Motorvator, the full effect of competition on Scottish Citylink was not yet apparent', [✂]. However, we note that, with such a short period of trading to assess the affect of a new operator on the routes, it is difficult to extrapolate the results forward with confidence. Our view is that Scottish Citylink's overall, and route level, profitability could have decreased or increased from its existing position at the commencement of the joint venture, depending on the actions taken by either and/or both parties.

19. For example, we noted that West Coast Motors stated that it did not believe that megabus's fares on the Saltire Cross were sustainable. This suggests that megabus fares would have had to increase at some point, potentially arresting the erosion of passenger numbers from Scottish Citylink services, if not reversing the trend altogether; and thus increasing the overall average revenue that both parties could obtain, so increasing profitability. Stagecoach also stated that Motorvator was not performing as expected and thus may have ceased trading. We discuss the financial performance of megabus in paragraphs 74 to 77.

20. [✂]

21. [✂]

22. [✂]

23. We considered whether Scottish Citylink, faced with the forecasts above, might have, either independently or as part of another entity, undertaken a more radical cost reduction programme. The parties' assumption was that Scottish Citylink would have maintained its current management, administrative and overhead structure and merely reduced parts of it rather than instigating a 'bottom-up' approach to evaluating the right cost base for any permanent reduction in revenue. A full review of overheads might have been carried out on this basis given the seriousness of Scottish Citylink's projected financial position.

[8] Letter to Chairman from Kua Hong Pak, Managing Director/Group CEO ComfortDelGro, dated 26 June 2006.

The relationship between Scottish Citylink and Braddell

24. [✂][9] Thus, absent such a plan, Braddell's financial position would not appear to be relevant to Scottish Citylink's future viability. However, as Scottish Citylink is a wholly-owned subsidiary of Braddell, it might have sought funding from its parent either on a short- or long-term nature, or as a guarantor for its own fundraising.[10] Scottish Citylink's position, therefore, within the Braddell group is pertinent in the period relevant to our inquiry. Whether Braddell would have funded Scottish Citylink if it had become loss-making is clearly unknown. The exact nature of any funding requirement and any restructuring plan would be specific to the circumstances at that time.

25. Braddell appeared to have the capability to fund Scottish Citylink. Braddell had a turnover of £174 million in 2004, producing a profit before tax of £7 million. It also had net assets of £35 million. This would suggest that it was capable of funding the projected short-term losses of its subsidiary, if it decided to do so.

26. Scottish Citylink's management accounts show that it was cash-flow positive in the nine-month period to September 2005.[11] In addition, on 7 September 2005 in anticipation of the transaction, Scottish Citylink paid Braddell a cash dividend of £[✂]. If this cash dividend had not been paid, Scottish Citylink, at the end of period 8 (August 2005), would have had net debt of £[✂] and cash of £[✂].[12]

27. [✂]

28. However, we considered that there were more positive benefits to Braddell arising from the joint venture than merely the avoidance of losses. The joint venture was a good business opportunity for both Braddell and Scottish Citylink. [✂][13]

29. The Braddell share of profit [✂].[14]

30. Braddell would reasonably have expected the joint venture revenue stream to increase. [✂]

31. [✂]

32. The joint venture also benefited Braddell because it was able to extract cash through dividends from the business prior to the commencement of the joint venture. Further, through the Management Agreement with Stagecoach, Braddell was able to remove itself from the operational concerns of the business.

33. The joint venture was thus a positive action for Braddell rather than just merely a reaction to projected losses. It produced a higher revenue stream, higher valuation of its assets, and removed management concerns to a greater extent than if Scottish Citylink had stayed independent.

---

[9] [✂]
[10] The annual accounts for Scottish Citylink for the year ended 31 December 2004 show that the company was a party to a cross-guarantee with Metroline plc (its immediate parent company during that year) and a number of other Metroline plc subsidiaries.
[11] Analysis excludes pre-joint-venture dividend payment.
[12] [✂]
[13] [✂]
[14] [✂]

Restructuring options considered by Scottish Citylink

34. [✂][15]

35. [✂]

TABLE 7 **Scottish Citylink potential acqusition targets identified pre-joint venture**

Target	*Description of target and negotiations*	*Scottish Citylink valuation*
[✂]		

Source: Scottish Citylink strategy papers.

36. [✂]

37. [✂][16]

38. The likelihood of a successful acquisition by Scottish Citylink would appear to have been remote. [✂]

39. The strategy papers assumed that Scottish Citylink's business model was fundamentally flawed. However, it is not clear that this was the case. NEG, the largest express coach business in the UK, subcontracts 80 per cent of its services, suggesting the subcontracting model can be profitable. The subcontracting model would appear to be more flexible than the owner-operator model. The subcontractor model means that Scottish Citylink had the ability to reconfigure services, amend diagrams and change subcontractors [✂].[17] This would allow it to respond quickly to changes in demand without the issue of asset underutilization. Subcontractors bear the mileage risk and internal cost of inflation. Rates are negotiated annually and, although a few have in-built fuel escalators, this is not universal.

The main parties' model of Saltire Cross route reconfiguration options

40. During the course of our inquiry, the parties modelled possible Scottish Citylink route reconfiguration options on the Saltire Cross absent the joint venture. Their model compared contribution from the Saltire Cross route group (assuming that reconfiguration took place in September 2005) with contribution achieved from that route group in the year leading up to the joint venture. Their model also assumed that megabus would not have reacted to Scottish Citylink's reconfiguration (for example, by expanding its own services). However, the parties considered that megabus would in fact have been likely to react, making Scottish Citylink's financial position even worse than that suggested by the model.

41. The parties developed four reconfiguration timetables: [✂].

42. Total direct costs were calculated by applying Scottish Citylink's subcontractor rates for the year leading up to the joint venture to the mileages implied by each reconfigured timetable.

[15][✂]
[16][✂]
[17][✂]

43. Revenues for each reconfigured timetable used Scottish Citylink's Saltire Cross revenues for the year leading up to the joint venture as a starting point. The parties calculated changes to daily frequency for each reconfigured timetable relative to the pre-joint-venture timetable, and this was transformed into a change in average headway. This in turn was used to calculate the proportional change in revenue relative to pre-joint-venture revenue using various values for headway elasticity derived from the CC's work on firm and market elasticities (see Appendix M), depending on whether journeys were slow or fast and whether they were on overlap or non-overlap flows (to take account of what was likely to be varying levels of competition from megabus services on these different types of flow).

44. According to this model, none of these route reconfiguration options would have returned Scottish Citylink to profitability. The parties submitted that, while it was impossible to model all possible reconfiguration options, the losses shown by their models were significant enough to provide sufficient assurance that other configuration options would also have been unlikely to return Scottish Citylink to profitability. This was particularly so, they argued, given that their modelling did not take into account the adverse effects on Scottish Citylink of any action by megabus to increase its services in response to reconfiguration of Scottish Citylink's services.

Individual route/route group analysis

Edinburgh–Glasgow

Route analysis

45. Table 8 shows the operating statements for Motorvator and Scottish Citylink for Edinburgh–Glasgow services for the year (13 periods) immediately prior to commencement of the joint venture.[18]

[18]The period runs from accounting period 6 2004/05 (around October 2004) to accounting period 5 2005/06 (around September 2005).

TABLE 8 **Motorvator and Scottish Citylink operating statements (Edinburgh–Glasgow services)**

		13 periods prior to joint venture October 2004–September 2005 £
Motorvator		
Turnover	A	
Direct costs	B	
Contribution before BSOG	C	
BSOG	D	
Contribution	E	
Depreciation		
Cash contribution		
Mileage		
Passengers		
Direct cost per mile (pre BSOG) (£)		
Direct cost per mile (post BSOG) (£)		
Average revenue per passenger (£)		
Scottish Citylink		
Turnover	A	
Sub contractor costs	B	
Other costs*	B	
Contribution before BSOG	C	✄
BSOG†	D	
Contribution‡	E	
Mileage		
Passengers§		
Direct cost per mile (pre BSOG) (£)		
Direct cost per mile (post BSOG) (£)		
Average revenue per passenger (£)		
Combined		
Turnover	A	
Direct costs	B	
Contribution before BSOG	C	
BSOG	D	
Contribution	E	
Cash contribution		
Passengers§		

Source: Motorvator: Glasgow depot accounts, and flow analysis (for passenger numbers). Scottish Citylink: Route contribution analysis.

*[✄]
†[✄]
‡[✄]
§[✄]

46. [✄]

47. [✄][19] However, this was the first full year of operation for the Stagecoach Motorvator service and it was in a start-up phase. Motorvator was attempting to compete with Scottish Citylink's established 900 service, using a similar type of operation in regard to frequencies, walk-up fares and season tickets as well as its own pre-booking via the megabus website. It was not a low-cost operation. This is demonstrated by Motorvator's mileage and direct costs being approximately [✄] per cent of Scottish Citylink's mature service. Costs in this phase of the business's cycle were not designed to be in line with revenue.

[19][✄]

48. [✂][20]

49. [✂]

50. Figure 1 shows the trading trends for the period from September 2004 (the launch of Motorvator under Stagecoach) to September 2005 (the commencement of the joint venture). [✂], indicating the possibility that, in certain circumstances, this route could sustain more than one coach operator. This possible sustainability is examined further below with an individual analysis of Motorvator and Scottish Citylink's 900 service.

51. [✂]

FIGURE 1

Combined Motorvator and Scottish Citylink Edinburgh–Glasgow revenue, contribution and passengers

[✂]

Source: Scottish Citylink and Stagecoach management account data.

Scottish Citylink's 900 service

52. A detailed review of Scottish Citylink's summary performance from May 2003 to September 2005 is set out below. [✂]

53. Figure 2 shows Scottish Citylink's financial performance between May 2003 and September 2005.

FIGURE 2

Scottish Citylink performance, May 2003–September 2005

[✂]

Source: Scottish Citylink and Stagecoach management account data.

54. The figure shows five distinct phases.

55. Phase 1: [✂].

56. Phase 2: August 2004 to September 2004. The period between the legal acquisition by Stagecoach of Motorvator in June 2004 and its subsequent relaunch by Stagecoach in September 2004. [✂]

57. Phase 3: October 2004 to January 2005. [✂]

58. Phase 4: February 2005 to May 2005. [✂]

59. Phase 5: June 2005 to September 2005. [✂][21]

---

[20]The Department for Transport and the Scottish Executive use the following calculation for BSOG: (total mileage/total fuel purchased) multiplied by (total eligible mileage) multiplied by BSOG rate for the fuel concerned.
[21]Subcontractor rates are calculated as direct costs divided by total route mileage. This may not in all cases correspond to the agreed mileage rate the subcontractor is paid.

Motorvator

Financial position pre-joint-venture

60. Table 8 shows the operating results for Motorvator for the 13 periods immediately prior to the commencement of the joint venture. As previously stated, this was the first full year of operation of the service and the figures may not be representative of future trends and, therefore, viability of the business.

61. Figure 3 shows the operating performance of Motorvator over the period September 2004 to September 2005. [✂]

FIGURE 3

Motorvator summary operating results

[✂]

Source: Stagecoach management account data.

62. [✂]

63. [✂]

64. Figure 4 shows Motorvator's mileage for the period. It shows an uneven pattern in period mileage suggesting that Stagecoach was experimenting with the level of mileage/frequencies/services to offer during this period. [✂]

FIGURE 4

Motorvator mileage

[✂]

Source: Stagecoach management account data.

65. [✂][22,23,24]

Effect on ongoing viability/profitability

66. As Motorvator was in the first full year of operation, the analysis of viability cannot be based on the full year revenues and costs. [✂][25] The analysis, therefore, of ongoing viability has been based on an average of August and September periods (accounting period 4 and 5 2005/06) in an attempt to alleviate the effects of these issues. The summary breakeven analysis is shown in Table 9.

67. The analysis is based on the current direct cost base after BSOG of £[✂] per mile and using an average mileage for the months of August and September of [✂], and assumes no increase in average revenue per passenger (£[✂]). To break even on this basis, passenger numbers would have to increase by [✂], to around [✂] per period, an increase of [✂] per cent (includes BSOG). If a 10 per cent increase in average revenue per passenger is assumed, the increase would have to be around

---

[22][✂]
[23][✂]
[24][✂]
[25][✂]

[✂] ([✂] per cent). However, this would assume that no passengers are lost as a result of this fare increase, which is unlikely.

TABLE 9 **Motorvator breakeven analysis**

	Period 4 2005/06	*Period 5 2005/06*	*Average for 2 periods*	*Required passenger calculation*	*Increase in passengers*	*2-month average with 10% price increase*	*Increase in passengers*
Revenue (£)							
Direct costs (£)							
Contribution (£)							
Passenger numbers				✂			
Mileage							
Average revenue (£)							
Direct cost/ passenger (£)							
Cost per mile (£)							

Source: Motorvator depot accounts and flow by flow analysis/CC calculation.

68. [✂] This would suggest that Motorvator would have to increase mileage again to increase its passenger numbers, if all other variables remain the same; that the passengers per coach are not increasing. This would mean that passenger numbers would have to increase to a level higher than the increase shown in Table 9 to cover increased mileage costs.

69. We have discounted in this assessment the possibility of Motorvator reducing fares to attract more passengers from Scottish Citylink. This is on the basis that fares are already at a lower level than Scottish Citylink and there would appear to be other factors such as brand loyalty and non-price quality factors that are offsetting the difference in fares for the passengers who still travel on Scottish Citylink's service. This appears consistent with the evidence that a significant proportion of passengers on this flow are commuters and any reduction in fares may thus have a limited success in attracting further passengers.

70. In the absence of increasing passenger numbers, Motorvator would have to decrease its cost base to improve its trading result. [✂] Motorvator would therefore need to restructure its business and/or reconfigure its routes to bring its cost base in line with its revenues.

Interconnectivity

71. The parties have estimated that the proportion of passengers booking through-tickets, involving route 900 (Edinburgh–Glasgow) in combination with some other Scottish Citylink route, is around [✂] per cent. [✂] This suggests that the Glasgow–Edinburgh route does not benefit from significant network effects and that there is no additional benefit from maintaining a presence on the route outside the route profitability or brand value itself. [✂]

Qualitative argument for Stagecoach maintaining presence on the route

72. Stagecoach has tried two different service models on the Edinburgh–Glasgow route. The service launched as megabus in August 2003. It was withdrawn in September 2004 and replaced with Motorvator. [✂] Stagecoach's Motovator service sought to address these issues by offering a similar service to the Scottish Citylink 900 service in regards to frequencies, walk-up fares, season tickets as well as offering pre-

booking via the megabus website. Stagecoach acquired Motorvator as it was 'still keen to retain a presence on this route'.

73. Stagecoach had shown a desire to improve its service on the Motorvator route through the introduction of double-deck vehicles in November/December 2004, increasing capacity on the service from 49 to 68 seats per journey. In addition, it invested in the quality of its vehicles in the period prior to the joint venture through [✂].

Saltire Cross

Megabus

74. [✂]

75. The operating statements for megabus's Scottish operations for the two years ended 30 April 2005, the five periods prior to the joint venture and the 13 periods immediately prior to the joint venture commencement are shown in Table 10.

TABLE 10 **Scottish megabus operating statements**

				£'000
	Years ended 30 April			
	2004	*2005*	*Pre-joint-venture 2006*	*13 periods prior to joint venture*
Turnover				
Drivers costs				
Fuel†				
Vehicle depreciation‡				
Other direct cost				
Gross profit				
Gross margin				
			✂	
Engineering costs				
Operations costs				
Premises costs				
Contribution				
Contribution margin				
Cash contribution (vehicle depreciation add back only)				

Source: Stagecoach management accounts.

[✂]
†[✂]
‡[✂]

76. The key feature in relation to the counterfactual is that, [✂][26], in the period up to the commencement of the joint venture in September 2005 Scottish megabus returned a positive depot contribution of £[✂][27] and a cash contribution of £[✂]. This would suggest that the business (which the parties characterized as experimental) was capable of being profitable and would continue during the period relevant to our inquiry.

[26][✂]
[27][✂]

77. [✂]

78. This view was corroborated by Stagecoach's UK Bus Finance Director in the first main party hearing when he stated that: 'The megabus concept was growing and it is still growing so there is no reason to think it would not have [continued].' That growth came predominantly from the extension of megabus's Scottish services to the entire Saltire Cross in August 2004. The effect of this extension on passenger numbers and revenue is shown in Figure 5. In addition, in assessing the likelihood of continuance of the Saltire Cross route group, it needs to be borne in mind that this extension occurred only a year before the joint venture, a short time over which to assess a route/service's viability.

FIGURE 5

megabus revenue and passenger numbers—Saltire Cross

[✂]

Source: Stagecoach management account data.

79. [✂]

Scottish Citylink trunk routes

80. A detailed analysis of trading performance of Scottish Citylink's trunk routes is set out below. This analysis shows that Scottish Citylink's trunk route group, as a whole, was under significant pressure from megabus in the period following the megabus network extension in August 2004. [✂]

81. Table 11 shows the summary operating statement for Scottish Citylink's trunk routes for the year (13 periods) immediately prior to the commencement of the joint venture ended mid-September 2005, the preceding year (13 periods) ended mid-September 2004 and the five periods immediately prior to the joint venture.

TABLE 11 **Scottish Citylink trunk routes summary operating performance**

£'000

	Year (13 periods) ended September 2004 AP6, 2003/04–AP5, 2004/05	*5 periods ended September 2005 AP1, 2005/06–AP5, 2005/06*	*Year(13 periods) prior to joint venture AP6, 2004/05–AP5 2005/06*
Turnover		✂	
Direct costs			
Contribution			
Passengers			

Source: Scottish Citylink—Route contribution analysis.

---

82. megabus competed head-to-head with Scottish Citylink on the Saltire cross/trunk routes. Some routes were served by the two parties with very similar services (see Appendix J). However, Scottish Citylink operated more differentiated coach services than megabus on the majority of these routes, incorporating both fast and slow services.

83. Figure 6 shows Scottish Citylink's revenue, contribution and passenger numbers for its trunk route group for the period May 2003 to September 2005, when the joint venture commenced. [✂] Within this overall trend it has two distinct phases linked to:

(a) the commencement of limited route operation of megabus; and

(b) the extension of megabus services to cover the entire route group.

FIGURE 6

Scottish Citylink trunk route group revenue, contribution and passenger numbers

[✂]

Source: Scottish Citylink route data.

84. It is not possible to calculate fully the effect on Scottish Citylink of the initial megabus services launched in August 2003 as Figure 6 does not show the full year prior to megabus's launch. [✂]

TABLE 12 **Scottish Citylink accounting period comparison**

	AP1–AP4 2003/04 May–Aug 2003	*AP1–AP4 2004/05 May–Aug 2004*	*AP1–AP4 2005/06 May–Aug 2005*
Turnover (£)			
Contribution (£)		✂	
Passengers			

Source: Scottish Citylink—route contribution analysis.

---

85. [✂]

86. [✂]

87. [✂]

88. [✂]

FIGURE 7

Trunk route performance indicators

[✂]

Source: Scottish Citylink route data.

89. [✂]

FIGURE 8

Scottish Citylink trunk mileage

[✂]

Source: Scottish Citylink route data.

90. [✂]

91. Table 13 sets out the passengers, revenue and contribution for each of Scottish Citylink's trunk route services for the year (13 periods) immediately prior to the commencement of the joint venture ended mid-September 2005 and the preceding year (13 periods) ended mid-September 2004. As stated in paragraph 4, these figures could be mis-stated by the parties due to allocation issues and some double counting of passengers. The following analysis has not made any adjustment for these issues. It may be, however, that revenues and contributions are understated by around 10 per cent (see paragraph 4).

TABLE 13 **Scottish Citylink trunk route summary service performance**

	Year (13 periods) ended September 2004 AP6, 2003/04–AP5, 2004/05	*Year (13 periods) ended September 2005 AP6, 2004/05–AP5, 2005/06*
957 Edinburgh–Inverness		
Passengers		
Revenue (£)		
Contribution (£)		
958 Edinburgh–Inverness		
Passengers		
Revenue (£)		
Contribution (£)		
962 Perth–Dundee		
Passengers		
Revenue (£)		
Contribution (£)		
963 Glasgow–Dundee		
Passengers		
Revenue (£)		
Contribution (£)		
964 Glasgow–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
965 Dundee–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
967 Edinburgh–Perth–Dundee		
Passengers		
Revenue (£)		
Contribution (£)		
969 Perth–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
987 Edinburgh–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
988 Glasgow–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
989 Glasgow–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
990 Glasgow–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		
991 Edinburgh–Dundee		
Passengers		
Revenue (£)		
Contribution (£)		
992 Edinburgh–Aberdeen		
Passengers		
Revenue (£)		
Contribution (£)		

	Year (13 periods) ended September 2004 AP6, 2003/04–AP5, 2004/05	Year (13 periods) ended September 2005 AP6, 2004/05–AP5, 2005/06
995 Glasgow–Inverness (ex)		
Passengers		
Revenue (£)		
Contribution (£)		
997 Edinburgh–Inverness (exp)	✂	
Passengers		
Revenue (£)		
Contribution (£)		

Source: Scottish Citylink route data.

92. As listed in Table 13, there are 16 services within the Scottish Citylink route group that have operated in the period since the introduction of megabus in Scotland. [✂]

Glasgow–Aberdeen

93. Scottish Citylink ran four services between Glasgow and Aberdeen (964, 988, 989 and 990). [✂] The services split into two groups. The 964 and 988 are slow services,[28] the 989 and 990 are mixed/fast services. It is therefore appropriate to analyse the profitability of the services in two service groups. The combined revenue, contribution and passengers on these two service groups are set out in Table 14.

TABLE 14 **Glasgow–Aberdeen route service groups**

Service number		*Type*	*Revenue*	*Contribution*	*Passengers*
964	Slow	One service Aberdeen to Glasgow			
988	Slow	One mid-afternoon service from Glasgow to Aberdeen, connecting with a service from Edinburgh. One mid-morning service from Aberdeen to Glasgow, connecting with a service to Edinburgh.			
989	Fast	One service from Glasgow to Aberdeen, 25 minutes before another journey operated by National Express 15 minutes before megabus (shown on Citylink timetable). Three services from Aberdeen to Glasgow, not in such close competition with National Express operated services.		✂	
990	Mixed	Mix of fast, semi-fast and slow services—some only between Dundee and Glasgow. Four services from Glasgow and two services from Aberdeen.			

Source: Scottish Citylink route contribution analysis and route data.

94. [✂][29]

95. [✂]

[28]Service 964 was only one coach going from Aberdeen to Glasgow, leaving at 16:20 and with frequent stops (ie slow service)
[29][✂]

96. Two other Scottish Citylink services operate on this route: Service 963 Glasgow–Dundee and service 965 Dundee–Aberdeen.

97. Service 963 Glasgow–Dundee [✂].

98. Service 965 Dundee–Aberdeen [✂].

99. Both Glasgow–Dundee and Dundee–Aberdeen services are covered by the longer Glasgow–Aberdeen route services.

Edinburgh–Inverness

100. The Edinburgh–Inverness service group comprises the 957 slow service and the 997 fast service. [✂]

TABLE 15 **Edinburgh–Inverness service group**

Service number	*Type*	*Revenue £*	*Contribution £*	*Passengers*
957	Slow		✂	
997	Fast			

Source: Scottish Citylink route contribution analysis and route data.

101. The 957 service was a slow service, with numerous stops between Edinburgh and Inverness. On average the journey took 280 minutes. [✂]

102. The 997 service was the fast Edinburgh–Inverness service. Average journey time was 220 minutes compared with 240 on megabus. [✂] The service is characterized by an increase in capacity in the summer season.

Glasgow–Inverness

103. [✂]

104. [✂] West Coast Motors told us it believed that if Scottish Citylink left this route there could be some fragmented entry on part of it.

Effect on Scottish Citylink of an exit of Motorvator

105. If Stagecoach were to withdraw fully from the Edinburgh–Glasgow route it would leave Scottish Citylink, in the absence of a new entrant, as the primary express coach provider on the route. To assess the effect this may have on the overall profitability of Scottish Citylink, and also on the ability of Scottish Citylink to cross-subsidize its trunk route group on the Saltire Cross, we need to consider several scenarios.

106. Table 16 shows a number of scenarios based on CC hypothesis. The table uses the figures set out in Table 8 as a base, and the following assumptions.

TABLE 16 **Motorvator exits Edinburgh–Glasgow route scenario assumptions**

Scenario		*Assumptions*
A	Passengers	✂
	Revenue	
	Mileage	
	Subcontract costs	
	Overheads	
B		
C		
D		

Source: CC.

[✂]

107. The scenario outcomes are set out in Table 17.

TABLE 17 **Scottish Citylink excluding Motorvator on Edinburgh–Glasgow route**

£

	Scenario A	*Scenario B*	*Scenario C*	*Scenario D*
Scottish Citylink				
Turnover				
Direct costs				
Gross margin				
Overheads		✂		
Operating profit				
Depreciation				
Cash operating profit/loss				

Source: Parties and CC analysis.

108. Table 17 shows that [✂].

Saltire Cross overlap service frequencies

109. Table 18 shows the service frequencies pre- and post-joint-venture for the two parties' overlap services on the Saltire Cross.

TABLE 18 **Saltire Cross overlap service frequencies**

Weekday service frequency		*Pre-joint-venture*			*Post-joint-venture*	
Flow	*Flow ID*	*Megabus*	*Scottish Citylink*	*Total*	*Total*	*Change*
Glasgow–Perth	037	8	16	24	29	5
Edinburgh–Perth	038	7	20	27	25	(2)
Perth–Inverness	040	6	12	18	14	(4)
Edinburgh–Inverness	041	6	10	16	13	(3)
Glasgow–Inverness	042	6	10	16	14	(2)
Dundee–Glasgow	043	8	16	24	28	4
Edinburgh–Dundee	044	7	19	26	26	0
Dundee–Aberdeen	060	7	8	15	13	(2)
Edinburgh–Aberdeen	069	7	7	14	13	(1)
Glasgow–Aberdeen	070	7	7	14	13	(1)
Perth–Aberdeen	130	7	7	14	13	(1)

Source: CC analysis.

Saltire Cross overlap passenger shares

110. Table 19 shows the coach passenger shares between megabus and Scottish Citylink pre-joint-venture for their overlap services on the Saltire Cross.

TABLE 19 **Saltire Cross overlap flows coach passenger shares**

Flow	*Flow ID*	*megabus %*	*Scottish Citylink %*
Glasgow–Perth	037		
Edinburgh–Perth	038		
Perth–Inverness	040		
Edinburgh–Inverness	041		
Glasgow–Inverness	042		
Dundee–Glasgow	043	✂	
Edinburgh–Dundee	044		
Dundee–Aberdeen	060		
Edinburgh–Aberdeen	069		
Glasgow–Aberdeen	070		
Perth–Aberdeen	130		

Source: CC analysis.

Note: The table ignores other coach operators where they exist on the routes as passenger numbers for these are unknown.

Third party views on sustainability of competition on the Saltire Cross

111. The main parties considered that the following third party views supported their case that the overlap routes between the parties on the Saltire Cross could not sustain competition due to a lack of passenger volume.

112. West Coast Motors said that it was not clear how the pre-joint-venture megabus fares could have been sustained. It considered that the most likely outcome was that Scottish Citylink would have withdrawn from providing services in the East of Scotland where megabus was strongest, and would have focused on its West of Scotland and Glasgow–Edinburgh services. Whilst it believed that another operator could enter on individual flows and be selective about routes such as Glasgow–Edinburgh and Glasgow–Inverness, it believed that there were few routes where head-to-head competition was sustainable.

113. National Express said that it lost money on its Scottish operations probably because many routes were over-provided, among other reasons.

114. Rapsons agreed with the view that the level of competition between Scottish Citylink and megabus and Motorvator was probably not sustainable because of the excess capacity on the overlap routes and the lack of sufficient passenger demand.

115. Fairline said that operators would not enter routes unless they were likely to make a profit. In Scotland this was unlikely to happen outside the Glasgow–Edinburgh route because most other routes did not have a passenger volume that was sufficient to sustain operators.

Subcontractor views on entry

116. We asked Scottish Citylink's four main independent subcontractors on the Saltire Cross what they might have done, if Scottish Citylink had withdrawn the services which they operated on behalf of Scottish Citylink.

Company A [✂]

117. Company A ran [✂] vehicles for Scottish Citylink (and [✂] for National Express). Of these, [✂] coaches are on the Glasgow–Edinburgh flow. We estimate that about [✂], ie around £[✂], related to Scottish Citylink.

118. Company A [✂] operate as a subcontractor [✂]. As Company A was a sub-contractor to Scottish Citylink, it had not previously considered running its own express services.

119. Company A said that if Scottish Citylink withdrew from the Saltire Cross it would certainly have to consider how to employ the coaches that it currently used on the subcontract routes. The company would consider where these vehicles could be used to get the best return from them, and entry on to the Saltire Cross would be one option.

120. Company A said that, whilst it was unfamiliar with the Scottish Citylink network as a whole, it would certainly examine the routes that it currently operated as a subcontractor. As a subcontractor it did not have much knowledge about the financial performance of those routes as it was not involved with revenue and passenger numbers, which would need to be examined.

121. The types of services offered (including frequencies, times of day coaches are run etc) would have to be considered in light of route returns. Company A would consider running the services at existing levels unless, on further examination, it felt that it would be more effective and profitable to manipulate the timetable.

122. If Company A chose to enter on to the routes as an operator in these circumstances, it told us that entry would not be temporary. It would consider all the opportunities and, if entry on to the Saltire Cross was considered the best use of the coaches, it would not be entry on a short-term basis.

Company B [✂]

123. Company B is the subcontractor on several of Scottish Citylink's services [✂], as well as services on the Saltire Cross. Of Company B's turnover, [✂] per cent comes from Scottish Citylink subcontracting, with [✂] of its vehicles used for this work.

124. If Scottish Citylink's branded services were withdrawn, Company B stated that it might look at entry on the routes and flows on which it currently operated as a subcontractor, which were close to its operations base. However, Company B felt that it would not be viable to expand beyond this unless there were substantial opportunities, as this would incur significant overheads in the form of depots and other facilities which would require investment.

125. We noted that Scottish Citylink's exit from the routes on which Company B was the existing subcontractor would mean Company B was no longer competing against what it saw as the main recognized network in Scotland. In addition, Scottish Citylink's exit would mean Company B faced losing [✂] per cent of its turnover if it did not enter.

126. Company B considered that Scottish Citylink's withdrawal would indicate that Scottish Citylink felt these routes were unviable. Unless Company B felt that Scottish Citylink was missing any significant opportunities, then entry on to those routes would also not be viable for Company B. However, we noted that, if Scottish Citylink were to withdraw from the Saltire Cross, it would be withdrawing from both profitable and unprofitable routes and flows.

127. Company B stated that the second-hand market for express coaches was not particularly buoyant, so it would find another use for those coaches which it currently used for Scottish Citylink operations. Because these vehicles were fairly new, these coaches could be used for other services run by Company B.

Company C [✂]

128. Of Company C's work, [✂] per cent relates to coaches. It is currently withdrawing from certain Scottish Citylink and National Express coach work. Its withdrawal from this coach work is not, we understand, linked to the joint venture. It has no coaches subcontracted to Scottish Citylink on the Saltire Cross at present, although it has done in the past.

129. Company C felt, in the event of Scottish Citylink withdrawing from the routes for which Company C currently had subcontract agreements, it would have no choice but to enter. Entry would not be confined to the short term. [✂]

130. Company C comments focused on the [✂] routes for which it had subcontract agreements. As Company C had not recently been active on the Saltire Cross, it was unable to comment specifically on its likelihood of entry on the Saltire Cross in the event of exit by Scottish Citylink.

Company D [✂]

131. Company D stated that it was difficult to envisage its entry on to the Saltire Cross routes if Scottish Citylink withdrew from them. This was because there were other Scottish Citylink subcontractors on these routes and because it did not have a ticket agency network available to it, which it felt would be required to provide support for the new services. However, Company D felt it could operate the routes if all the subcontractors were to become involved in some form of 'conglomerate' to provide services on the Saltire Cross.

132. Company D said that, if Scottish Citylink exited the Saltire Cross, it would consider other uses for the vehicles that it presently used on that route group, including private hire.