

## 4 History and finance

### The companies involved in the merger

4.1. The newly-created group is the result of a merger completed on 22 April 1988 between two independent groups, Badgerline Holdings Ltd (BHL) and Midland Red West Holdings Ltd (MRWH). The new corporate structure is shown in Appendix 4.1; it includes a newly-formed company, Badgerline Buses Ltd (BB), which acts as a sub-holding company for all the group's bus companies. Prior to the merger MRWH owned Bristol Omnibus Company (BOC), the company operating bus services within Bristol and trading as City Line. At that time BLH owned Badgerline Ltd (BL), a company operating services in the country districts of Avon (including services into Bristol) and into the adjoining counties of Somerset, Wiltshire and Gloucestershire.

4.2. BHL was formed in June 1986; more than 95 per cent of the issued share capital is owned by employees of the group, many of them being former employees of National Bus Corporation (NBC). In September 1986 it purchased BL from BOC, at the time a subsidiary of the NBC. Following the acquisition of BL, BHL expanded its activities into newsagents, travel agents, coach tours and bus operations outside the areas covered by BL. In 1987 BHL acquired a 39 per cent shareholding in Western National Ltd (WN), a major bus operator in Cornwall. The shareholding was increased to 66 per cent in August 1988. The turnover and profits for BHL in 1987 are shown in Table 4.1; this is the only complete year's trading for which audited accounts are available.

TABLE 4.1 Analysis of turnover and profits of BHL in the year ending 31 December 1987

			£'000
	<i>BL</i>	<i>Other BHL activities</i>	<i>Total BHL</i>
Turnover	15,429	3,560	18,989
Profit/(loss) before tax	(577)	(306)	(883)

Source: Badgerline Holdings.

Table 4.1 shows the important role BL's bus operations have within the BHL group. In 1987 BL contributed 81 per cent of the group turnover. The loss of £577,000 made by BL includes losses of £560,000 in Salisbury and Poole where BL unsuccessfully set up in competition with the incumbent operator. In 1988 further losses of £402,000 were incurred before the services were discontinued. The consolidated profit and loss accounts and balance sheets of BHL since its formation in 1986 are shown in Appendices 4.2 and 4.3.

4.3. MRWH was formed in December 1986 to acquire by management buy-out the bus operations carried on in the counties of Hereford and Worcester by NBC's subsidiary company Midland Red West. In September 1987 MRWH expanded by purchasing the City Line operation (BOC) from NBC. The 1987 turnover and profits of MRWH, including BOC for the period after acquisition in September 1987, are shown in Table 4.2.

TABLE 4.2 Turnover and profits of MRWH in the year ending 31 December 1987

	MRW	BOC*	£'000 Total MRWH
Turnover	15,238	4,844	20,082
Profit before tax	677	246	923

Source: MRWH.

\*Results since BOC was acquired by MRW on 18 September 1987.

The consolidated profit and loss account and balance sheet for MRWH in 1987 are shown in Appendices 4.4 and 4.5.

### History of BOC

4.4. The bus services in Bristol and the surrounding areas had been operated since 1969 by BOC, a subsidiary of NBC. In 1983 BOC was split into three companies: Cheltenham and Gloucester Omnibus Company (CGOC) for the operations in Gloucester, Bristol Engineering for vehicle maintenance; and BOC which operated the bus services in Bristol, Avon and parts of Somerset and Wiltshire. At this time BOC was further subdivided into two operating divisions: Bristol City Bus for the operations within Bristol and Bristol Country Bus for services in Avon, North Somerset, West Wiltshire and country routes into the city of Bristol. In April 1985 Bristol Country Bus was renamed Badgerline and Bristol City Bus changed its name to City Line.

4.5. Following the decision to privatize the operating subsidiaries of NBC the Badgerline operation was sold by BOC to BHL (see paragraph 4.2), CGOC was the subject of a management buy-out, and Bristol Engineering was sold to Frontsource Ltd, a company formed to acquire a number of such NBC engineering businesses. BOC then consisted solely of the City Line bus operation in the city of Bristol and continued to be owned by NBC.

4.6. In September 1987 NBC sold BOC to MRWH. One of the results of the subsequent merger between MRWH and BHL is to reunite Badgerline and City Line into the same ownership, the position which existed prior to 1986. Appendix 4.6 shows the BOC profit and loss accounts for the years 1984 to 1987 and Appendix 4.7 shows the balance sheets.

### Ownership of the share capital of the companies within the group and financing of their acquisition from NBC

4.7. BHL was formed in 1986; 95 per cent of the share capital was owned by former managers and employees of NBC. The purchase arrangements negotiated for management buy-outs of bus companies from NBC were complex, and in the case of the purchase of BL by BHL it involved deferred consideration payable on realization of development value of certain properties. BHL funded its purchase of BL by substantial borrowings and some equity capital. The buy-outs of MRW and City Line by MRWH from NBC were also funded by substantial borrowings and small amounts of equity capital.

4.8. The final stage in the creation of the existing group was the merger between BHL and MRWH. This was achieved by BHL purchasing MRWH share capital for £7,616,145 in cash and 201,213 new shares in BHL. The leveraged nature of the BL, MRW and City Line buy-outs and the cash used in the merger between BHL and MRWH are significant factors in creating the highly-g geared balance sheet shown in Table 4.3. Employees and management now own 97.2 per cent of BHL share capital.

### The group after the merger of BHL and MRWH

4.9. A consolidated balance sheet of the group immediately after the merger is shown in Table 4.3. This includes the effect of purchasing National Travelworld Ltd (a company with 80 travel agencies) from NBC in March 1988. It does not include the increase in the holding in WN from 39 per cent to 66 per cent; this took place after the merger.

TABLE 4.3 Consolidated balance sheet of BHL/MRWH at 22 April 1988

	£'000
<i>Fixed assets</i>	
Land and buildings	6,122
Buses and other vehicles	11,720
Plant	1,891
	<u>19,733</u>
<i>Current assets</i>	
Stock	900
Trade debtors	3,624
Other debtors	5,723
Trade creditors	(7,856)
Other creditors	(5,546)
	<u>(3,155)</u>
Capital employed	16,578
<i>Net borrowings</i>	
Loans	(4,544)
Overdrafts	(1,418)
Lease finance	(7,111)
	<u>(13,073)</u>
Net assets of the group	<u>3,505</u>
Share capital	1,202
Reserves (after eliminating of goodwill)	1,911
Deferred tax	392
	<u>3,505</u>
Gearing	373.0%

Source: Badgerline Holdings Ltd.

Table 4.3 shows gearing in excess of 300 per cent. However, BHL said that its gearing was not high when account was taken of the excess of market value of its fixed assets (land, buildings and buses) over book value and the high proportion of lease finance in debt. It also said that the gearing will not inhibit its future capital expenditure programme which includes £7 million in the next 18 months for purchase of new buses, which as in the past will be financed by lease contracts. BHL's experience when using this form of finance is that the most important criteria is expected future cash flows and not balance sheet gearing.

4.10. The majority of the new group's employees work in the subsidiary companies operating bus services in the county of Avon. Table 4.4 shows that in 1987 approximately 66 per cent of the employees were employed by City Line and Badgerline, since then the acquisition of Travelworld and Western National has reduced this percentage to 50.

TABLE 4.4 Average number of employees in the year ending 31 December 1987

	<i>BHL</i>	<i>MRW</i>	<i>BOC</i>	<i>Total group</i>
Number of employees	1,120	939	1,104	3,163
Number employed on bus operations in Avon	1,017	—	1,104	2,121

Source: Audited accounts of the companies.

**Bus operations of BHL within the County of Avon**

4.11. In recent years Badgerline and City Line have introduced minibuses and midibuses to provide greater frequency of service and reduce the bus running costs. Table 4.5 shows the purchase of buses in 1987 and 1988 concentrated on minibuses and midibuses.

TABLE 4.5 Bus purchase and fleet size

	Bus purchase		Number of buses
	1987	1988	Allocated fleet November 1988
<i>Badgerline</i>			
Double-deck	12		90
Single-deck	28		94
Coach	—		21
Mini and midi	30	24	199
	<u>70</u>	<u>24</u>	<u>404</u>
<i>City Line</i>			
Double-deck			118
Single-deck			64
Mini and midi	70	28	173
	<u>70</u>	<u>28</u>	<u>355</u>

Source: Badgerline Holdings Ltd.

Note: Single-deck and coaches have a seating capacity of between 43 and 57, midibuses have a capacity of 33, and minibuses a capacity of about 16.

Badgerline said the increasing use of midibuses and minibuses has enabled bus service frequency to be improved, and led to a substantial increase in the volume of vehicle miles provided by City Line. They have grown from 8.6 million in 1985 to an expected 14.5 million in this year. For Badgerline the growth has been from 12.1 million miles in 1985 to 18.3 million in the current year. Over the same period City Line's passenger boardings increased from 31.5 million to 39.4 million and Badgerline's from 23.8 million to 26.1 million. In both companies the average cost per bus mile has fallen. BHL also said that the reduction in costs per mile had enabled City Line fares for many categories of journey to be reduced (in real terms) between the first quarter of 1986 and the first quarter of 1988 and for the same period Badgerline believes it has held fare increases at around the level of inflation, whilst offering an improved product.

4.12. City Line has four bus depots which are used for maintenance and storage of vehicles. Three of the depots are occupied under licence from Bristol City Council, but it does not own any bus stations for use by its passengers. Badgerline has depots at Bath, Bristol, Weston-super-Mare and Wells. Badgerline also operates a bus station at Marlborough, Street, Bristol, which provides the site of its Bristol depot. This station is used primarily by Badgerline but also by 15 other bus operators, including City Line to a limited extent, as well as by long-distance coach operators. In addition Badgerline operates under licence a bus station at Bath and uses bus stations at Chippenham, Dursley and Wells.

4.13. The Badgerline depots at Marlborough, Street, Bristol and Wells and the City Line depot at Kingswood are considered to have property development potential. The depots concerned have a value in the balance sheet of £3,033,000. Ways of realising this potential are being investigated and may include the merger of Badgerline Bristol and City Line engineering workshops on to a single site.

**Operating results in 1986 and 1987 for Badgerline and City Line, the BHL subsidiary companies operating in Avon**

4.14. BHL profits for 1986 include only those profits earned by Badgerline after acquisition from NBC in July 1986. However, the full year's operating results of Badgerline for 1986 are set out in Table 4.6 along with those of 1987, thus enabling a comparison for two complete years of operations. The profit before tax has deteriorated from £826,000 in 1986 to a loss of £577,000 in 1987. The main reasons for the deterioration are the reduction of local authority support after deregulation in October 1986, an increase of £242,000 in management charges from BHL and

losses of £560,000 sustained in Salisbury and Poole in 1987 (See paragraph 4.2). Had it not been for these circumstances the 1987 results would have shown a worthwhile improvement over 1986.

TABLE 4.6 **Badgerline operating statement**

	<i>£'000</i>	
	<i>1986</i>	<i>1987</i>
<i>Turnover and other income</i>		
Local authority support and subsidies	2,398	1,630
Bus operations	11,927	12,729
Other income (including coaching, commission and fees from operating bus stations)	<u>1,186</u>	<u>1,768</u>
	<u>15,511</u>	<u>16,127</u>
<i>Costs</i>		
Operating expenditure	11,587	12,362
Depreciation	903	1,286
Marketing	481	570
Administration (including management charges from BHL)	<u>1,609</u>	<u>2,213</u>
	<u>14,580</u>	<u>16,431</u>
Operating profit/(loss)	931	(304)
Interest payable less interest received	<u>(106)</u>	<u>(273)</u>
Profit/(loss) before tax	<u>825</u>	<u>(577)</u>

Source: Badgerline.

4.15. City Line operating results for 1986 and 1987 are shown in Table 4.7. City Line was not acquired by MRWH until September 1987 and became a subsidiary of BHL only in April 1988. The profit before tax deteriorated from £466,000 in 1986 to £112,000 in 1987; this was mainly because the local authority support grants received in 1986 were replaced by smaller amounts of subsidies for contract routes. This reduction in income was in part offset by improvement in operating efficiency.

TABLE 4.7 **City Line operating statement**

	<i>£'000</i>	
	<i>1986</i>	<i>1987</i>
<i>Turnover and other income</i>		
Local authority support and subsidies	2,267	1,223
Bus operations	13,713	14,293
Other income	<u>396</u>	<u>382</u>
	<u>16,376</u>	<u>15,898</u>
<i>Costs</i>		
Operating expenditure (including marketing)	12,558	13,265
Depreciation	740	744
Administration	2,048	1,667
Redundancy	<u>537</u>	<u>62</u>
	<u>15,883</u>	<u>15,738</u>
Operating profit	493	160
Interest payable less interest received	<u>(27)</u>	<u>(48)</u>
Profit before tax	<u>466</u>	<u>112</u>

Source: City Line.

4.16. The results shown in Tables 4.6 and 4.7 reflect the deregulated environment established on 26 October 1986, with 1987 being the first complete year of operations in that environment.