

Part II

Background and evidence

3 The regulatory environment and the companies involved in the merger

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Introduction

3.1. This chapter begins with a description of deregulation and privatization of the bus industry, then goes on to consider the procurement of bus services in London and the role of various statutory bodies both within and outside London. The second part of the chapter deals with the parties to the merger.

Deregulation and privatization of the bus industry

3.2. Prior to 1986 bus services in the UK were provided by local authority-owned operators, by the subsidiaries of publicly-owned corporations-primarily the NBC in England and Wales-and by smaller private operators.

Outside London

3.3. The 1985 Act abolished the requirement for road service licensing outside London and hence removed all quantitative restrictions on the supply of bus services. Under the 1985 Act licensed operators are merely required to register services with the Traffic Commissioner for the appropriate Traffic Area (see paragraphs 3.43 to 3.45) by giving at least 42 days' notice of the intention to introduce, withdraw or modify a service. They must, however, provide the Traffic Commissioner with details of the proposed route, the terminal points, timetables and stopping arrangements.

3.4. The 1985 Act also provided for the dissolution and disposal of the NBC, which operated in England and Wales. It was divided into 72 separate companies which were sold between 1986 and 1988. In only two instances were buyers initially allowed to acquire more than three NBC bus operating subsidiaries. Separate but similar arrangements were applied to the Scottish Bus Group in Scotland in 1990 and 1991.

3.5. Local authorities are legally able, but not obliged, to dispose of the bus companies that they own. The stimulus to privatization was enhanced by Government incentives to encourage voluntary sales and only 17 local authority-owned bus companies now remain.

3.6. As a result of the 1985 Act and the measures described, the bus industry outside London has moved from being one which was highly regulated and substantially under public sector control to one which is largely unregulated (except by the Traffic Commissioners) and almost entirely in the private sector.

3.7. The structure of the bus industry has also changed during the last ten years. Whilst initially privatization created a large number of companies under separate ownership, increasingly these have merged to form a few national groups. Figures prepared by TAS indicate that the three largest groups (FirstBus, Stagecoach and Cowie) between them now account for over 50 per cent in terms of turnover of the bus market in mainland Britain, although there are still around 1,800 bus companies in total (see Table 4.1).

Inside London

3.8. Bus services in London (defined as the geographical area which was previously administered by the Greater London Council) were excluded from the provisions of the 1985 Act. Instead, under the provisions of the 1984 Act, LT, through its Tendered Bus Division, subsequently renamed LTB, instituted a system of competitive tendering for bus routes in the capital with its own bus operating arm, LBL, competing with private sector operators for the right to run services.

3.9. In 1989 LBL's bus business was divided between 11 operating subsidiaries (with limited liability status) each representing a different area of London. A separate subsidiary (Stanwell Buses Limited trading as Westlink) had also been established in 1986 but one of the new subsidiaries (London Forest Travel Limited) was closed in November 1991. In November 1993 the Government announced its decision to privatize the remaining 11 'London bus companies' and accordingly they were sold to private operators (either third parties or their own management) between January and December 1994.

3.10. With the objective of promoting fair and sustained competition, the DOT and London Transport, in consultation with the competition authorities, developed guidelines which were given to LT. This guidance stipulated that no single purchaser would be allowed to obtain more than 25 per cent of total registered mileage or to operate in contiguous areas. As a result no more than any two of the London bus companies were sold by LT to any single operator. A list of the London bus companies which were sold at privatization and their current owners is set out at Appendix 3.1.

3.11. The non-statutory objectives of the Government in privatizing the London bus companies were, among other things, to promote sustained and fair competition in the provision of bus services in London, to provide an opportunity for the management and staff to take a stake in the privatized companies and to maximize as far as practicable the net proceeds of privatization.

3.12. A further aim of privatization was to free the companies from the restrictions which public ownership had placed on them and in so doing allow them to operate bus services outside London.

3.13. At the time of privatization bus depots which were operational were either sold or leased to the appropriate purchasing company. There were, however, clauses which provided for a possible clawback if these depots were sold at a profit by their new owners within a specified period of time.

3.14. LTB also owned several non-operational depots, which had become vacant following the award of tenders to private operators before privatization. As a short-term expedient, some of these depots have been let to the new operators. However, in the longer term LT is obliged to dispose of these depots for their maximum value, which is unlikely to be for use as bus depots. LT therefore has no continuing responsibility for the provision of bus depots to other operators (although it still has reserve powers to operate bus companies directly).

3.15. The Government announced in November 1993 that deregulation of bus services in London would not occur in the current Parliament, although it remained its long-term aim.

The procurement of bus services in London

3.16. In the following paragraphs we consider the special features of London, particularly with regard to the operation of bus services, the duties and role of LT and the evolution of the tendering process in London.

Particular features of London

3.17. LTB provided details of some of the special features of the London bus market. London is one of the largest urban bus markets in the world. It has a population of approximately 6.8 million, the vast majority of whom live within a five-minute walk of a bus stop. Buses in London run in excess of 200 million miles each year. Approximately 3.6 million bus journeys are made each weekday, accounting for around one-quarter of all road journeys in London. Around 27 per cent of all bus journeys undertaken in Great Britain are in London, compared with some 12 per cent of the population.

3.18. The London bus network currently comprises over 700 routes. The routes and the schedule of services operated on them are run under contract to LTB by private operators. LTB has in the region of 56 pre-qualified operators which are invited to bid for contracts and a total of 32 operators which currently provide services. For convenience we have divided these 32 operators into 7 'large groups' (comprising 18 bus operators) and 14 'small groups' or companies, on the basis of the size of their London operations. A list of these companies and groups is set out at Appendix 3.2.

3.19. Any bus operator can apply for pre-qualification by LTB, which assesses the technical and commercial competence and financial viability of the operator against a published set of objective and non-discriminatory criteria, in accordance with the UK regulations for procurement by utilities.

3.20. The route network, timetable and fare structure is specified by LTB in order to meet both commercial and social considerations and to complement services provided by British Rail, the Train Operating Companies, the London Underground and the Docklands Light Railway. This approach is aimed at discharging LTB's statutory obligations, as described in paragraph 3.29, of providing or securing the provision of public transport services for London. At the same time buses compete to some degree with private motor cars and taxis.

3.21. The average speed of traffic in London is estimated by LT to be between 10 and 11 miles an hour. However, in parts of south London, which has a less developed underground network and fewer trunk roads than north London, it is probably considerably below that. Traffic congestion is therefore a considerable problem. The River Thames also forms a natural barrier to transport by road between north and south London, because of the limited number of crossings.

3.22. Accordingly, bus travel is a relatively slow means of transport. The average length of a bus journey undertaken in London is just over two miles, the average route length is six miles and bus services attract a higher proportion of shoppers, schoolchildren and leisure travellers, as opposed to business users, than the railway or the underground. LT also told us that a higher proportion of those on lower incomes used the bus than the underground.

3.23. There was also evidence that the fares elasticity of demand for the two modes of transport was different. Whereas passengers on the underground might have no realistic alternative means of travelling to work when faced with a fares increase, it seemed that higher bus fares were a greater disincentive to potential customers, particularly those who had access to a private car.

3.24. An important feature of public transport in London is the complementary operation of rail, underground and bus services. Flexibility is provided to passengers by the availability of a variety of travel passes, which are valid for specified periods of time and zones of London. Some passes are valid on all three modes of transport whilst others are limited, for instance just to buses. There are also concessionary passes available to senior citizens, for example, which are subsidized by local authorities.

3.25. Passengers pay in advance for travel passes. This is a more reliable and arguably more cost-effective means of collecting fares than 'on-bus' collection. Whilst the system of travel passes offers convenience to passengers and speeds up the flow of people and vehicles, it does mean that in order to allocate revenue between different modes of transport and different elements within each mode, LT must apportion 'off-bus' revenue in accordance with a predetermined formula. The popularity of travel passes means that between 60 and 70 per cent of bus revenue arises off-bus-a substantial majority of a bus operator's revenue.

3.26. Another feature of London is that whereas rail and underground links provide mainly radial services to and from the centre of the capital, many bus routes are across-town and are deliberately designed not to replicate these arterial services.

3.27. In south London, Croydon is a major commercial centre in its own right and accordingly many bus services are designed to carry passengers into Croydon from outlying residential areas. Furthermore, the Government has recently announced the award of a contract under the Private Finance Initiative to a consortium (which includes a major London bus company-CentreWest) to build and operate a tram network in and around Croydon on the basis of a 99-year concession.

3.28. Whilst the full implications of this are not yet known, it seems likely that there will be considerable disruption to local bus services during the construction of the tramway and a reduced need for certain bus services once it is complete. However, offsetting this, LT envisages some new bus services being required as feeder services to the tram system.

The duties and role of LT

3.29. Under the 1984 Act, LT is responsible for providing or securing the provision of public passenger transport services for London. In carrying out these duties LT must have regard to the transport needs for the time being of London and the efficiency, economy and safety of operations. LT also has a financial duty under sections 15 and 16 of the 1984 Act. It is accountable to and financed by the DOT.

3.30. Section 6 of the 1984 Act empowers LT to invite other persons to submit tenders to run bus services for such periods and on such a basis as may be specified in the invitation to tender. The procurement of bus services is performed by LTB. Each bus route is individually tendered. However, where appropriate an operator may bid for a group of routes being offered as part of the same tender and quote prices for such a package.

3.31. Tenders are evaluated on the basis of value for money, that is taking into account an assessment of the likely quality of service that will be provided as well as its cost. Factors which LTB considers when choosing a successful tenderer include:

- its ability to recruit and retain suitable staff and their terms and conditions of employment;
- the availability and suitability of the premises from which the service will be operated;
- the vehicle types offered and their availability to meet the contract start date;
- its financial strength or that of its holding company;

- its performance on existing or previous contracts;
- its compliance with LTB's specifications; and
- its health and safety policy and record.

3.32. In addition to its role in procuring bus services through the tendering process, LTB has responsibility for other operational aspects of providing bus services in London, such as route planning, specification of vehicles, fares, timetables, information services to passengers, ticket inspectors and the provision of passenger facilities at bus stations and bus stops, although it also consults with the bus operators over these matters.

3.33. As appropriate LTB also liaises or consults *inter alia* with the 33 London boroughs, the Metropolitan Police, the London Regional Passengers Committee (LRPC) (a statutory body which monitors public transport in the capital), and the Traffic Director for London (representing the DOT in relation to major road schemes and traffic management) to deal with such matters as the environmental impact of buses, the creation of road traffic schemes designed to benefit buses (for example, red routes), passenger needs and the Passengers' Charter.

The evolution of tendering and awarding contracts in London

3.34. The first contracts were put out to tender in 1985 and were tendered on a gross cost basis. This meant that LT retained all the income from fares and awarded contracts on the basis of the gross cost the operator was prepared to quote in order to provide the service. Although this was successful in both raising standards and reducing costs, it meant that the operators were insulated from the commercial risks and rewards of providing the service once their tenders had been successful, since their income from the individual route or routes covered by the tender was fixed. By 1995 over half the network had been tendered under the gross cost system.

3.35. The remaining routes were operated under 'block grant arrangements'. These were informal arrangements (effectively within LT since it owned the operating companies) whereby the operating company received a subsidy from LT funds to make up the difference between the budgeted cost of operating a service and the budgeted on-bus revenue. LT received and kept all the off-bus revenue.

3.36. However, by April 1993 these block grant arrangements were replaced by negotiated net cost contracts. Under these negotiated contracts a sum was paid either to or by the operator representing the difference between the projected costs and the projected revenues (on-bus and off-bus) of running a service. These contracts were formal arrangements put in place as a precursor to privatization and also required LTB (for the first time) to allocate the off-bus revenue between routes.

3.37. LTB told us that from April 1997 onwards, under a rolling tendering programme, all the gross cost contracts and the negotiated net cost contracts will be replaced by tendered net cost contracts. Under this tendering regime the operator is awarded the contract in return for a fee or a subsidy (about 40 per cent of routes now need no subsidy) and the operator retains all fare income relating to the routes tendered. Under these contracts the commercial risk from fluctuating revenues has therefore been passed to the operator.

3.38. Contracts usually commence between eight and nine months after they have been awarded, so the first negotiated net cost contracts starting in April 1997 have already been awarded. This period is intended to give a new operator time to make the necessary arrangements and investment to commence operation. Thereafter, contracts run for five years from commencement, with a break clause available to either party after three years. Accordingly, all contracts will have been tendered, awarded and commenced under the new net cost tendering regime by April 2002. A diagram summarizing the past and future tendering programme is set out at Appendix 3.3.

Non-tendered bus services within London

3.39. It is also possible for bus operators to run bus services within London other than by submitting tenders to LTB. In order to do so an operator needs either a London local licence or an agreement with LT under section 3(2) of the 1984 Act (a section 3(2) agreement).

3.40. A London local licence can be issued upon application by the South East and Metropolitan Traffic Commissioner (see paragraphs 3.43 to 3.45). Under such a licence the bus operator can retain any fares collected in the course of operation but cannot participate in any allocation of off-bus revenue received by LT. Since off-bus revenue usually forms a high proportion of fares on a route, it would be extremely rare for an operator to be able to identify a new commercial bus route in London that could be operated profitably solely on the basis of on-bus revenue.

3.41. Section 3(2) agreements were principally originated in order to allow cross-border routes-often local authority-tendered services running into London from the counties outside London-to participate in off-bus revenue for the portion of the route that was within London. However, after privatization, it was feared that the basis of allocating off-bus revenue on section 3(2) agreements (on miles travelled as opposed to passengers carried) had led to some abuse of the system, with operators registering routes simply in order to obtain the off-bus revenue, and consequently there are currently strict controls on the issue of any new section 3(2) agreements.

3.42. London local licences and section 3(2) agreements account for less than 2 per cent of bus mileage within London.

The role of the Traffic Commissioners

3.43. The Traffic Commissioners are appointed by the Secretary of State for Transport. Six Traffic Commissioners currently administer eight defined Traffic Areas throughout Great Britain. Whilst the 1985 Act substantially reduced bus operator licensing requirements, the Traffic Commissioners remain the licensing authority for operators of heavy goods vehicles (HGVs) and public service vehicles (PSVs). As such, before granting an operator licence, they must be satisfied that applicants meet the statutory requirements of good repute, appropriate financial standing and professional competence. They monitor the ongoing performance of bus operators and check their compliance with specific legal requirements, such as vehicle maintenance, drivers' hours and road traffic regulations. In addition, they are responsible for dealing with disciplinary cases involving the conduct of HGV and PSV drivers.

3.44. The Traffic Commissioners' powers include the ability to attach conditions to an operator's licence if the operator fails to run local services in accordance with the registered details, intentionally interferes with the services of another operator, or operates services in a manner dangerous to the public. The conditions may also prohibit the operator from providing services on certain routes, or even from providing local bus services at all. The Traffic Commissioners have no power to control fares.

3.45. New regulations which came into effect on 1 February 1995 have strengthened the powers of the Traffic Commissioners in areas experiencing significant traffic congestion. Traffic Commissioners can now regulate the number of buses operating on a particular route if requested to do so by the relevant traffic authority.

The role of local authorities (outside London)

3.46. The 1985 Act provided for the private sector to deliver the majority of local bus services, but local authorities continue to be involved. First, they have powers (which virtually all use) to provide financial support for socially necessary services and to operate concessionary fare schemes for particular groups, such as elderly, young and disabled people. Secondly, they have been obliged to transfer their bus operations into companies operating at arm's length, although they have not been compelled to sell these companies.

3.47. Financial support by local authorities for non-commercial (tendered) services may take one of two forms:

- (a) *minimum cost*: the tendering authority retains all revenues and the contractor tenders for the whole cost of operating the contract (revenue risk is taken by the authority); or
- (b) *minimum subsidy*: the operator retains all revenues and tenders for the cost of operating the service less the estimated revenue (revenue risk is taken by the operator).

3.48. The contract usually specifies the detailed characteristics of the service (vehicle requirements, route and exact timetable) and very often the fares (or a range of fares). Most contracts include clauses allowing them to be suspended if another operator decides to register the service commercially: the tendering authorities are not expected to subsidize services which are commercially registered.

The parties to the merger

3.49. In the following paragraphs we consider the companies involved in the merger, their history and trading activities, the events leading up to the merger, its effects and subsequent events, the past financial performance of Cowie and British Bus and the age of Cowie's London bus fleet and British Bus's total fleet.

Cowie

3.50. Cowie was incorporated in 1938 and originally traded in Sunderland as a retailer and repairer of motor cycles. This trade expanded with the addition of new outlets after the Second World War. In 1961 Cowie began trading in motor cars (initially second-hand), adding new car franchises throughout the 1970s. Cowie expanded further, notably by buying a vehicle leasing operation, Interleasing (part of its acquisition of Hanger Investments PLC), in 1984 and Hughes DAF Limited, which distributed DAF coach chassis, in 1988.

3.51. Cowie has been quoted on the London Stock Exchange since 1964 and is now a major UK plc still with its headquarters in Sunderland. It has net assets of approximately £250 million and a market capitalization of about £981 million (based on the share price on 31 January 1997). It currently has four operating divisions: vehicle leasing and financing; motor retailing; bus distribution; and bus service operations.

Vehicle leasing and financing

3.52. Vehicle leasing and financing consists of contract hire, fleet management, leasing and instalment credit. These activities are carried on under the trading names of Cowie Interleasing, Broadwood Finance and Cowie Lease. Cowie Interleasing has a fleet of over 70,000 vehicles (mainly company cars), making it one of the largest such operators in the country, dealing primarily with large commercial organizations. Cowie's leasing activities are financed by two revolving credit facilities amounting to £370 million.

Motor retailing

3.53. The motor retailing division comprises 32 dealerships retailing new and used cars and motor cycles. The dealerships are spread across mainland Britain and represent a number of different manufacturers. The division also engages in the service and repair of motor vehicles, supply of automotive parts and the provision of self-drive hire vehicles.

Bus distribution

3.54. Bus distribution is carried on under the name Hughes DAF, which is the sole UK importer for DAF bus and coach chassis. Working with a number of major European coachbuilders, Cowie supplies a range of double-deck, single-deck, midi- and minibuses and coaches, which it sells to bus and coach operators. Drawing on the group's experience in leasing, the division has developed finance schemes for its customers, and it also has a fleet of 550 vehicles which are available for rental to customers.

3.55. Since the merger the bus distribution division has acted as a supplier of buses to Cowie's bus service operations division (including British Bus), although there are a number of other suppliers which have also been used. In conjunction with the leasing division it would clearly also be able to provide such buses and coaches on lease or rental agreements, although Cowie told us that to date all the bus service operations division's leases were with third parties.

Bus service operations

3.56. Prior to its acquisition of British Bus, which was conditionally agreed on 18 June 1996 and completed on 1 August 1996, Cowie had previously acquired the following bus and coach service operations:

- Grey Green which was acquired in 1980 with a depot at Stamford Hill, subsequently adding another at Barking, both in London. It currently operates bus services under contract to LTB in east London, having sold a local bus and London commuter coach operation, based near Rochester in Kent, in 1996.
- Leaside (one of the privatized London bus companies) which was acquired for £29 million in September 1994 and operates bus routes under contract to LTB in north London.
- SLT (the last of the London bus companies to be privatized) which was acquired for £16 million in December 1994 and operates bus routes under contract to LTB in south London. Cowie had already acquired Leaside and was approached as a suitable purchaser of SLT following the collapse of a management buy-out after severe criticism of maintenance standards at SLT by the Traffic Commissioner and the curtailment of its operator's licence from five years to six months.
- County Bus which was acquired in February 1996 for £10 million. It operates bus routes under contract to LTB in north and east London as well as some commercial and tendered bus services in Hertfordshire and Essex.
- North East Bus which was acquired from West Midlands Travel Limited in July 1996 for £25 million. It operates commercial bus services primarily in Cleveland, south-west Durham and on the North Yorkshire coast.

British Bus

3.57. British Bus Group Limited (British Bus) was incorporated on 8 March 1994 in order to take over British Bus Plc. British Bus Plc had been set up in 1992 by the management of Drawlane. Drawlane had been the investment vehicle whereby a group of private investors had acquired a number of bus companies, both at the time of privatization of the NBC and subsequently.

3.58. On 10 December 1992 British Bus Plc acquired the majority of the assets and operating subsidiaries of Drawlane, with the principal exception of its 25 per cent interest in National Express which was simultaneously floated on the London Stock Exchange. British Bus Plc then disposed of a number of the Drawlane businesses which were unrelated to the core business and acquired some more bus operating companies.

3.59. Partly in order to facilitate the pursuit of growth by acquisition, the group was restructured and refinanced in a series of transactions between November 1993 and 5 May 1994, when British Bus became the group holding company. At the same time British Bus raised new equity and increased its borrowing facilities.

3.60. Equity of £35 million was raised from Charterhouse Development Capital Limited and CINVen of which £20.5 million was paid out to the existing shareholders of British Bus Plc to realize part of their investment. A syndicated loan facility (led by the Bank of Boston) was put in place, initially for £30 million, but increased to £110 million.

3.61. By 31 December 1995 British Bus had a bus fleet of over 5,200 vehicles, turnover for that year of £261 million, profit before taxation of £11 million and net liabilities of £65 million. This reflected its policy of

rapid growth by acquisition, financed mainly by borrowing and involving the write-off of large amounts of acquired goodwill against reserves. A list of the main operating subsidiaries of British Bus, their principal geographical areas of operation and year of acquisition by British Bus is given at Appendix 3.4.

The acquisition of British Bus

3.62. It had been intended to float British Bus on the London Stock Exchange in the summer of 1995. However, those plans were abandoned when the Serious Fraud Office commenced an investigation into certain activities of two of the then directors of British Bus in July 1995. Accordingly British Bus's institutional and management shareholders decided to seek a trade sale of the company instead.

3.63. Cowie was initially approached by the vendors' advisers in January 1996, but at that time was otherwise preoccupied with another potential acquisition in a different business sector in Europe. When that potential transaction fell through and the approaches were repeated in April 1996 it expressed an interest based on a desire to expand significantly its bus operations business. This led to a period of further inquiry and negotiation and culminated in an offer by Cowie, which was informally accepted in principle by all the shareholders of British Bus on 7 June 1996.

3.64. By that time, after unsuccessful approaches to a number of major companies, the only alternative which the shareholders of British Bus were still contemplating was a management buy-out of the company. However, it was considered that this would have left the company in a relatively weak position in the market as it would have lacked the necessary funds for large-scale investment. Accordingly, Cowie was seen as the only realistic chance of selling the company as a whole.

3.65. Under the terms of its offer Cowie agreed to acquire the share capital of British Bus for a minimum consideration of £89 million and assume responsibility for the payment of accrued dividends of £7 million. Up to a further £20 million of consideration was to be payable in the event that British Bus's operating profits for the year ended 31 December 1996 exceeded £34 million. Cowie also agreed to pay off British Bus's syndicated loan of £102 million and assume £84 million of credit liabilities in relation to its bus fleet. The maximum aggregate consideration given for British Bus was therefore £302 million.

3.66. The acquisition was conditional, among other things, on a successful rights issue by Cowie to raise £186 million, to be used to purchase the share capital and to repay the syndicated loan of £102 million. The acquisition was completed on 1 August 1996, when Dawson Williams, Chairman of British Bus, and Gordon Watt, its Deputy Chief Executive, both resigned and three Cowie directors were appointed to the Board of British Bus, joining the three executive British Bus directors who remained in office.

3.67. The minimum purchase price paid by Cowie for British Bus represented one times British Bus's expected 1996 turnover (compared with 1.1 times at the maximum price—that is, assuming the £20 million earn-out payment was made). At the time this was reckoned by Cowie's advisers to be a somewhat lower multiple than the equivalent multiples (of turnover to market capitalization) for the major quoted bus operators (Stagecoach, FirstBus, Go-Ahead and National Express) and also below that paid in two comparable major transactions involving bus groups in the first half of 1995. British Bus's advisers had similarly advised British Bus's shareholders, *inter alia*, that in their view the company should be worth a multiple of 1.1 times 1996 expected turnover.

Post-acquisition position of the combined group

3.68. A pro forma statement of the combined net assets of Cowie and British Bus is set out at Appendix 3.5. This shows the effect of combining the balance sheets of Cowie and British Bus as at the end of 1995, together with the impact of the payment of the maximum purchase consideration and the rights issue by Cowie to help to finance the acquisition.

3.69. As a result of the acquisition and the rights issue Cowie's gearing ratio (net debt divided by net debt plus equity) rose fractionally from 63 to 64 per cent. The pro forma net assets of Cowie and British Bus combined were £232 million.

3.70. So far as operational matters were concerned Cowie told us that the bus operations of Cowie and British Bus had not yet been brought together under the control of one chief executive, although this was in prospect along with the appointment to the main Board of such an executive. However, Cowie considered that strategic decisions were often best taken at a local level, because a detailed knowledge of the operating environment-the competition, geography and demography-was vital.

3.71. In addition Cowie told us that it might choose not to integrate the two businesses, as its philosophy was to promote competition between different parts of the group as a way of securing better performance. This would not prevent the group from making cost savings arising from greater buying power.

3.72. So far as capital expenditure plans were concerned, Cowie told us that it intended to restore British Bus's capital spending programme, which had previously been reduced by British Bus below its desired optimum of 10 per cent of turnover. The cost of this in 1997 was estimated to be £45 to £50 million (of which £35 million had already been committed), compared with a projected £17 million if British Bus had continued as an independent company under a management buy-out.

Financial performance of Cowie

3.73. A table showing summarized profit and loss information and average net operating assets of Cowie for each of the five years ended 31 December 1995 is set out at Appendix 3.6. This indicates that between 1991 and 1995 turnover increased by 77 per cent from £565 million to £1,001 million. In the same period operating profit rose by 48 per cent from £54 million to £80 million.

3.74. During this period return on sales (operating profit divided by turnover) has fluctuated but declined overall from 9.6 per cent in 1991 to 7.9 per cent in 1995. Return on average net operating assets (operating profit divided by average net operating assets) has also fluctuated, although it has risen overall in the period, from 13.1 per cent in 1991 to 16.2 per cent in 1995.

Segmental analysis

3.75. An analysis of turnover and profit before taxation relating to each operating division of Cowie and its head office is set out in Table 3.1.

TABLE 3.1 Cowie: turnover and profit before taxation by division, 1993 to 1995

	Years ended 31 December					
	1993		1994		1995	
	£m	%	£m	%	£m	%
<i>Turnover</i>						
Vehicle leasing and financing	230	29	230	25	225	22
Motor retailing	519	64	650	69	655	65
Bus and coach distribution	16	2	20	2	25	3
Agricultural, industrial and horticultural*	21	3	7	1	-	-
Bus and coach operations	14	2	27	3	96	10
	800	100	934	100	1,001	100
<i>Profit before taxation</i>						
Vehicle leasing and financing	24	63	28	63	33	59
Motor retailing	8	22	10	23	11	20
Bus and coach distribution	2	5	3	7	3	5
Agricultural, industrial and horticultural*	0	0	0	0	-	-
Bus and coach operations	2	5	3	7	10	18
Head office and miscellaneous	2	5	0	0	(1)	(2)
	38	100	44	100	56	100

Source: Cowie.

*Business disposed of in 1994.

3.76. Table 3.1 shows how the bus and coach operations division had grown both in terms of its absolute size and relative to the rest of the group, even before the acquisition of British Bus, as a result of the acquisition of Leaside and SLT in 1994 (see paragraph 3.56). Following the acquisition of British Bus the division is likely, in the Board's view, to be the largest contributor to Cowie's profits.

Financial performance of Cowie's London bus operations

3.77. Table 3.2 shows the turnover and operating profit of Cowie's London bus operating subsidiaries for the last three completed accounting periods (prior to 31 December 1996). The figures are taken from the statutory accounts of the companies concerned and reflect changes in accounting dates and periods of trading prior to acquisition by Cowie. They are not therefore comparable with the figures in Table 3.1.

TABLE 3.2 Cowie: turnover and operating profit by London bus operating company, 1993 to 1995

	£ million		
	1993/94	1994/95	1995
<i>Turnover</i>			
Grey Green	14.5	15.2	15.5
Leaside	43.3	34.3*	48.5
SLT	33.1	34.4	25.2*
<i>Operating profit</i>			
Grey Green	1.6	2.2	1.8
Leaside	0.6	1.8*	4.8
SLT	2.1	(0.7)	0.0*
<i>Return on sales†</i>			
Grey Green	11.1	14.2	11.7
Leaside	1.4	5.3‡	9.9
SLT	6.5	(1.9)‡	0.2

Source: Cowie.

*Nine-month accounting period.

†Operating profit divided by turnover.

‡Acquired by Cowie during the period.

Financial performance of British Bus

3.78. A table showing summarized profit and loss information, return on sales and return on average net operating assets of British Bus (or for periods before May 1994 the antecedent companies which were acquired by British Bus when the group was restructured) for each of the four years ended 31 December 1995 is set out at Appendix 3.7. This indicates that between 1992 and 1995 turnover increased by 158 per cent from £101 million to £261 million. In the same period operating profit rose by 240 per cent from £10 million to £34 million (before £8 million of exceptional items). These growth rates reflect the large number of acquisitions that were made by British Bus.

3.79. During this period return on sales (operating profit divided by turnover) initially fell from 9.4 per cent in 1992 to 8.0 per cent in 1993 but thereafter increased to reach 13.0 per cent in 1995. Return on average net operating assets (operating profit divided by average net operating assets) has risen from 17.9 per cent in 1993 to 28.7 per cent in 1995.

Age profile of bus fleets

3.80. British Bus writes off the cost of its buses over varying periods of between 5 and 15 years (depending on the type of vehicle) on a straight line basis with no residual value. British Bus told us that the average age of its fleet was 9.2 years. An analysis of its buses by age is set out in Table 3.3.

TABLE 3.3 Analysis of British Bus buses by age, September 1996

	<i>Number</i>	<i>%</i>
Up to 5 years old	1,460	29
Over 5 up to 10 years old	1,482	29
Over 10 up to 15 years old	779	15
Over 15 up to 20 years old	1,081	22
Over 20 years old	<u>227</u>	<u>5</u>
	5,029	100

Source: British Bus.

3.81. An analysis of Cowie's London bus fleet (that is, for all its bus companies excluding North East Bus) is set out in Table 3.4. The relatively high proportion of buses over 20 years old may be attributed to the requirement of LTB to operate certain routes using Routemaster buses, which are invariably over that age.

TABLE 3.4 Analysis of Cowie's London bus fleet by age, November 1996

	<i>Number</i>	<i>%</i>
Up to 5 years old	286	21
Over 5 up to 10 years old	237	18
Over 10 up to 15 years old	396	29
Over 15 up to 20 years old	266	20
Over 20 years old	<u>159</u>	<u>12</u>
	1,344	100

Source: Cowie.