Part II

Background and evidence

3 The companies: history, finance and the proposed joint venture

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Introduction

3.1. This chapter first summarizes the history, current activities and financial performance (including historical and projected profitability on the Short Sea routes) of the two main parties with which we are concerned in the inquiry, P&O (paragraphs 3.2 to 3.37) and Stena (paragraphs 3.38 to 3.71). It then outlines the proposed joint venture between the parties (paragraphs 3.72 to 3.97), the financial projections for the joint venture for 1997 to 2000 (paragraphs 3.98 to 3.101) and the anticipated annual cost savings (paragraphs 3.102 to 3.110).

P&O

History and current activities

3.2. P&O was incorporated by Royal Charter in 1840 and has been listed on the London Stock Exchange since 1876. It was initially developed as a pure shipping concern, establishing cargo and passenger shipping routes throughout Europe, the Near and Far East and to Australasia. Since the 1970s, P&O has diversified into other areas of the transport industry and also into property and services (including construction).

3.3. In February 1985 P&O merged with Sterling Guarantee Trust PLC. This merger brought into the group several service businesses and property companies. In the years which followed this merger, P&O has developed organically and through acquisition with a strong emphasis on growth in overseas markets.

3.4. P&O is a broadly-based group with management currently organized into a number of operating divisions. P&O Ferries (the ferry division) operates passenger and freight ferry services between mainland Great Britain and the Continent, Northern Ireland and the Orkney and Shetland Islands. P&O European Transport Services is a road freight transport and warehousing concern, which operates a number of ro/ro vessels for the maritime leg of its international road transport services. P&O Cruises operates a leisure cruise business. P&O owns 50 per cent of a deep sea container shipping operation, P&O Nedlloyd. P&O Bulk Shipping operates deep sea dry bulk vessels. P&O Australia has various areas of business including port management and handling services, cleaning and catering and cold storage. The Earl's Court and Olympia division includes international exhibition management and other service businesses. The Bovis Homes and Bovis Construction Group divisions are respectively involved in housebuilding and construction. The Property division has a large portfolio of commercial property and carries out both property investment and development.

3.5. P&O's overall direction is in the hands of its Board of Directors, which comprises nine executive directors, including the Chairman, Lord Sterling, and five non-executive directors. P&O told us that its management style is one of decentralization, so that decisions best taken at operating division level are indeed taken there, subject to requirements for the main strategic, management and financial issues to be discussed and agreed at parent company level. This decentralized approach is designed to encourage initiatives within the divisions and in practice they are responsible for all day-to-day management decisions and for developing their businesses within the constraints of the market, capital which the parent is prepared to give them and operational standards which it sets them. P&O has currently set for its divisions a target rate of return on capital in excess of 15 per cent, although this can vary from division to division depending on the nature of the business, the risk involved and the maturity of the assets concerned.

History of P&O's involvement in ferry services

3.6. P&O has been involved with North Sea and English Channel ferry services since the 1960s. In January 1985 P&O sold its then cross-Channel activities, comprising its services on Dover-Boulogne and Southampton-Le Havre, to European Ferries. In January 1986 P&O acquired an interest in European Financial Holdings Limited which held shares in European Ferries. This acquisition was referred to the MMC. The MMC's report[1] concluded that the merger was not against the public interest. In 1987 P&O acquired European Ferries, thereby gaining control of several cross-Channel ferry services and establishing the basis of P&O's current ferry division.

3.7. At the time of the MMC's inquiry into the cross-Channel ferry industry in 1989,[2] P&O operated combined passenger and freight services on a number of Anglo-Continental routes: Dover-Calais, Dover-Boulogne, Dover-Zeebrugge, Felixstowe-Zeebrugge, Portsmouth-Le Havre and Portsmouth-Cherbourg. A freight-only service was also operated on Felixstowe-Rotterdam. A pooling agreement was in operation between P&O and the Belgian national ferry company, Regie voor Maritiem Transport (RMT). Under that agreement, mixed passenger and freight services were operated between Dover-Ostend, Dover-Zeebrugge and Felixstowe-Zeebrugge. P&O also owned 50 per cent of North Sea Ferries, a joint venture with Royal Nedlloyd operating mixed passenger and freight ferry services to Zeebrugge and Rotterdam from Hull, Ipswich and Teesport.

3.8. The routes on which P&O Ferries operates can be divided into six sectors-the Short French Sea, the Belgian Straits, the Western Channel, the North Sea, the Irish Sea and the Scottish ferry routes. These sectors, apart from the Scottish Ferry routes, are described in Chapter 5.

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[1]See footnote to paragraph 2.51.

[2]See footnote 2 to paragraph 2.17.

3.9. In the Short French Sea sector, P&O told us that at the end of 1992 it withdrew its service on Dover-Boulogne as part of the consolidation of its operations in advance of the opening of the Channel Tunnel. In April 1993 one additional vessel was introduced on Dover-Calais. Dover-Calais is now a five-vessel operation, offering 25 departures a day in both directions during the peak summer period. Two of the largest multi-purpose ferries on the Short French Sea routes are P&O's *Pride of Dover* and *Pride of Calais*, which were refurbished in 1993. Three smaller vessels, *Pride of Burgundy*, *Pride of Kent* and *Pride of Bruges*, are also employed on Dover-Calais.

3.10. In the Western Channel sector, a new route was opened in 1993 from Portsmouth to Bilbao in northern Spain. The *Pride of Bilbao* was chartered specifically for this route and is the largest multi-purpose ferry in P&O's fleet. Two second-hand, multi-purpose vessels (the *Pride of Le Havre* and the *Pride of Portsmouth*) were also chartered during 1994 and introduced on to the Portsmouth-Le Havre route. The *Pride of Hampshire* and *Pride of Cherbourg*, which were previously operated on the Le Havre route, were transferred to Portsmouth-Cherbourg and two older and smaller vessels were sold. The fleet operated on this sector has remained the same since 1994 except for the removal of two freight-only vessels from the Portsmouth-Le Havre route, one in 1995 and one in 1996.

3.11. On the Belgian Straits sector, P&O closed its passenger service from Dover-Zeebrugge at the end of 1991. The route is now operated as a freight-only service using three vessels. The pooling agreement with RMT was terminated in 1994 and the Dover-Ostend route was discontinued. In the North Sea sector P&O's Felixstowe services were reorganized in 1995, with two extra freight vessels put on to Felixstowe-Rotterdam in response to increased demand. Although an extra vessel had been added to the route in 1994, the passenger service from Felixstowe to Zeebrugge was discontinued as part of the 1995 reorganization and became a two-vessel, freight-only operation. North Sea Ferries' freight-only route between Ipswich and Rotterdam was discontinued in 1995. In September 1996 P&O acquired Royal Nedlloyd's stake in the North Sea Ferries joint venture.

3.12. On the Irish Sea, a fast craft was chartered in 1996 for the Cairnryan-Larne crossing to replace one multi-purpose ferry. The other multi-purpose ferry continues to operate together with two freight-only ferries.

3.13. Table 3.1 sets out the routes (together with the numbers of vessels) currently operated by P&O's ferry division.

TABLE 3.1 **P&O Ferries: routes operated and number of vessels, February 1997**

	Number of vessels		
Routes operated	*Multi-purpose*	*Freight-only*	*Fast craft*
Dover-Calais	5	-	-
Dover-Zeebrugge	-	3	-
Felixstowe-Zeebrugge	-	2	-
Felixstowe-Rotterdam	-	4	-
Cairnryan-Larne	1	2	1
Portsmouth-Cherbourg	2*	-	-
Portsmouth-Le Havre	2	-	-
Portsmouth-Bilbao	1	-	-
Hull-Zeebrugge	2	1	-
Hull-Rotterdam	2	2	-
Teesport-Zeebrugge	-	2	-
Teesport-Rotterdam	-	1	-
Scottish Mainland-Orkney and Shetland Islands	3	1	-

Source: P&O.

*The Portsmouth-Bilbao vessel is deployed on the Portsmouth-Cherbourg crossing for one return trip each week.

3.14. Pandoro and Ferrymasters, subsidiaries of P&O's European Transport Services division, both operate freight-only maritime services as part of their integrated door-to-door road transport services, with spare capacity on board the vessels being sold to third parties. On the North Sea, Ferrymasters operates between

Middlesbrough and Gothenberg, whilst on the Irish Sea, Pandoro operates services between Larne and Ardrossan, Larne and Fleetwood, Dublin and Fleetwood, Dublin and Liverpool and Rosslare and Cherbourg.

Financial performance

P&O

3.15. Table 3.2 summarizes the financial performance of the P&O group over the past six years.

TABLE 3.2 **P&O group: summary of financial performance, 1991 to 1996**

£ million

	Years ended 31 December					
	1991	*1992*	*1993*	*1994*	*1995*	*1996*
Turnover	4,992.0	5,214.4	5,717.5	5,989.6	6,571.1	7,090.8
Operating profit	313.2	339.4	396.3	477.3	490.8	509.3
Profit before interest and taxation	360.2	392.7	674.7	485.4	491.1	521.7
Borrowings (net of cash)	1,238.5	2,214.6	1,721.6	1,838.4	2,193.7	1,890.9
Shareholders' funds	2,249.7	2,220.9	2,634.8	2,653.9	2,659.3	2,614.2
Capital employed*	3,698.6	4,458.9	4,418.9	4,670.6	5,084.6	4,726.4
Average capital employed	3,595.0	4,078.8	4,438.9	4,544.8	4,877.6	4,905.5
						per cent
Operating profit as a percentage of turnover	6.3	6.5	6.9	8.0	7.5	7.2
Profit before interest and taxation as a percentage of average capital employed	10.0	9.6	15.2	10.7	10.1	10.6
Gearing#	55.1	99.7	65.3	69.3	82.5	72.3

Source: P&O.

*Capital employed comprises the fixed assets and other assets and liabilities used in the business excluding borrowings, taxation, dividends payable and minority interests.

#Borrowings (debt-including finance lease obligations-less cash and short-term deposits) as a percentage of shareholders' funds.

3.16. Table 3.3 provides an analysis of P&O's results for the year ended 31 December 1996 by division. This shows that in 1996 P&O Ferries contributed around 8 per cent of total turnover and 8 per cent of total operating profit. Its return on capital employed of 9.5 per cent fell short of P&O's stated target for return on capital employed of 15 per cent. In fact across its operating divisions P&O achieved a return on capital employed of 10.4 per cent in 1996.

3.17. The analysis of operating profit by half year that was included in P&O's preliminary announcement of 1996 results on 25 March 1997 showed that the reduction in operating profit for P&O Ferries of £32.5 million (from £73.5 million in 1995 to £41.0 million in 1996) occurred as to £24.3 million in the first half of 1996 and as to £8.2 million in the seasonally more profitable second half.

P&O Ferries

3.18. P&O Ferries has five main UK operating subsidiaries, all of which have been wholly owned since P&O's purchase of Royal Nedlloyd's share of North Sea Ferries at the end of 1996. These subsidiaries and the routes they operate are set out in Table 3.4. Since January 1997 the Felixstowe routes previously operated by P&O European Ferries (Felixstowe) Limited and all the routes operated by North Sea Ferries Limited and North Sea Ferries BV have come under the same management, P&O North Sea Ferries. There are a number of other subsidiaries in the division and certain fixed assets are owned by other group companies. In addition, the port of Larne (Northern Ireland) is owned by the P&O group and its result is reported under other service businesses.

TABLE 3.3 **Analysis of P&O's trading results for the year ended 31 December 1996**

£ million

	P&O Ferries	*P&O Cruises*	*P&O Containers*	*P&O Bulk Shipping*	*P&O European Transport Services*	*P&O Australia*	*Earl's Court and Olympia and other service businesses*	*Bovis Homes*	*Bovis Construction Group*	*Property development*	*Investment property*	*Total*
Turnover	602.5	1,007.0	1,436.8	171.2	883.4	662.1	138.4	292.2	1,546.2	168.2	182.8	7,090.8
Operating profit	41.0	157.5	30.3	1.1	13.5	52.9	27.9	28.8	14.8	38.8	102.7	509.3
Capital employed*	435.9	962.6	485.9	162.8	177.9	411.5	199.9	232.0	(21.0)	388.7	1,290.2	4,726.4
Average capital employed	432.0	931.1	621.0	188.3	190.7	388.1	194.6	267.1	(27.5)	427.0	1,293.2	4,905.5
												per cent
Operating profit as a percentage of turnover	6.8	15.6	2.1	0.6	1.5	8.0	20.2	9.9	1.0	23.1	56.2	7.2
Operating profit as a percentage of average capital employed	9.5	16.9	4.9	0.6	7.1	13.6	14.3	10.8	-	9.1	7.9	10.4

Source: P&O.

*Capital employed comprises the fixed assets and other assets and liabilities used in the business excluding borrowings, taxation, dividends payable and minority interests.

TABLE 3.4 **P&O Ferries: operating subsidiaries and routes, December 1996**

Operating subsidiary	*Routes*
P&O European Ferries (Dover) Limited	Dover-Calais Dover-Zeebrugge
P&O European Ferries (Portsmouth) Limited	Portsmouth-Le Havre Portsmouth-Cherbourg Portsmouth-Bilbao
P&O European Ferries (Felixstowe) Limited	Felixstowe-Zeebrugge Felixstowe-Rotterdam Cairnryan-Larne
North Sea Ferries Limited North Sea Ferries BV	Hull-Zeebrugge Hull-Rotterdam Teesport-Zeebrugge Teesport-Rotterdam
P&O Scottish Ferries Limited	Scottish mainland to the Orkney and Shetland Islands

Source: P&O.

3.19. Table 3.5 summarizes the financial performance of P&O Ferries over the past six years.

TABLE 3.5 **P&O Ferries: financial performance, 1991 to 1996**

£ million

	Years ended 31 December					
	1991	*1992*	*1993*	*1994*	*1995*	*1996*
Turnover	535.1	568.9	605.6	673.5	654.1	602.5
Operating profit	83.5	78.5	76.5	113.9	73.5	41.0
Capital employed*	421.5	489.5	446.9	447.0	428.1	435.9
Average capital employed	362.4	455.5	468.2	447.0	437.6	432.0
						per cent
Operating profit as a percentage of turnover	15.6	13.8	12.6	16.9	11.2	6.8
Operating profit as a percentage of average capital employed	23.0	17.2	16.3	25.5	16.8	9.5

Source: P&O.

*Calculated as the fixed assets and other assets and liabilities used in the business excluding borrowings, taxation, dividends payable and minority interests.

3.20. The 1994 results benefited from growth in both the passenger and freight markets. P&O attributed this growth to improvements in the service provided by ferry operators and the ending of the recession which had affected many of the European economies. The strongest growth was seen on Dover-Calais where P&O reported a 25 per cent increase in its carryings of passengers and freight traffic.

3.21. In 1995 the Channel Tunnel came into full operation. Despite its impact, there was continued growth in the market (P&O reported 25 per cent growth in the whole passenger and freight market on Dover-Calais although not in its own carryings) and P&O achieved a return on average capital employed of 17.1 per cent. In 1996 P&O Ferries experienced a fall in turnover of 7.9 per cent from £654.1 million to £602.5 million and its return on average capital employed fell to 9.5 per cent.

3.22. Table 3.6 provides an analysis of turnover and operating profit by operating division for 1994 to 1996. This table shows that the two Dover routes, run by P&O European Ferries Dover, provided over half the turnover of the division in 1994 and 1995 and just under half the total in 1996. This division made by far the largest contribution to the operating profits of P&O Ferries and covered losses being made by some other divisions, [*Details omitted*. *See note on page iv*].

3.23. Dover-Calais is by far the most significant of the routes operated by P&O Ferries in terms of its contribution to turnover and profits. In 1996 the P&O Ferries division as a whole made operating profits of £41 million (1995-£74 million) on turnover of £602 million (1995-£654 million). Dover-Calais made operating profits of £[*] million (1995-£[*] million) on turnover of £[*] million (1995-£[*] million).

TABLE 3.6 **P&O Ferries: analysis of turnover and operating profit by main operating division**

			£ million
		Years ended 31 December	
	1994	*1995*	*1996*
Turnover			
P&O European Ferries Dover	[		
P&O European Ferries Portsmouth			
P&O European Ferries Felixstowe			
North Sea Ferries			
P&O Scottish Ferries			
Operating profit		*Figures omitted.*	
P&O European Ferries Dover		*See note on page iv.*	
P&O European Ferries Portsmouth			
P&O European Ferries Felixstowe			
North Sea Ferries			
P&O Scottish Ferries			
Divisional expenses			
			]

Source: P&O Ferries.

Historical and projected route profitability

3.24. The proposed joint venture, which is the subject of this inquiry, would take over P&O's existing Dover-Calais and Dover-Zeebrugge routes. P&O provided us with historical information about the profitability of these routes.

3.25. Table 3.7 summarizes the financial performance for the two routes from 1993 to 1996. Further detail of revenues and costs are provided in Appendix 3.1.

*Figures omitted. See note on page iv.

TABLE 3.7 **P&O summary of financial performance for Dover-Calais and Dover-Zeebrugge, 1993 to 1996**

				£ million
	Years ended 31 December			
	1993	*1994*	*1995*	*1996*
Turnover (net of on-board cost of sales)				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	307	341	298	241
Profit before interest and taxation				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	67	112	88	51
Average capital employed				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	297	284	276	254
		per cent		
*Profit before interest and taxation as a percentage of capital employed**				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	22.6	39.4	31.9	20.1

Source: P&O.

*Because of the effect of allocating certain overheads and assets to the two routes the figures shown are not necessarily reliable indicators for the routes on a stand-alone basis.

3.26. P&O told us that strong growth in the passenger market in 1994 resulted in the higher profits and return on capital employed in that year.

3.27. P&O told us that it estimated that the impact of the Tunnel fire on the 1996 financial results had been to increase turnover net of on-board cost of sales on Dover-Calais by £[#] million and operating profit by £[#] million (over the period from 19 November 1996 to 31 December 1996).

3.28. P&O also provided us with financial projections for Dover-Calais and Dover-Zeebrugge for 1997 to 2000 in the absence of the joint venture.

3.29. These projections had been prepared under two scenarios. The first scenario assumed a `low Tunnel market share' (with Le Shuttle's share of the passenger market increasing from [#] per cent in 1997 to [#] per cent in 1998, 1999 and 2000). The second scenario assumed a `high Tunnel market share' (with Le Shuttle's share of the passenger market increasing from [#] per cent in 1997 to [#] per cent in 1998, [#] per cent in 1999 and [#] per cent in 2000). The projections assume that there are no long-term effects of the fire in November 1996 on Le Shuttle's market share.

3.30. Table 3.8 summarizes P&O's projections for the two routes under both the high and low Tunnel market share scenarios. Further details of the revenues and costs and the assumptions on which the projections are based are provided in Appendix 3.2.

TABLE 3.8 **P&O: projected financial performance for Dover-Calais and Dover-Zeebrugge, 1997 to 2000**

				£ million
	Years ending 31 December			
	1997	*1998*	*1999*	*2000*
Low Tunnel market share				
Turnover (net of on-board cost of sales)				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	207	210	197	186
Profit/(loss) before interest and taxation				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	13	11	(10)	(28)
Average capital employed				
Dover-Calais	[			
Dover-Zeebrugge	*Figures omitted. See note on page iv.*			
Combined routes				]
				per cent
*Profit/(loss) before interest and taxation as a percentage of average capital employed**				
Dover-Calais	[			
Dover-Zeebrugge	*Figures omitted. See note on page iv.*			
Combined routes				]
High Tunnel market share				
Turnover (net of on-board cost of sales)				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Dover-Zeebrugge				]
Combined routes	207	205	185	171
Profit/(loss) before interest and taxation				
Dover-Calais	[			
Dover-Zeebrugge	*Figures omitted. See note on page iv.*			
Loss on sale of ships				]
Combined routes	13	7	(22)	(26)
Average capital employed				
Dover-Calais	[			
Dover-Zeebrugge	*Figures omitted. See note on page iv.*			
Combined routes				]
				per cent
*Profit/(loss) before interest and taxation as a percentage of average capital employed**				
Dover-Calais	[			
Dover-Zeebrugge	*Figures omitted. See note on page iv.*			
Combined routes				]

Source: P&O.

*Because of the effect of allocating certain overheads and assets to the two routes the figures shown are not necesarily reliable indicators for the routes on a stand-alone basis.

3.31. P&O told us that its decisions on ship replacement would not be assessed on the basis of the currently achieved return on capital expenditure but by reference to an internal rate of return (IRR) calculation. The IRR is the discount rate which, when applied to the estimated cash flows projected to be derived from the asset over its expected life, produces a capital sum equal to the initial capital cost of the asset. P&O regarded an appropriate IRR (post-tax) for a new ferry to be around 11 per cent but it drew attention to the importance of consistently adequate historical rates of return in developing reliable IRR projections, without which a higher IRR might be needed to justify investment. P&O also emphasized that expenditure on vessel replacement was always subject to confidence that future market conditions would enable an adequate return to be made over the lifetime of the new vessel.

Cost structure

3.32. Using information provided by P&O, we examined its operating costs on the Dover-Calais and Dover-Zeebrugge routes for the years from 1993 to 1996.

3.33. We analysed the operating costs into three categories:

(a) variable costs, that is, the passenger and freight tolls paid to the ports and travel agents commissions;

(b) ship operating costs, including crew costs, fuel, refit and maintenance, insurance, vessel port costs, charter hire (if applicable) and depreciation (this latter item would not necessarily equal the cost of hiring the ship from a third party); and

(c) administration and marketing costs.

Details of these costs are provided in Appendix 3.1.

3.34. In 1996 P&O's available capacity (measured in car equivalents) on Dover-Calais was 9.2 million PCUs (see Table 5.11). During the year P&O actually carried passenger and freight traffic, equal to 3.9 million PCUs (see Table 5.13), giving a capacity utilization of some 43 per cent.

3.35. We compared the level of P&O's Dover-Calais operating costs in 1996 with the level of capacity (measured in car equivalents) it provided on the route. We calculated the cost of each unit of capacity assuming three different levels of capacity utilization: 40 per cent, 50 per cent and 65 per cent. The results are shown in Table 3.9.

TABLE 3.9 **P&O Ferries: cost per unit of capacity**

£

	per cent capacity utilization		
	40	*50*	*65*
Variable costs*	9.10	9.10	9.10
Semi-variable costs#	17.58	14.05	10.82
Overheads	11.08	8.86	6.82
Depreciation	3.21	2.58	1.97
Total costs	40.97	34.59	28.71

Source: MMC based on data provided by P&O.

*Port transit costs and travel agents' commissions.
#Includes payroll costs, fuel and maintenance.

3.36. For comparative purposes we calculated the average ticket revenue and profit from on-board sales (that is, after deduction of product cost of sales) per PCU in 1996 when average capacity was 43 per cent. The average ticket revenue was £25.60.[1] Average profit from on-board sales per PCU was £[*].[1]

[1]Car, coach and freight revenues (£100.6 million) divided by PCUs carried in 1996 (3.930 million PCUs).

3.37. The above analysis ignores the costs associated with carrying foot passengers. P&O told us that in 1996, 12 per cent (1,131,499 passengers) of the total number of passengers carried on Dover-Calais were foot passengers. Ticket revenues from foot passengers amounted to 2 per cent (£2.1 million) of the total ticket and freight revenues.

Stena

History and current activities

3.38. Stena Line AB was incorporated in Sweden in 1962 and has been listed on the Stockholm Stock Exchange since 1988. Stena's main business is the operation of ferry routes in north-western Europe. Details of the routes operated by Stena Line (UK) Limited are set out in paragraph 3.55.

3.39. Stena's largest shareholder is Stena AB (which owns 45.7 per cent). Stena AB, together with Stena Metall (which also owns 7.5 per cent of Stena Line AB) and Sessanlinjen AB, are wholly owned by the Sten Allan Olsson family. These three companies together with their wholly- and partly-owned subsidiaries, are collectively referred to by the owners as the Stena Sphere. The Stena Sphere's world-wide business interests comprise ferries, offshore contracting for the oil and gas industry, shipping (including bulk shipping, oil tankers and ship management), drilling, property, finance and metals. In the year ended 31 December 1995 the Stena Sphere made profits before taxation of SEK 691 million (approximately £57.6 million[2]) on turnover of SEK 21,700 million (approximately £1.8 billion[1]). At 31 December 1995 the combined net assets of companies in the Stena Sphere was SEK 5,718 million (approximately £476 million[1]).

3.40. Stena's operations began between Sweden and Denmark in 1962. In the early 1980s Stena acquired the Scandinavian ferry companies Sessanlinjen AB and Lion Ferry AB. In 1989 Stena acquired the Dutch ferry operator Stoomvaart Maatschappij Zeeland (now known as Stena Line Holland BV) and in 1990 Sealink British Ferries Limited was acquired from Sea Containers.

3.41. Stena currently operates 15 ferry routes which it divides into four business areas-English Channel, Kattegat (services between Sweden, Denmark, Poland and Germany), Skagerrak (services between Norway and Denmark) and the Irish Sea. It has a fleet of around 35 ferries. The group wholly owns three harbours (Harwich, Holyhead and Stranraer) and has a 50 per cent share in Fishguard. In Denmark, the group runs three hotels as an integrated part of its ferry operations.

Financial performance

Stena

3.42. Table 3.10 summarizes Stena's financial performance over the past six years.

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[1]Average profit per passenger (£[*]) multiplied by the number of car, coach and freight passengers (that is, excluding foot passengers) per PCU (2.02 passengers).

[2]Translated at £1 = SEK 12.

*Figures omitted. See note on page iv.

TABLE 3.10 **Stena: financial performance, 1991 to 1996**

*£ million**

	Years ended 31 December					
	1991	*1992*	*1993*	*1994*	*1995*	*1996*
Turnover	623	665	753	785	786	767
Operating profit/(loss)	19	57	65	76	45	(5)
Interest	(47)	(43)	(43)	(35)	(28)	(32)
Profit/(loss) before taxation	(28)	14	22	41	17	(37)
Borrowings (net of cash)	453	447	394	313	353	453
Shareholders' funds	51	73	181	233	221	205
Net operating assets#	504	520	575	546	574	658
Average net operating assets	500	512	548	560	560	616
						per cent
Operating profit/(loss) as a percentage of turnover	3.0	8.6	8.6	9.7	5.7	(0.6)
Operating profit/(loss) as a percentage of average net operating assets	3.8	11.1	11.3	13.6	8.0	(0.8)
Gearing ~	887.9	610.0	218.2	134.6	159.9	220.6

Source: Stena.

*All figures translated at £1 = 12 SEK.

#Net operating assets comprises tangible fixed assets (excluding investments) and other net assets (excluding proposed dividends and cash/borrowings).

~ Borrowings (debt-including finance lease obligations-less cash and short-term deposits) divided by shareholders' funds.

3.43. Following the acquisition of Sealink, Stena Line (UK) Limited commenced a programme of savings and rationalization in the UK operation in 1991 with the aim of reducing costs. This programme led to improved profits for the group in 1992. Thereafter the group has continued to grow largely through organic growth. While turnover increased in 1995 over 1994 levels, the group's profit fell primarily as a result of weaker markets in Scandinavia, higher shipping costs and increased competition from the Channel Tunnel.

3.44. Table 3.11 analyses Stena's 1996 turnover by business area. Stena's English Channel business contributed 39 per cent of turnover for the year ended 31 December 1996. For convenience Stena includes Harwich-Hook of Holland under English Channel.

TABLE 3.11 **Stena: analysis of 1996 turnover**

*£ million**

	Total	*Travel*	*On-board sales*	*Freight*	*Ports*
Turnover					
English Channel	297	103	122	65	7
Kattegat	256	84	112	60	-
Skagerrak	51	17	28	6	-
Irish Sea	163	74	49	35	5
	767	278	311	166	12
					per cent
Percentage of total turnover					
English Channel	39	37	39	39	58
Kattegat	33	30	36	36	-
Skagerrak	7	6	9	4	-
Irish Sea	21	27	16	21	42
	100	100	100	100	100

Source: Stena.

*All figures translated at £1 = 12 SEK.

Stena Line (UK) Limited

3.45. Stena's routes between Great Britain and the Continent and between Great Britain and Ireland are operated by Stena Line (UK) Limited (Stena Line) with the exception of Harwich-Hook of Holland which is operated by Stena Line Holland BV. The UK business was originally owned by the British Railways Board (BRB). In 1979 the assets and business of the Shipping and International Services Division of BRB were vested in a wholly-owned subsidiary, Sealink UK Limited. In July 1984 BRB sold all the shares[1] in Sealink UK Limited to British Ferries Limited (a wholly-owned subsidiary of Sea Containers), a company registered in Bermuda, whose principal activities at the time of the acquisition of Sealink UK Limited included container leasing, hotels and container shipping.

3.46. In April 1990 Stena acquired most of the assets of Sealink from Sea Containers for £195.5 million. The assets acquired excluded the Hoverspeed, Heysham port, Isle of Wight and Western Channel activities. In its annual report and financial statements for the year ended 31 December 1990, Stena Line reported that the business acquired from Sea Containers included £114.1 million of goodwill, comprising £28.9 million for the Dover routes and £85.2 million for the other services (including the non-Dover routes and ports).

3.47. At the time of its acquisition by Stena, Sealink operated passenger and freight ferry services on Harwich-Hook of Holland, Dover-Dunkirk, Dover-Calais, Folkestone-Boulogne, Fishguard-Rosslare, Holyhead-Dun Laoghaire and Stranraer-Larne. The company also owned the harbours in Harwich, Holyhead and Stranraer and managed the port of Fishguard as part of its interest in the Fishguard and Rosslare Railway and Harbour Company in which it had a 50 per cent ownership interest.

3.48. As part of the acquisition Stena also acquired 49 per cent of SPN snc, a partnership under French law (the remaining 51 per cent is controlled by SNCF). This partnership dates from the time of Sealink's pooling agreement with SNAT (now SeaFrance). SPN's assets are two vessels which it currently leases to SeaFrance.

3.49. Following the acquisition, Stena Line's 50 per cent interest in the Harwich-Hook of Holland passenger and freight ferry service was transferred to another group company, Stena Line Holland BV.

3.50. Since the acquisition Stena has made several changes to ferry services to or from Great Britain. In 1991 the Folkestone-Boulogne service was closed and the Southampton-Cherbourg service was opened. This service was, however, closed in December 1996.

3.51. In 1992 a service was introduced on the Newhaven-Dieppe route following SNAT's withdrawal from this route. In the 1996 summer season a fast craft service was introduced on to Newhaven-Dieppe reducing the crossing time from 4 to 2 hours.

3.52. At the time of the Channel Tunnel opening in 1994 Stena Line took over operation of the Harwich-Zeebrugge freight-only service from Railfreight Distribution following the latter's decision to route all its freight through the Channel Tunnel.

3.53. In 1995 a freight-only service commenced from Holyhead to Dublin, the route becoming a seasonal multi-purpose route in 1997 following the transfer of the *Stena Challenger* from Dover. The service from Stranraer to Larne was rerouted to Belfast in November 1995.

3.54. Up until the end of 1995, Stena Line operated the Dover-Calais and Dover-Dunkirk services as part of a pool with the French ferry operator SNAT, now known as SeaFrance.

3.55. Table 3.12 sets out the routes (together with the numbers of vessels) currently operated by Stena Line.

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[1]With the exception of one `golden' preference share which continues to be held by the Secretary of State in order to protect national defence interests in relation to the Sealink fleet.

TABLE 3.12 **Stena Line: routes operated and number of vessels, February 1997**

	Number of vessels		
Routes operated	*Multi-purpose*	*Freight-only*	*Fast craft*
Dover-Calais	3	-	1
Newhaven-Dieppe*	2	-	-
Harwich-Zeebrugge	-	2	-
Fishguard-Rosslare	1	-	-
Holyhead-Dun Laoghaire	-	-	-
Holyhead-Dublin	1	-	-
Stranraer-Belfast	2	-	1

Source: Stena Line.

*The number of vessels on this route varies from season to season. Over the 1996 summer season there were three vessels in use (one multi-purpose, one freight-only ferry and one fast craft).

3.56. Table 3.13 summarizes the financial performance of Stena Line over the five years 1992 to 1996. Figures for 1996 results are provisional and have yet to be finalized.

TABLE 3.13 **Stena Line: financial performance, 1992 to 1996**

£ million

	Years ended 31 December				
	1992	*1993*	*1994*	*1995*	*1996 (provisional)*
Turnover (net of on-board cost of sales)	337.5	391.4	408.2	414.9	443.7
Operating profit/(loss)	31.2	39.7	40.1	34.0	(8.3)
Profit/(loss) before interest and taxation	36.1	41.6	41.8	35.4	(9.2)
Net operating assets*	322.5	309.1	274.9	293.8	298.1
Average net operating assets	345.7	315.8	292.0	284.4	295.6
					per cent
Operating profit/(loss) as a percentage of turnover	9.2	10.1	9.8	8.2	(1.9)
Profit/(loss) before interest and taxation as a percentage of average net operating assets	10.4	13.2	14.3	12.4	(3.1)

Source: Stena Line.

*Net operating assets comprise tangible fixed assets (excluding investments) and other net assets (excluding proposed dividends and cash/borrowings).

3.57. Table 3.14 provides an analysis of Stena Line's turnover and profit before interest and tax between its two main activities, ferries and ports.

TABLE 3.14 **Stena Line: analysis of turnover and profit before interest and tax by activity, 1993 to 1996**

				£ million
		1996		
	1993	*1994*	*1995*	*(provisional)*
Turnover				
Ferries	360.1	377.7	385.3	[
Ports	42.7	44.4	45.5	
Other*	(11.4)	(13.9)	(15.9	
Total turnover	391.4	408.2	414.9	
Profit/(loss) before interest and tax				#
Ferries	33.2	28.4	24.1	
Ports	6.5	11.7	9.9	
Other*	1.9	1.7	1.4	
Total profit/(loss) before interest and tax	41.6	41.8	35.4	]
				per cent
Profit/(loss) before interest and tax as a percentage of turnover				
Ferries	9.2	7.5	6.3	[#
Ports	15.2	26.4	21.8	]

Source: Stena Line.

*Includes internal port turnover, income from associated companies, profit on sale of fixed assets and unallocated interest.

3.58. Stena told us that in the years following its acquisition of Sealink in 1990, it had changed the structure of the organization to address the high cost of its operations and the quality of the service. It decentralized the operational functions and introduced live-on-board on to the vessels. Stena said that the practice of live-on-board reduced the crew ratio from 4.0 to 2.17 and generated a significant reduction in costs. During this time Stena also took steps to improve the quality of its on-board service. The profitability of Stena Line's services gradually improved, reaching a peak in 1994. Stena Line's 1995 results showed a small decline over the previous year as the impact of Eurotunnel's operations began to be felt.

3.59. A significant factor affecting Stena Line's 1996 results was the ending of the pooling arrangement with SNAT at the end of 1995. Stena Line told us that during 1996 it introduced three additional vessels to replace the capacity which had previously been supplied by SNAT. Two of these vessels were new (*Stena Lynx III* and *Stena Cambria*), the third one being the *Stena Empereur* which replaced the *Stena Challenger*. As a consequence Stena Line's operating costs increased significantly during 1996 and the company incurred an operating loss of £12.1 million.

3.60. Dover-Calais has historically been consistently among the most significant of the routes operated by Stena Line in terms of its contribution to turnover and profits. In 1995 Dover-Calais made operating profits of £[#] million (1994-£[#] million) on turnover of £[#] million (1994-£[#] million). In 1996 Dover-Calais' operating profits fell to £[#] million on turnover of £[#] million.

Historical and projected route profitability

3.61. The proposed joint venture will take over Stena Line's existing Dover-Calais and Newhaven-Dieppe routes. Stena Line provided us with historical information about the profitability of these routes.

3.62. Table 3.15 summarizes the financial performance for the two routes from 1993 to 1996. Further details of revenues and costs are provided in Appendix 3.3.

TABLE 3.15 **Stena Line: summary of financial performance for Dover-Calais and Newhaven-Dieppe, 1993 to 1996**

£ million

	1993	*1994*	*1995*	*1996 (provisional)*
Turnover (net of on-board cost of sales)				
Dover-Calais	[	*Figures omitted. See note on page iv.*		
Newhaven-Dieppe				]
Combined routes	129	133	117	156
*Profit/(loss) before interest and taxation**				
Dover-Calais	[	*Figures omitted. See note on page iv.*		
Newhaven-Dieppe				]
Combined routes	20	26	11	2
*Average capital employed**				
Dover-Calais	[	*Figures omitted. See note on page iv.*		
Newhaven-Dieppe#				]
Combined routes	113	111	109	128
				per cent
Profit/(loss) before interest and taxation as a percentage of average capital employed				
Dover-Calais	[	*Figures omitted. See note on page iv.*		
Newhaven-Dieppe#				]
Combined routes	18.1	23.7	10.4	1.7

Source: Stena Line.

*Profit figures are stated before amortization of goodwill on Dover-Calais and income received from SPN. Goodwill (£[~] million) and investments in SPN (£[~] million) and STTD (£[~] million) have also been excluded from capital employed.

#Capital employed on Newhaven-Dieppe includes one owned vessel in 1996. The remaining vessels used on this route are chartered by Stena Line and do not form part of capital employed.

3.63. Stena told us that the impact of the Tunnel fire on the 1996 financial results had been to increase turnover on Dover-Calais by £[~] million and operating profit by £[~] million (over the period from 19 November 1996 to 31 December 1996).

3.64. Stena also provided us with financial projections for Dover-Calais and Newhaven-Dieppe for 1997 to 2000 in the absence of the joint venture.

3.65. These projections had been prepared under low and high Tunnel market share scenarios (referred to in paragraph 3.30). Table 3.16 summarizes Stena's projections for the two routes under both the low and high Tunnel market share scenarios. Further details of the revenues and costs and the assumptions on which the projections are based are provided in Appendix 3.4.

TABLE 3.16 **Stena Line: projected financial performance for Dover-Calais and Newhaven-Dieppe, 1997 to 2000, under low and high Tunnel market share assumptions**

£ million

	Years ending 31 December			
	1997	*1998*	*1999*	*2000*
Low Tunnel market share				
Turnover (net of on-board cost of sales)				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Newhaven-Dieppe				]
Combined routes	156	162	141	131
*Profit/(loss) before interest and taxation**				
Combined routes	(3)	(6)	(22)	(32)
*Average capital employed**				
Dover-Calais	[			
Newhaven-Dieppe	*Figures omitted. See note on page iv.*			
Combined routes				]
High Tunnel market share				
Turnover (net of on-board cost of sales)				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Newhaven-Dieppe#				]
Combined routes	156	158	129	116
*Profit/(loss) before interest and taxation**				
Dover-Calais	[*Figures omitted. See note on page iv.*			
Newhaven-Dieppe#				]
Combined routes	(3)	(8)	(19)	(21)
*Average capital employed**				
Dover-Calais	[			
Newhaven-Dieppe#	*Figures omitted. See note on page iv.*			
Combined routes				]

Source: Stena Line.

*Profit figures are stated before amortization of Stena goodwill on Dover-Calais and income received from SPN. Goodwill (£[~] million) and investments in SPN (£[~] million) and STTD (£[~] million) have also been excluded from capital employed.

#[*Details omitted. See note on page iv.*]

Note: Capital employed on Newhaven-Dieppe includes one vessel. The remaining vessels used on this route are chartered by Stena Line and do not form part of capital employed.

Cost structure

3.66. Using information provided by Stena, we examined the operating costs of Stena Line on Dover-Calais and Newhaven-Dieppe for the years from 1993 to 1996.

3.67. The approach we followed in identifying the operating costs is set out in paragraph 3.33. Details of Stena's operating costs are provided in Appendix 3.3.

3.68. In 1996 Stena Line's available capacity (measured in car equivalents) on Dover-Calais and Newhaven-Dieppe was 7.2 million PCUs (see Table 5.11). During the year Stena Line actually carried passenger and freight traffic on these routes, equal to 2.8 million PCUs (see Table 5.13), giving a capacity utilization of some 38 per cent. The figures for Dover-Calais alone were capacity of 6.4 million PCUs: and traffic carried of 2.2 million PCUs: a capacity utilization of some 34 per cent.

3.69. We compared the level of Stena Line's Dover-Calais operating costs in 1996 with the level of capacity (measured in car equivalents) it provided on the route. We calculated the cost of each unit of capacity assuming three different levels of capacity utilization: 40 per cent, 50 per cent and 65 per cent. The results are shown in Table 3.17.

TABLE 3.17 **Stena Line: unit cost of capacity**

			£
	per cent capacity utilization		
	40	*50*	*65*
Variable costs*	11.20	11.20	11.20
Semi-variable costs#	20.76	16.61	12.76
Overheads	11.64	9.31	7.16
Depreciation	3.28	2.62	2.03
Total costs	46.88	39.74	33.15

Source: MMC based on data provided by Stena Line.

*Includes port transit costs and travel agents' commissions.
#Includes payroll costs, fuel, maintenance and charter hire.

3.70. For comparative purposes we calculated the average ticket revenue and profit from on-board sales (that is, after deduction of product cost of sales) per PCU in 1996. The average ticket revenue was £28.98.[1] Average profit from on-board sales per PCU was £[~].[2]

3.71. The above analysis ignores the costs associated with carrying foot passengers. Stena told us that in 1996, 19 per cent (1,051,097 passengers) of the total number of passengers carried on Dover-Calais were foot passengers. Ticket revenues from foot passengers amounted to 3 per cent (£2.2 million) of the total ticket and freight revenues.

The joint venture

3.72. P&O and Stena told us that the idea of a joint venture along the lines of the present proposal was first put forward in July 1996 when the Secretary of State released both P&O and Stena from the undertakings given in 1979 and 1982 (discussed in paragraphs 5.2 to 5.5). Further negotiations continued over the summer months motivated in part by further increases in market share being taken by Eurotunnel over that time.

3.73. P&O and Stena told us that in the ten months ended October 1996, Le Shuttle had captured 39 per cent of the Short French Sea passenger vehicle market and 15 per cent of the Anglo-Continental freight market. Eurostar's passenger service and intermodal freight operators also saw increasing volumes. As a consequence, P&O and Stena considered their individual operations on the Short Sea had substantially greater capacity than could be economically operated in future. In addition the situation was forecast to worsen because of:

(a) further increase in market share by Le Shuttle and other services using the Tunnel;

(b) loss of revenue as a result of the impending abolition (at the end of June 1999) of the duty-free concession so far as travel between EU member states was concerned; and

(c) further expenditure on the ferry fleet to comply with the new SOLAS regulations.

3.74. P&O and Stena announced on 3 October 1996 that they had signed a Memorandum of Understanding for the merger of their ferry interests on the Short Sea routes.

3.75. P&O told us that its primary aim was to make a reasonable return for its shareholders. At earlier stages, P&O had considered alternative arrangements for its cross-Channel operations (including a pooling

[1] Car, coach and freight revenues (£63.4 million) divided by PCUs carried in 1996 (2.187 million PCUs).

[2] Average profit per passenger (£[~]) multiplied by the overall number of car, coach and freight passengers (that is, excluding foot passengers) per PCU (2.08 passengers).

~ Figures omitted. See note on page iv.

arrangement with Sealink in 1989). P&O said that it considered that a pooling arrangement would not provide sufficient cost savings to prove effective or give rise to a single, unified management with a clear purpose and culture and that the joint venture was the best way to get back to a viable operation.

3.76. Stena told us that it considered its cross-Channel ferry business was a long-term investment. However, it was nevertheless important that the investment produced a satisfactory return. Although each route was expected to produce a positive return, Stena's Short Sea routes were currently making losses. Stena said that its reluctance to surrender ownership interests in any of its ferry operations generally led it to prefer pooling or other forms of co-operation but it recognized that, on the Short Sea routes, the cost savings and the commercial benefits of a single business offered only by the merger were essential.

3.77. Stena and P&O told us that the proposed joint venture would combine the parties' Short Sea services into a joint venture company, to be known as P&O Stena Line. The aims of the joint venture would be to create a strong and well-equipped ferry company (which the parties saw as essential to mount an effective challenge to Le Shuttle), to reduce costs, to develop synergies and optimize benefits of economies of scale and to enhance customer satisfaction.

Principal features of the proposal

3.78. The proposed joint venture will operate out of what are now P&O's headquarters in Dover. The joint venture will take over both P&O's and Stena's mixed passenger and freight services on the Dover-Calais route. It will also operate P&O's freight-only service on the Dover-Zeebrugge route and Stena's mixed passenger and freight service on the Newhaven-Dieppe route.

3.79. The proposed joint venture will initially have a fleet of 14 ships, three of which will be sold off. The ships and the routes they are planned to serve are shown in Table 3.18.

TABLE 3.18 **Proposed joint venture: composition of initial fleet**

Vessels	*Route*	*Transfer value £m*
P&O		
Pride of Dover	Dover-Calais	[
Pride of Calais	Dover-Calais	
Pride of Kent	Dover-Calais	
Pride of Burgundy	Dover-Calais	
Pride of Bruges	Newhaven-Dieppe	
European Seaway	Dover-Zeebrugge	
European Pathway	Dover-Zeebrugge	
European Highway	Dover-Zeebrugge	
		*
Stena		
Stena Fantasia	Dover-Calais	
Stena Empereur	Dover-Calais	
Stena Invicta	To be sold	
Stena Cambria	To be sold	
Stena Lynx III	Newhaven-Dieppe	
Stena Antrim	To be sold	
		]

Source: P&O/Stena.

3.80. Six ships are planned for Dover-Calais to provide a sailing schedule with a departure every three-quarters of an hour for 18 hours a day and every hour during 6 hours of the night. P&O's current sailing schedule provides for departures every three-quarters of an hour in peak times only, with gaps of up to an hour and a half between sailings at other times. Stena's Dover-Calais service departs every hour in peak periods. The merged service on this route will therefore offer more frequent departures than either party currently offers and will also be a more regular service.

3.81. All the ships to be employed on Dover-Calais have fast turn-around times and will be capable of making six round trips a day, although the planned schedule will only require five. The resulting spare

*Figures omitted. See note on page iv.

operational capacity will enable the frequency of the service to be maintained during refits or breakdowns, and will provide the potential for an increase in the number of trips per day in times of emergency.

3.82. Stena's fast craft on Dover-Calais (the *Stena Lynx III*) will be withdrawn to take over operations on Newhaven-Dieppe in 1997 (in substitution for the *Stena Pegasus* fast craft which operated on the route in 1996). The use of a fast craft on Newhaven-Dieppe has reduced the crossing time from 4 hours to between 1 and 2 hours.

3.83. The Dover-Zeebrugge freight-only service will continue in its current form.

3.84. On the two passenger routes, the joint service will offer a range of on-board services and catering amenities combining features of both parties' current fleets; in particular:

(a) a range of on-board catering: full à la carte waiter service restaurants, self-service restaurants, fast food outlets (Stena currently operates McDonald's franchises on a number of its vessels);

(b) executive lounges: P&O's Club Class lounges will be extended to all vessels in the fleet;

(c) improved on-board sales outlets for both tax-free and duty-free goods: in preparation for the loss of the duty-free concession, the parties told us that they would be placing greater emphasis on improving the quality and choice of non-duty-free products; and

(d) a consistent level of service across the fleet to be achieved through harmonized training and the meeting of acknowledged quality standards.

3.85. The shore-based parts of the service will also be combined, creating cost reductions by removing duplication. Other areas such as fleet management and on-shore administration will also be combined, reducing overheads further. The cost savings are discussed in paragraphs 3.102 to 3.110.

3.86. Sales and marketing functions will be combined and the joint venture will operate a single passenger reservation system. In the passenger market, the joint venture will not require advance bookings to be made, but will provide a telephone sales service and will have arrangements with travel agents and other intermediaries for ticket sales for those who wish to purchase their ticket and book a sailing in advance. Passengers will continue to have the flexibility to take a sailing other than that for which they have booked. The brand name `P&O Stena Line' will combine established names and an initial advertising campaign is planned to launch the new services.

3.87. In the freight market, sales will be combined in a single sales department, with direct sales in the UK. Direct sales and/or sales agency arrangements will be set up on the Continent as necessary. A common freight-administration computer system will be implemented, covering bookings, shipping details and accounting information.

Structure of the proposal

3.88. The framework agreement, governing the overall structure of the transaction, was signed on 23 December 1996. A shareholders' agreement, which will provide for certain subscriptions of shares by the parties and which (together with the Articles of Association of the joint venture holding company) will prescribe P&O's and Stena's continuing rights and obligations as shareholders, will be executed once the conditions precedent to the proposal have been fulfilled, allowing completion of the framework agreement. Those two documents and certain ancillary documentation are attached to the framework agreement in agreed form. The principal conditions precedent to completion of the framework agreement are as follows:

(a) clearance from all relevant competition authorities;

(b) the conclusion of banking facilities on terms reasonably satisfactory to P&O and Stena and such facilities becoming unconditionally available for drawdown; and

(c) certain ship-financing documents becoming effective.

3.89. Consideration for the transfer of each of the Short Sea businesses to the joint venture holding company will be in the form of shares, cash and repayments of debt. The holding company (to be renamed P&O Stena Line (Holdings) Ltd) will have two classes of share capital-ordinary and preference shares. The preference shares will be issued at par for £51.25 million in cash and will carry a 10 per cent (net of tax credit) cumulative dividend. These preference shares will not carry rights to vote at general meetings of the holding company, except in very limited circumstances. P&O and Stena will each hold 5,625,000 voting shares in the holding company, while P&O will also hold 2,812,500 non-voting ordinary shares.

3.90. P&O will accordingly hold 60 per cent of the ordinary shares (but 50 per cent of the voting rights) and all of the preference shares and Stena will hold 40 per cent of the ordinary shares (and 50 per cent of the voting rights). In addition, at completion of the framework agreement new banking facilities to be made available to the joint venture will meet certain bank indebtedness and intra-group loans owed by or owing to the P&O and Stena parent companies.

3.91. The joint venture will have assets of approximately £400 million. These will be funded by approximately £100 million of equity with the balance from borrowings and other liabilities. It is intended that around £200 million of debt will be raised by the joint venture with mortgages on the vessels. The remaining borrowings will be funded by unsecured facilities guaranteed by P&O. P&O will receive a guarantee fee of [*] per cent a year, up to 30 September 1998 and [*] per cent a year thereafter, calculated on the average daily amount available for drawing from the unsecured facilities.

3.92. The Board of Directors will comprise nine directors, including (as a non-voting member) the Chief Executive Officer. The eight other directors will comprise an equal number of appointees of each of the parent companies. The Co-Chairmen will be Lord Sterling and Mr Dan Sten Olsson. The other members of the Board will be Mr Svante Carlsson, Mr Bo Lerenius and Mr Gareth Cooper from Stena, and Sir Bruce MacPhail, Mr Graeme Dunlop and Mr Michael Gradon from P&O. Of the eight voting directors, six are also directors of P&O or Stena Line AB. Voting rights on the Board (as at shareholder level) will be split equally between P&O and Stena. The Board will take decisions by a simple majority save for certain key areas which will require unanimity (including any contracts between the joint venture and its parent companies, material variations to the business plan, appointing and removing directors other than the appointees of the shareholders, the remuneration of directors and key personnel, significant financial decisions, changes to the vessel fleet and commencement of non-Short Sea-related business).

3.93. In the event of a deadlock situation there is provision for termination of the joint venture through a mechanism allowing for the sale of one party's shareholding to the other. In the event of a material breach of agreements, insolvency or change of control by or affecting one party, the other party has a right of compulsory purchase of the interest of the other. [

Details omitted. See note on page iv.

]

3.94. P&O will contribute fixed assets worth £[*] million in total to the joint venture. These assets comprise eight vessels (valued at £[*] million) and other fixed assets (valued at £[*] million). P&O told us that the book value of these fixed assets at 31 December 1996 was £[*] million. It said that the transfer value was reached after detailed negotiation between the parties and took into account each party's assessment of the market values of the individual ships.

3.95. Stena will contribute assets worth £[#] million in total to the joint venture. These assets comprise five vessels (valued at £[#] million) and other assets (valued at £[#] million). Stena told us that the book value of these assets at 31 December 1996 was £182.6 million. It said that the difference between the net book value and the transfer value reflected the fact that the transfer values had been the subject of negotiations between the parties and were not materially different from the market values of the assets on a willing buyer, willing seller basis.

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*Figures omitted. See note on page iv.

3.96. The joint venture will operate services only from ports located on the section of the UK coastline stretching from (and including) Newhaven to (but excluding) Harwich, and on the stretch of the French/Belgian coastline between (and including) Dieppe and Zeebrugge. The parties have undertaken not to compete with the joint venture in that geographical area, otherwise than in the provision of services into the port of Zeebrugge, where P&O North Sea Ferries Limited and Stena Line both operate.

3.97. Table 3.19 shows the pro forma summarized balance sheet and gearing of the proposed joint venture at completion of the framework agreement (referred to in paragraph 3.88).

TABLE 3.19 **The joint venture: pro forma balance sheet, at completion**

	£m
Fixed assets:	
Ships	[
Property	
Other fixed assets	#
Investment in SPN	]
	410.00
Borrowings and other liabilities:	
Secured interest-bearing debt	200.00
Unsecured interest-bearing debt and other liabilities	107.50
Total liabilities	307.50
Net assets	102.50
Share capital:	
Ordinary shares	51.25
Preference shares	51.25
	102.50
Gearing* (%)	300

Source: P&O/Stena.

*Borrowings as a percentage of shareholders' funds.

Projections for the joint venture

3.98. P&O and Stena provided us with financial projections for the joint venture for 1997 to 2000. The projections have been prepared on two different bases:

(a) *Low Tunnel market share*. [
Details omitted. See note on page iv.
]

(b) *High Tunnel market share*. [
Details omitted. See note on page iv.
]

The low and high Tunnel market shares are described in more detail in paragraph 3.29.

3.99. The projections also assume that:

(a) there are no long-term effects of the fire in November 1996 on Le Shuttle's market share;

(b) no other competitor (Holyman Sally, SeaFrance or Hoverspeed) exits from the passenger market in the four years to 2000; and

(c) the duty-free concession is abolished at the end of June 1999.

3.100. Table 3.20 summarizes the projections under both scenarios.

TABLE 3.20 **The proposed joint venture: summarized revenue and profit projections for the combined routes, 1997 to 2000, under low and high Tunnel market share assumptions**

£ million

	Years ending 31 December			
	1997	*1998*	*1999*	*2000*
Low Tunnel market share				
Turnover				
Passenger ticket revenues	[			
On-board sales (net)	*Figures omitted. See note on page iv.*			
Freight				]
	342	349	307	287
Port taxes	[			
Ship costs				
Shore costs				
Office administration	*Figures omitted. See note on page iv.*			
Marketing				
Costs of restructuring*				
Loss on sale of ships				]
Profit before interest and taxation	10	61	32	5
Average capital employed	[*Figures omitted. See note on page iv.*]			
				per cent
Profit before interest and taxation as a percentage of average capital employed	[*Figures omitted. See note on page iv.*]			
High Tunnel market share				
Passenger ticket revenues	[			
On-board sales (net)	*Figures omitted. See note on page iv.*			
Freight				]
	337	341	276	252
Port taxes	[			
Ship costs				
Shore costs				
Office administration	*Figures omitted. See note on page iv.*			
Marketing				
Costs of restructuring*				
Loss on sale of ships				]
Profit before interest and taxation	7	49	21	5
Average capital employed	[*Figures omitted. See note on page iv.*]			
				per cent
Profit before interest and taxation as a percentage of average capital employed	[*Figures omitted. See note on page iv.*]			

Source: P&O/Stena.

*Costs of restructuring comprise the estimate of costs to be borne by the joint venture in restructuring the businesses of the parent companies to create the joint venture initially and in taking out surplus capacity to reflect withdrawal of ships in later years.

3.101. P&O and Stena told us that after the year 2000 the joint venture was projected, if there was no deterioration in the competitive position of the company, to return to a reasonable level of profitability as the overall market grew.

Savings resulting from the joint venture

3.102. P&O and Stena told us that the joint venture would allow annual cost savings of around £75 million (when compared with the annualized costs of their individual operations in 1996) except that in the first year restructuring costs and losses on sale of ships would reduce this level to £[*] million. The projections for the joint venture include provisions in 1997 for restructuring costs (£38 million) and losses on sale of ships (£[*] million). Table 3.21 shows the breakdown of the restructuring provision.

TABLE 3.21 **Restructuring provision, 1997**

	£m
Redundancy (including seafaring and administration staff)	[
Property obligations	
Finance lease termination costs	*
Rebranding/relaunch costs	
Other	]
Total restructuring provision	38.0

Source: P&O/Stena.

3.103. P&O and Stena estimate that the joint venture will lead to a reduction in the workforce of around 900 full-time equivalent staff (500 sea staff and 400 shore staff). In addition, 600 further sea staff redundancies would be necessary. These were originally intended to be effected as a consequence of the parties' planned capacity reductions on a stand-alone basis at the beginning of 1997 (which did not in fact occur because of the impact of the Tunnel's closure). Redundancies for seafaring staff are likely to be predominantly Stena employees (since the three vessels to be sold are Stena vessels) although redundancies will be funded by the joint venture company. Stena has already announced a voluntary redundancy programme. Redundancies in administration staff at Dover and Calais will be shared between both P&O and Stena employees and these costs will either be incurred or reimbursed by the joint venture. P&O and Stena stated that the long-term reduction in employment would be considerably greater in the event that the joint venture did not proceed because the parties individually would be compelled to take materially greater remedial action, causing a higher level of redundancies.

3.104. Property obligations referred to in Table 3.21 comprise Stena's costs of leases on Charter House at Ashford (expiring in 2004) and bonded warehouses at Southampton (with obligations extending to 2012) which will no longer be needed. The parties have agreed that Stena's costs of these future lease payments will be reimbursed by the joint venture. These figures are based on full costs and assume no offsetting savings (for example, arising from reletting property).

3.105. Rebranding and relaunch costs will include repainting the vessels in a common livery.

3.106. Three of the ships to be transferred to the joint venture will be sold. They are expected to incur a loss on sale (calculated as the difference between the combined transfer value (£[*] million) and the expected sale proceeds (£[*] million)). All three (*Invicta*, *Antrim* and *Cambria*) are Stena ships.

3.107. Table 3.22 shows the breakdown of the annual cost savings.

*Figures omitted. See note on page iv.

TABLE 3.22 **Annual cost savings arising from the proposed joint venture**

	£m
Ship operating costs	
Dover-Calais:	
Ships withdrawn	
Invicta, *Cambria*, *Lynx III* (Stena ships)	[
Pride of Bruges (P&O ship)	
Newhaven-Dieppe:	
Ships withdrawn	
One multi-purpose vessel, *Pegasus*, chartered freight ship (Stena ships)	
Replaced by ex-Dover ships	
Pride of Bruges and *Lynx III*	*
Total savings in ship operating costs	
Overheads	
Port costs at Dover and Calais	
Office administration	
Marketing	
	__]
Total cost savings	75

Source: P&O/Stena.

3.108. Ship costs include crew costs, fuel, vessel port costs, other ship costs, depreciation or charter costs (as applicable), refit and maintenance.

3.109. No account in these costs savings has been taken of possible further savings from the introduction of live-on-board or of further costs because of additional services to be provided on the Stena vessels within the joint venture (for example, Club Class equivalent to that provided by P&O).

3.110. The joint venture will adopt features from both P&O's and Stena's current services. Its administration and marketing functions will be based substantially on P&O's shore-based operations; hence P&O and Stena estimate that savings equal to most of the costs of administration and marketing currently being incurred by Stena can be made. The savings in port costs at Dover and Calais are assumed to be equivalent to Stena's 1996 costs (£[*] million). The savings in office administration represent Stena's 1996 costs less £[*] million (for the guarantee fee payable to P&O). The savings in marketing again mainly represent Stena's 1996 spend.

*Figures omitted. See note on page iv.