

Financial information on Svitzer and Adsteam

Svitzer

1. The UK trading division of Svitzer also encompasses the group's Canadian operations, which are included within its UK management accounts. In 2005 the Canadian business accounted for roughly £[redacted] of turnover and £[redacted] of operating profit.
2. The financial performance of Svitzer for the two years to December 2005, together with various operating statistics, is summarized in Table 1.

TABLE 1 Svitzer: summary of financial performance for the two years to 31 December 2005

	£'000	
	Years ended 31 December	
	2004	2005
Net revenue		
Variable costs		
Depreciation		
Other fixed costs		
Operating surplus		
Overheads		
Port contribution		
Group charges		
Profit/loss on disposals of fixed assets		
Operating profit		
Interest		
Profit before tax		
Taxation		✕
Net profit after tax		
Average net operating assets		
<i>Operating statistics</i>		
Operating margin (%)		
Return on average net operating assets (%)		
Average number of tugs during the year		
Number of tug jobs in the year		
Average towage revenue per tug job (£)		
Contribution per tug (£'000)		
Crew wage cost per tug (£'000)		

Source: Svitzer management accounts.

3. Around 80 per cent of net revenue is derived from harbour towage (including customer and owner terminal towage). Variable costs in the management accounts comprise tug crew wages, fuel costs, stores, repairs, dry docking, crew costs and other variable costs. Svitzer's crew wage costs per tug averaged £[redacted] in 2005. Svitzer estimated that this was almost four times the level for a non-unionized operator such as SMS due to so-called 'legacy costs' (ie the accumulation of pay awards and other beneficial terms that have built up over many years, which have increased wage and pension costs to current levels).
4. Depreciation is provided on new tugs on a straight-line basis over [redacted] to a residual value of [redacted] per cent of cost. Svitzer currently has 41 tugs operating in the UK, of which [redacted] are owned directly by Svitzer and [redacted] are chartered from other group

companies. As part of its tax planning whilst under the tonnage tax regime, Svitzer sold [%] of its tugs to group companies in Sweden and Denmark. Now that Svitzer has left the tonnage tax regime it is likely that Svitzer will buy them back.

5. Other fixed costs comprise primarily chartering costs, as well as insurance, launch costs, radio/navigational aids and other fixed costs.
6. Internal charter arrangements are on an arm's length basis and comply with transfer pricing rules. However, they can imply a difference in UK profit from what it would have been if the tugs had been owned directly by Svitzer and given rise to a depreciation charge and a finance cost, instead of the charter cost (see paragraph 12). From time to time tugs are also chartered externally, for instance to cover for breakdowns.
7. Overheads include central overheads relating to the cost of running the regional head office of Svitzer in Teesside, of roughly £[%], which are apportioned between the various ports on the basis of the number of tugs, the number of crew and revenue at each port.
8. The interest charged to the division relates mainly to intergroup borrowings at rates of [%] and [%] per cent and is also apportioned in the management accounts between the various ports on the basis of the capital employed in each cost centre. Profits after tax in 2005 benefited from a £[%] deferred tax credit in respect of tonnage tax. Under the tonnage tax regime the company was able to calculate corporation tax by reference to the tonnage of its vessels rather than its profits, which resulted in a lower overall charge. This concession ended with effect from January 2006.
9. In the two years considered, the number of tug jobs grew by 6.4 per cent and revenues by [%] per cent. The latter was partly attributable to two new non-towage income streams (Tetney Management Services and Tees Waste barge). Nonetheless operating profit fell by [%] per cent. Svitzer attributes this mainly to higher wage costs (in particular, redundancy costs and £[%] of pension costs) and higher fuel costs. Svitzer told us that it was not always able to pass on higher fuel costs in surcharges.
10. There are significant variations in profitability between ports, due to the individual circumstances at each port. Table 2 sets out key performance data for the ten UK port areas carrying out harbour towage taken from Svitzer's management accounts for the year ended 31 December 2005.

TABLE 2 **Switzer: analysis of key performance data by port for the year ended 31 December 2005**

Port/cost centre	Average number of tugs in year	Number of tug jobs in year	Net revenue £'000	Operating profit £'000	Average towage revenue per tug job £	Operating profit per tug £'000*	Operating margin %
Avonmouth	6	()					
Belfast	3						
Forth (Grangemouth)	2						
Greenock	4						
Liverpool	6						
Milford Haven	3						
Port Talbot	7						
South-east Wales (Newport)	3						
Tees	6						
Tyne	3						
Total for 10 ports	43						
Central overheads for 10 ports							
Other operations (incl Canada)							
Surplus†							
Profit/loss on disposal							
Unallocated central/group costs							
Operating profit							

Source: Svitzer management accounts.

*Before allocating central costs.

†See paragraph 12.

11. Table 2 shows that there were wide variations in the revenue and profit profiles of the different ports in 2005. Three ports are either wholly or mainly dedicated to terminal towage, rather than harbour towage. These are Forth (Grangemouth), Milford Haven and Port Talbot. Tees derives roughly [%] per cent of its revenue from terminal towage. These ports all exhibit a high level of revenue per tug job, along with Greenock where towage jobs take an exceptionally long time. Liverpool had the lowest operating margin and was the only port to make an operating loss after allocation of central overheads (see paragraphs 13 to 20), although it too has a significant element of terminal towage (around [%] of its harbour towage business by volume).
12. The total operating profit for the ports in Table 2 combined is much larger than Svitzer's total divisional operating profit and operating margins are correspondingly much higher. This is because the 'Surplus' cost centre made [%]. This £[%] represents various costs incurred by Svitzer, which are not part of the normal cost of running the regional office and which are not attributable to individual ports. In particular, an amount of £[%] is accounted for by the excess of charter hire costs over depreciation on the [%] tugs sold to group companies in Sweden and Denmark and chartered back (see paragraphs 4 and 6). A further £[%] relates to pension costs and £[%] relates to costs associated with vessels awaiting disposal.

Svitzer's Liverpool operations

13. Svitzer normally operates six harbour towage tugs and one oil recovery vessel at the port of Liverpool. As well as regular trades in animal feed, coal and general cargo, the tugs service Shell's oil refinery at Tranmere under an owner terminal contract and support BHP's Offshore Storage Installation (for oil produced as a by-product of natural gas) in Liverpool Bay. The tugs also provide assistance in Holyhead, if required.
14. The financial performance of Svitzer's Liverpool operations over the five years to December 2005 taken from the management accounts is set out in Table 3.

TABLE 3 Svitzer: summary of financial performance of Liverpool, five years to December 2005

	Years ended 31 December					£'000
	2001	2002	2003	2004	2005	
Net revenue						
Variable costs						
Depreciation						
Other fixed costs						
Operating surplus						
Port overheads						
Port contribution						
Central overheads						
Operating profit/loss						
Interest						
Profit/loss before tax						
<i>Operating statistics:</i>						
Operating margin (%)						
Average number of tugs during the year						
Number of tug jobs in the year						
Average towage revenue per tug job (£)						
Contribution per tug (£'000)						

Source: Svitzer management accounts.

15. In each of the last five years Svitzer's Liverpool operations made a positive contribution to the division's profits before central overheads and interest, although port contribution of £[redacted] in 2005 was significantly lower than the level in 2001 of £[redacted], with some fluctuation in between.
16. The decrease in port contribution from 2001 to 2002 was due to increased depreciation following the revaluation of the entire fleet in August 2001 after the acquisition of Wijismuller by the Danish Svitzer group. The increase in port contribution from 2002 to 2003 was principally due to increased revenue from an increased number of tug jobs. This reflects a busy port in 2003, but this dropped off in 2004 and after wage increases, pension increases and the arrival of two new tugs the contribution dropped. In 2005 the revenue levels went up but this was offset by an increase in wages, bunkers and repairs (see paragraph 17). The forecast port contribution for Svitzer's Liverpool operations for the year ending 31 December 2006 (based on actual results to September 2006) is for [redacted].
17. The increase in variable costs in 2005 primarily relates to tug crew wages, bunker costs and repair costs. Wages increased as a result of increased activity, redundancy costs to facilitate the move to three-man manning, pay increases and an extra £[redacted] of pension costs. Bunker costs doubled, due in part to increased activity, but mainly bunker price increases. Only a fraction of the increased costs were recovered in surcharges, [redacted]. Repair costs were the other big increase which arose from the need to bring the older vessels up to standard and a number of incidents during the year.
18. The increase in other fixed costs (primarily internal charter hire charges) and decline in depreciation in 2004 and 2005 was as a result of replacing two tugs with newer more powerful boats. The programme of investment in new tugs had been intended to improve Svitzer's competitive offering in Liverpool and increase revenues, but has apparently been largely unsuccessful at doing so.
19. After deducting a share of central overheads and interest expense (see paragraphs 7 and 8), the management accounts show that [redacted].

TABLE 4 [REDACTED]

[REDACTED]

Source: [REDACTED].

20. Svitzer told us that it was continually striving to reduce what it termed 'legacy costs' in all its ports ([REDACTED]). These are the inherited costs associated with an established business having a highly unionized labour force. However, it considered that progress would take many years. [REDACTED]

Adsteam

21. The financial performance of Adsteam for the two years to June 2006, together with various operating statistics, is summarized in Table 5.

TABLE 5 Adsteam: summary of financial performance, two years to June 2006

	£'000		
	Years ended 30 June		
	2004	2005	2006
Net revenue			
Controllable expenses			
Managed EBITDA			
Non-controllable expenses/income			
EBITDA			
Depreciation			
EBITA			
Taxation			
Capital charge*			
Port economic profit			
Net fixed assets			
Other operating assets/liabilities			
Net operating assets			
Average net operating assets			
<i>Operating statistics</i>			
EBITA margin (%)			
Return on average net operating assets			
Average number of tugs during the year			
Number of tug jobs in the year			
Average towage revenue per tug job (£)			
EBITA per tug (£'000)			
Crew wage cost per tug (£'000)			

Source: Adsteam management accounts.

*A notional charge to reflect the cost of capital employed in the business.

22. Over 90 per cent of Adsteam's net revenue is attributable to harbour towage services. Controllable expenses comprise crew costs, vessel operating costs and administration costs, whereas non-controllable expenses comprise charter costs, one-off costs (redundancy, restructuring, etc) and profits and losses on the disposal of assets.

23. Adsteam has no significant finance costs and so for management accounts purposes a notional capital charge, calculated by applying a weighted average cost of capital of [X] per cent to adjusted funds employed (including vessels at market value, but excluding goodwill), is deducted from EBITA, together with the taxation charge, in order to arrive at 'port economic profit'. Adsteam told us that the weighted average cost of capital of [X] per cent, which Adsteam used as an internal target, was not significantly different from market-determined calculations of Adsteam Marine's weighted average cost of capital produced by analysts covering the company, which is quoted in Australia.
24. Adsteam owns all its tugs and chartering costs are therefore low. Operating profit and its asset base will therefore tend to be higher than if the opposite were the case. In 2006 the number of tug jobs [X] per cent and revenues [X] per cent, whilst EBITA [X] per cent. Adsteam told us that it lost a significant contract (BP Coryton), which held back revenue growth. Extra costs were incurred when Adsteam chartered in tugs during a dispute with the TGWU about reducing manpower, as a result of the imposition of National Insurance on offshore manning, from increased pension costs and from higher depreciation on investment in new tugs.
25. Table 6 summarizes the key performance data for the year ended 30 June 2006 of the six major port areas that Adsteam services together with the remaining components of its business, including the costs of its regional head office in Hull.

TABLE 6 Adsteam: analysis of key performance data by port for the year ended 30 June 2006

Port/cost centre	Average number of tugs in year	Number of tug jobs in year	Net revenue £'000	EBITA £'000*	Average towage revenue per tug job £	EBITA per tug £'000	EBITA margin %
Liverpool (incl Falklands)*	7	[]	[]	[]	[]	[]	[]
Southampton	7						
Medway	7						
Thames	5						
Felixstowe	4						
Humber	12						
	42						
Intergroup adjustment							
Felixarc							
Salvage							
Corporate costs							

Source: Adsteam management accounts.

*See paragraph 31.

26. In 2006 the weakest performances were at [X] did worst, reflecting [X]. Adsteam has recently rationalized its operations in the Medway and Thames by removing two tugs from Thames operations and allowing the two tug fleets to support one another.
27. In addition, Adsteam faced an increasing threat from SMS, a low-cost operator, which had commenced operations on the Humber in 2003. EBITA for the Humber [X] £[X] between 2005 and 2006. Adsteam has recently set up its own low-cost operation on the Humber (trading as Humber Tugs), which operates three tugs carrying out basic towage operations. The port of Liverpool is discussed further below.

Adsteam's Liverpool operations

28. Adsteam operates six tugs from Liverpool, which service the ports of Liverpool, Birkenhead and Garston on the River Mersey, as well as assisting vessels to and

from the Manchester Ship Canal. The main cargoes handled are containers, oil, grain, coal, scrap metals, ferries and general cargo.

29. Adsteam also has a contract with the Ministry of Defence under which it supplies one tug for military use in Port Stanley in the Falkland Islands. This contract is managed from Liverpool and included within its management accounts. It accounted for approximately £[redacted] of net revenue and £[redacted] of EBITA in 2006.
30. The financial performance of Adsteam's Liverpool operations over the five years to June 2006 is set out in Table 7.

TABLE 7 Adsteam: summary of financial performance of Liverpool, five years to June 2006

	Years ended 30 June					£'000
	2002	2003	2004	2005	2006	
Net revenue						
Controllable expenses						
Managed EBITDA						
Non-controllable expenses/income						
EBITDA						
Depreciation						
EBITA						
<i>Operating statistics</i>						
EBITA margin (%)						
Average number of tugs during the year						
Number of tug jobs in the year						
Average towage revenue per tug job (£)						
EBITA per tug (£'000)						

Source: Adsteam management accounts.

31. Adsteam told us that it did not consider the Falklands contract with the Ministry of Defence to be truly an element of its Liverpool operation. It told us that adjusting the turnover and EBITA figures to remove the Falklands contract would yield the revenue and EBITA figures set out in Table 8.

TABLE 8 Adsteam: summary of revenue and EBITA of Liverpool (excluding Falklands), five years to June 2006

	Years ended 30 June					£'000
	2002	2003	2004	2005	2006	
Net revenue						
EBITA						

Source: CC, based on Adsteam data.

32. After adjusting for the Falklands contract, Adsteam's Liverpool operations made a [redacted]. Adsteam told us that its Liverpool operations [redacted], calculated on the adjusted funds employed at Liverpool and using Adsteam's target WACC of [redacted] per cent (see paragraph 23).
33. [redacted]
34. [redacted]
35. [redacted]