



URBAN TRANSPORT GROUP

Report

Bus operator profitability analysis

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1. Introduction

- 1.1. This briefing paper describes the financial position of the largest bus companies operating in the six largest English metropolitan areas outside London (also known as PTE areas¹) over the past ten years, and compares their performance with that of their London and non-metropolitan counterparts.
- 1.2. Our analysis covers active bus companies. In general, the companies included have a minimum of 50 employees. However, not all companies report the number of employees, or have reported a very low number in the most recent years. Where these companies are relevant we have included them in the analysis². We estimate there to be 155 companies in Great Britain which meet this criterion, representing approximately 90% of the GB bus industry turnover (see figure 1). We have classed bus companies which are estimated to operate at least 25% of their services into PTE areas from the surrounding region as PTE companies.

Figure 1. Key indicators for the market covered in this analysis

Area	Number of bus companies	Turnover in most recent year (£000s)
PTEs	21	1,446,503
GB exc. London and the PTEs	117	3,042,699
London	17	1,868,267
Total	155	6,357,469

- 1.3. Our analysis is based on published accounts from operating companies and does not take into account the overall financial results of owning groups. The reason for this is that consolidated accounts (those produced by the owning group) provide little or no disclosure of transactions between the owning group and individual operating companies. This makes it difficult to disentangle financial records that pertain to the owning group only from those that relate to operating companies.
- 1.4. Our approach may, in some cases, give an incomplete picture of the financial position of operating companies. For example, if an owning group chose to concentrate all losses within its group functions, this would overstate the profitability of individual operating companies. In practice, this seems an unlikely scenario and, in fact, declared profits for the UK bus division of owning groups tend to be in line with the market average profits for individual operating companies.
- 1.5. We would note that the financial performance of individual bus companies can vary significantly from year to year, in particular as the result of network expansion/contraction, acquisitions, large scale investment and changes in accounting practice. Our analysis therefore covers the last 10 years for which we can obtain accounts data. This should ensure that the results presented in this paper are robust and can stand up to scrutiny. That being said, the analysis of financial statements is not an exact science and results can often be

¹ The strategic transport bodies operating in these areas were formally known as Passenger Transport Executives (PTEs) and these areas are still often referred to as PTE areas. In recent years, some PTEs have been abolished with their functions transferred onto successor bodies, such as Combined Authorities.

² We have included 30 companies that report either no employees or less than 50 employees.



open to different interpretations. It is therefore important for readers to acquaint themselves with the definitions in the following section and to take any caveats firmly into account when looking at the rest of the paper.

- 1.6. Following this introduction, section two provides a brief explanation of the key financial indicators which we refer to throughout the paper. Section three summarises our key findings. Sections four, five and six then look at bus companies' financial performance by area during the latest available year, and over the past five and ten years, respectively. Section seven compares the performance of metropolitan area bus companies within each of the major owning groups. Section eight lists the top ten PTE bus operating companies by average operating profit over the last ten years.

2. Definitions

- 2.1. In this report we refer to a number of financial indicators, which are defined below. Unless indicated, these indicators are expressed as a percentage of turnover, although they can equally be expressed in absolute terms.
 - **EBITDA** – Earnings before interest, tax, depreciation and amortization. This is often used by analysts as a proxy for net operating cash flow, effectively the amount of money generated by the day to day operation of the business, which is available to pay for longer term investments, finance and to reward shareholders. This indicator can be used, for example, to assess for how much longer (or whether) a bus company can continue to operate with its existing fleet (i.e.: without investing in new vehicles).
 - **Operating profit.** A more useful indicator than EBITDA, this is a measure of the amount of money left over once the business has paid for all its expenses but before interest and tax, due or owed, are taken into account. Because the decision of how much money to borrow or lend is at the discretion of management, this indicator provides a fairly robust measure of the intrinsic profitability of a given operation. By including both the cost of operating leases and the depreciation of owned assets, this indicator should also ensure some degree of parity between companies which choose to either own or lease their fleet.
 - **Profit before tax.** This equals operating profit plus (/minus) any interest owed (/due). In the case of metropolitan bus operators, this indicator is often greater than operating profit, which suggests that, for the period under consideration, many companies have lent or invested money outside the business from past surpluses, which have subsequently given rise to interest payments. Close inspection of a sample of company accounts suggests that net positive interest payments largely result from financial applications relating to employee pension funds. However, bus companies provide Limited disclosure in this regard and so the impact of interest payments on profitability needs to be treated with caution.
 - **Profit after tax.** This equals profit before tax minus corporation tax due on positive earnings.
 - **Dividends.** This is the share of after tax profits which the operating company decides to pay back to shareholders. Once this money is paid out it is no longer available for the company to invest in its business. Dividends can, on occasion, exceed after tax profits in a given year, for example if the company decides to dip into past earnings.



- **Retained profit.** This is the amount of money left over to be used by the business once dividends have been paid out. If the company decides to return more dividends to shareholders than the after tax profit made in a given year, then this indicator is negative. Although bus companies have other sources of finance available, the proportion of retained profit relative to dividends provides an indication of the proportion of surplus generated by the business which is re-invested. Clearly, not all after tax profit can be re-invested in the business if shareholders are to earn a positive return. However, a low level of retained profit suggests that management sees few profitable growth opportunities which could generate greater returns in the future.

- 2.2. In this report, we largely focus on changes in **operating profit**, effectively the money made from bus operations once all relevant costs (including long term costs such as fleet acquisition) have been taken into account. This is likely to give the most comparable benchmark of profitability across bus companies and should be easily recognised by those in the industry. However, given the large proportion of interest payments received by many bus companies in PTE areas, there is a case for also looking at after tax profit when investigating the performance of individual companies as this provides an indication of past earnings.
- 2.3. One important question that is likely to arise when reading this report is “what is a fair rate of return for the bus industry”? This is a complex issue which we do not try to address directly. The value of our analysis lies instead in revealing the relative levels of profit made by different operating companies. Assuming that the companies in our sample are at a similar stage of development, have required comparable levels of investment and face similar market conditions then the profitability which owners/investors would be willing to accept is likely to be close to the market average. It could therefore be argued that companies which have consistently made above average profits are reaping excess profits.
- 2.4. Another point to highlight is that the level of risk, and hence the rate of return expected of bus companies by shareholders, in London and other parts of England is different and hence profit margins are likely to be different as well. While the bus market is fairly stable and this issue shouldn't be over-stated, this is one factor that needs to be taken into account when comparing different parts of the country.
- 2.5. Finally, it should be noted that profit margins and rates of return are seldom the same thing. Typically, rate of return is measured as the value of the cash flow received by shareholders over time relative to amount they invested in the business. Profit margin, on the other hand, relates to the cash surplus generated by the business relative to total turnover. Estimating the rate of return is more challenging than measuring profitability at a given point in time, as it requires a greater degree of judgement and information that is not available in company accounts. However, we may be able to extend our analysis to include it in a future version of this paper.

3. Key findings

- a. Average operating profits have been consistently higher in the largest metropolitan areas (former PTEs) outside of London than elsewhere.
 - In the latest year available, operating profits in the former PTEs were 8.6%, compared to 6.1% in London and 6.9% elsewhere.



- Over the last ten years, operating profits in the former PTEs were 8.3%, compared to 3.6% in London and 6% elsewhere.
- b. Despite a steep dip in profits at the start of the recession in 2008, PTE bus companies have been quick to recover. However, the past three years have seen a slight reduction in profit margins, possibly as the result of cuts in central and local government funding. Despite this, average operating profit margins over the past five years have been considerably higher than over the previous five (9.1% compared to 7.6%). This is somewhat surprising and would warrant further investigation.
- c. Whilst the level of profit in PTE areas is relatively high little of this is invested back into the business. Over the past ten years, PTE bus company dividends have been, on average, 5.2% of turnover compared to after tax profit of 8% of turnover.
- d. Bus operators in PTE areas are earning significant revenue through interest payments, largely, it seems, from intra-group loans. This suggests that, in some cases, money has in the past been taken out of profitable PTE bus companies to be reinvested in other parts of the owning group's business. This means that, alongside high dividends, a lot of retained profits have subsequently flowed out of PTE bus companies. This is also one way in which companies can artificially suppress operating profit margins and one reason to also look at pre-tax profit margins (which include interest).
- e. Looking at the most recent year, the list of most profitable PTE bus companies is topped by Stagecoach in the North East (Busways Travel Services Limited) which made an operating profit of 20.1%, followed by Stagecoach in Greater Manchester (Greater Manchester Buses South Limited) which made an operating profit of 16.6%.
- f. Only three companies failed to make an operating profit in the most recent year: First South Yorkshire Limited, First Midland Red and Arriva Midlands North Limited.

4. Latest available year

- 4.1. Focusing on accounts from the most recent year available (see figure two), it is apparent that profits were considerably higher in PTE areas than in London for all measures. For example, using operating profit, PTE areas had higher profit levels than bus companies in London (8.6% compared to 6.1%). The figure for non-metropolitan areas (6.9%) is in-between PTE areas and London.



Figure 2. Average bus company profitability by area – annual figure for the most recent year available (as % of turnover except where stated)

Area	Turnover £000s	EBITDA (%)	Operating Profit (%)	Pre-tax profit (%)	Post- tax profit (%)	Dividends paid (%)	Retained Profit (%)
West Midlands	411,950	13.4	7.5	6.7	5.8	0.1	5.8
Merseyside	148,635	18.8	12	11.2	8.6	0	8.6
North East	185,490	17.2	11.8	12.3	9.7	3.8	5.9
South Yorkshire ³	192,977	10.6	3.7	7.3	6.6	2.2	4.4
Greater Manchester	276,610	16.7	9.1	8.6	7.6	2.7	4.9
West Yorkshire	235,867	16.2	9.4	10.1	8.2	0	8.2
PTE area average	1,451,529	15.1	8.6	8.9	7.4	1.3	6.1
GB exc. London and PTEs	3,042,699	13.2	6.9	6.6	5.5	2.2	3.3
London	1,868,267	10	6.1	5.9	4.7	1.7	3

- 4.2. Our figures show that pre and post-tax profit levels are sometimes higher than operating profit. This is unusual as it implies that many companies, particularly in PTE areas are making a substantial amount of money outside of their direct operations as a bus company. Closer inspection of a sample of individual company accounts shows that interest received is largely associated with investments made from the assets of employee pension funds. In such cases, operating profit seems like the most appropriate indicator of current levels of profitability. However, interest income (and hence pre-tax profit) can be useful in studying longer term profitability and past behaviour.
- 4.3. Since we completed the previous version of this analysis, in 2014, profitability levels in PTE areas has increased across all measures, apart from pre-tax profit, with the same also being true for London. At the same time, the level of retained profit has also increased (from 2.8% of turnover to 6.4% of turnover in PTE areas), suggesting that a greater proportion of profits are being retained within companies.

5. Ten-year trend

- 5.1. In discussing profitability it is common to focus on the latest available year. However, a one-year analysis can be skewed by one-off events or accounting decisions. It may therefore be a poor proxy for a business's steady state performance. In this section, we therefore show average financial indicators for the last ten years for which data is available in figure 3.

³ There have been a number of restructures to Stagecoach companies in South Yorkshire over recent years. We have reflected this as closely as possible in our analysis of bus company profitability.



Figure 3. Average bus company profitability by area - ten year averages (as % of turnover except where stated)

Area	Turnover £000s	EBITDA (%)	Operating Profit (%)	Pre-tax profit (%)	Post- tax profit (%)	Dividends paid (%)	Retained Profit (%)
West Midlands	3,461,259	14.2	8.5	8.7	6.9	3.6	3.3
Merseyside	1,085,145	11.4	8.1	8.9	6.7	1.5	5.1
North East	1,599,614	15.8	10.2	11	8.6	6.9	1.8
South Yorkshire ⁴	1,459,296	9.4	2.4	6.9	6.2	5.2	1
Greater Manchester	2,756,752	15.3	8	10.4	8.5	7	1.5
West Yorkshire	2,158,269	16.6	10.8	14.2	10.7	6.4	4.3
PTE average	12,520,335	14.3	8.3	10.1	8	5.2	2.8
GB exc. London and PTEs	25,185,534	12.4	6	6.2	4.9	3.8	1.1
London	15,879,315	7.2	3.6	4.6	3.9	3.2	0.7

5.2. This analysis confirms, in overall terms, that bus operators in PTE areas have been earning higher levels of profits when compared to bus companies in other areas of the country and have also paid out higher levels of dividend.

5.3. As with the most recent year's accounts, pre and post-tax profit margins are again considerably higher than operating profit, more so in PTE areas.

⁴ There have been a number of restructures to Stagecoach companies in South Yorkshire over recent years. We have reflected this as closely as possible in our analysis of bus company profitability.



Figure 4 Operating profit over time by area type

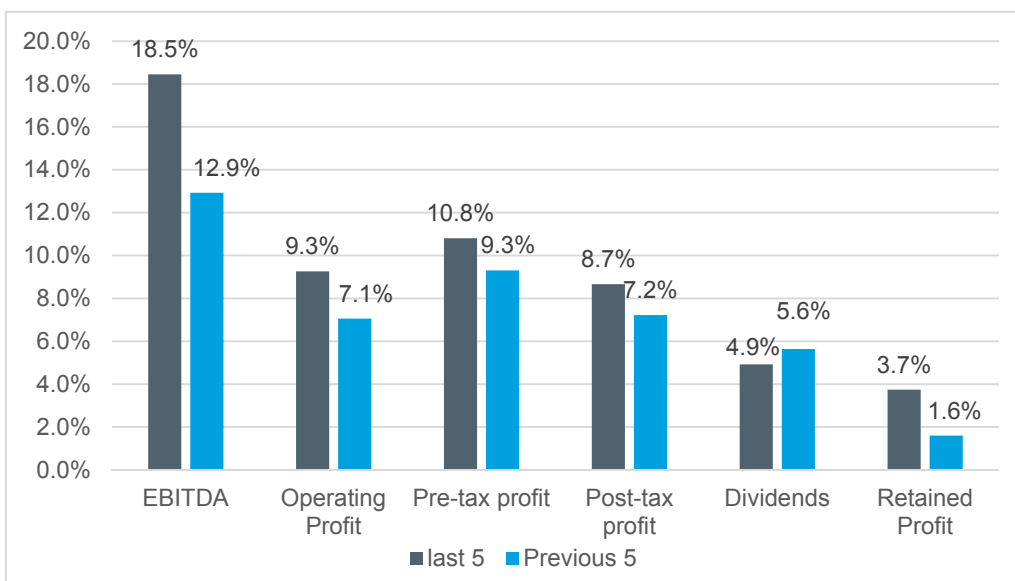


- 5.4. Figure 4, shows that the level of operating profit made in PTE areas has been higher than in London or in non-PTE areas for all of the last ten years.
- 5.5. From the low point nine years ago, PTE profits increased rapidly, moving away from other area types. However, the figures have become closer over the last three years, with the PTE average operating profit falling slightly against an increase in London in particular. However, operating profit in PTE areas remains higher than elsewhere.

6. Five-year trends

- 6.1. Having explored the most recent year in detail and ten year trends, this section breaks the last ten years down into two blocks of five. The figures taken combine the most recent five years together, i.e. 2012-2016, and the five years before that, 2007-2011⁵.

Figure 5. PTE-wide financial analysis

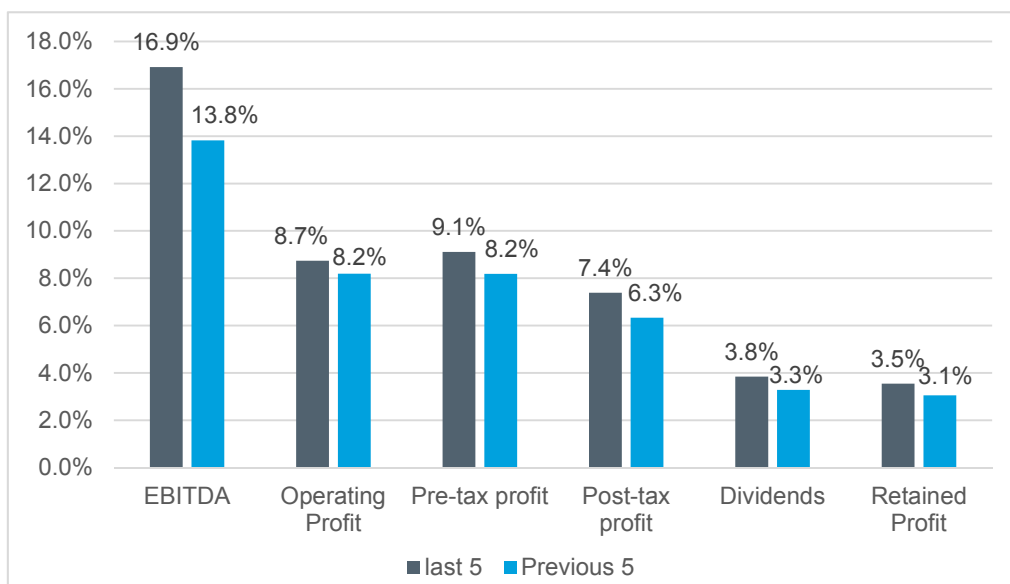


⁵ Because the analysis uses the most recent accounts available, there could be some cases where the most recent five years are 2011-2015.



- 6.2. Across all indicators, bus operator profitability in PTE areas was higher over the last five years (i.e. 2012-2016) when compared to the previous five. The largest difference has been in EBITDA, which averaged 18.9% in the last five years compared to 12.9% over the five years previous.
- 6.3. The level of dividends paid as a percentage of turnover has decreased slightly, which means that the level of retained profit as a percentage of turnover has doubled in the most recent five years.
- 6.4. The results are broken down into the different PTE areas below. It is clear from the graphs that there is not a common single trend across PTE areas.

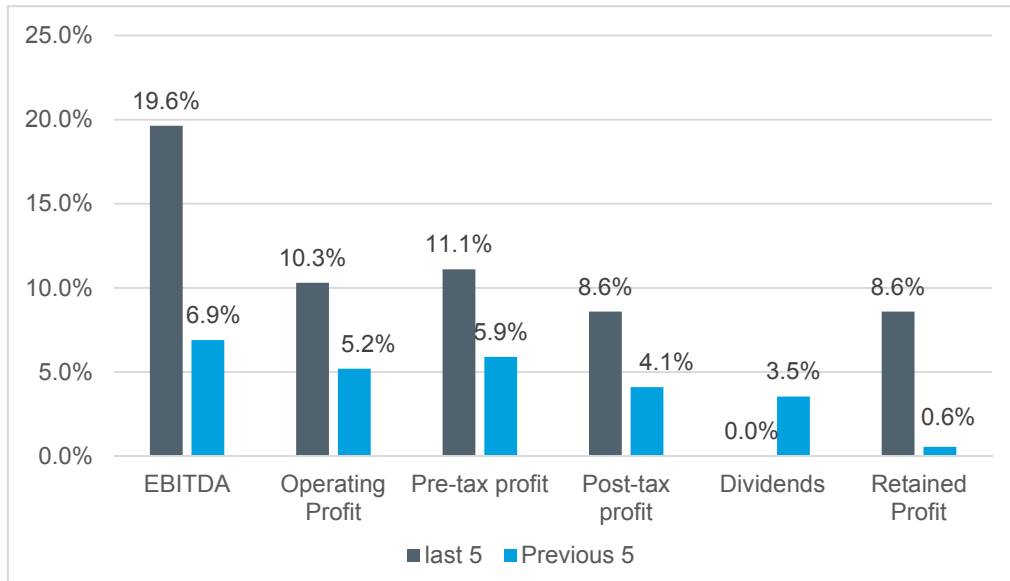
Figure 6. West Midlands financial analysis



- 6.5. Across all measures, bus operator profitability in the West Midlands was higher over the last five years when compared to the previous five. The level of dividend paid as a percentage of turnover was also slightly higher, as was retained profit as a percentage of turnover.

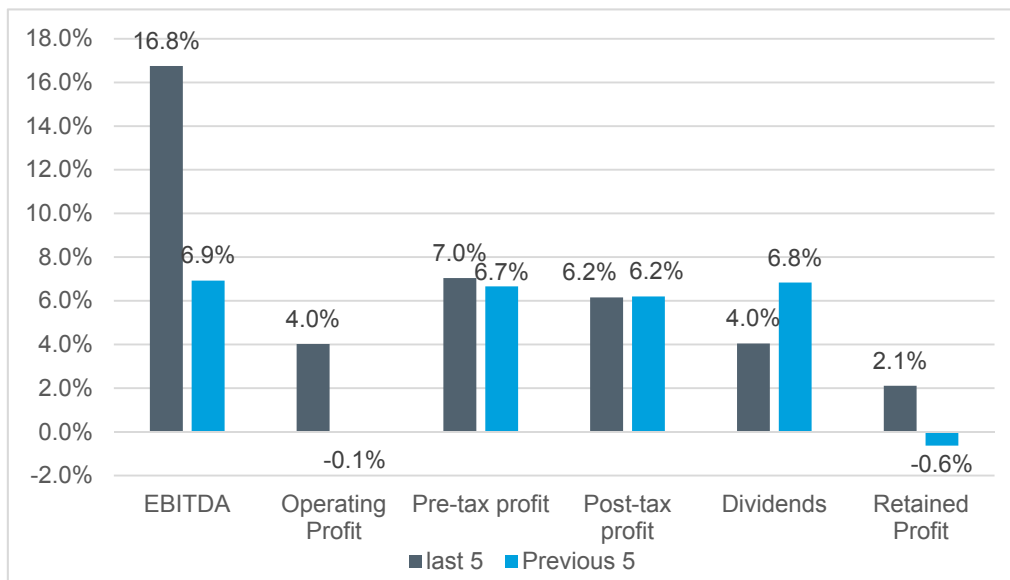


Figure 7. Merseytravel financial analysis



- 6.6. Across all measures, bus operator profitability in the West Midlands was considerably higher over the last five years when compared to the previous five.
- 6.7. There were no dividends paid in the last five years which has led to a large increase in the level of retained profit as a percentage of turnover.

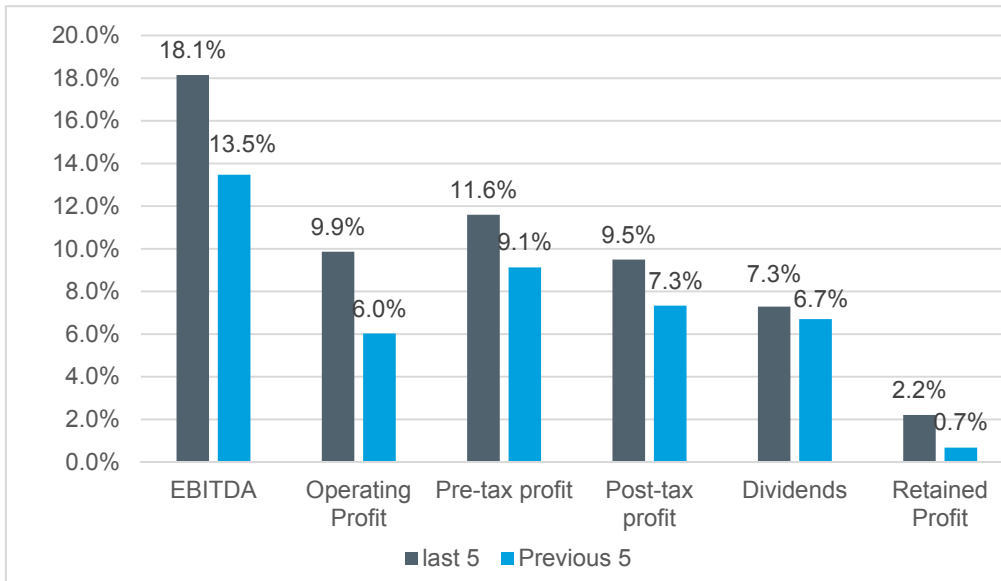
Figure 8. South Yorkshire financial analysis



- 6.8. There has been an increase in profitability in most measures for bus operators across South Yorkshire. There has been a large increase in EBITDA from 6.9% to 16.8%, and operating profit has risen from a slight loss over the previous five years to a profit of 4% over the last five.
- 6.9. Despite the increase in profit, the level of dividends has fallen as a percentage of turnover, with retained profit increasing from a small loss to 2.1%.

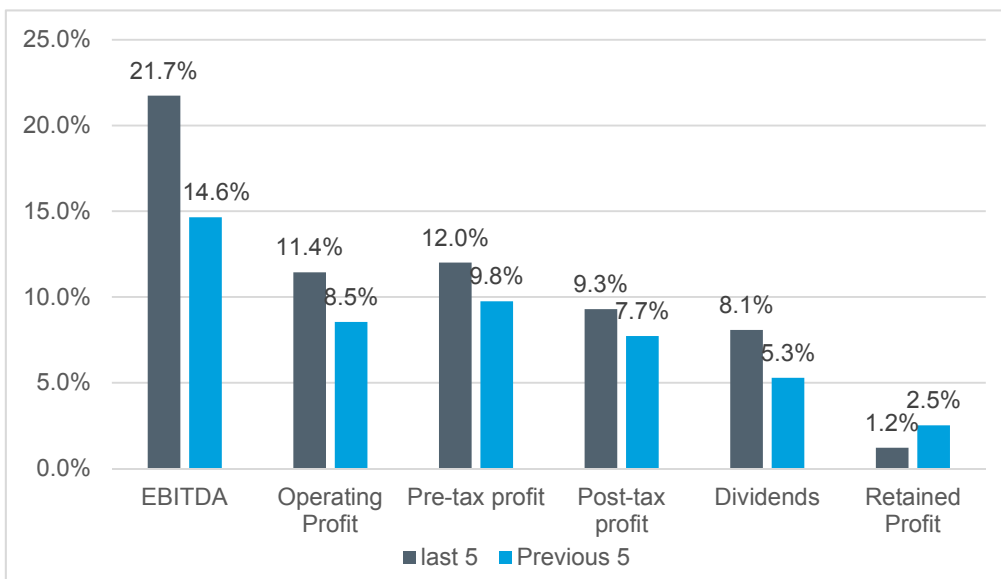


Figure 9. Greater Manchester financial analysis



6.10. Profit levels in Greater Manchester grew strongly, with EBITDA increasing and operating profit growing by 50% comparing the last five years against the previous five. The level of dividends paid out increased from 6.7% to 7.3%, with the level of retained profit more than doubling to 2.1%.

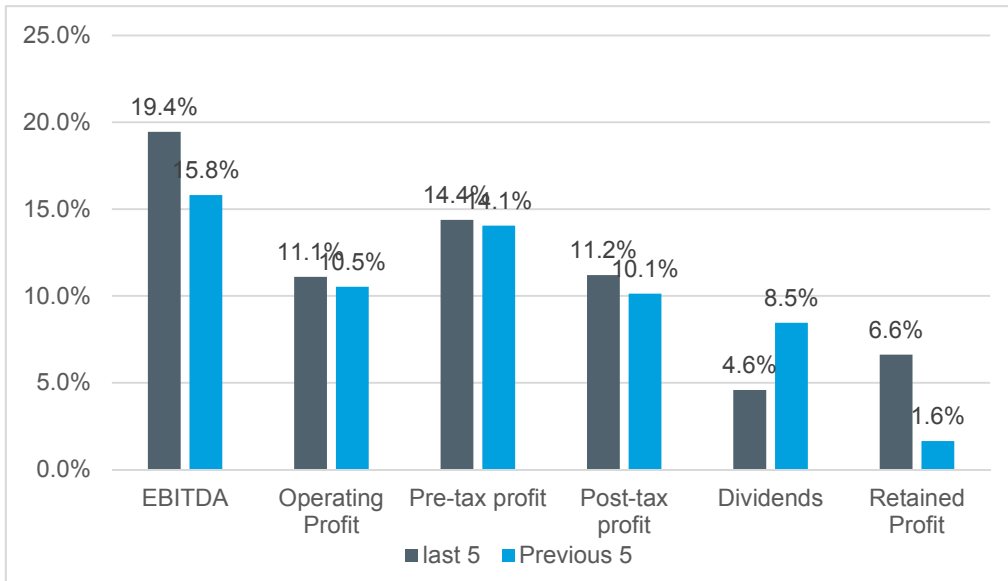
Figure 10. North East financial analysis



6.11. Across all indicators, average bus operator profitability in the North East was higher over the last five years when compared to the previous five. The average level of dividends paid has increased from 5.3% to 8.1%, with the level of retained profit as a percentage of turnover dropping from 2.5% to 1.2%

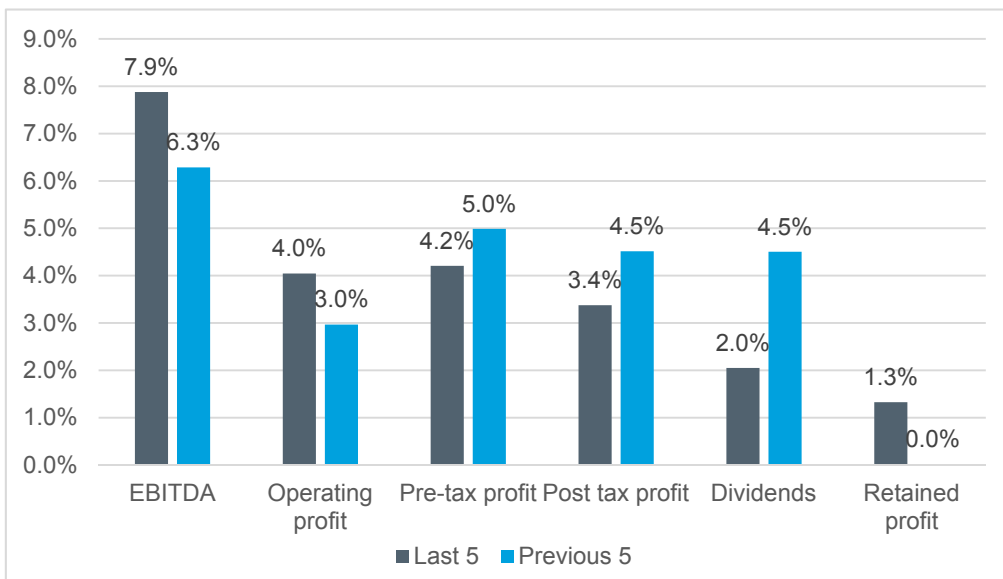


Figure 11. West Yorkshire financial analysis



6.12. EBITDA, operating profit, pre-tax profit and post-tax profit in West Yorkshire were higher over the last five years when compared to the previous five. Dividends as a percentage of turnover fell from 8.5% to 4.6% and retained profit more than doubled to 6.6%.

Figure 12. London financial analysis



6.13. EBITDA and operating profit in London were both higher over the last five years when compared to the previous five. However, pre-tax and post-tax profit dropped somewhat suggesting a substantial increase in interest payments. The level of dividends paid as a percentage of turnover has fallen by more than half to 2% and the level of retained profit has increased from zero to 1.3%.



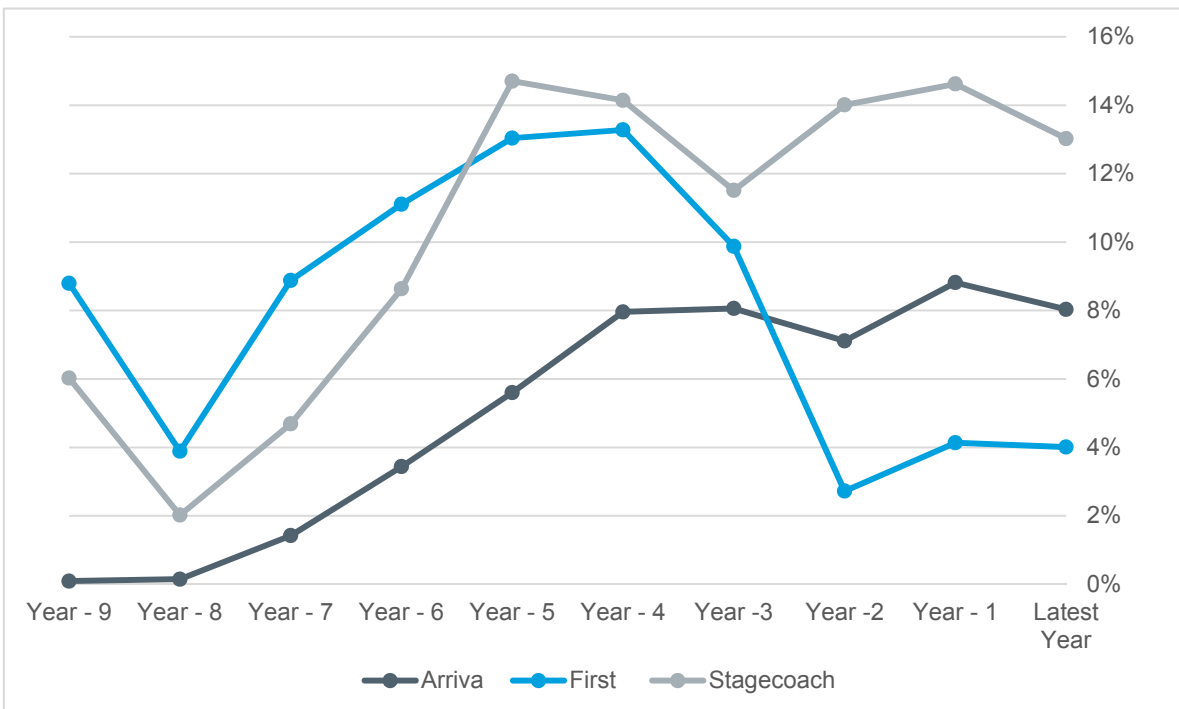
What do the five years trends show us?

- EBITDA and operating profit have increased considerably in most PTEs over the last five years. This suggests that bus operations of PTE companies are healthy and are generating more profit than the previous five years.
- Dividends are on average down across the PTEs, but are still higher than for London bus companies. Conversely, the level of retained profit has increased in PTE areas, suggesting that more profit has been retained at operating company level.
- Over the last five years, bus companies in PTEs have made an average EBITDA of 18.9% and operating profit of 9.1%. This compares to 7.9% and 4% for bus companies in London.

7. How the three largest operators behave across PTE areas

- 7.1. The following section explores the profit levels of operators across PTEs. The section focuses on the three main operators, Arriva, First and Stagecoach, as they are all present in the majority of PTEs.
- 7.2. Operating profit has been selected as the indicator for this section. This allows the analysis to focus purely on the profitability of the operations⁶.

Figure 13. Operating profit of the big companies in PTE areas.



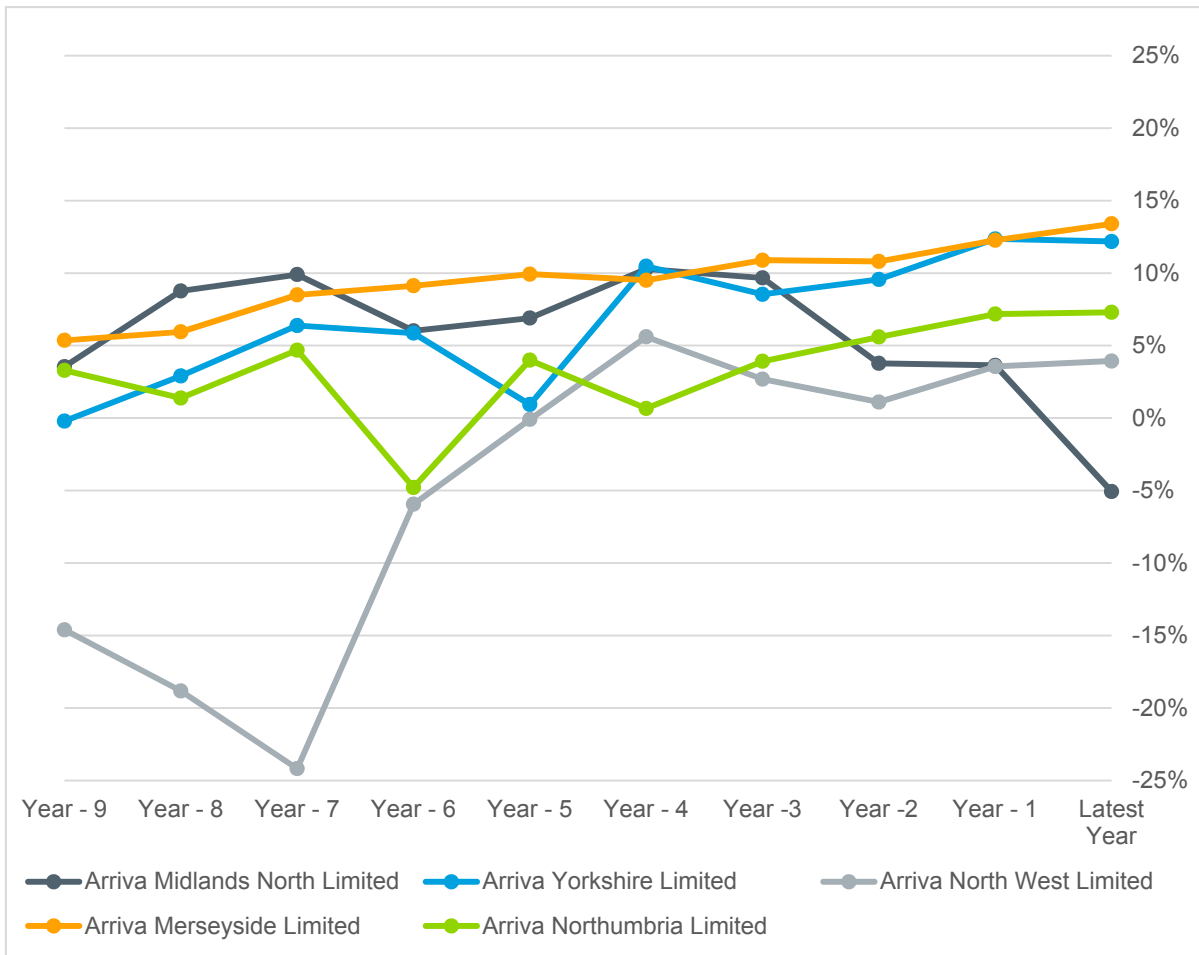
- 7.3. Over the last four years, First bus companies have seen a large reduction in their operating profit, falling from almost 14% down to 4%. Operating profits at Arriva have risen steadily through the ten year period, reaching 8% over the last two years.

⁶ A number of companies appeared to receive significant sums of other money and interests, making the pre and post-tax profit levels higher than the operating profit. This has been removed to allow a focus purely on operations, but it must be recognised that tax and any interest owing is still to be paid on top of the figures that are quoted.



- 7.4. Stagecoach make a much higher operating profit of around 13%. There has been a small reduction in the last year, but on average operating profit margins remain significantly above other operators.
- 7.5. The report now looks at the operators in more detail to see how their different companies act across the PTEs.

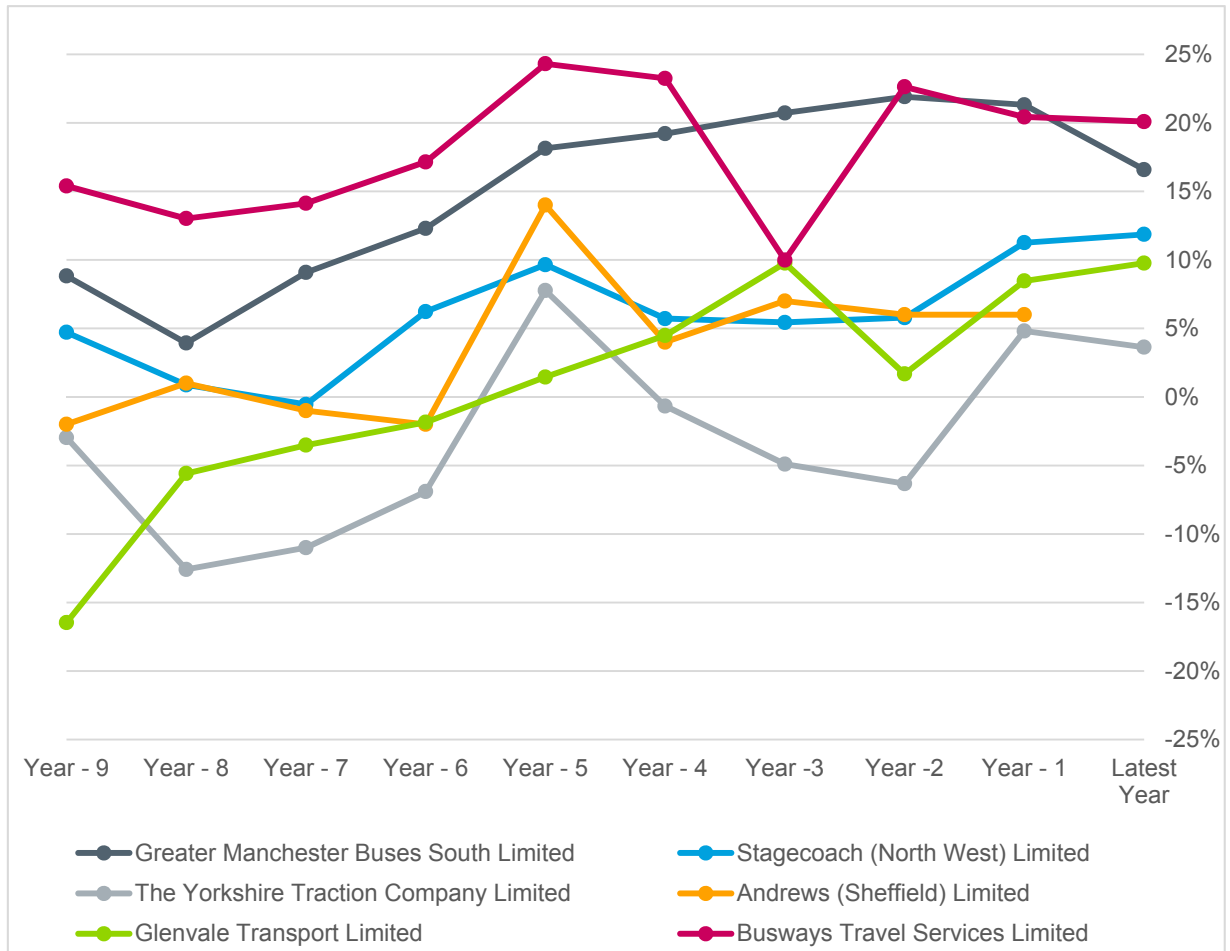
Figure 14. Operating profit for Arriva companies in PTE areas.



- 7.6. With the exception of Arriva Midlands North Limited, all Arriva companies that operate in PTE areas made a profit. Two companies, Arriva North West Limited and Arriva Northumbria Limited made between 4-8%, whilst Arriva Yorkshire Limited and Arriva Merseyside Limited made in excess of 10%.
- 7.7. Profit levels have increased or remained stable at all companies over the last couple of years with the exception of Arriva Midlands North, which had fallen from making an operating profit of around 10% to a loss of 5%.



Figure 15. Operating profit for Stagecoach companies in PTE areas⁷

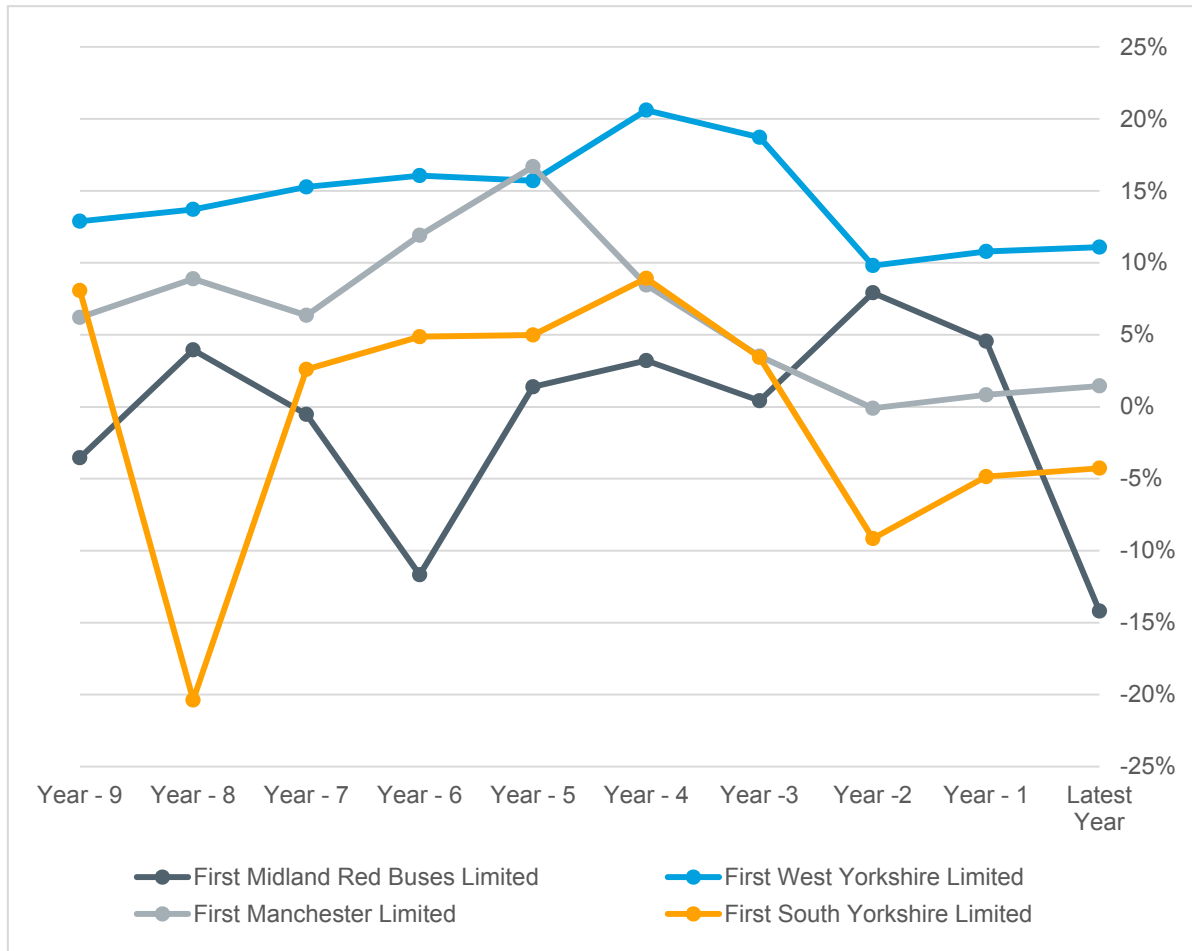


- 7.8. All Stagecoach companies operating in PTE areas made an operating profit in the last year, with Busways Travel Services and Greater Manchester Buss South both making in excess of 15% profit.
- 7.9. Stagecoach companies, on average, make a larger operating profit than the other major bus companies in PTE areas.

⁷ During the latest year for which accounts are available, Andrews (Sheffield Limited) was incorporated into the Yorkshire Traction Company Limited. The latest figures for Andrews relate to only part of the year (2014/15).



Figure 15. Operating profit for First companies in PTE areas



7.10. The average operating profit levels of First companies is below that of other groups. Two of the four companies operating in PTE areas made a profit in the most recent year, with First West Yorkshire making by far the highest (10%).

7.11. First South Yorkshire lost 5% in the most recent year, and First Midland Red Buses Limited lost almost 15% in the most recent year despite having made a profit in excess of 5% in the two previous years.

7.12. Although First appear to have a lower operating profit figure than the other large companies that operate in PTE areas, this is not always the case when looking at other measures of profitability.

8. Top ten profit making companies over the last ten years

8.1. The table below lists the top ten profit making companies by operating profit over the last ten years. The table also shows, for each of these companies, what proportion of turnover flowed out of the company as dividends and what proportion was retained by the company.



Figure 16. The top profit making companies over the last ten years

Company	PTE	Operating profit (%)	Pre-tax profit (%)	Dividends paid (%)	Retained profit (%)
Busways (Stagecoach)	NEXUS	18.2	20.3	9.4	6.1
Greater Manchester Buses South (Stagecoach)	TfGM	15.9	18.1	11.9	2.4
First West Yorkshire Limited	WYCA	14.5	20.0	9.5	5.5
Midland Red (South Limited) (Stagecoach)	TfWM	13.4	14.2	10.6	0.3
Wellglade Holdings Limited (Stagecoach)	SYPTE	10.4	11.1	4.0	4.5
Arriva Merseyside	Merseytravel	9.8	11.3	2.1	6.2
West Midlands Travel Limited (Nat Ex)	TfWM	9.3	9.8	3.1	4.8
Arriva Yorkshire Limited	WYCA	8.0	7.8	1.5	4.5
First Manchester	TfGM	6.7	8.9	4.9	2.1
Go North East Limited	NEXUS	6.7	6.9	6.3	-0.8