



May 2018 Gateway case study examination – pre-seen material



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Introduction

Menta is a leading multinational public transportation group, employing more than 35,000 people worldwide. The company offers both local and long-distance (inter-city) bus services in several developed and developing countries. Menta was founded in Centralia in the 1980s.

Menta's worldwide operations are organised into three geographical regions: Central Eurozone, Western International, and Eastern International. Menta's head office is in Centralia, which is a country in the Central Eurozone. 70% of Menta's revenues are earned in Centralia. The currency in Centralia is the C\$.

You are a financial manager in Menta's head office in Centralia. Your specific role is associated with the Central Eurozone region, although you often liaise with colleagues in the other regions. Your primary responsibilities are associated with management accounting.

Bus regulation and state ownership

Public transport raises critical issues for governments. Many people rely on buses and trains for travel. Also, an efficient and attractive public transport service encourages car owners to make some journeys by bus or train, with reductions in road congestion and pollution.

Many countries, including Centralia, used a combination of state ownership and regulation to ensure that public transport was efficient and reliable. For many years, most of Centralia's large bus operators were owned by government agencies. They aimed to make profits, but they also continued to cover unprofitable routes as a public service.

The other way in which bus services were protected was through the law that required bus operators to seek route licences for each route that they planned to operate. This reduced competition between bus operators, making it potentially more profitable to operate routes that might not have had large passenger numbers.

In the 1980s, there was a global shift away from state ownership and regulation. Centralia gradually reduced the restrictions on offering bus services, although this is still a heavily regulated industry. Bus companies are now encouraged to operate unpopular routes through a system of government subsidies. For example, a local bus company might receive a grant to operate a regular service between a rural area and the nearest town centre, even though fare income is insufficient to make the route commercially viable.

The 1980s also saw the sale of many large state-owned bus companies, including Centralia's. This released cash for other purposes, but also left the government dependent on commercial bus operators to ensure an adequate public transport system.

Menta's history

Andrew Whiteford established Menta as a road haulage garage in Centralia for the maintenance and repair of goods vehicles and buses in the 1950s. The business grew steadily, but remained a family-owned company until the 1980s. By then, the business had been inherited by brothers Phil and Robert Whiteford, who are Andrew's nephews. Each brother owned 50% of the company. Phil, the older brother, had his own travel agency and took no active part in the running of Menta. Robert, a trained mechanic, was Menta's General Manager.

In 1980, Centralia's government relaxed the need to obtain a route licence for long-distance routes, defined as those originating at a point more than 50 kilometres from the final destination. This meant that bus operators were free to compete with one another on long-distance routes, undercutting their rivals on fares if they so wished. Initially, this led to chaos, with many bus operators entering this market and then realising that they were making losses. A number of bus companies failed because of this.

The Whiteford brothers thought that the deregulation was an excellent opportunity for them to apply their skills to the creation of a profitable venture. Phil had considerable experience of organising coach trips for tourists and other groups, hiring buses and drivers from local operators. Robert's work in the garage meant that he understood the challenges of maintaining and operating buses and other vehicles and his contacts with local bus companies meant that he understood their businesses. Menta purchased four second-hand coaches. They offered an express service between Centralia's capital city in the south of the country and Marpool, a major city 400 kilometres to the north.



Phil used his knowledge of the travel business and his contacts to manage the commercial aspects of Menta's newly-established coach business and Robert kept the small fleet of old buses running both safely and reliably. Menta grew slowly but steadily, despite competition from much larger and long-established national carriers. By 1985 Menta had 30 buses, operating on a total of six inter-city routes.

In 1985, Centralia's government sold all of its bus companies. It also changed the law so that any bus operator could service any route without seeking a route licence. Menta saw this as an opportunity and purchased many of the buses that had previously belonged to the government-owned bus companies. Menta also established several subsidiaries across Centralia, offering local bus services in the towns and cities in which they were based. Menta also continued to operate and expand on the long-distance routes.

Menta competed aggressively against other operators in every market that it operated in, primarily through cutting fares. Menta's pricing was often sufficiently low to force many competitors out of business, thereby enabling Menta to expand rapidly by acquiring their buses, depots and drivers. By 1990 Menta had 11 inter-city routes and 7 local bus companies, with a fleet of over 450 vehicles and over 2,500 staff.

Menta's growth continued into the early 1990s, with further acquisitions in Centralia. It acquired further subsidiaries, often breaking up newly acquired companies in order to incorporate selected elements into the Menta Group and selling other elements that were deemed to be surplus to requirements. For example, Menta purchased Northeast Airport for C\$50m before selling it two years later for C\$80m, after incorporating all of the bus links between the airport and surrounding towns and the city of Esston into its operations.



Menta also retained the tram service that connects Northeast Airport to the nearest major railway station, rebranding it as Mentair Tram. Menta then won the franchise to operate the tram network that serves the city of Esston, transforming it from unpopular and loss-making to a successful service. Menta has since sold the tram company in order to concentrate on bus services.

Menta has acquired a number of business assets through this approach, including park-and-ride facilities that enable drivers to park easily and cheaply before catching a Menta shuttle bus to the city centre, bus depots and maintenance facilities, and local minibus services.

Menta continues to expand, primarily overseas. The company is already dominant in Centralia and in its neighbouring countries.

Group strategy

The key elements of Menta’s business strategy to deliver long-term shareholder value are:

- To deliver organic growth across all of Menta’s operations by providing safe, reliable, customer-centred transport services that deliver excellent customer experience at a competitive rate.
- To acquire businesses that complement Menta’s existing operations, in areas where Menta’s management has proven expertise and which offer prospective returns on capital that exceed Menta’s weighted average cost of capital.
- To maintain and grow the business by bidding for selected tram franchises, government contracts for education or health transport and other bus contracts.

The Menta Group is organised on a regional basis:



Each of Menta’s operating units is responsible for servicing specific bus services. Each is staffed and equipped accordingly. For example, each of the 28 city operating units in Central Eurozone has its own depot that acts as a base for the buses that cover that town or city. Inter-city operating units operate over wider areas and so some have more than one depot, but each has a specific set of routes.

The operating units report directly to their regional management teams: Western International, Central Eurozone and Eastern International.

There is very little interaction between the operating units because most serve a designated geographical area, with almost no overlap. Each operating unit has its own fleet of buses that is optimised for its local conditions.

Inter-city services are single-decker coaches, essentially buses with comfortable seats and other comforts such as air conditioning.



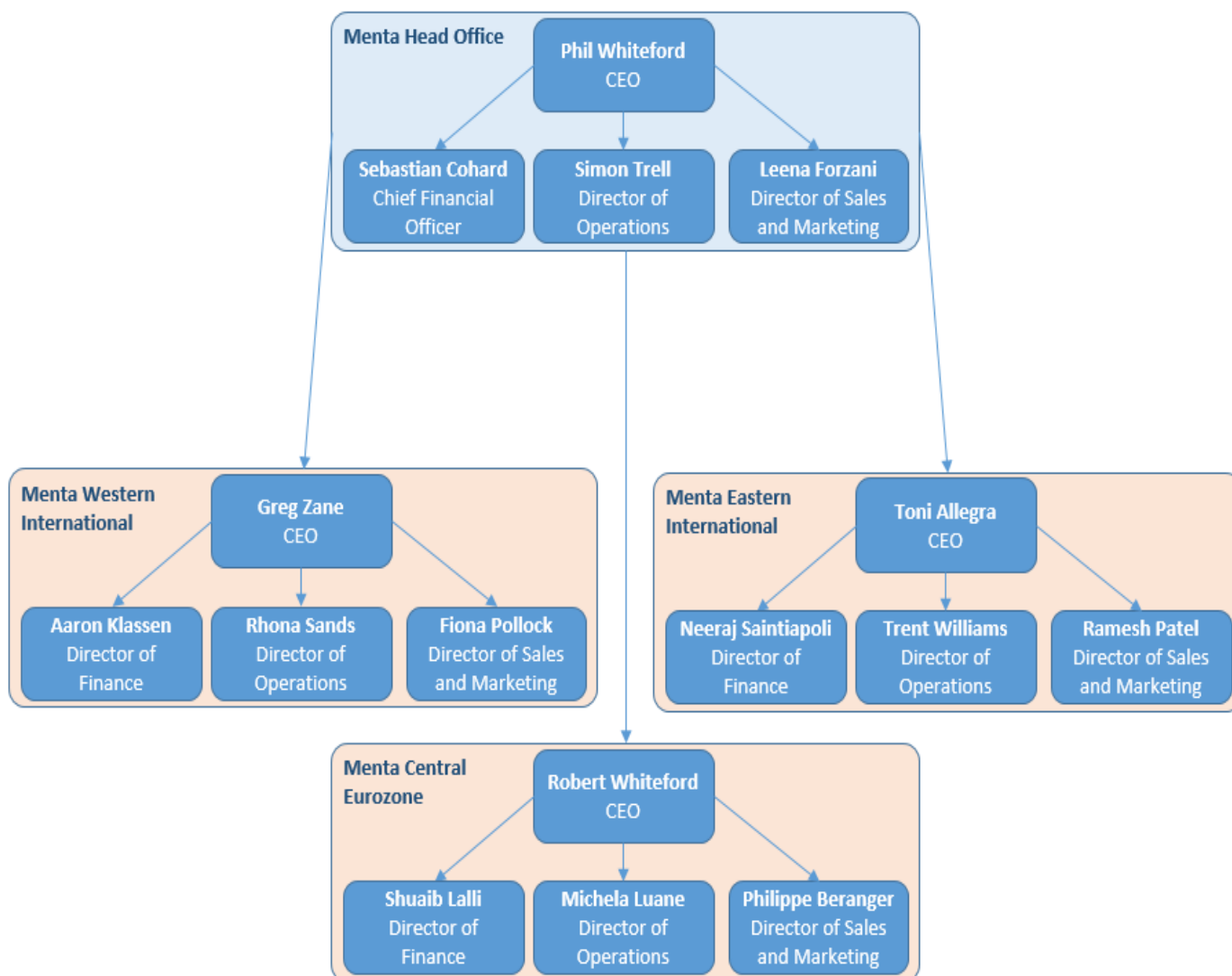
City services are generally operated with a mixture of single and double-decker buses. Journeys are generally short and so seating is designed to be safe and functional, with the maximisation of passenger numbers being the priority.



Rural services are generally single-decker buses that are smaller than those used on city routes. There are fewer passengers and so smaller buses are both more economical and better suited to country roads.



Organisation chart



The regulatory environment

Most governments, including Centralia's, have deregulated the licensing of routes, but there is still a host of rules and regulations relating to the operation of buses. These rules are necessary because of public safety, both for passengers and for other road users. Furthermore, bus services are generally heavily subsidised by local governments. Where this is the case, they are closely monitored to ensure that any bus operator in receipt of government subsidies is capable of offering a reliable service. Centralia offers high levels of subsidy.

All countries require bus drivers to hold special licences before they can be permitted to carry fare-paying passengers on the public roads. These licences are granted only after the driver has completed training and passed both written and practical tests. There are also detailed background checks for criminal convictions. Trainee drivers can practise their skills on public roads provided they are under the supervision of two qualified bus drivers and provided there are no passengers on board.

Revenue sources

Most of Menta’s bus services carry fare-paying passengers. Passengers can buy tickets for each individual journey that they take, or they can pay in advance for season tickets that permit them unlimited travel on a designated route for either a week or a month. Season tickets are popular with commuters because they are slightly cheaper than buying a ticket for each individual journey.

Most of the countries in which Menta operates offer travel concessions to elderly or disabled people. Eligible passengers may be permitted to travel either free of charge or at a massively reduced fare. Menta then invoices the government for the number of travel concessions taken.



Bus tickets are often purchased for cash from the bus driver. Each bus is equipped with a ticket machine that tracks the numbers of passengers and the type of fare that they purchase. Passengers can also buy tickets online. When they do so they can either receive an email that they can print out or a code that is delivered to their mobile phone. The printed email or the code is validated by a scanner linked to the ticket machine in the bus.

Menta receives route subsidies for operating routes that might otherwise be uneconomic. These subsidies are lump-sum payments for maintaining satisfactory service levels on routes that would otherwise carry too few passengers for Menta to serve on a commercial basis. These are often services between rural communities and nearby towns. These are referred to as ‘tendered routes’ because there is often competition between bus companies to win these subsidies, and they generally submit tenders with their plans and proposed fees for serving these routes.

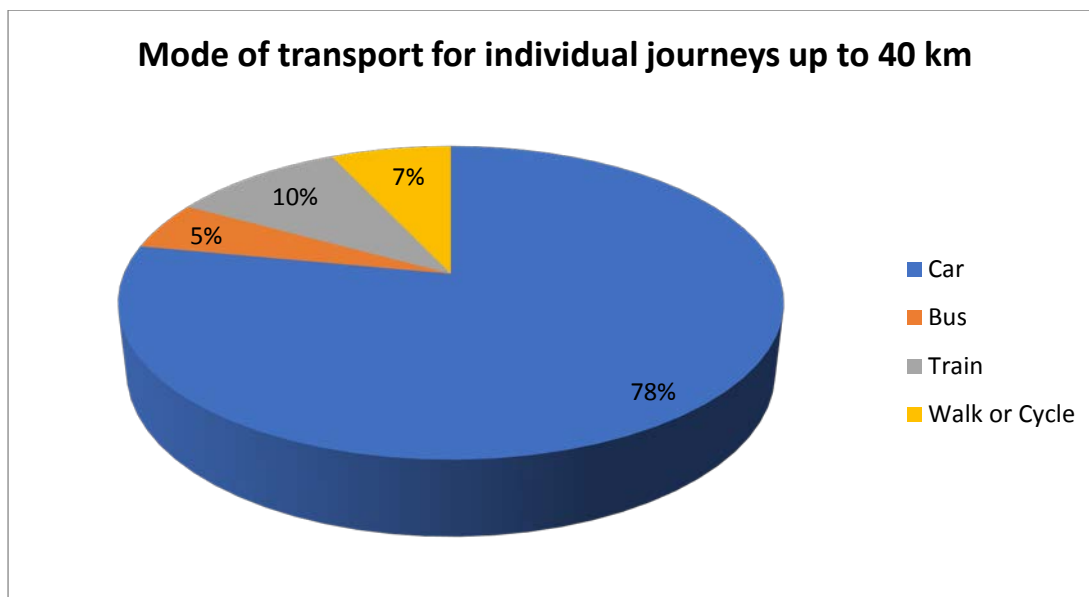
State-funded schools are managed by local school boards in many countries. School boards are responsible for the management and oversight of all of the schools in their designated area. Many school boards provide transport for pupils. School buses collect children from designated bus stops and deliver them safely to school, returning them at the end of the school day. The school boards pay Menta directly for this service. These services also require a tender to the relevant local school board.

Sources of revenue – Central Eurozone	
Fares on individual journeys	35%
Season ticket fares	10%
Tendered routes (effectively a subsidy from local government)	15%
Educational tenders	15%
Health or age-related travel concessions	25%

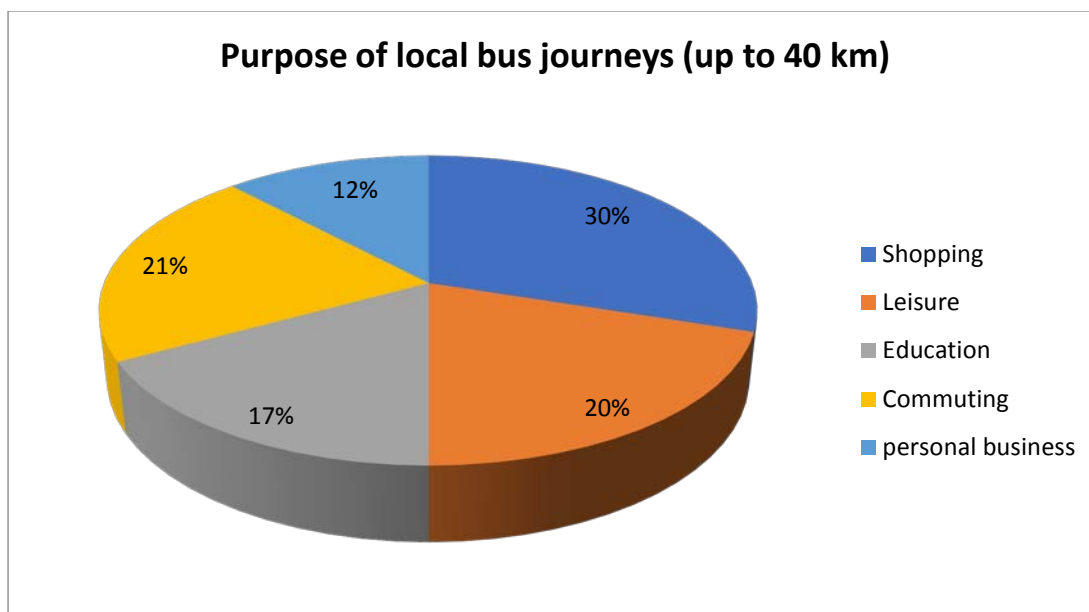
Market opportunity

Centralia is Menta’s key market, providing 70% of the company’s revenue. Menta has a 30% share of the market in its home country by revenue.

The Centralian government believes that there is still scope for developing bus travel because it accounts for only a small proportion of passenger journeys. The government wishes to encourage bus travel because it reduces road congestion and causes less pollution. It is clearly in the interests of all bus operators to increase demand for bus services.



Source: Centralia Transport Authority



Source: Centralia Transport Authority

Public transport has always been viewed as causing less environmental damage than private cars. Many major cities are developing initiatives to encourage greater use of buses. For example, dedicated bus lanes can mean that a bus journey is less likely to be delayed by heavy traffic at peak times. Park-and-ride facilities enable motorists to drive to a car park on the outskirts of a city before completing their commute using a shuttle bus to the city centre.

There have been further developments that are aimed at making public transport cheaper and more efficient. Developments such as driverless buses and trams will reduce wage bills. Many cities are actively discouraging car drivers by increasing parking charges and reducing the number of parking spaces. Improved traffic monitoring and traffic management systems are improving bus journey times.

Menta has invested heavily in information technology so that it can measure the effects of changes to the pricing and frequency of its services. Approximately 70% of operating costs vary with distance travelled. Operating costs vary little with the number of passengers, so it is highly desirable to carry as many passengers as possible on any given bus. Menta's sales and marketing managers pay very close attention to the implications of developments such as park-and-ride, using different capacity buses, varying routes and so on.

While Menta has been experimenting with strategies for attracting passengers away from other forms of transport such as private cars, its main concern is with protecting and, if possible, increasing its market share of existing bus travel. Local operating units pay close attention to the activities of rival bus companies and report any developments to the head office.

Competition

Dawlbus is Menta's single largest competitor. Dawlbus operates exclusively in Centralia, where its market share is slightly higher than Menta's. Dawlbus offers very similar services to Menta. The two companies have a mutual respect and rarely undercut one another's prices by more than a few cents.

The other bus companies in Centralia are relatively small operators, many of which provide local services within a single town or city. Menta does not operate a service in every town in Centralia and so these smaller businesses do not necessarily compete for revenue.

In some towns, the local bus company is sufficiently large and efficient to compete with Menta and/or Dawlbus. This is generally the case in larger towns and cities, where there is sufficient demand for bus travel to support two or more major providers.

Menta's overseas operations face different competitive environments from country to country. For example, the Western International operations are exclusively inter-city and Menta is operating against large and well-established long-distance coach operators. Menta's Eastern International operations are city-based, again in direct competition with local bus companies.

Costing information

The following averages relate to the primary three bus vehicles used in the delivery of services to Menta's Central Eurozone customers across inter-city, city and rural bus services.

	Coach	Minibus	Bus
Capital cost	\$200,000	\$70,000	\$140,000
Life expectancy (years)	6	8	10
Annual depreciation	\$26,667	\$6,875	\$12,000
Residual value	\$40,000	\$15,000	\$20,000

The luxury coaches used in the inter-city services are modern express vehicles fully fitted with comfortable seats with passenger seat belts and equipped with Wi-Fi. These come in 45 or 60 seater models; baggage can be stowed by the driver in the ample luggage area. There are on-board toilet and catering facilities.

The minibuses used primarily on rural routes come in 9, 16, 19 and 23 seater models. These can also be deployed in shuttle bus services to city centre from park-and-ride, airports, hospital outpatient collections and school trips. These are also fitted with passenger seat belts. There is an adequate baggage area for light luggage. Some models are equipped with a wheelchair lift at the rear.

The standard buses used in city transport have 48 or 66 seats and room for 20 standing. These models have utility bench seats without seatbelts, and low access steps for wheelchairs and baby buggies. They have minimal capacity for luggage.

The minibus and standard buses are used in mixed quantities according to route popularity amongst city and rural areas.

All vehicles are regularly maintained in accordance with government public service vehicle (PSV) regulations. Menta sees considerable benefit in maintaining the vehicles to a very high standard as this not only prolongs vehicle life but results in a much more reliable service, free from breakdown and interruption.

	Intercity	Rural	City
Average speed (km/hour)	80	30	14.4
Fuel economy (litres/100 km)	30	32	39
Operational hours/day	15	15	15
Operational days/year	287	287	287
Fuel (litres/day)	360	144	84
Route (km/day)	1,200	450	216
Route (km/year)	344,400	129,150	61,992

All vehicles are expected to run 75-90 hours a week, 11 days out of 14. Each vehicle needs a minimum of 2.5 drivers to run shifts on the long operational days. Two drivers are required on all inter-city routes to comply with regulations. The second driver has a mandatory rest period during the long-distance journeys but also has the opportunity to serve refreshment and help with luggage loading.

The vehicles are maintained on a 4, 6 and 8 weekly cycle depending on distance covered. They are cleaned after every shift and any repairs are immediately attended to.

ANNUAL COSTS (C\$)	Inter-city		Rural		City	
Drivers' wages	122,710	37%	61,355	38%	61,355	40%
Fuel	92,988	28%	37,195	23%	21,759	14%
Tyres	4,305	1%	1,614	1%	775	1%
Maintenance	10,186	3%	5,793	4%	7,257	5%
Cleaning	5,740	2%	5,740	4%	5,740	4%
Insurance and repair	15,689	5%	15,258	9%	15,124	10%
Overhead	35,344	11%	20,129	12%	20,062	13%
Depreciation	26,667	8%	6,875	4%	12,000	8%
Staff benefits	17,530	5%	8,765	5%	8,765	6%
Annual vehicle costs	331,158		162,725		152,837	

Staff-related costs are by far the largest element of operational costs. Including drivers, cleaners, maintenance and administration staff, over 50% of costs are directly staff-related.

Vehicle Costs (C\$)	Inter-city	Rural	City
Cost per day	1,153.86	566.99	532.53
Cost per Km	0.96	1.26	2.47

Due to distances travelled at higher speed on inter-city and rural routes, the costs per kilometre are significantly less on the inter-city, predominantly major road travel.

These figures can be used to evaluate the break-even passenger load for each type of bus, assuming different fare rates per kilometre travelled. For example, if inter-city fares are based on a rate of C\$0.025 per kilometre of the journey, then inter-city buses will require an average

passenger load of 38.5 to break even. The average load on an inter-city bus is 40, which means that a fare of that amount would leave only a very small contribution.

City buses cover shorter routes, which means that Menta can charge a higher fare per kilometre. A fare of C\$0.25 per kilometre would require an average passenger load of 9.9 to break even, which is well below the average passenger load of 15 for city buses.

Fare charged per km in C\$			Break-even passenger load for fare rate (number of passengers)		
Inter-city	Rural	City	Inter-city	Rural	City
0.050	0.50	0.50	19.2	2.5	4.9
0.045	0.45	0.45	21.4	2.8	5.5
0.040	0.40	0.40	24.0	3.1	6.2
0.035	0.35	0.35	27.5	3.6	7.0
0.030	0.30	0.30	32.1	4.2	8.2
0.025	0.25	0.25	38.5	5.0	9.9
0.020	0.20	0.20	48.1	6.3	12.3
0.015	0.15	0.15	64.1	8.4	16.4
0.010	0.10	0.10	96.2	12.6	24.7
Average passenger load			40	7	15

Menta's rural and city fares are generally priced so that buses do not reach break-even with average loads. This is mitigated by the fact that loads vary throughout the day, with busy periods in the morning and the evening. Effectively, Menta makes a profit because of peak travel during the morning and evening rush hours. These figures also ignore the revenues from government subsidies.

In general, Menta aims to undercut local competitors in terms of fare structure. Bus passengers often travel frequently and so even a small price difference can be a factor in deciding which bus to take.

The pricing of inter-city services is more complicated. Menta has adopted the approach taken by the airline industry. Passengers can book up to a month before their journey and those who book well in advance generally pay less. Those booking at the last minute or who buy a ticket on the day of travel will generally be charged significantly more. Menta also charges more for popular times. For example, a morning departure is more attractive than afternoon and so passengers can save by selecting services that might otherwise be less busy. Inter-city buses generally operate at close to full capacity and at a good contribution.

Menta inter-city routes link up with city and rural travel, passengers can be dropped at park-and-ride locations, which Menta has aggressively acquired over the past 30 years. These act as local hubs and depots for ongoing travel, including airport and city centre shuttles.

Public sector contracts are important sources of revenue. These include tendered routes to support communities that would otherwise be isolated for those who do not own cars, and school services. The level of subsidy depends on the needs of the community and the potential

for full-fare passengers to make the route viable without subsidy. For example, a route that linked an outlying village to a local hospital and shopping centre would be more likely to win funding than one served by local train services.

Menta has always bid aggressively for supported service tenders. These allow an immediate support to rural communities and generate revenues that pay for buses to operate outside of the peak periods when people are travelling to and from work.

Extracts from Menta's financial statements

Consolidated statement of profit or loss

For the year ended 31 December

	2017	2016
	C\$m	C\$m
Revenue	4,217.8	4,017.0
Operating costs	(2,741.6)	(2,731.6)
Operating profit	1,476.2	1,285.4
Finance costs	(22.8)	(36.5)
Profit before tax	1,453.4	1,248.9
Taxation	(319.7)	(299.7)
Profit for the year	1,133.7	949.2

Other comprehensive income for the year

Gain taken to translation reserve	11.8	9.3
Total comprehensive income for the year	1,145.5	958.5

Consolidated statement of financial position**As at 31 December**

	2017	2016
	C\$m	C\$m
Non-current assets		
Goodwill	171.3	142.8
Property, plant and equipment	1,667.9	1,147.3
	<u>1,839.2</u>	<u>1,290.1</u>
Current assets		
Inventories	22.1	21.6
Trade receivables	210.9	223.2
Cash and cash equivalents	327.4	348.9
	<u>560.4</u>	<u>593.7</u>
Total assets	<u><u>2,399.6</u></u>	<u><u>1,883.8</u></u>
Equity		
Share capital and share premium	587.3	424.7
Retained earnings	942.8	427.6
Translation reserve	84.5	72.7
	<u>1,614.6</u>	<u>925.0</u>
Non-current liabilities		
Loans	285.0	456.3
Current liabilities		
Trade payables	192.6	204.9
Tax liability	307.4	297.6
	<u>500.0</u>	<u>502.5</u>
	<u><u>2,399.6</u></u>	<u><u>1,883.8</u></u>

Segmental information

Revenue split geographically

	2017	2016
	C\$m	C\$m
Centralia	2,910.3	2,892.2
Rest of Central Eurozone	506.1	562.4
North and Central America	337.4	241.0
Asia	464.0	321.4
	<u>4,217.8</u>	<u>4,017.0</u>

Revenue split by type of service

	2017	2016
	C\$m	C\$m
Inter-city	1,347.1	1,299.1
City	1,878.6	1,641.4
Rural	992.1	1,076.5
	<u>4,217.8</u>	<u>4,017.0</u>

Operating profit split geographically

	2017	2016
	C\$m	C\$m
Centralia	1,062.9	912.6
Rest of Central Eurozone	132.9	167.1
North and Central America	88.6	160.7
Asia	191.8	45.0
	<u>1,476.2</u>	<u>1,285.4</u>

Operating profit split by type of service

	2017	2016
	C\$m	C\$m
Inter-city	585.5	565.6
City	688.7	458.5
Rural	202.0	261.3
	<u>1,476.2</u>	<u>1,285.4</u>

Extracts from Dawlbus' financial statements

Consolidated statement of profit or loss For the year ended 31 December

	2017	2016
	C\$m	C\$m
Revenue	3,458.6	3,357.9
Operating costs	(2,351.8)	(2,384.1)
Operating profit	1,106.8	973.8
Finance costs	(26.7)	(32.8)
Profit before tax	1,080.1	941.0
Taxation	(237.6)	(225.8)
Profit for the year	<u>842.5</u>	<u>715.2</u>

Consolidated statement of financial position

As at 31 December

	2017	2016
	C\$m	C\$m
Non-current assets		
Goodwill	157.1	157.1
Property, plant and equipment	1,416.8	1,185.2
	<u>1,573.9</u>	<u>1,342.3</u>
Current assets		
Inventories	18.6	18.1
Trade receivables	172.9	186.6
Cash and cash equivalents	253.4	249.8
	<u>444.9</u>	<u>454.5</u>
Total assets	<u><u>2,018.8</u></u>	<u><u>1,796.8</u></u>
Equity		
Share capital and share premium	411.8	411.8
Retained earnings	920.7	624.8
	<u>1,332.5</u>	<u>1,036.6</u>
Non-current liabilities		
Loans	296.7	364.4
Current liabilities		
Trade payables	155.4	169.1
Tax liability	234.2	226.7
	<u>389.6</u>	<u>395.8</u>
	<u><u>2,018.8</u></u>	<u><u>1,796.8</u></u>

Press coverage

Centralia Daily News

Parents' fury after school bus accident

An accident took place yesterday involving a collision between a school bus and a lorry. Parents are furious as there were no seatbelts available on the bus. It appears that several pupils were not even seated at the time of the accident, resulting in a number of injuries.

A spokesperson for Menta, the company who operates the school bus, explained that there is no regulation to require that buses should be fitted with seatbelts. The buses operate with a driver, whose attention is focussed on the road, and there is no-one else available to supervise the schoolchildren.

A police spokesman confirmed that the law states that seatbelts should be worn if they are available. The bus involved in the accident was 22 years old and had no seatbelts fitted.

The Centralia Daily News contacted more than 20 local bus companies across the country and none have seatbelts in their buses.

Centralia Daily News

Local bus services decline

A report published by the Centralia Transport Authority suggests that many communities are losing their local bus services. Intense competition between bus operators for lucrative routes has forced many smaller bus companies out of business. The remaining companies do not always find it cost-effective to service quieter routes, even if there are local government subsidies available.

There is very little to be done to prevent this from continuing. Any operator whose buses meet the safety requirements and whose drivers are licensed can simply pay a C\$50 fee to register a new route. There have been cases of large bus companies moving into towns and running services at a loss until their local competitors have gone out of business.

The deregulation of bus routes was intended to simplify the provision of bus services and encourage growth in public transport. Unfortunately, the demise of many independent bus operators has been an unintended consequence of this.

The Jaria Advertiser

Jaria Buses ceases trading

Jaria Buses, which has serviced the local community for 30 years, has been forced to close down. Menta moved in six months ago and started a local route that passed through Jaria and went to several of nearby larger towns six times a day.

Menta's fares were cheaper and they provided a very reliable service.

The local community is shocked that 23 people have lost their jobs with Jaria Buses and will find it very hard to get work in the local area. Menta have just announced a 20% fare increase as they now have no competition.

Jaria was one of the most recent towns in Centralia to have services provided by Menta.

Centralia News

Environmentalists target Menta

A recent report highlighting the benefits of using electric trains instead of diesel buses is being blamed for environmentalists blockading the bus station and preventing Menta's buses from running.

Centralia's electricity is mainly produced by wind turbines which the report said was much cleaner and safer than diesel.

Many school children use the buses and many of the buses used on the school runs are very old and inefficient.

The environmental group who organised yesterday's blockade intend to repeat it tomorrow.