



Private equity fund investment in the European ferry industry

Alfred J. Baird ^{1*}

¹ *Transport Research Institute (TRI), Edinburgh Napier University, Scotland*

Abstract

Over recent years Private Equity Funds (PEF's) have found the European ferry market to represent an attractive investment opportunity. This paper explains the development and working of PEF's, reviewing the pros and cons for this type of investment model. Over the last decade there have been 22 separate transactions completed by PEF's involving the acquisition of 11 different ferry companies throughout Europe. Combined, this amounted to a total investment of €7.7 billion. A series of case studies undertaken by the author relating to the acquisition of individual ferry operators by PEF's offers preliminary understanding of these transactions. The case studies highlight specific characteristics of the ferry market that private equity investors find attractive. Not least among these characteristics is: barriers to entry, long established businesses, the essential infrastructure nature of ferry services, steady cash flows, and high market share. PEF's appear to regard ferry services as displaying characteristics quite similar to other essential transport infrastructure investments such as roads and railways. Based on this analysis, it seems that PEF's view the ferry market as a relatively safe and attractive investment opportunity. Sellers, and regulators of ferry markets (perhaps more especially in the case of subsidized or island 'lifeline' services), need to be conscious of the potential opportunities, as well as the possible disadvantages of PEF investment and ownership. Buyers (i.e. PEF's) also need to be aware of the risks involved (e.g. from over-paying, new regulations etc), as well as the rewards.

Keywords: Private equity fund; European ferry market; Investment.

1. Introduction

The entry of private equity funds (PEF's) into European ferry markets is a relatively recent phenomenon. Hence this issue has not yet been researched to any significant degree, until now. This paper provides an initial analysis of the activities of PEF's in acquiring ferry companies in Europe.

Firstly, an overview of private equity funds is presented followed by discussion of the pros and cons of private equity fund investment. Then the ferry operators that have been acquired by private equity funds are considered. Through brief case studies with

* Corresponding author: Alfred J. Baird (a.baird@napier.ac.uk)

emphasis on the various transactions involving ferry lines that have been acquired by PEF's, it has been possible to establish a number of common characteristics. The conclusions outline the main findings, highlighting key issues and questions for further research.

Literature specifically concerning the subject of PEF's acquiring ferry companies is at best limited, which in turn makes this paper quite timely and necessary. The methodology here therefore includes reference to trade/industry press, and industry conference proceedings, as well as relevant academic literature, supported by discussions the author has had with several of the ferry company managers and PEF's involved. The research is thus preliminary in nature, which is understandable given the recency of the PEF phenomenon in terms of acquiring ferry operations. This implies that, over time, further research will be necessary to more fully analyse the longer term impacts and consequences of such investments.

2. Private Equity Funds

Private equity is medium to long-term finance provided in return for an equity stake in potentially high-growth unquoted companies (Price Waterhouse Coopers, 2004). Private equity provides what can be termed long-term, committed share capital in unquoted companies. Private equity funds (PEF's) are unlisted funds that raise capital from institutional investors. That capital is then used to 'shop' for assets that fit the fund's description and aims. PEF's, in other words, use institutional and other investors' capital in order to buy already established firms.

PEF's depend to a large extent on making high financial returns achieved through acquired company profits and thereafter finally when subsequently selling the acquired company on to another buyer at a monetary gain. For each fund it creates, a PEF is paid base fees in return for asset management plus a performance bonus. The general investment characteristics typical to a PEF may therefore be summarized as follows:

- Private equity is medium to long-term finance (i.e. hold equity in acquired business for 3-5 years, then exit)
- Finance is provided in return for an equity stake in unquoted companies
- Institutional investors provide private equity capital
- Potential annual returns range up to 30% for the more successful funds

According to the British Venture Capital Association, almost US\$700bn of private equity was invested globally in 2007¹. The regional breakdown of global private equity investments 2007 was as follows:

- North America 71%
- Europe 15%
- Asia-Pacific 10%

The private equity process is illustrated in Figure 1. The PEF is the 'General Partner' and is linked to the investors who are known as the 'Limited Partners'. Together they

¹ www.bvca.com

create and own the PEF. The PEF then makes specific investments in acquired companies which provide the fund's portfolio of investments.

PEF's typically retain their holding in companies for between 2-5 years then take an exit. The exit can be achieved in any one of a number of ways, for example:

- Repurchase (i.e. selling the shares back to the management)
- Refinancing (i.e. Selling the shares to another investor, even perhaps another private equity firm)
- Trade Sale (i.e. sale of the company's shares to another company)
- Flotation (i.e. the company achieving a stock market listing)
- Involuntary exit (i.e. where the company goes into receivership or liquidation).

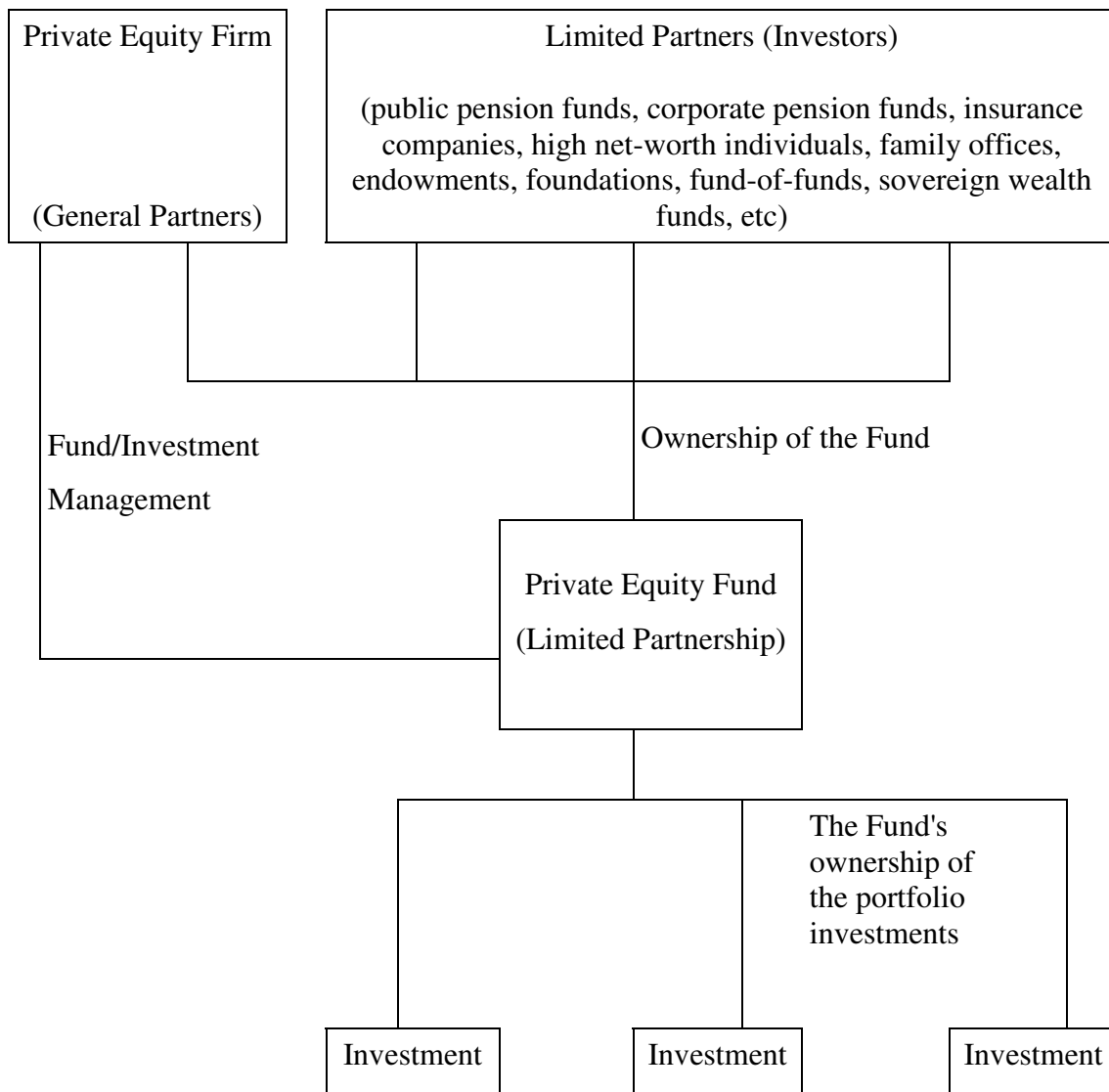


Figure 1: The private equity process (Source: BVCA)

According to Thomsen (2008), there are a number of specific features that make target companies attractive to PEF investors, including:

- A company's strong management
- Exciting development prospects
- Clear plan for value growth
- Meaningful market share
- Further acquisitions a possibility
- Barriers to entry for competitors
- Complex multi-jurisdictional situations

Thomsen stresses the benefit of management retaining independence (that is, existing managers continue to manage the acquired firm) but also emphasizes the need to provide incumbent management with incentives. The PEF focus is on medium to long-term 'value creation', with the prospect of earnings growth sought through the strategic attractiveness of a targeted business supported by the PEF's expertise in change management. Leverage is based on "cheap" financing, with exit planning forming a key part of the strategy. The power of quick and effective execution of decisions and access to a network of high-calibre executives (inside the PEF) are other advantages, according to Thomsen.

Table 1 illustrates some of the differences between private equity and other investor options. PEF's offer good access to capital compared with private ownership, but also allows for capital and competence to be brought together, unlike public equity providers who are less active in the acquired company's strategy. The investment horizon of PEF's is also much longer than the quarterly focus of public investors.

In terms of reporting requirements, the PEF needs frequent information, perhaps comprising monthly management accounts and trends analyses; however this is for internal purposes and is not made public. Conversely, public equity providers and indeed stock exchange regulations generally require frequent disclosure of extensive relevant financial and corporate information which is then in the public domain, thus offering a potential advantage to competitors as well as giving management a more onerous task which diverts their attention from other important matters.

Table 1: Private equity advantages over other investment options.

	<i>Private</i>	<i>Private Equity</i>	<i>Public Equity</i>
Access to capital	Limited	Good	Good
Contribution	Competence	Capital and Competence	Capital
Investment horizon	Varying	4-7 years	Quarterly focus
Reporting requirements	Annual	Frequent internal/private	Frequent external/public

Source: Adapted from Thomsen (2008)

3. Pros and cons of private equity funds

Private equity is not secured on any assets, although part of the non-equity funding package provided by the private equity firm may seek some security over assets. The private equity firm therefore faces the risk of failure just like other shareholders. The private equity firm is an equity business partner and is rewarded by the acquired

company's success, generally achieving its principle return through realising a capital gain via an exit, in addition to receipt of annual profits/dividends extracted during its tenure of ownership.

Conversely, a provider of debt (generally a bank) is rewarded by interest and capital repayment on the loan provided, which is usually secured either on business assets or on directors own personal assets, such as their homes. As a last resort, if the company defaults on its repayments, the lender can put the business into receivership, which may lead to the liquidation of assets.

PEF's tend to adopt a more "hands-on" or pro-active approach with the aim being to add value to the acquired company. In addition to advising on strategy and development, the PEF may have useful business connections to share with its management. The PEF aims to be more like a business partner, someone to approach for helpful ideas and discussion. A hands-on investor is particularly suited to a company embarking on a period of rapid expansion. However, day-to-day operational control is rarely sought by PEF's. In order to provide this support, some PEF's will expect to participate through a seat (or seats) on the board of the acquired company. The director may be an executive from the private equity firm or an external consultant and fees will need to be paid in return for the director's services. In an organizational and administrative sense the private equity firm will expect to:

- Receive copies of management accounts, promptly after each month end
- Receive copies of the minutes of the board of directors' meetings
- Be consulted and involved in, and sometimes have the right to veto, any important decisions affecting the company's business. (This will include major capital purchases, changes in strategic direction business acquisitions and disposals, appointment of directors and auditors, obtaining additional borrowings, etc.)

Some PEF investors may nevertheless have a less active role in the business, more a "hands-off" or passive approach, essentially leaving management to run the business without involvement from the private equity firm, until it is time to exit. They will still expect to receive regular financial information. However, if the company defaults on payments, does not meet agreed targets or runs into other types of difficulties, a hands-off investor is likely to become more closely involved with the management of the company to ensure its prospects are turned around.

According to Stevenson (2008), more private equity is expected to be attracted to shipping in future. Private equity is now targeting an internal rate of return (IRR) of 25-30% which implies the value of invested capital is tripled over a 5-year investment period. Certain shipping sectors are considered capable of providing returns of this level, notwithstanding rather more notorious volatility in areas such as bulk and liner container. As bank debt becomes scarce, so private equity is searching for new opportunities with an estimated US\$450 billion of private equity believed to be available for investment in 2008, though this was not all used up. The financial crisis might therefore be expected to result in more private equity interest in shipping, not less, as more low cost investment opportunities arise due to asset write-down's and other business changes.

Key attractions/requirements for private equity investment in target companies include:

- Lower prices (acquired company bargains, more likely in an economic downturn)
- Sustainable cash flows
- A reasonable growth trajectory
- IRR target of 25-30% or more

PEF's, however, are not without their critics. One criticism of PEF's relates to the high salaries paid to some executives. Macquarie, the Australian PEF, is nicknamed "the millionaires factory" because of the very high bonuses it pays staff. In 2005 Macquarie Bank revealed it paid its chief executive Aus\$18.5 million in the previous financial year and that another five top executives were paid more than Aus\$10 million each (Sydney Morning Herald, July 28th 2005).

This and related matters were considered by the Isle of Man Parliament's (Tynwald) Select Committee² during its 2008 investigation of pricing and service-related matters pertaining to the Macquarie-owned Isle of Man Steam Packet Company (Tynwald Court, 2008). Steam Packet, the only ferry company serving Isle of Man, was acquired by Macquarie in 2005, with senior management of the acquired company remaining in place after the takeover. Equity fund managers are just that; they are not ferry company managers and therefore depend on the existing managers to continue to manage the actual business itself. This raises another question, and that is, what added value do equity fund managers bring aside from buying and selling firms and extracting profit? In the case of Isle of Man Steam Packet Company, the select committee found evidence of high prices especially in the freight market, high profits/dividends (relative to other ferry lines in Europe), as well as some apparent limitations with respect to a willingness of the PEF owner to make capital investment in new tonnage and terminal facilities.

Whilst a major advantage of PEF's is that they do not need to disclose inner workings, like public companies, on the other hand this leaves their activities rather difficult to discern (Kuttner, 2007). There is criticism of the standard *modus operandi* of the funds which is viewed as being to buy in, beef up the chosen investment, and sell out fast at a substantial profit. Thus, PEF's are sometimes accused of selling off firms in pieces, sacking staff, collecting profit, and creating zero wealth, leading to windfall returns for 'financial engineers'. Another accusation is that whereas PEF's do make big investments (in buying up firms) they tend to have little experience in shipping (Brogren, 2007). In this regard shipping is considered to be a very long-term business (e.g. the economic lifetime of a ship can exceed 25 years), whereas at 3-5 years time horizon PEF's are rather short-term by comparison³. Perhaps most emphatically, PEF's have been described as "Deal Junkies", constantly looking for a deal, perhaps any deal, at times resulting in what appears to be rather inflated prices being paid for acquisitions purchased in an auction type sales frenzy (Docherty, 2008).

Sanchez & Wilmsmeier (2008) studied ports and terminals bought by PEF's. They found that ports in general made sound returns and represented an attractive proposition for PEF's. Ports are regarded by PEF's as positive and secure infrastructure investment opportunities. To PEF's, ferry operations are also regarded, like ports almost, as

² The author was appointed Advisor to the Isle of Man (Tynwald) Select Committee investigation into Isle of Man ferry services in 2007-8, and subsequently reappointed as advisor in 2009 for a second investigation.

³ Owners may nevertheless sell vessels in the market and therefore disinvest; whilst not eliminating risk, the latter option will be risk reducing to a greater or lesser extent, depending on the state of the market at a given point in time.

‘essential infrastructure’, in turn implying to some degree a safe investment option compared with certain other sectors.

Once a company has been acquired, the private equity owner may be less interested in making additional investments in expensive assets (e.g. ships, or port facilities). Its primary focus will be on recovering the already significant investment made in acquiring the company. Evidence in relation to Isle of Man Steam Packet Company’s somewhat problematic ship investment/replacement strategy seemed to reflect this, the latter purchasing a 10-year old high-speed craft in 2008 instead of opting for a new or nearly new ship.

If a PEF pays what seems to be an inflated price for a business (e.g. a very high EBITDA multiple), this might in practice be least positive for service users. Equity fund managers will insist on maintaining high profits as that will be essential in order to repay to investors the high initial cost of the acquisition. High profit levels can only really be maintained through high prices to service users, a task easier to achieve in less competitive (i.e. monopolistic) instances.

Private equity fund ownership of ferry lines therefore needs to be considered with a degree of caution, especially with respect to future investment needs in vessels and harbours. The imperative to maintain high and sustained profit levels, essential to repay investing institutions for the high (perhaps inflated) upfront acquisition costs, in addition to hefty management and bonus fees for the PEF’s management, implies considerable pressure will be placed on ensuring a minimum of further capital investment is made (e.g. in ships, terminals etc).

This implies that the PEF may not be able (or willing) to consider long-term aspects commonly associated with investment in ships (e.g. such as ship depreciation over the operating lifetime of the asset). There may instead be a focus on acquisition of second-hand ships or charter, even where newbuilds make more long term sense.

Furthermore, with private equity ownership there is always going to be the possibility of a further sudden disposal of an acquired company. For example, should an operator’s profits fall below a certain level, or if the ‘market’ value were to rise (e.g. through further strengthening of barriers to entry, long-term service agreements etc), that could be the trigger for a PEF to sell on again. Such a scenario may imply companies being regularly bought and sold, perhaps being traded between PEF’s. A key question in this regard relates to whether or not PEF priorities are compatible with, and/or appropriate to, essential island ferry service operations.

4. Ferry operators acquired by private equity funds

Table 2 shows that eleven ferry operators in Europe have either been acquired by or ‘bought into’ by PEF’s (Baird, 2008). Several lines have been bought and sold more than once during the past decade. In all there have been 22 transactions involving an aggregate total investment by PEF’s of almost €7.7 billion. Geographically, four of the operators serve UK routes, six serve Mediterranean Sea trades, and one is active in the Baltic Sea.

The earliest noted activity of PEF’s in the European ferry market dates back to 1995 when both Condor and Wightlink, respectively serving the Channel Islands and Isle of Wight, sold some of their shares. Wightlink has been sold three times to various PEF’s,

while Condor has been sold on between four different PEF's. This reflects the fact PEF's tend to look for an exit after 2-5 years, perhaps even less. Red Funnel Ferries has been sold on to three PEF's while Isle of Man Steam Packet Company was sold twice during 2003-2005.

The proportion of equity held by PEF's varies between ferry operators. In the early period up to 2000, PEF's tended to take only a minority stake in ferry companies. However this practice has since changed and PEF's are now generally taking a majority or even 100% ownership, with some exceptions.

Table 2: Private Equity Fund acquisitions/investment in the European ferry industry, 1995-2008.

<i>Operator</i>	<i>PEF Buyer</i>	<i>Year</i>	<i>Price Paid (€million)</i>	<i>Equity share (estimated)</i>
Wightlink	Cinven	1995	160	Min Holding
Wightlink	Royal Bank of Scotland	2001	270	35%
Wightlink	Maquarie Bank	2004	350	Maj Holding
Condor Ferries	3i	1995	50	33%
Condor Ferries	ABN-AMRO	2002	225	Maj Holding
Condor Ferries	Royal Bank of Scotland	2004	360	Maj Holding
Condor Ferries	Maquarie Bank	2008	390	Maj Holding
Red Funnel Ferries	JP Morgan	2001	105	Min Holding
Red Funnel Ferries	HBOS	2004	145	49%
Red Funnel Ferries	Prudential	2007	300	Maj Holding
Moby Lines	Efibanca/MPS	2000	5	4.3%
Moby Lines	Equinox	2004	20	14%
Moby Lines	Clessidra	2005	50	30%
Isle of Man Steam Packet	Montagu Private Equity	2003	210	100%
Isle of Man Steam Packet	Maquarie Bank	2005	315	100%
Grandi Navi Veloce	Permira	2004	522	80%
Grandi Navi Veloce	Investitori Associati	2006	700	87%
Scandlines	3i / Allianz	2007	1,560	
Superfast Ferries	Marfin Investment	2007	500	90%
Blue Star Ferries	Marfin Investment	2007	500	85%
UN RoRo	Kohlberg Kravis Roberts	2007	910	100%
SNCM	Butler Capital Ptnrs	2006	35	38%
Total			7,682	

Source: Cruise & Ferry Info: ShipPax, Halmstad, Sweden.

Figure 2 illustrates recent private equity activity in the European ferry market, showing in matrix form the logo of each ferry line, and the logo of the respective private equity buyer, together with the relevant year of sale/acquisition.

In the next section of the paper each of these acquisitions is analysed individually in more detail. The aim is to identify and explore some of the key factors pertaining to each acquisition, and to highlight any aspects common to the decision-making process of PEF's and their investments in the ferry sector. The analysis builds on, updates and augments earlier research undertaken by the author (Baird, 2008a).

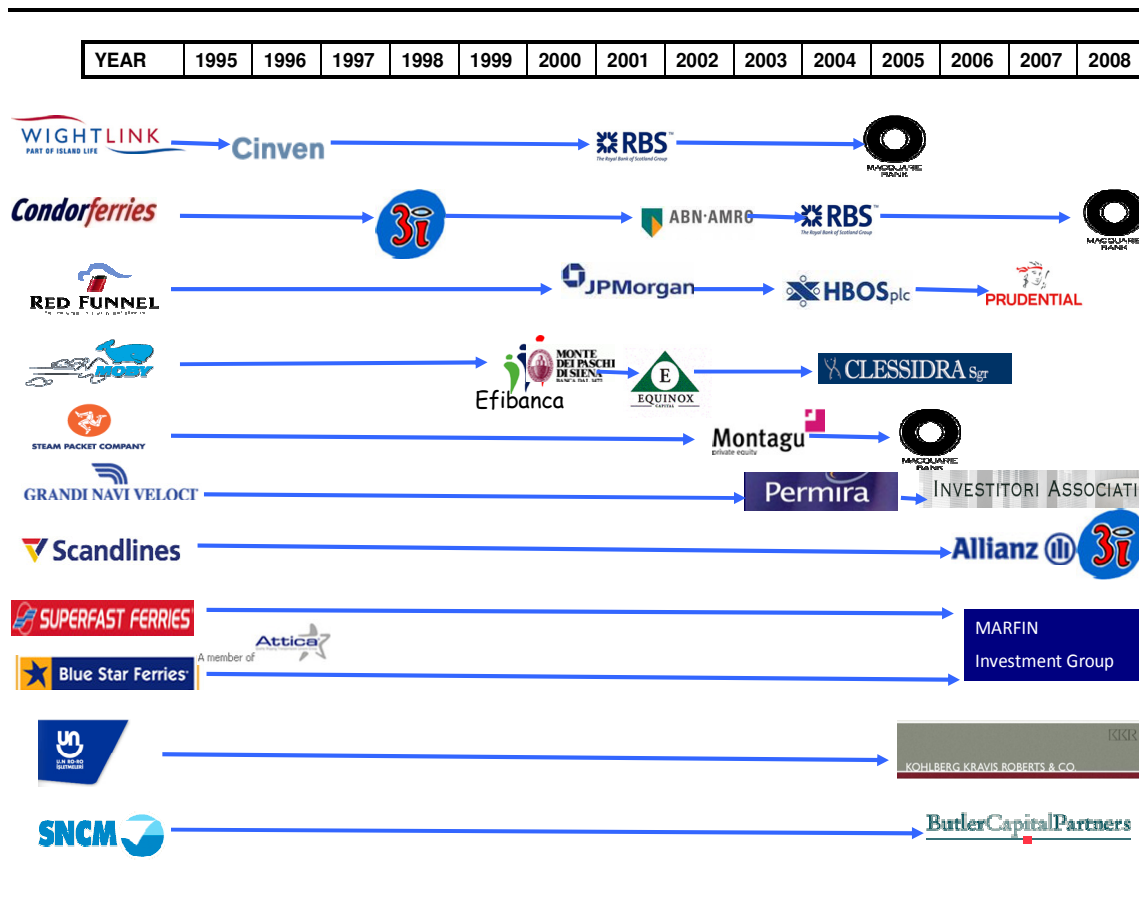


Figure 2: Ferry operators acquired by private equity funds, by year of transaction.

5. Case studies

5.1. Wightlink

Wightlink is a long-established firm (160 yrs old). The company has a significant market share of about 40% of the UK-Isle of Wight ferry market. Wightlink has control over key terminals on the British mainland at Portsmouth and Lymington, and on the Isle of Wight it owns the port of Fishbourne. The company's revenue in 2007 was estimated at €77m with EBIT of €16m. The fleet consists of 11 ships with an estimated re-sale value of about €100m. Annual traffic carried in 2007 amounted to 5.7m passengers, 1.2m cars, and 150,000 coaches/lorries.

Wightlink was formerly part of the ex-British Rail ferry company Sealink which was sold to Sea Containers during the mid-1980's (Cruise & Ferry Info, May 2003). The company was then sold by Sea Containers to venture capital company Cinven Ltd in 1995 for €160m. In 2001, Wightlink was purchased by the private equity division of Royal Bank of Scotland (RBS) in a management buy-out, with the management retaining 65% of the business and leaving RBS with 35% in return for a total investment of €270m. In 2003 Goldman Sachs was appointed to advise on the further disposal of Wightlink. Several international PEF's were among the bidders looking to acquire the

company. In 2004 Wightlink was acquired by Macquarie Bank of Australia for €350m. The company's strong market share, long established routes, and consistent revenue and profit stream made it an attractive proposition in the eyes of PEF's.

In 2006 there was a call for an Isle of Wight fares investigation by the local Member of Parliament (Cruise & Ferry Info, October 2006). It was claimed that the main operators (Wightlink and Red Funnel) had increased fares in excess of inflation. It was also claimed that a new pricing structure including price increases was introduced following the acquisition by Macquarie. The need to raise prices seems to be related to the increasing purchase price paid for the business by subsequent owners (with EBITDA remaining relatively constant) and the need to make a return on investment. Wightlink has since embarked on a fleet replacement programme (several of its ships were rather elderly and needing replaced), with new ferries ordered from low-cost yards in Croatia and the Philippines for delivery between 2008-2010. This added capital investment may be expected to motivate the PEF owner to seek increased returns.

5.2. Condor Ferries

Condor Ferries took over operations of the then British Channel Island Ferries service between the UK and the Channel Islands of Jersey and Guernsey in 1994. The company secured a 6-year 'franchise' awarded by the Channel Islands government to operate ferry services (albeit no subsidy is paid). This franchise provides Condor with a dominant market position for the transport of passengers, cars and freight by sea.

In 2007 the company achieved estimated revenues of €102m with an EBIT of approximately €25m. Condor's fleet comprises 5 ships with a total estimated re-sale value of approximately €70m. Annual traffic flows in 2007 were 940,000 passengers, 198,000 cars, and about 80,000 trailers.

UK venture capital group 3i retained a one third stake in Condor for several years until 2002 when the company, then part of the Commodore Group, was sold to a management buy-out backed by ABN-AMRO Capital for €225m. In 2004 a controlling interest in Condor was bought by RBS for €360m, the purchase closely following the award of a new 6-year operating concession to 2009.

Amid speculation in early 2008 that RBS wished to sell the company, the governments of Guernsey and Jersey published a joint sea transport policy stating that neither island would look for new operators until the end of 2013 unless the market or current operator fails (Cruise & Ferry Info, March2008). This effective monopoly position served to enhance the sale potential somewhat. Following the extended operating agreement, in mid 2008 Macquarie Bank acquired Condor for €390m.

While the resale price of Condor has continued to rise, traffic volumes and EBITDA appear to have remained relatively constant and the assets more or less unchanged. The increase in (perceived) value appears to be more related to the contract with government to serve the islands which effectively ensures that a barrier to entry for competitors exists.

5.3. Red Funnel Ferries

Red Funnel Ferries is another very long-established firm (150 yrs old) with a significant market share of about one third of the UK-Isle of Wight market. The company has control of key ports and routes between Southampton city and the island.

In 2007 Red Funnel had estimated revenues of €65m and EBIT of €16m. It has a fleet of 6 ships which have a re-sale value estimated at about €65m. Annual traffic flows amount to 3.0m passengers, 555,000 cars, and 103,000 coaches/trailers

Like Condor Ferries and Wightlink, Red Funnel has also had a succession of PEF owners over recent years. Formerly owned by ex state-owned Associated British Ports (at one time a listed company and now itself owned by a PEF), Red Funnel was sold to a management buy-out backed by JP Morgan International Capital in 2001, the latter paying €105m. As with other sales the new owner left the existing Red Funnel management in place. In 2004 Bank of Scotland Corporate Banking (HBOS) purchased Red Funnel in a €145m deal giving it a 49% holding. In 2007 the infrastructure fund of insurer Prudential Group paid an estimated €300m for Red Funnel. Prudential said it was attracted by the high quality of the business, growth potential and strong management (Cruise & Ferry Info, July 2007).

The management of Red Funnel, much like some other ferry operators acquired by PEF's, has therefore worked their way through several different owners in the space of only a few years. An issue raised by one former senior manager concerns the 'EBITDA multiple' paid for the operator (Docherty, 2008). In Red Funnel's case, the first PEF owner paid 5 x EBITDA, the second paid more than 10 x EBITDA, and the third paid closer to 20 x EBITDA.

In the ferry company management's mind, this raised the question of how a PEF came to value an acquisition, and also why subsequent valuations increased so much whilst at the same time EBITDA, and traffic volumes and revenues, remained more or less constant. In other words, how can a company continually be worth more when at the same time its traffic flows and net profit remain constant?

5.4. Moby Line

Moby line is an established ferry company that has been operating between Italy and Sardinia/Corsica for almost 20 years. The company has a significant market share across the routes it serves. In 2007 operating revenue was estimated at €180m with EBIT of €15m. Moby operates 14 ships, a mix of old and new, with an estimated re-sale value of about €300m. Annual traffic flows amount to some 4.0m passengers plus an unknown number of cars and freight trailers.

The participation of PEF's in Moby Lines has taken a rather different format compared with other operators. This has mostly involved the sale of minority shares in the company with PEF's providing capital for Moby's business expansion. In 2000, Monte Paschi Ventures Banca and Efibanca took a 4.3% holding in Moby. These investors supported the implementation of the first stage of Moby's strategy to become the leading operator on the Sardinia-continent trade by transforming the business model into a low cost operation. In 2004, the PEF Equinox took a 14% share in Moby. This was followed in 2005 by the sale of 30% of Moby for €50m to PEF Clessidra (ShipPax Correspondents, December 2006). These minority capital injections paved the way for investments in additional vessels (new and second hand) and also in the subsequent acquisition by Moby of a competing carrier, Lloyd Sardegna, in 2007. In this sense the investments by PEF's have been used by Moby primarily to augment its operations and to strengthen its market position.

It is envisaged that Moby will eventually look for a public listing which will allow some of the PEF investors to take an exit. From the perspective of PEF investors in

Moby, the value of a shipping line is considered to be not only in the steel (i.e. ships). The value includes assessment of a mix of factors such as existing charter-in and charter-out contracts, the order book and purchase options, the management, the freight contracts, and risk management (Scorza, 2007). Looking at net asset value (NAV) is an important aspect, but according to Clessidra this needs to be accompanied by a wider analysis of the company and its operations and markets in a holistic sense. However the role of the PEF investor still remains largely passive, allowing the management to continue to manage the operation.

5.5. Isle of Man Steam Packet Company

The Isle of Man Steam Packet Company (SPC) is reputed to be the oldest continuously operating shipping company in the world, its service dating back almost 200 years. The company enjoys a dominant market position being the only provider of ferry services between the UK mainland and the island, which lies in the middle of the Irish Sea. The Isle of Man government rents the port facilities at Douglas only to SPC for its use under what is known as the 'Linkspan User Agreement'. In an extension to the Agreement in 2007, this was further extended to 2020 with an option to take it to 2026.

No subsidy is paid to SPC, and no tender is/was used to select the operator, unlike many other island trades, and even for non-subsidized services such as the Channel Islands. The company's revenues in 2007 were estimated to be €61m with EBIT of €22m. On a return on sales basis this made the SPC one of the most profitable ferry operators in Europe. The company's 3 ships in 2007 had an estimated re-sale value of about €35m. A larger high-speed craft (second-hand conversion) was acquired in 2008 at a cost of approximately €25-27m including modifications. Annual traffic flows in 2007 amounted to 556,000 passengers, 166,000 cars and 38,500 trailers.

SPC was acquired by Sea Containers during the mid-1990's for an unknown figure, although as the company was in some distress at the time it is thought to be below €20m. In 2003 SPC was sold to Montagu Bank for €210m. Montagu thereafter quickly sold the company on to Macquarie Bank for €315m in 2005. Both PEF owners allowed the same management to continue.

In its 2008 investigation of SPC, the Isle of Man Parliament (Tynwald) Select Committee raised a number of issues to do with SPC's finances and operations (Tynwald Court, 2008):

- The lengthy and unusual User Agreement was contrasted with the more common tender process used by other islands to secure ferry services;
- Pricing was considered excessive, particularly for freight;
- The very high acquisition prices paid by PEF's for SPC, relative to assets, meant earnings would need to be maintained at high levels, which in turn implied a need for high transport prices;
- The Department of Transport needed to consider its role as regulator, more especially as it seemed to be acting rather like a partner to SPC;
- It was not certain that the private equity model (in this instance) was entirely compatible with long-term essential island ferry service provision.

There was in addition some evidence that the PEF owner was constraining the company's ability to invest in new or replacement ships, or to make investments in port

facilities. This suggested a drive on the part of the PEF to minimize costs and maximize EBIT. Given the shipbuilding cycle, variations in vessel prices over time, and the long-term nature of ship investment, this raised the question of whether or not the shorter timescale of PEF ownership (e.g. 2-5 years) was compatible with that of the shipping industry in general.

The somewhat inflated sale price of SPC, reflecting in large part the economic worth of the long-term User Agreement with the Government, was considered to be least positive for service users. In the case of SPC this was more especially related to freight customers. Equity fund managers may insist on maintaining high profit as that will be essential in order to cover the high initial cost of the (leveraged) acquisition. In the case of SPC, high profit levels can best be maintained through high freight rates, this being possible in large part due to the absence of competition in the freight market, the UA giving SPC an effective monopoly.

However, this also implies that the Isle of Man freight transport logistics sector is to a large extent paying the price for the high/inflated SPC purchase price paid by Macquarie, and before that by Montagu. Of course, this also means that the real cost of the UA is being met by the Isle of Man economy, its producers and consumers.

On the issue of fleet renewal, the aborted SPC attempt in 2007/8 to acquire *Spirit of Ontario*, a nearly new high-speed ferry that was available for purchase at around half the newbuild cost, appeared to be due to the fact SPC would only offer to charter the vessel rather than buy it. This approach was possibly due to pressure at the time from its owner for SPC not to purchase the ship. Similarly, it is believed that fast craft builders offered SPC new and attractive vessel options but SPC has been prevented from purchasing a more expensive newbuild because its owner, the PEF, has a focus on maximising short and medium term returns.

Instead of acquiring a new or nearly new fast craft, SPC subsequently received permission from its owners to acquire a second-hand (10-year old) vessel previously used by the US Navy and to upgrade it to an acceptable standard at a total cost of about £20 million (i.e. about half the price of a new vessel). It is possible that a similar degree of pressure is placed on SPC by the bank not to invest in shoreside/terminal facilities, given the findings of the Select Committee on the quality of passenger terminal provision.

In early 2009 the Select Committee was re-convened for the purpose of investigating further the financial accounts of SPC, implying some disquiet amongst local politicians at the PEF model adopted in this instance.

5.6. *Grandi Navi Veloce (GNV)*

GNV, which stands for 'Grand Navi Veloce' (translates as 'big fast ships') was established by the Genoa-based Grimaldi Line in 1991, although the Grimaldi family has been involved in shipping for generations. The company has a significant market share on its key routes based in Genoa and connecting Sicily, Corsica, Sardinia, Malta, Spain and North Africa. The fleet in 2008 consisted of 10 ships, most of which were wholly-owned. Annual traffic flows amount to 1.3m passengers, 433,000 cars and 2.47m lane metres (i.e. approx 200,000 x 12.6metre freight units). In 2007 GNV's estimated revenues were €267m achieving an EBITDA of €60m.

The company's policy since start-up has been to introduce one brand new vessel almost every year (actually 8 new ships were introduced over an 11 year period). By

2003 GNV was encountering some difficulties with its debt repayments, estimated to be in excess of €350m (Scorza, 2007a). Moreover, while sales were constantly growing, there was little improvement in EBITDA. This led to the sale of 80% of the company to PEF Permira in 2004 for €522m, an earlier plan to float the company on the Milan Stock Exchange having failed. The Grimaldi family became minority shareholders but still led the management of the company.

In 2006 Permira took an early exit through the further sale of GNV to Investitori Associati (as lead PEF together with 2-3 other smaller PEF investors participating), the latter paying €700m for an 87% holding. Some seven investment funds had been in competition to acquire GNV. One of the other attractions of GNV was the fact it had acquired 4 new well-designed RoPax ferries (with options for a further 4, subsequently exercised) at very competitive prices from Italian shipbuilder Apuania (a total cost estimated at €450m for all 8 ships) just prior to a dramatic rise in newbuild material costs. Indeed, by late 2008 Grimaldi Holdings as it had then become, had sold three of the 8 newbuildings and long-term chartered a fourth, resulting in significant gains for the new owner Investitori (Cruise & Ferry Info, December 2008).

5.7. Scandlines

Until 2007 Scandlines was owned jointly by the Danish Ministry of Transport and Deutsche Bahn (DB), the German state-owned rail company. In operation for over 105 years, Scandlines maintain a wide range of services on the Baltic Sea, mainly between Germany, Denmark and Sweden.

The company has a significant market share on all its routes. In 2007, revenue was €547m and EBIT a healthy €76m. Scandlines has 17 ageing ships, most of which are owned, and with a sale value estimated at about €300m (2007). It also owns 5 of its strategic ports. Annual traffic flows during 2007 was 18.5m passengers, 4.0m cars and 1.0m trucks.

In 2006 the state owners decided to sell Scandlines via an auction. At the beginning of the auction industry press considered an approximate price of €400m would be sufficient to acquire Scandlines. Scandlines themselves disclosed that interest from buyers was 'phenomenal' (Cruise & Ferry Info, January 2006). But as several private equity bidders became involved, the initial price estimate was soon bid upwards to some €800m. Eventually in 2007 it was announced that a joint venture bid of two PEF's, Allianz and 3i, had acquired Scandlines for a figure of €1.5 billion, which is about four times higher than the initial estimate. A third shareholder, the shipping company DSR of Rostock, was included in order to operate the business on behalf of the two main PEF shareholders.

According to Thomsen (2008), the key factors that made 3i and Allianz purchase Scandlines were:

- Stable infrastructure-like assets
- Good underlying growth drivers in freight and passenger traffic
- Good mix of passengers, freight and retail sales (border liquor stores etc)
- Opportunities to expand ferry services and related services
- Steady cash flows
- Opportunities for regional market consolidation
- Network of short crossing routes offering high potential for related sales

The acquisition has not done too well because the current financial crisis has resulted in reduced demand, for travel and goods transport, and this affects ferry operators just like others in the shipping and transport sectors. After years of double-digit growth, Scandlines experienced an overall decline in its transport volume in 2008 and a significant decline in profitability (Krieger, 2009). On its nine Baltic Sea services, the number of passengers declined by 3% to 17.3m. Car, truck and rail traffic also fell.

Scandlines attributed the decline to the financial crisis and the high price of oil. Tourist traffic slowed down markedly on the company's routes. As a result of falling demand, Scandlines terminated its service between the Danish ports of Arhus and Aabenraa and the Lithuanian port of Klaipeda. It also reduced its services between Rostock and the Danish port of Gedser as well as between Rostock and the Latvian port of Ventspils. The company said that declining demand for industrial and consumer goods in 2009 would continue to slow down freight traffic with the Baltic States and would also affect the Scandinavian services.

5.8. Superfast Ferries/Blue Star Ferries

Superfast Ferries was established by the Greek Panagopolous shipowning family during the mid 1990's when it started fast RoPax Trans-Adriatic services between Patras in Greece and Ancona in Italy. From that beginning the company expanded its concept further in the Adriatic, then the Baltic Sea and the North Sea. This means the company has a relatively recent history compared with most other acquisitions of ferry lines by PEF's. The Superfast parent company, Attica, which was listed on the Athens Stock Exchange, subsequently established another line, Blue Star Ferries to serve the domestic island trades in Greece.

Both Attica subsidiaries enjoyed a significant market share on their main respective routes. However these routes are highly competitive and are fully commercial operations (i.e. without subsidy or government contracts). The fast speed of the vessel also resulted in continuous pressure on costs, principally fuel expense. For the few years prior to its disposal, Attica strategy centered on disposal of some vessels at a time when the market for such tonnage was still quite high, and with few shipbuilding slots, also prior to the point when the fuel price started to increase significantly. The resultant high prices obtained for some of ships resulted in significant gains leading to reasonable profits and dividends being maintained during tough trading conditions.

In 2007 the PEF Marfin Investment Group (MIG) paid approximately €500m for a 90% holding in Superfast Ferries. During the same period MIG had acquired a majority ownership of sister company Blue Star Ferries (85%); although the price of the latter acquisition is not known it is considered to be approximately €300m, which means MIG paid about €800m for all the Attica ferry interests. Subsequently both lines were merged into Attica.

Prior to its disposal in 2007, Attica had revenues of €316m and an EBITDA of €70m. Its fleet comprised 13 ships with a total re-sale value estimated at around €500-600m. Annual traffic carried (2006) was 4.0m passengers, 580,000 cars and 298,000 trailers.

5.9. UN RoRo

UN RoRo based in Istanbul was established in 1993 by Turkish trucking interests. The basic idea was to develop a new 'Motorway of the Sea' link between Istanbul and

Trieste thereby avoiding the highly problematic road transport journey through the various countries of the former Yugoslavia (Torbianelli, 2000). Over the past 15 years or so UN RoRo has managed to secure a significant market share (37%) of the traffic previously moving by road (Cruise & Ferry Info, November 2007).

The company had purchased a fleet of nine modern RoRo ships by 2007 with further vessels on order. The fleet is entirely based around the highly successful standard Flensburger RoRo design of 195m long 3,000+ lane-metre 21-knots vessels. UN RoRo has established its own terminals in Turkey at Pendik and another at Ambarli, conveniently located away from urban areas and avoiding more expensive traditional docker working practices, the latter an essential aspect in development of the Japanese coastal 'Motorways of the Sea' since the 1970's (Baird, 2000).

UN RoRo's revenue in 2007 was estimated to be about €130m with EBIT of €10-15m. The company's 9 ships had an approximate re-sale value estimated at €250-300m. Annual traffic flows are around 100,000 trailers based on a daily service on what is a 52-hour voyage (Buchanan, 2007).

The largest shareholder, trucking owner Ulusoy, was opposed to the takeover by US-based PEF KKR in 2008. Ulusoy subsequently started a competing Ro-Ro service under the name Ulusoy Sea Lines, with orders placed at Flensburger for similar vessels to those used by UN Ro-Ro.

One of the first actions of KKR was to raise freight rates by €130 per trailer within a few months of acquiring the line. UN Ro-Ro claimed this was necessary because of the rising bunker prices. But some truckers were said to have realized that although they were happy to get a good price from KKR for their shares, the inevitable consequence of a PEF taking control is a focus on profitability and this will generally mean raising prices (Cruise & Ferry Info, January 2008).

Debt financing for the acquisition was arranged by Turkish banks Garanti Bankasi and Turkiye Is Bankasi. Reflecting the experience with several other PEF deals, a large number of professional advisors were involved in the transaction, aside from KKR and UN Ro-Ro, including⁴:

- Norton Rose LLP together with Özel & Özel acted as the legal advisors for U.N RoRo Isletmeleri A.S.;
- Morgan Stanley acted as the financial advisor;
- White & Case LLP and Simpson Thacher & Bartlett acted as the legal advisors for KKR;
- Finsbury Group, Kekst and Company and Bersay Communication acted as PR advisors to KKR;
- Deloitte acted as financial advisors for KKR;
- The currency conversion was made through www.oanda.com.

5.10. SNCM

SNCM is a very long established company (158 yrs) serving the government-subsidized routes between south-east France and Corsica. The company has a significant market share, albeit in some decline over recent years.

⁴ <http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=36571630>

In 2007 the company's revenues amounted to €190m, with EBIT € negative. SNCM has a fleet of 10 ships with a re-sale value estimated at approximately €250m. Annual traffic flows in 2007 were 1,079,308 passengers, 358,000 cars, and approximately 100,000 trucks/trailers.

For a long period there had been conflict between the French state and the trade unions representing crews and other SNCM workers. This coincided with rising financial losses. The European Commission investigated increasing subsidy levels and the impacts on private competition, mainly on rival Corsica Ferries. Substantial changes were recommended and subsequently the French state took the decision to dispose of SNCM.

A consortium comprising the PEF Butler Capital with public transport specialist Veolia successfully bid for SNCM in 2007. However the bid was conditional as it involved a pull-out clause in the event that SNCM was not awarded the new 8-year concession contract for Corsica routes. SNCM eventually won the tender and with it a state subsidy amounting to €97m/year.

Butler Capital at the outset acquired a 38% holding in SNCM for €38 million, with Veolia taking a slightly lesser stake. In order to address public interests, the French state retained a 20% holding in the company. To appease the employees, a share of around 8% was allocated to the trade unions. Butler Capital subsequently took an exit in 2008 through selling its shares to partner Veolia for an undisclosed sum, with the other minority shareholders remaining as before.

The strategy of Veolia is to use its extensive transport management expertise to rapidly turn the company around (through efficiency savings) so that it will generate a profit. The role of Butler Capital in this instance was to help finance the initial purchase (privatization) of SNCM but then to take an exit at the earliest possible opportunity, which has been achieved.

6. Conclusions

The entry of PEF's into the European ferry market is a relatively recent phenomenon. It is still early days but already some results and trends can be detected.

To begin with, it is evident that PEF'S tend to focus on companies in the ferry sector that have the following characteristics:

- Established ferry services/essential 'infrastructure' (e.g. serving islands and/or 'Motorways of the Sea' type services)
- Protected or semi-protected markets/barriers to entry (e.g. via control of strategic ports, and/or through government contracts to maintain 'lifeline' type services)
- Significant or dominant market share

A number of common features have been identified relating to the majority of transactions. These have been separated into five different aspects and are summarized as follows:

1. PEF's tend to pay high prices to acquire ferry lines

With few exceptions, purchase prices paid by PEF's to acquire ferry companies tend to be a high multiple of EBITDA, and several times greater than net asset value (i.e. net worth of the ships). The auction of a ferry operator appears to help further raise the end price achieved due to intense competition in the market between PEF's.

2. PEF's have an immediate/intense focus on profits/dividends (ROI)

PEF's need to ensure the acquired business generates a profit. The PEF will look for substantial dividends annually. This is necessary to repay investors, not least because such acquisitions tend to be highly leveraged arrangements (i.e. based on loans as well as equity). There therefore seems to be a tendency to increase ferry service prices in order to raise profits.

3. PEF's leave ferry managers/partners to operate the business

The PEF is led by 'financial engineers' not maritime business managers. The existing ferry company managers will therefore tend to be retained, with few changes. The PEF holding a majority of shares will nevertheless generally control the board of directors and seek regular management meetings with a strong focus on financial performance. However, a PEF may also bring with it an experienced transport operator as joint venture partner; this seems more likely where the management and operational efficiency of an acquired ferry company can be significantly improved (e.g. the case of former state-run operations, such as Scandlines and SNCM).

4. PEF's have limited focus on newbuildings/terminals/route development investments

Once a PEF has made a significant investment in the acquisition of a ferry operator, it will not be too keen to spend further large amounts of money on new assets. Hence there is less focus on buying new ships, or making expensive outlays in terminal upgrades, or in start-up of new routes. The key emphasis for the PEF is to sweat the existing assets and routes, for which a premium will normally have been paid.

5. PEF's tend to look for an exit after 2-5 yrs

PEF's require an exit through a further sale of the acquired ferry company typically after a period of between 2-5 years from the time of the initial acquisition. It is important for the PEF that the re-sale value increases over the time of ownership. The current financial crisis and general economic conditions will inevitably put pressure on valuations. More limited takeover activity in the past year or so suggests PEF's are waiting a little longer than usual in order to exit at a time when markets are more stable. This may have implications for re-financing of leveraged deals (e.g. where bullet loans used by PEF's to acquire a firm become due for repayment).

There is clearly a need for further research in this developing area. Some important questions to consider include:

- Do PEF's leave lines in better condition after sale?
- Are there better sources of finance?
- Shipping is generally regarded as a long-term investment, PEF's are not; does this matter?
- And, what happens after the global financial crisis?

Finally, there is the matter of whether the PEF entry into the ferry business will last. To a large extent this depends on whether or not PEF's continue to enter into attractive deals and don't find themselves overpaying for businesses (Reinikainen, 2007). And, of course, whether they can maintain positive financial returns on an annual basis is something that is going to be testing during times of economic downturn.

References

- Anon (2003) "Wightlink appoint consultants to advise on sale", *Cruise & Ferry Info*, ShipPax, Halmstad, May.
- Anon (2005) "Millionaire's Factory' defends \$10m salaries", *The Sydney Morning Herald*, July 28th.
- Anon (2006) "Scandlines: new owners before next summer", *Cruise & Ferry Info*, ShipPax, Halmstad, January.
- Anon (2006) "Calls for Isle of Wight fares probe", *Cruise & Ferry Info*, ShipPax, Halmstad, October.
- Anon (2007) "KKR completes purchase of UN Ro-Ro", *Cruise & Ferry Info*, ShipPax, Halmstad, November.
- Anon (2007) "Red Funnel bought by Prudential", *Cruise & Ferry Info*, ShipPax, Halmstad, July.
- Anon (2008) "Condor Ferries: On the market?", *Cruise & Ferry Info*, ShipPax, Halmstad, March.
- Anon (2008) "UN Ro-Ro: Truckers concerned about prices", *Cruise & Ferry Info*, ShipPax, Halmstad, January.
- Anon (2008) "Going for pole position on the Adriatic Sea", *Cruise & Ferry Info*, ShipPax, Halmstad, December, pp. 50-51.
- Baird, A. J. (2000) "The Japan coastal ferry system", *Maritime Policy & Management*, Vol. 27, No. 1, pp. 3-16.
- Baird, A. J. (2008) "The Private Equity Merry-Go-Round", *Interferry 33rd Annual Conference*, Hong Kong, 5-7 October.
- Baird, A. J. (2008a) "Private Equity Investments in the Ferry Sector", *TRI Maritime Forum*, Edinburgh, 22nd October, Napier University TRI, Edinburgh.
- Brogren, K. (2007) "The private equity trip – a trap?", *Cruise & Ferry Info*, ShipPax, Halmstad, November.
- Docherty, T. (2008) "Private Equity to Infrastructure: An Operator's Perspective", *33rd Annual Interferry Conference*, Hong Kong, October 3-7.
- Kuttner, R. (2007) "Hedging Disaster", *The American Prospect*, April 30th.
- Krieger, F. (2009) "Scandlines suffers 3% dip in passengers", *Lloyds List*, 30th January, Page 3.
- Price Waterhouse Coopers (2004) *A Guide to Private Equity*, British Venture Capital Association, London.
- Reinikainen, K (2007) *Ferries for dessert*. *Cruise & Ferry Info*, ShipPax, Halmstad, February.
- Sanchez, R. J. and Wilmsmeier, G. (2008) "Private equity investment in ports and terminals: where do we go now?", *TRI Maritime Forum*, Edinburgh, 22nd October, Napier University TRI, Edinburgh.
- Scorza, A. (2007) "All is not gold that glitters", *Cruise & Ferry Info*, ShipPax, Halmstad, February.
- Scorza, A. (2007a) "Aiming high", *Cruise & Ferry Info*, ShipPax, Halmstad, October.
- ShipPax Correspondents (2006) "Ferry News", *Cruise & Ferry Info*, ShipPax, Halmstad, December.
- Stevenson, C. (2008) "Private Equity and Shipping", *Fifth City of London Biennial Meeting*, Cass Business School, London, 18-19 November.
- Thomsen, S. (2008) "3i & Private Equity", *Interferry 33rd Annual Conference*, Hong Kong, 5-7 October.
- Torbianelli, V. A. (2000) "When the road controls the sea: a case study of Ro-Ro transport in the Mediterranean", *Maritime Policy & Management*, Vol. 27, No. 4, pp. 375-389.
- Tynwald Court (2008) *Report of the Select Committee on the Isle of Man Steam Packet Company*, Tynwald (Isle of Man) Parliament, PP120/08, November.