A Conversation with the Managing Director

John CHAN Cho Chak
Managing Director

Reinforcing our leadership

We will be a major participant in the development of public transport systems across the China Mainland

A matter of considerable interest to the Group's stakeholders over the past year was the progress of negotiations with the Government of the Hong Kong Special Administrative Region ("HKSAR" or "Hong Kong") on a new franchise for The Kowloon Motor Bus Company (1933) Limited ("KMB") and a new fare adjustment mechanism for the franchised public bus industry in Hong Kong. In the following interview, the Managing Director of Transport International Holdings Limited ("Transport International"), Mr John Chan Cho Chak, discusses the challenges that the Group faced in the past year, the implications of the new fare adjustment mechanism for the Group and the strategy to drive the Group forward.

Q Do you think 2005 has been a particularly challenging year for Transport International? What is your key message to shareholders this year?

A Transport International continues to be a solid, well regarded, progressive, community-orientated Group. If you look closely at our figures of last year, or indeed those of the last couple of years, you will see there has been a downward adjustment in profits. This is mainly due to influences which are very largely beyond our control — increases in oil prices, tunnel toll charges, interest rates and wages, coupled with a continuing drop in patronage as a result of the commissioning of new railway lines. But there have been some very positive outcomes for the year as well — our continued expansion into the Mainland of China, the introduction of a more transparent and objective fare adjustment mechanism by the Government, and of course the successful renewal of KMB's franchise until 1 July 2017.

Q While the Group is becoming increasingly diverse in terms of business interests, KMB remains your flagship company. How important is the new franchise agreement it has reached with the Hong Kong Government?

A Quite simply, it gives KMB the right to continue to provide quality franchised public bus services in Hong Kong through to 1 July 2017. It is an agreement that assures our ongoing role as a leader in Hong Kong's public transport sector. Remember, we have more than 70 years of history here. That is quite a reputation to live up to. Over the years, KMB has evolved into one of the most cost effective public bus operators in the world. Today, its average bus fare is just about HK$5.60. And for that price passengers enjoy riding on buses that are superbly designed and maintained, offering standards of safety and comfort that are far better than those of many other operators in the world's major cities. It is a standard that Hong Kong passengers have come to expect. While rising costs might prompt us to consider lowering our service standards, it would certainly not please our customers. Nor would it fit in with our commitment to seek the best for our passengers. It has always been our mission to provide an efficient, reliable and user-friendly bus service that gives our customers excellent value for money. And we operate to that maxim in Hong Kong and elsewhere in the region.

Q In that case, how does the new fare adjustment mechanism, which came into effect on 10 January 2006, benefit your company?

A In addition to those factors specified under the previous fare determination mechanism namely: changes in operating costs and revenue since the last fare adjustment; forecasts of future costs, revenue and return; the need to provide the operator with a reasonable return; public acceptability and affordability; and the quality and quantity of service provided which are mostly subjective and qualitative in nature, the new mechanism includes a measurable formula that will cater for both upward and downward fare adjustments based on objective criteria and actual statistics. Under this new formula which is to be applied for the next 3 years, the extent of a fare adjustment is based on 50 percent of the change in the composite consumer price index ("CCPI") and 50 percent of the change in the wage index of the transport sector ("Wage Index"), minus a fixed value of 0.3% per annum. The CCPI and the Wage Index are data published periodically by the Government's Census and Statistics Department, both of which are easily accessible and understood by the general public. The fixed value of 0.3% per annum represents 50% of the productivity gain for the bus industry in Hong Kong based on the data for 1995 to 2004. Although the new formula will not operate as the sole determinant of a fare adjustment, the Government will use the outcome of this formula as the reference indicator in considering whether a fare adjustment rate is supportable. The introduction of the new formula into the mechanism not only improves the objectivity of the fare adjustment process and provides greater responsiveness to changing economic conditions, but also depoliticises any future fare increase to be approved by the Government.

Q The previous fare adjustment mechanism had a profit sharing element. Does the new mechanism contain such an element?

A There was no ceiling rate of return for the franchised bus industry in Hong Kong. In the past, any profit in excess of a stipulated rate of return was shared between the operator and passengers on a 50/50 basis. The previous triggering point for this profit sharing arrangement for the period between 12 December 2000 and 9 January 2006 was 13% on the average net fixed assets (ANFA) of the franchised bus companies. Under the new fare adjustment mechanism, the triggering point has been set at 9.7%. This rate is calculated by the Government based on the weighted average cost of capital (WACC) for the bus industry which is considered more in line with the prevailing economic conditions. The balance of any excess return will either be used to reduce the magnitude of fare increases required in the future, or be used to provide fare concessions to passengers.

Q So, in the negotiations you faced a win-lose scenario?

A The new fare adjustment mechanism is not ideal from our point of view. As a company representing shareholders, we would have liked something more favourable. But we must recognise that we are operating under a franchise granted by the Government and we are entrusted by the public too. The new franchise has extended KMB's operating right for another nine years and eleven months. That is a good base for planning purposes.

Q Is the controlled nature of the Hong Kong market the reason for Transport International to expand into the Mainland of China?

A Hong Kong is a mature market for public transport services. There is little potential for significant growth. On the other hand, business potential on the Mainland is vast. Rapid economic growth in the Mainland accelerates the demand for improvement in both the quality and quantity of public transport services. It is an opportune time for a company like Transport International, with its strong Hong Kong experience and its international reputation, to enter this market. Our team is continuing to identify promising projects and suitable partners on the Mainland.

Q What profile do you see for Transport International in 10 years' time?

A We will be far more regionally orientated. Our business model may well be based on multi-modal transport operations. We will certainly be a major participant in the development of public transport on the Mainland. And we will continue to be a globally-recognised motivator for innovative bus designs and a standard setter for quality service.