Chartered Institute of Management Accountants

CIMA

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You are a Financial Manager in Flote, a shipping company.

Flote

Flote is one of the world's largest transport companies. Its head office is located in Zeeland, but the company operates globally.

The company was established more than 30 years ago. It has been quoted on its national stock exchange for most of that time.

Flote's primary business is in shipping and managing the movement of shipping containers.

Zeeland

Zeeland is Flote's home country. Zeeland's currency is the Z dollar (Z$).

Zeeland has adopted International Financial Reporting Standards.

Zeeland is an industrialised country that has a strong maritime tradition. It was a major exporter of manufactured goods for much of the twentieth century, and depended on the sea for much of its international trade. Zeeland's economy now depends largely on services, including shipping.

Maritime law requires all ships to be registered to a home port. The location of the home port determines which nation has the ultimate legal authority over the ship. Different countries have different shipping standards with respect to checks on the safety and seaworthiness of ships. Zeeland's shipping standards are regarded as being among the strictest anywhere in the world. All of Flote's ships are registered in Zeeland.

Containerised shipping

Shipping containers were invented in the 1940s in order to make the transportation of goods more efficient. The original shipping container was twenty feet long and eight feet wide. The capacity of ships and other handling facilities is traditionally measured in terms of TEU (twenty-foot equivalent units), although most of the containers in use today are double length, making them forty feet long and eight feet wide. Worldwide, more than 90% of the cargoes that can be fitted into containers are shipped in this manner.

The basic design of each size of container is standardised so that containers can be stacked for efficient use of space on land and in ships' holds. Special cranes and hoists have cradles that can lift a container securely. Heavy goods vehicles (HGVs) can tow a standard trailer that can carry a single forty-foot container for transportation by road. Railway wagons can carry containers for transportation by rail.

Most industrialised countries have a sophisticated infrastructure for handling containers. Factories frequently have the ability to accept containers delivered by road and to load HGVs with full containers of finished goods. Large factories often have their own railway sidings that are equipped to load and unload freight trains.

Most ports have the necessary cranes and hoists to handle containers. Docks often permit HGVs and freight trains to stop alongside docked ships so that containers can be moved directly to or from the ship, thus minimising the number of times each container has to be handled.

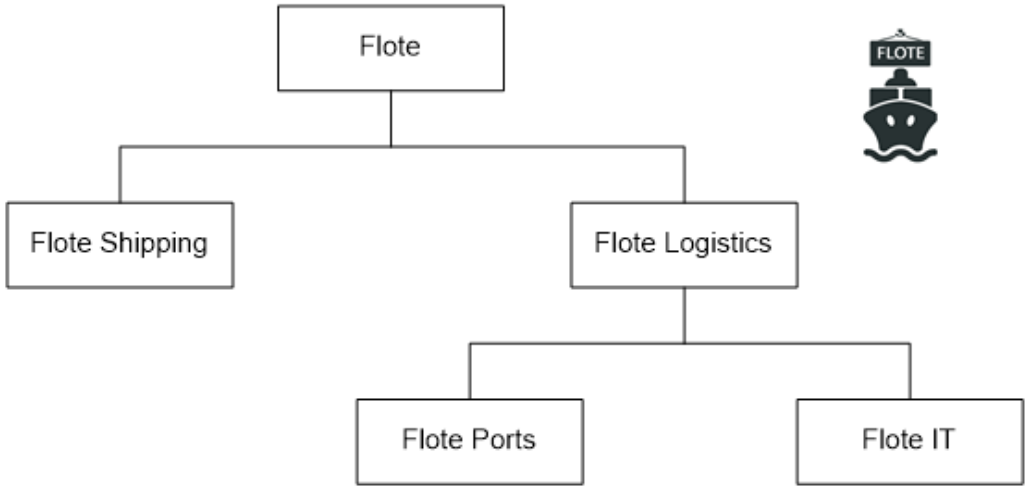
Most containers are designed to transport non-perishable dry goods, but there are modified versions fitted with refrigeration units for perishables and sealed versions for carrying liquids.

Container ships can carry a wide range of products and so container shipping is very versatile. The same ship can carry electronic goods, clothing, processed foods and many other types of product simultaneously. Most container ships have cranes that enable them to be loaded and unloaded at almost any dock, although it is much quicker and more efficient to use specialised container docks.

Some cargoes require specialised ships. For example, tanker ships carry oil and gas. Bulk carrier ships carry products such as grain or coal that are too bulky to be loaded into containers. Cars and other vehicles are transported using specialised ships that are designed to carry new vehicles from factories to their markets around the world. Each type of specialised ship generally requires special handling facilities at ports and so they use different docks from those used by container ships.

Flote's organisation and structure

Flote has two main lines of business: Flote Shipping and Flote Logistics.



Flote Shipping

Flote Shipping owns and operates 387 ships, all of which are designed to transport shipping containers. Flote Shipping's fleet has a capacity of 2.2 million TEUs, making it one of the largest in the world. Flote Shipping does not undertake any overland transportation itself, but the company can organise the movement of containers for the overland part of their journey.

Flote Logistics

Flote Logistics offers port and cargo services for loading and unloading container ships. The company owns and operates a total of 46 facilities in 30 different countries. These facilities are used by Flote Shipping and by other shipping companies. Flote Logistics does not own any facilities that are capable of loading or unloading tankers, bulk carriers or vehicle carriers.

Flote Logistics also offers information technology support for shipping companies. Keeping track of containers is complicated because of the very large numbers of virtually identical containers that are in transit at any one time. Most ships carry thousands of containers. It is unusual for larger ships to carry an entire cargo of containers from one port to another. Typically, ships follow routes and unload some of their containers at every port, while loading additional containers for onward transportation. The sea-borne part of a journey can involve one or more intermediate stops. For example, a consignment of containers could be loaded onto a ship in Asia and dropped at a port in Europe, before being loaded onto another ship for carriage to the United States.

Every container has a unique reference number which is used by shipping companies to track each container throughout its journey. Making the most efficient use of space on every ship and minimising journey times for cargoes requires specialist software. Flote Logistics can schedule container movements for customers, regardless of whether the containers are to be carried by Flote Shipping or by another company. If required, this tracking service can cover the land transportation part of the journey, from the point of origin until the final delivery.

Communication and control systems on Flote's ships

Flote Logistics has invested in advanced modes of communication with its vessels. Vessels include ships and tankers.

All of Flote's ships have a continuous plotting signal which is received and monitored at Flote's head office. This means that staff can see exactly where each vessel is at any given time.

All vessels carry the Global Maritime Distress and Safety System (GMDSS). This is an important safeguard for all large cargo ships on international voyages. This international system uses terrestrial and satellite technology and radio systems for automatic alerting of shore based authorities and ships in the immediate vicinity in the event of maritime distress.

There are also SOS or emergency callboxes on board each ship, for example to notify a central control room about a fire, a personal injury or a need to evacuate.

Each of Flote's ships has radio, telex and satellite telephones. It is never possible for a ship to be out of contact for an extended period of time even in remote and isolated locations. Ships can be connected with key decision-makers whenever necessary.

Ships are harsh environments and robust, heavy duty telephones are used which can operate in dirty or exposed marine areas.

The ships carry advanced computer systems linking the engine control room to the bridge and cargo control room. The level of automation enables Flote to operate a large ship with a crew of fewer than twenty people.

Investment in communication technology is necessary for crew safety, and to effectively manage the fleet. But Flote also consider it important to ensure that crew members can stay in contact with their families to improve their quality of life on board. Flote has a high level of crew retention and crew members expect to be able to use email, connect to social media, surf the internet and carry out online banking regardless of where their ship is located.

Flote's communication systems route calls over the internet when possible to reduce costs.

Shipping News

14 January 2015 | No.7819 $2.50

Keeping your fleet afloat: measuring maritime performance

Ian Hicks, Financial Correspondent

Cargo shipping has come a long way since the days when traders paid staff to stand on clifftops watching for a vessel coming in to harbour – sometimes for weeks on end when arrival times were a matter of guesswork and luck. Now we know where a ship is with an error tolerance of just a few metres, and the estimated time of arrival at a port will be predictable pretty much to the minute.

As the technology has changed so have our expectations, and the way in which we measure performance. With the shipping industry facing tightening profit margins and ongoing over-capacity, accurately measuring how your fleet is performing has never been more crucial.

Key Performance Indicators (KPIs) for the shipping industry are more sophisticated and cover a wider range of factors than ever before. Information could be collected at ship level and collated for the entire fleet within minutes. CEOs have real time information at their fingertips.

Collecting and analysing this data will help fleet owners to answer the questions - where are we underperforming and why are we underperforming? But to survive in the current challenging environment, fleet owners also need answers to the bigger question - how do we improve?

Shipping Today

1 February 2015 | No. 518 **$2.20**

Slim potential for growth in the global shipping industry

Matthew Nelson, Shipping Analyst

A recent report commissioned for Shipping Today indicates the prospect of a slight growth in earnings before interest, tax, depreciation and amortisation (EBITDA). The predicted increase is expected to range between 3% and 8% across the industry. Even though the predicted rise is relatively small, it marks the end of a steady decline that has persisted since the emergence of over-capacity in the shipping fleet that first came to notice in 2008.

Sadly, the news is not necessarily particularly encouraging. The authors of the report stressed that the growth in EBITDA reflected a reduction in costs across the industry rather than an improvement in economic and commercial fundamentals. The question of over-capacity is being addressed, but slowly.

Recent declines in the price of oil, which occurred after the report was compiled, may further enhance the prospect of growth in EBITDA. Many companies have indicated that they are working on the identification of further efficiencies to enable them to reduce operating costs further.

Operating costs for container ships

Flote Shipping owns three classes of container ship. Each has a different capacity for cargo, which has implications for the external size of the ship.

Panamax ships are capable of navigating the Panama Canal. Their cargo capacity is 4,000 TEU for each ship.

Post-Panamax and Post-Panamax Plus are both larger classes of ship. Neither can navigate through the Panama Canal.

The average annual operating costs per ship for each class of ship are as follows:

	Panamax	Post-Panamax	Post-Panamax Plus
Capacity (TEU)	4,000	6,000	10,000
	Z$million	**Z$million**	**Z$million**
Port charges	15.2	20.8	23.2
Fuel	33.6	46.4	56.0
Administration	0.8	0.8	0.8
Lubricants and other renewables	2.4	2.4	3.2
Insurance	6.4	7.2	13.6
Repairs and maintenance	5.6	7.2	8.8
Crew costs	6.4	8.0	6.4
	70.4	92.8	112.0

These costs exclude depreciation and financing costs. They are based on the assumption that the ship is operating at normal capacity, which implies that the ship is generally either at sea or in port for loading and unloading, or maintenance.

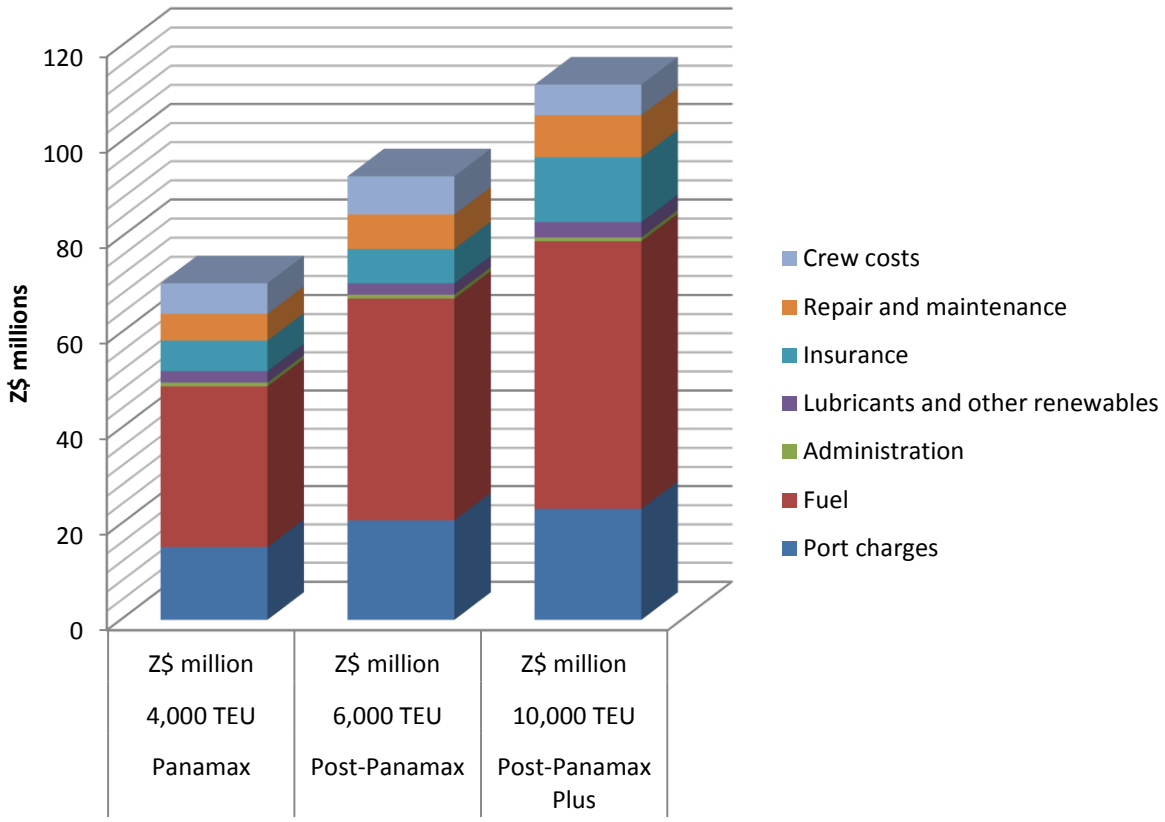
Port charges depend on the size of the ship, the number of port visits and the length of each stay. Post-Panamax ships tend to make fewer port visits, but they cost more to berth and each visit involves landing and loading a large number of containers so the length of stay tends to be longer than for smaller ships.

Fuel charges are affected by the cost per tonne of marine diesel bunker fuel, the distance travelled and the speed of the ship.

Insurance costs cover the ship itself, both for loss or damage and for liability to third parties arising from, say, collision or spillage.

Repair costs are for parts used for small repairs while at sea and also cover the cycle of refits that require ships to be taken into dry docks at regular intervals for major refurbishment. These refits are not required every year and so the cost has been averaged to give an annual figure.

Crew costs are a function of the number of crew members. Post-Panamax Plus ships tend to be more modern than Post-Panamax and so there is more scope for automation.



Average annual operating costs per ship

Post-Panamax ships tend to follow global routes, such as a circular route from Japan to Malaysia, The United Arab Emirates, Rotterdam and New Jersey in the USA, before returning to Japan, perhaps revisiting other ports on the return journey. Each stop is for the purpose of transferring a large number of containers and the ports may be regarded as hubs rather than the final destination.

The other classes of ship are often used to move containers between smaller ports and cargo hubs. For example, Panamax ships could follow routes between ports in Japan in order to assemble cargoes for Post-Panamax Plus ships. They could use their return journeys to transfer containers of imported goods and materials to the smaller ports for collection and final delivery by road or rail.

Market information

Flote's share price has increased steadily as the world economy has recovered from the credit crunch.

The price earnings (P/E) ratio is currently 21.3. In May 2010 the P/E ratio was 14.7.

Flote's Board of Directors

Executive directors

Arthur Gemmell – Chief Executive Officer

Arthur Gemmell has served as Chief Executive Officer (CEO) since 2008. Previously, Mr Gemmell served as a director of Global Bank, a major international commercial bank. He had worked for Global Bank since leaving university. Mr Gemmell is a non-executive director of Freight Railways, a company that operates freight services throughout Zeeland.

Harold Fisher – Finance Director

Harold Fisher has been Finance Director since 2010. He is a professionally qualified accountant. He has held senior financial management positions in other shipping companies. Mr Fisher is the convener of the disciplinary committee of his professional body.

Alison Kenworth – Operations Director

Alison Kenworth has been Operations Director since 2011. She has worked for Flote since 2002, joining from a major logistics company as manager in charge of Flote's IT services. Ms Kenworth is a board member of a national charity that provides unemployed school leavers with IT and employment skills.

Captain Rajiv Singh – Human Resources Director

Captain Singh joined Flote as an officer cadet straight after school and spent more than 30 years at sea, latterly as captain of some of Flote's largest container ships. Captain Singh holds a masters degree in human resource management, which he completed by distance learning during his sailing career. He transferred to a senior management position in Flote's Human Resources department in 2003 and was promoted to Human Resources Director in 2012.

Julia Chan – Marketing Director

Julia Chan has been Flote's Marketing Director since 2009. She has specialised in the marketing of services since graduating from university with a marketing degree. She has worked in business to business sales for four other major companies: an electrical utility, a commercial bank, a facilities management company and a road haulage company. Ms Chan is a visiting professor of marketing at Zeeland's largest university.

Non-executive directors

Yvonne Liang – Chairman

Yvonne Liang has been Flote's Chairman since 2011. She had previously served as CEO of the Zeeland Port Authority. Ms Liang serves on Flote's audit and nomination committees. She is also a non-executive director of the Zeeland Arts Council.

Simon Lakes – Non-executive Director

Simon Lakes has been a non-executive director since 2011. He has previously had a successful career in business. Mr Lakes is the convener of Flote's nomination committee.

Graham Phillips – Non-executive Director

Graham Phillips has been a non-executive director since 2012. Previously, he had a successful career in banking. Mr Phillips convenes Flote's audit committee.

Gillian Norton – Non-executive Director

Gillian Norton has been a non-executive director since 2013. She was previously a partner with a major accountancy firm. Ms Norton serves on Flote's nomination and audit committees.

Godson Segeja – Non-executive Director

Godson Segeja has been a non-executive director since 2012. He has had a very successful career in the management of Globe Tankers, a multinational shipping company. Mr Segeja serves on Flote's nomination and audit committees.

Extracts from Flote's financial statements

Flote
Statement of profit or loss

		Year ended 31 March 2015 Z$ million	Year ended 31 March 2014 Z$ million
Revenue		101,354	115,280
Operating costs	[1]	54,737	62,447
Profit before depreciation, amortisation and impairment losses		46,617	52,833
Depreciation, amortisation and impairment losses		24,491	21,693
Loss on disposal on non-current assets		94	728
Profit before finance costs		22,032	30,412
Finance costs		4,002	4,875
Profit before tax		18,030	25,537
Tax expense		5,754	7,216
Profit for the year		12,276	18,321

Flote
Statement of changes in equity
for the year ended 31 March 2015

	Share capital Z$ million	Retained earnings Z$ million	Total Z$ million
Opening balance	140,000	17,549	157,549
Profit for the year		12,276	12,276
Dividend		10,538	10,538
Closing balance	140,000	19,287	159,287

Flote
Statement of financial position

	As at 31 March 2015 Z$ million	As at 31 March 2014 Z$ million
Non-current assets		
Intangible assets	248	262
Property, Plant and equipment	166,579	171,793
	166,827	172,055
Current assets		
Inventory	2,048	2,880
Trade receivables	7,632	11,459
Cash and cash equivalents	6,876	1,137
	16,556	15,476
Total assets	183,383	187,531
Equity		
Share capital and share premium	140,000	140,000
Retained earnings	19,287	17,549
	159,287	157,549
Non-current liabilities		
Long term borrowings	10,000	14,000
Deferred tax liabilities	588	750
	10,588	14,750
Current liabilities		
Trade payables	9,957	10,134
Tax liabilities	3,551	5,098
	13,508	15,232
	183,383	187,531

Flote
Cash flow statement

	Year ended 31 March 2015 Z$ million	Year ended 31 March 2014 Z$ million
Cash flows from operating activities		
Profit before finance costs	22,032	30,412
Depreciation, amortisation and impairment losses	24,491	21,693
Loss on disposal on non-current assets	94	728
Change in working capital	4,482	(1,274)
Tax paid	(7,463)	(4,213)
Net cash from operating activities	43,636	47,346
Cash flows from investing activities		
Purchase of non-current assets	(19,580)	(14,862)
Proceeds of disposal of non-current assets	223	4,216
Net cash used in investing activities	(19,357)	(10,646)
Cash flows from financing activities		
Long term borrowings repaid	(4,000)	(5,000)
Dividends paid	(10,538)	(500)
Interest paid	(4,002)	(6,100)
Net cash used in financing activities	(18,540)	(11,600)
Net increase/(decrease) in cash and cash equivalents	5,739	25,100
Cash and cash equivalents at beginning of period	1,137	(23,963)
Cash and cash equivalents at end of period	6,876	1,137

Note 1 - operating costs

	2015 Z$ million	2014 Z$ million
Bunker fuel	16,958	18,254
Terminal running costs	3,336	3,912
Intermodal costs	6,806	8,790
Port costs	10,201	14,706
Wages	9,237	11,458
Ship storage	3,921	980
Other operating expenses	4,278	4,347
	54,737	62,447

Bunker fuel is the cost of fuel used to power Flote's ships.

Terminal running costs are the costs, excluding depreciation and wages, of operating Flote's ports around the world.

Intermodal costs are the costs associated with loading and offloading containers to and from Flote's ships.

Port costs are the costs associated with docking and berthing ships at ports other than those owned by Flote.

Ship storage arises from the costs associated with berthing ships that are owned by Flote that are not currently in use.

Note 2 - segmental information

Geographical revenue analysis

	2015 Z$ million	2014 Z$ million
Asia	45,609	44,959
Europe, Middle East and Africa	18,244	24,209
America	37,501	46,112
	101,354	115,280

Revenue by line of business

	2015 Z$ million	2014 Z$ million
Flote Shipping	71,961	86,031
Flote Logistics	29,393	29,249
	101,354	115,280

Operating profit by line of business

	2015 Z$ million	2014 Z$ million
Flote Shipping	17,185	18,186
Flote Logistics	4,847	12,226
	22,032	30,412

Note 3 - intangible assets

	IT software Z$ million
Cost	
At at 31 March 2014 and 31 March 2015	304
Amortisation	
At at 31 March 2014	42
Charge for year	14
At at 31 March 2015	56
Net book value as at 31 March 2015	248
Net book value as at 31 March 2014	262

Note 4 - tangible assets

	Ships Z$ million	Property Z$ million	Port plant and equipment Z$ million	Total Z$ million
Cost or valuation				
At at 31 March 2014	241,011	6,300	26,303	273,614
Additions	9,497	1,060	9,023	19,580
Disposals	(560)			(560)
Impairment adjustments			(12,910)	(12,910)
At at 31 March 2015	249,948	7,360	22,416	279,724
Depreciation				
At at 31 March 2014	87,212	1,863	12,746	101,821
Charge for year	12,665	147	3,425	16,237
Disposals	(243)			(243)
Impairment adjustments			(4,670)	(4,670)
At at 31 March 2015	99,634	2,010	11,501	113,145
Net book value as at 31 March 2015	150,314	5,350	10,915	166,579
Net book value as at 31 March 2014	153,799	4,437	13,557	171,793

Note 5 - commitments

Flote has entered into binding contracts to purchase ships with a total cost of Z$10,000 million over the next three years. These ships will enter service as and when their construction is complete.

Risk management

Flote regards risk management as an important factor in ensuring that shareholder value is enhanced. The Board of Directors has responsibility for assessing and managing risks. The Risk Management Committee, which reports to the Audit Committee, regularly reviews risk assessments, risk reporting and risk mitigation. Risks and mitigation measures are documented in our risk register. Principal risks are as follows:

Risk	**Mitigation**
Operational performance depends on the reliability of our systems and the effective deployment of ships.	Our IT policies and procedures are regularly reviewed. Contingency measures are in place to mitigate systems failures. Our ships are built to a high standard and well maintained. We follow a programme of continuous capital investment in logistics.
Piracy risk may lead to damage to our vessels, and injury or loss of life to crew.	We are committed to running safe operations and our systems are enhanced by excellent training for crew and officers.
Loss of key staff or an inability to attract new staff could affect our ability to achieve our objectives.	We are committed to recruiting and training high quality staff. We offer regular training, annual performance appraisal and incentive packages. Our crew retention rates are excellent.
Liquidity risk may lead to Flote being unable to meet its obligations as they fall due.	Treasury policies are regularly reviewed to ensure that sufficient funds are available and bank covenants are complied with.
Lack of deployment of vessels could adversely affect revenue.	We aim to secure contracts of a year or more where possible to stabilise our earnings.
Poor customer service could lead to loss of business, adversely affect the Flote brand and damage our reputation.	We deliver a high quality reliable service using good quality vessels and modern systems. Our customer service teams communicate regularly with customers to ensure high satisfaction levels.
Failure to comply with environmental standards could lead to adverse financial impact and reputational damage.	Flote makes continuous efforts to reduce emissions by fuel efficient operations. We train our crew to minimise the risk of accidents that would cause pollution.
An accident could result in service disruption, endanger crew, damage reputation and incur costs.	Whilst we make every endeavour to ensure safe operations we also take insurance cover and regularly reassess the level of cover needed.

SeaLode

SeaLode is Flote's closest competitor in Zeeland.

There are significant differences between the business models of the two companies:

- SeaLode does not operate any docks or port facilities. The company provides shipping services only.
- Flote's shipping fleet consists entirely of container ships. SeaLode's fleet consists of approximately equal numbers of container ships, bulk carriers and tankers.
- Each company operates approximately the same number of ships.

SeaLode and Flote compete for business in the containerised shipping business.

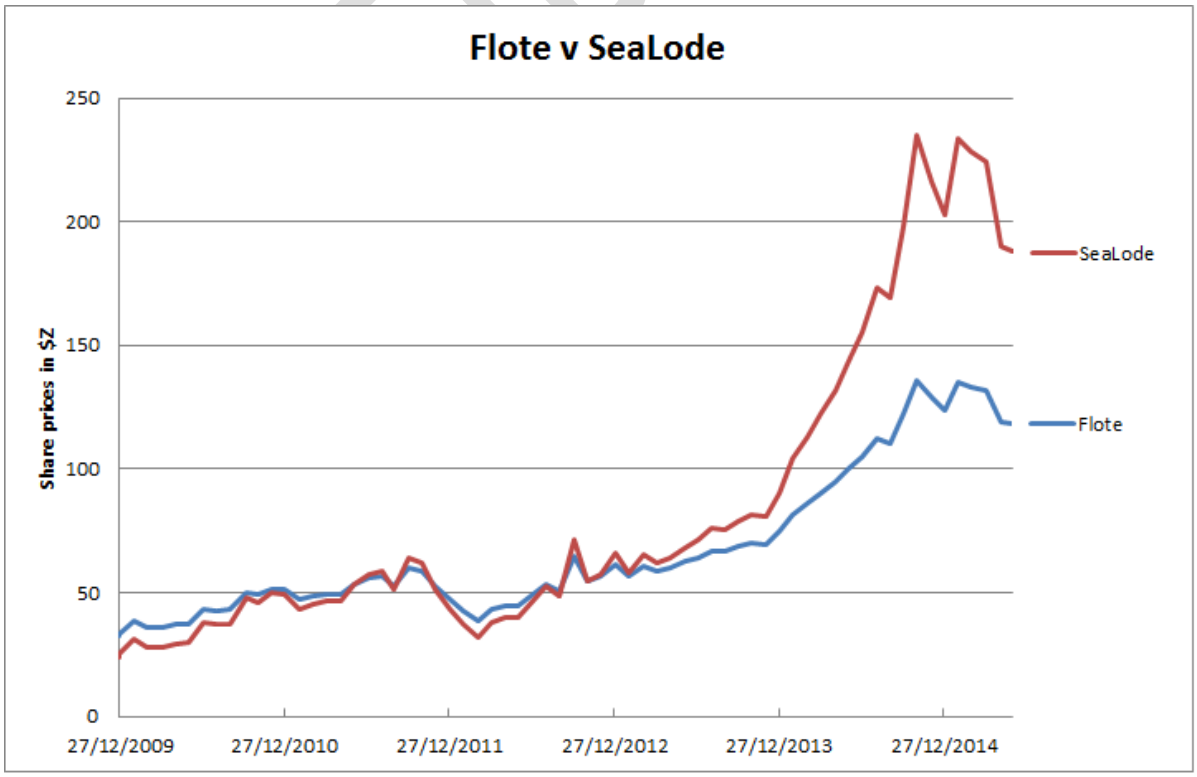
SeaLode's tankers specialise in carrying crude oil from exporting countries to importers. The tankers are loaded and unloaded by pumping the cargo into and out of the ships' tanks.

SeaLode's bulk carriers carry dry commodities in their holds. SeaLode's carriers specialise in carrying grain from major wheat growing exporters to importers. All of SeaLode's bulk carriers are designed to be loaded and unloaded using conveyor belts, which is a relatively efficient method of handling these cargoes.

Most of the voyages undertaken by SeaLode's tankers and bulk carriers involve a full cargo being loaded at the port of origin and unloaded at a single destination.

Share price movements

The following diagram shows Flote's share price movements against those of its competitor SeaLode.



Extracts from SeaLode's financial statements

SeaLode
Statement of profit or loss

	Year ended 31 March 2015 Z$million	Year ended 31 March 2014 Z$million
Revenue	139,110	133,939
Operating costs	44,671	43,603
Profit before depreciation, amortisation and impairment losses	94,439	90,336
Depreciation, amortisation and impairment losses	19,573	18,760
Profit before finance costs	74,866	71,576
Interest and other financial expenses	2,500	2,500
Profit before tax	72,366	69,076
Tax expense	4,235	4,078
Profit for the year	68,131	64,998

SeaLode
Statement of changes in equity
for the year ended 31 March 2015

	Share capital and share premium Z$ million	Retained earnings Z$ million	Total Z$ million
Opening balance	60,000	58,308	118,308
Profit for the year		68,131	68,131
Dividend		(61,719)	(61,719)
Closing balance	60,000	64,720	124,720

SeaLode
Statement of financial position

	As at 31 March 2015 Z$ million	As at 31 March 2014 Z$ million
Non-current assets		
Intangible assets	58	60
Property, Plant and equipment	135,691	129,952
	135,749	130,012
Current assets		
Inventory	1,870	1,742
Trade receivables	8,247	8,963
Cash and cash equivalents	1,123	1,489
	11,240	12,194
Total assets	146,989	142,206
Equity		
Share capital and share premium	60,000	60,000
Retained earnings	64,720	58,308
	124,720	118,308
Non-current liabilities		
Long term borrowings	10,000	12,000
Deferred tax liabilities	478	426
	10,478	12,426
Current liabilities		
Trade payables	7,495	7,284
Tax liabilities	4,296	4,188
	11,791	11,472
	146,989	142,206

Comparative ratios

Flote		
	2015	2014
Return on capital employed	13%	18%
Operating profit/revenue	22%	26%
Gearing	6%	9%
Sealode's comparatives		
Return on capital employed	55%	55%
Operating profit/revenue	54%	53%
Gearing	8%	10%