Transcript of FirstGroup's full year results presentation for the year ending 31 March 2018

Thursday 31 May 2018

Matthew Gregory, Interim COO and CFO: Good morning everybody. I'm trying this with a new pair of glasses, so hopefully this will work okay.

So let me start off with saying that in summary we're clearly disappointed with this year's operational performance, with weaker results in our US businesses outweighing the better results in the UK. However, the reduction in US tax rates and control of our interest costs means adjusted EPS remains stable and we generated strong cashflow, allowing us to reduce leverage, and the bond refinancing strengthens the balance sheet further. The impact of some of the challenges we've faced has required us to take some large one-off charges this year and by this I'm referring to Greyhound and also TransPennine Express. I'll give you some further detail on this as we go through each business, but overall we remain a business with operational resilience and one that's expecting to deliver a stable performance next year and will continue to generate significant cash in the coming years.

So let me take you through the financials and provide you with some more colour on those headlines. Overall, revenue grew by 13%, but if we take out the mid-year introduction of South Western Railway as well as the 53rd week seen in our Road divisions, at constant currency the business grew by 1%. Operating profits fell by 10% on the same basis, which is clearly a disappointing result. We did deliver, though, £317 million of adjusted operating profit.

The US divisions performed poorly, with Greyhound facing particular challenges in its long-haul markets, while Rail's performance was resilient and First Bus performed well, returning to passenger revenue growth and improving margins by 140 basis points to 5.7%. Interest cost has fallen by £12 million this year with approximately half of that reduction driven by lower financing costs and the other half from a lower notional interest charge from our insurance liabilities. The tax rate reduced by 360 basis points to 22.4% following US tax reform and also the lower weighting of US profits. Adjusted attributable profit after tax, interest and non-controlling interests fell by 1% and this flowed through to a largely flat EPS.

On the cash front, we delivered in line with our expectations, with total inflow of nearly £200 million, which was £111 million before the working capital inflow from South Western Railway, another strong cash performance. Net debt reduced to £1.1 billion and as a consequence of our strong cash generation and the South Western Railway working capital, reported leverage has reduced to 1.5 times net debt to EBITDA.

Moving on to our revenue bridge, I'm going to run through each of the divisions on the coming slides but first just let me set out the key points. Moving from left to right, you can see that currency reduces revenue by approximately 1%. We then show divisional performance before the impact of the 53rd week, with First Student slightly down, First Transit up 2.4%, Greyhound down 1%, First Bus just positive and First Rail up 4% without South Western Railway. This gives growth of around 1% at constant currency and before the impact of the 53rd week. And then you can see the impact of South Western Railway, the 53rd week, showing overall revenue up 14% on a constant currency basis.

Turning to operating profit performance, you can see that this fell by 6.5%, or 4% on a constant currency basis, but 10% when the impact of South Western Railway and the 53rd week is excluded. Divisional operating profit performance reflects the poorer performance in the US, outweighed by the stronger performance in the UK.

But let's go through that in a more detailed basis on a division by division basis and I'll start with First Student. Revenue was down 1.1% in constant currency prior to the impact of the 53rd week, with the positive benefits of our contract pricing strategy offset by continued impact of reducing the bus fleet through our up or out strategy and fewer school operating days. We continue to maintain our contract pricing discipline and retention rates increased to 83%. This was positive versus the prior year but slightly lower than our expectations due to lost business, primarily in Canada. Across the whole of the portfolio, retention has been 94%. On 'at risk' contacts we achieved price increases of 5.3%, in line with our expectations. First Student's operating performance was not where we wanted it to be, given the progress we made in the prior year, with margins falling from 9.6% to 9.0% in local currency. Pricing did deliver margin improvements and that, combined with $13 million of management initiatives, was sufficient to offset the impact of higher driver shortages which continues to be an issue in the transport sector in North America. However, a worse second half weather impact than last year, and slightly lower retention than expected, reduced the margin overall.

Moving on to how we view the coming year, we've learned our lessons from retention last year and have taken an even more focused approach this year. And as a result, we feel more confident about the coming year's retention levels and are currently seeing rates well in excess of last year's, with pricing at similar levels. Clearly it is important that we see pricing at levels higher than inflation so as to counteract the driver wage inflation. This continues to remain a challenge and we're seeing the issue of driver costs and shortages affecting all transportation, trucking and distribution companies across North America. We're working hard to improve our processes to keep on top of this issue and are reflecting wage pressures in our renewal negotiations and bid models.

Going forward, we see ourselves moving towards a position where the bus fleet numbers are stable after a number of years where the bus numbers have declined as a result of our 'up or out' strategy. We are also seeking to grow through small bolt-on acquisitions, the pipeline for which we're looking to develop. We'll continue to increase the uptake of our best-in-class app, which is called FirstView and enables parents to track their children on the buses and know exactly when the buses will arrive. And we'll also begin to develop a range of managed services for our customer base to further leverage our position as the preferred and trusted supplier to this industry. And from a margin perspective, there is further scope to grind out more cost savings and I expect that margins can be brought back to around last year's level – and this would reaffirm us as generating industry leading margins befitting our position as the market leader in the sector.

Moving on to First Transit, the business grew again this year, with 2.4% constant currency growth and this was despite the continued low level of activity in the Canadian oil sands area and the loss of two larger poor performing contracts that we referenced at the half year. This was more than offset by winning 33 new contracts, including some major paratransit and fixed route contracts in Los Angeles and Vancouver, as well as the impact of inflationary increases built into our contracts.

Now, you'll recall that at the half year profitability was affected by increased driver costs, as well as the impact of hurricanes, particularly in Puerto Rico. At that time, we predicted the business would deliver 7% margins for the second half as it strove to improve contract performance, and this is what the business delivered, despite continued driver shortage pressure in certain areas. Contract performance did improve, as did the situation in Puerto Rico, albeit with higher employee medical costs affecting the business in the second half.

We talked before about the reduced activity in the Canadian oil sands region and going forward we will need to work hard to overcome the loss of two contracts in that region worth around $40 million. This was a high margin business and so our expectations for margin for this division next year will have to reflect that. We continue to maintain our leadership position in our existing markets and look to develop new growth markets. We've now undertaken six autonomous vehicle trials, most notably at this year's Super Bowl in Minneapolis. In addition, we're partnering with ride sharing companies to win business in Americans with Disabilities Act-compliant transportation.

Despite showing 1.2% growth in the first half, Greyhound ended the year 0.7% down, reflecting a decline of 2.7% in the second half. Although our point-to-point Express business continues to grow and was up 7.7% in the year, this has not been sufficient to offset the reduction in long haul revenue. As referenced in our Q3 update, the market has moved, with increased capacity in the ultra low cost airline space affecting demand on our long-haul routes. And we continue to see reduced revenue along the southern border regions as a result of tougher immigration control in this area.

The reduced revenue in the second half has effectively dropped through to the bottom line, with minimal opportunities to reduce the cost base in the short term. In addition, maintenance costs have increased as the fleet has aged, and driver training and recruitment costs have increased in this business. Trading in Canada remains challenging, with losses of $10 million incurred but we've now been given approval to withdraw from certain routes in British Columbia and we continue to actively examine options to further reduce the losses being incurred.

I said that I'd return to the subject of the large one-off charges being made this year and as you're aware, we're required to assess the value of goodwill and other assets on our balance sheet. Looking ahead, whilst we continue to improve our service offering and are increasing the use of our yield management tools across the whole network, we have not yet seen any significant impact on demand from the recent uptick in oil prices and are not seeing any let up in the long-haul market competition from ultra low cost carriers. As a result, we've taken the decision to write down the goodwill and other assets in Greyhound this year and the value of this adjustment is £277 million. Also, whilst at a headline level this is disappointing, I'd emphasise that this is a non cash item.

And you should not take this as us having given up the fight with this business. We have a number of plans to improve our performance levels, including the continued reduction of routes in Canada and also pursuing partnership opportunities in the outer reaches of our network. However, in light of current market conditions, where sustaining Greyhound performance will be a challenge, we have appointed an external consultant to help us perform a wide-ranging business and strategy review of Greyhound. This will cover a variety of issues and options and we expect to be able to update you at the half year stage on this.

Moving on to First Bus, trading has been a bright spot with like-for-like passenger revenue growth of 1.1%. The business continues to operate in a challenging marketplace, with reduced high street footfall, lowering motoring costs supporting a modal shift to cars and also congestion. And we continue to see a wide variation in performance across the country, with revenue affected by very local issues. However, encouragingly, revenue grew in each quarter of the year as the impact of our digital, contactless payment and local market strategies begin to bear fruit. Profitability has also moved forward, with operating profit growing by 35% to £50 million and margins up 140 basis points.

Not only have we seen an improvement in revenue growth, we've also put in place additional plans to reduce costs from the business and this has resulted in more than £20 million of profit improvement from a combination of network rationalisation, pricing, depot restructuring and more efficient working practices. We've recently announced plans to move a variety of administrative functions to a central shared service centre and have begun to modernise older working practices through renegotiating terms and conditions and I'd expect this activity to continue in the coming year, driving margins further forward.

Looking ahead, the commercial offering of the business has been radically improved, with the installation of contactless payment card readers on 80% of our fleet. We'll have completed the roll out by July and we'll become the first national bus company to do so and this will improve the simplicity and convenience to our customers and reflect our strategy of taking cash off the bus for a number of reasons, including improving the journey speeds. Our digital strategy continues to progress, with higher uptake of mobile and electronic tickets in many of our regions.

Now, whilst revenue was affected by severe weather in March, when entire cities such as Glasgow ground to a halt and the change in Easter timing, we're starting to see a reversion to last year's growth rates in recent weeks. Finally, we continue to focus our investment in customer service improvements and fleet to regions that genuinely offer a partnership to deliver more reliable bus services – areas such as Leeds and Bristol – and it's this approach that's allowed the division to generate cash for the first time in a number of years.

Moving on to First Rail, headline revenue has increased by 55% as a result of the introduction of the South Western Railway franchise in August 2017. On a like-for-like basis passenger revenue grew by 4.1% in the year. The entire rail industry is affected by a slowdown in passenger growth and we are no exception. Great Western Railway continues to be affected by high levels of engineering works across the route but has improved its performance over last year, up 2.7%, due to the introduction of the Hitachi Intercity Express Trains. TransPennine Express continues to drive industry leading growth at 10%, demonstrating the level of demand for services in that region, and the business saw a varied operating performance this year, with Great Western Railway generating slightly lower margins than prior years and the new South Western Railway franchise was introduced in August 2017 and generated a profit this year.

TransPennine Express generated a loss of £7 million in the year as revenue is not growing in line with our original plans. However, overall First Rail has contributed significantly to group performance, generating £58 million of profit, up 7% versus prior year.

So, coming back to the TransPennine Express contract in more detail, as I said, although the franchise is generating industry leading growth, this wasn't sufficient to meet the estimate set out in the bid and so we lost money this year; £7 million. And this is largely due to the lower growth rate experienced by the industry as a whole. Now, we've assessed the future growth rates required from the franchise to meet its objectives, along with the current losses, and although significant capacity and growth will be generated from the franchise over the remaining life, we believe it will fall short of the bid target over the remaining five year period. And if revenue is generated at the rates set out in our current forecast, then our best estimate is that losses of £106 million will be generated over the coming five years. And I want to reemphasise that despite the potential for making losses from this franchise, we remain committed to delivering our plans over the term of the franchise, including the new capacity and services that will make this railway, and the communities it serves, a success over the coming years.

So, looking at our other train operating companies, Great Western continues to be affected by the ongoing engineering and electrification works but we're pleased that the option to extend the franchise until 2020 has been exercised and we also have the opportunity to negotiate a new contract of two-plus-two years for the franchise. And this demonstrates the excellent stakeholder relationships that we've developed over the years and the success we've had in introducing a new fleet to this franchise.

The start-up of South Western Railway was as difficult as we anticipated, given that we took over during the Waterloo upgrade project. However, we're also experiencing further infrastructure challenges along the route. But we are starting to see improvements to performance and are looking forward to beginning the process of adding significant capacity to this railway over the coming years. Going forward, we expect margins to trend downward, in line with the industry, and we'll continue to play our part in delivering the largest investment in capacity in the market for many years.

Given the major adjusting items discussed in the previous slides, I thought it'd be useful to summarise where we are in one page. I won't talk about amortisation, that always gets pulled out separately, or go over Greyhound or TransPennine Express again, but we do have a number of other adjusting items. As discussed last year, the cost improvement programme at First Bus required one-off costs to achieve and around £21 million of costs have been adjusted out of ordinary profit. In addition, we provided £5 million of closure costs that have arisen from the loss of the two large contracts in Fort McMurray. We've then provided £33 million to account for deterioration in a small number of North American insurance claims that relate to prior years and in particular 2015/16 year. And finally, we've pulled out the cost of the bond 'make whole' that will deliver us £14 million lower interest costs next year.

Having explained the adjustments, I'll now take you through the bottom half of the P&L. Interest costs are around £12 million lower than last year at £120 million and approximately half this reduction was driven by lower financing costs and half from lower notional interest charge from our insurance liabilities. Going into next year, we'd expect interest costs to fall to £106 million as a result of the £14 million savings we've flagged arising from our refinancing earlier in the year. The tax rate reduced by 360 basis points to 22.4% and clearly this has been driven by the US tax reform, driving federal tax rates down to 21% from 35% – as a result of the US tax reform and also the lower weighting of US profits this year. We expect the natural level of tax to level off between 24–25% going forward but for next year we expect the tax rate to be around 23%. As a reminder, cash tax remains low, costing us £12 million this year and this is likely to be a similar number next year.

Non-controlling interest costs increased this year, moving to £5 million and this increase is driven by the new South Western Railway franchise and MTR's 30% interest in that business. Taking all this above into account, EPS was largely flat and up 3% in constant currency.

Before I look at overall cash flow, I'd like to spend some time looking at capital expenditure. We've continued to invest in the business during the year and the spend is heavily weighted towards our fleet, as well as continuing investment in upgrading our IT systems. Cash capex spend for the year, excluding the First Rail business, or as we now refer to it the Road business, is £300 million, approximately £20 million below last year and this is in line with the guidance we gave you last year and reflects continued tight capital management and efficient cascading of older buses.

The lower spend this year also reflects lower investments in the First Bus businesses. Our focus does remain on capital allocation and ensuring we drive appropriate growth and returns from the invested capital. The First Student business continues to consume the most capital and capital levels will maintain similar to levels last year through continued discipline around the cascade process. Spending in First Bus reduced as expected as we took back control of our spend post-Disability Act compliance. And Greyhound recommenced investment in its buses after three years of reduced investment.

Looking forward, we expect cash capex from our Road divisions to increase to around £350 to £360 million as retention rates in First Student increase as well as some investment in First Transit where some specific shuttle contracts are up for renewal. And this is before any small bolt-on acquisitions are made.

As you know, we exclude Rail from this discussion since the cost is largely funded and so cash net-neutral over time. This can move significantly depending on bid commitments, new projects and also timing. And you'll recall that we flagged higher spend in First Rail last year and the spend was nearly £50 million higher than last year.

As a result of continued depot redevelopment, station improvements and the new South Western Rail franchise, we expect First Rail gross capex to be significantly higher. And although this will largely be cash-neutral, you could see as much as £200 million of funded capex in addition with this division. Clearly, as ever with Rail, this is subject to the timing of significant projects.

Now let me walk you through the cash flow performance for the year. Overall, net cash inflow was £199 million, £52 million better than last year. £89 million of this cash came from the working capital inflow from the South Western rail franchise leaving us with a net cash inflow of £111 million. Operating cash flow of £296 million was generated, a conversion rate of 93%, up from 89% last year.

As you can see, the bulk of our operating cash flow is generated by the EBITDA less capex. There's been minimal change from our insurance provision movement and the working capital was positively impacted by timing on Rail receipts and payments offset by the minority buyout of the Student acquisition made in 2014, plus some cash restructuring costs.

Pension contributions in excess of the P&L charge was £10 million higher than last year and cash interest is around £20 million higher, largely due to the cash cost of paying back the bond early.

Overall, this leaves us with £111 million of net cash inflow. This performance, and the basis behind it, is very much in line with what we set out last year.

Looking forward, taking account of capital requirements and trading performance, we continue to see the business being able to generate cash in the coming year.

Our overall financial position has improved again this year and remains strong with headroom under our committed facilities and free cash at £800 million. As I mentioned earlier, reported net debt to EBITDA ratio fell from 1.9 times to 1.5 times. We're conscious that some of this reduction came from the additional ring-fenced cash from South Western Rail. And when we remove this, the net debt to EBITDA fell from 2.3 times to 2.1 times.

This year, we were able to begin the process of refinancing our expensive longer-term debt after paying back $100 million of US PP debt in the first half. In February, we raised $275 million in the USPP market at an average rate of 4.25%. And this allowed us to repay the first of our expensive bonds before the year end.

And we're very pleased to have been able to access this marketplace after a long absence and that we were well-supported and could obtain very competitive terms and conditions.

Average debt maturity has logically risen to 4.1 years and the rating agencies Standard & Poor's and Fitch currently have us at BBB- and stable. And their normal process is to update this shortly after the publication of our results.

And now that we've commenced the refinancing programme, we can start to be more efficient with the balance sheet. The January bond of £250 million will be repaid using the existing RCF. We'll continue to apply discipline to cash and borrowing to minimise our interest charge. And for guidance purposes, you can assume that cash interest will be around £90 million next year.

As a final point, you'll note that the pension deficit is reduced from £360m to £270m due to better asset returns and the impact of foreign exchange translation. As I mentioned at the half year, we've been successfully merging our UK local government pension schemes during the year and our UK Bus and Group schemes closed a future accrual with effect from 1 April 2018.

We continue to progress a variety of plans to reduce risk in this area in discussion with the workforce and trustees. But it is worth pointing out that the Group pays around £50m of deficit reduction payments a year as a result of the actuarial deficit valuation of its schemes. As you know, the actuarial valuation differs from the accounting valuation. These payments and plans have been agreed with the trustees and the regulators and in some cases are backed up by a parent company guarantee or letters of credit.

Overall, we've continued to strengthen the balance sheet during the year despite the challenges faced by the business. Looking forward, we expect to generate substantial cash flow next year and we believe that this cash is best used to further de-lever the group and for targeted growth within the business. We believe that our current approach delivers the best value for our shareholders overall.

Before I close, I thought it worthwhile and helpful to bring together some of the guidance we've peppered through the results. We expect our Road divisions to improve in the coming year with Student and Bus driving that performance. First Rail will still deliver a contribution, but at lower margins than last year, reflecting prevailing industry conditions.

Note the revenue for TransPennine Express will continue to be reported in our results but the provision for future losses will be utilised in the coming year. Overall, we see operating profit as being stable next year.

We continue to generate free cash after disciplined investment to support customer needs and Road cash capital investment would be approximately £350-360m, cash interest reduced to £90m and tax increase to 23% and cash tax would be largely similar to this year.

Let me close with the summary. It's been a difficult year for the Group but despite this, we've shown resilience by delivering one-third of £1bn in operating profit and in excess of £100m in cash. The balance sheet is robust, and the financing of our expensive bonds has commenced.

We have strong market positions, solid divisional plans and there is further scope to improve both our commercial offering and our cost base going forward. With that, I'll hand over to Wolfhart for his thoughts.

Wolfhart Hauser, Executive Chairman: Good morning everyone. Let me summarise in two slides where the company stands and where we're going.

In the first slide, you can break down our activities in different ways. From a financial perspective, it's really interesting if you look at the Road businesses, the green parts, you see some of the financial criteria on the left-hand side and you can look at the Rail business in yellow.

There are many different ways you could break it down strategically, for example looking at the UK business, in that pink or red colour and what are US businesses. It's always interesting to keep that in mind and also what different divisions are doing, be it more long-haul or short-haul travel by bus or by rail.

What we have at the end of that slide, is five market-leading public transportation businesses. Half of our revenues are coming from 1,400 contracts and most of those contracts are with national or local authorities. That gives us great stability, as we have great experience of handling those bids and then operating those bids in a very effective way so that they create the return we want to see.

With our leading positions in the markets in North America and the UK, we also can drive forward new ways of mobility. I will come back to that later. I think what we have not done that enough, so that we really created the financial value of the returns out of our leading market positions, and that will really be a focus in the coming years.

Matthew also mentioned, and it's always important to talk about our balance sheet, net debt to EBITDA reduced from 2.2x in 2014 to 1.5x this last financial year.

And what is even more important is what happened to the free cash flow over the years. It steadily moved up every year from £27m in 2014, to last year, if you take the rail cash out, £110m. I think this is a great success story. It's slow, yes, but I think it shows that we're moving in the right direction in relation to the balance sheet and the cash generation.

The next slide gives you a bit of an outlook. Clearly, we're disappointed with this year's results. If you look at last financial year, everything looked quite positive for further development, but it has not continued in that way as we had expected.

Tim O'Toole, who has been Chief Executive for nearly eight years, thinks it's the right time to step down, and the search for his successor in underway. In between, I think we have strong management in our five divisions. We have Matthew, who is not only doing the role of a CFO, he will be active as COO and, let me add that I think he has been active in that role already over recent months. Some of the improvements in cost savings and operational results are directly linked to him.

The Board, in addition, is on an ongoing strategy process all the time, but we now have an opportunity to look for a fresh pair of eyes into all the options we have and there are many. It's important to then take the ones which really create real shareholder value, and not do very short-term measures which at the end are not delivering the value which is inherent in the Group.

I'd just give you a few examples. We have an external strategic review of the Greyhound business. We have to see that there are a lot more opportunities in new customer groups than what we usually do and to really evaluate the opportunities of that business. Whatever decision we take then, what we might do with that business, it's important to have clear data on that. And we took one of the larger consulting companies to do that review. That will be concluded in the coming months, and in the summer, we will know more about that and then we will make a decision how we move on with that.

We have, as Matthew mentioned, growth opportunities in Student where we now have the margins we want to see. The margins should come close to 10%. I think what is important, with all the restructuring and operational efficiency, at the end, we have to get the top line going. And so, we will push very hard in Student to get growth out there because that would add a lot of value.

If you look into the transportation business, it's all about customer convenience. It's about connected mobility of the future, and we think, as the leading company in those five sectors, we can really take a more leadership role in all of those things. You've heard about contactless payment for example, but that is only one example. We have to really have a vision of what we will do in the future – with more IT, with huge data available – and I don't see that in the very near future, but let's say autonomous cars. You have also to see the whole change with discussions about diesel engines and not having them in cities. I think there will be big changes in the industry, and we are prepared for that, but we have to drive that really in the right direction.

So, we have considerable opportunity to create more shareholder value. The shareholder value clearly overall, if you look at the share price, the returns have not increased in the way we would like to have seen. I think we really have to focus on that, to do that also in the near-term future.

Finally, we are here in a financial review, but we should not forget that a company has many, many stakeholders not only shareholders. And I think as a public transportation company, we also have to reflect those other stakeholders. These are our customers, and our customers want to have more convenience and they want to know what is happening in their regions.

A lot of our businesses are very regional, and they have to give and we have to listen to input, what we're doing in those different regions for them. And building for example an InterCity network in the northern part of England, I think that is also very, very important. It's a role we should not forget when we talk about financial results which clearly today are the most important aspect of we're talking about. Thank you.

Damian Brewer, RBC: Thank you. Damian Brewer from Royal Bank of Canada. Three questions please. First of all, on the UK Bus side, could you give us some idea of what the dispersion of the margin performance of the business looks like both at the EBIT level? But I guess also more importantly, what the free cash flow margin dispersion of the business looks like given the differential in capex between the regions.

Secondly, on the pensions, last year, Matthew mentioned that, this year, we're expecting an increase in the differential between the P&L and the cash flow and that's come through. Are we now at the peak of that and is there any chance that could diminish in the future?

And thirdly, on South West Railway, in light of TransPennine, have you re-reviewed the bid assumptions and the contract there? Is there anything that leaves you more comfortable with your bid there, and how does the dead-banding cope with the change in employment travel to work patterns? Does that support it, or is that something where you are at risk? Thank you.

Matthew Gregory: We've been through this conversation in the past. We're reluctant to talk about the dispersion of our UK Bus profits, and also the capital does move around depending on how we want to cascade fleet around that business.

What I would say is we continue to have some areas that are very good for us and some that aren't particularly good for us. Again, they're all making a contribution and as you can expect, they have all moved forward this year. That's really all I'd say on that.

In terms of the pension, I don't know if we're necessarily at the peak. I don't think there's a huge amount that we would expect to move either down or up on that. What I'd say is, we have a split between our US and our UK pension schemes and the way that you fund them are different. I think, you know, we're very comfortable with the agreements we've made in the UK and those agreements will roll forward. I think in the US, we may end up paying a little bit more going forward. But it's not something that's going to be a huge drag on the cash flow.

Coming on to South West Railway: of course we've looked at the performance of that business. We've looked at how it's performed over the seven months that we've owned that in financial terms. Clearly, we've had a very difficult period. We've had the Waterloo upgrade which had totally disrupted performance and then we've had further disruption on the infrastructure which has caused real issues.

So, it's a little bit difficult. We don't really have a firm footing but, you know, we knew about that going into the bid, we knew that these things were coming on. I think all I'd say on that is that we've looked at it, it made a profit this year, we're comfortable that this is a good franchise with better protection mechanisms than we've had in the past and we're looking forward to adding capacity to the network.

Sam Bland, JPMC: Sam Bland from JP Morgan. I've got two please. Your road capex, the depreciation has historically been about 1x roughly as an average. I think going forward this year, it's going to be more like 1.2. Is that sort of − as maybe Student starts growing or at least becomes a bit more stable, is that 1.2x level which is maybe a little bit more consistent with peers, kind of a new normal, and it would be around that level on an ongoing basis or is the sort of 360m you alluded to kind of a peak and it may drop back down a little bit more?

And the second question is, I noticed in Tim's statement, he says this is a good time to clear the way and that the Chairman maybe has a new direction for the company. Is there any light you might be able to shed on that in terms of where there may be a different view going forward on a couple of issues specifically versus the approach taken in the past?

Matthew Gregory: You're right, Sam. The future expectation of capex is going to be higher than the 1x depreciation, and we have always said that. It was always going to be 1.1–1.2x, so we would be very happy if Student grows and we back that with investment. So for us, 1.2x is what we would expect to be a normal range of capex. We've had a couple of years of lower, of the 1x for the last couple of years, but we would expect this sort of 1.1x, 1.2x to be more normal going forward.

Wolfhart Hauser: When you look at what has been achieved, I think there will be no change in relation to that, and we will continue to drive cash and all these things I showed are positive. Where we have to have, and will have constantly, are fresh eyes – what are the changes in the transportation industry and that is really changing? You can see the examples in Greyhound. In Greyhound there was always a lot of time talking about, fuel costs and other things, and weather. But if you really look into that in more detail, it's been the budget airlines which are really competing with that.

And we have other modes of transport evolving in many areas – I don't have to mention Uber. There are many other ways, look into maybe some other areas, even bicycles. You know, nobody is talking about them, but look into Continental Europe. Go into Amsterdam and you see how transportation can work in a totally different way. I'm not saying that it's changing in the UK in that direction, but I am just saying I think we really have to look very actively forward. Do the right steps, and for example, you see in the slides, nowadays you cannot do everything on your own. You might do some partnering in some activities we are doing to really be successful, to offer the convenience customers today expect. You know, I think it's no longer just customer service. It's customer convenience. And people today want to expect different things than how it was ten years ago.

In relation, to that, you see also the overall rate of growth? It's not the old assumptions, you put in bids and then you talked about growth. They are changing, and the environment is changing, and with that we will also change our strategy. But that does not mean we do a drastic change now from the strategy the Group had so far.

Joe Thomas, HSBC: Joe Thomas from HSBC. Matthew, can you tell us what the latest assumptions are in TransPennine Express right now please? Secondly, you said that Transit margins are going to come down. What are they going to come down to? Presumably you've got some visibility there now. And likewise, can you answer the same question for Rail, where you said margins would trend down there? And finally, exceptional costs. What is your guidance for this year, and indeed, future?

Matthew Gregory: In terms of TransPennine Express, I don't want to get into too much detail on that. But what I'd say is we're looking at revenue growth – probably 1% down on where we'd expected, because of the large increases that we're going to be putting through with the capacity, that obviously compounds over the five-year period. That's what we're looking at there for TransPennine Express.

In terms of Transit, I mean, these Fort McMurray contracts were very good for us – we had about four or five years where we were earning $140m from Fort McMurray and we're going to be down to $20m or $30m from that area. That is going to have a big dent, so I'd expect Transit to be down towards the 6% level.

From a Rail perspective, we're expecting margins to be in the mid-1%'s, maybe that's the kind of area we'd expect that to turn out at.

And then for the exceptional costs, we're not planning anything significant at this point. There may be a little bit on Bus, but actually we think our plan is sufficiently far progressed to have accounted for what we want to do next year on Bus. So, with the revenue coming through as it is – through the way that that's been growing – and the plans that we put in place, we feel that is largely all covered.

Joe Thomas: TransPennine Express, the phasing of the provisions: is that relatively evenly split?

Matthew Gregory: What I'd say, over the next three to four years, you'd expect that sort of loss or cash cost to come through. I won't go into every year, but you can roughly spread it across the next three or four years. So, it's not out there in year four, and it's not all going to happen next year, I'd say, just a relatively smooth number there.

Joe Spooner, Jeffries: Joe Spooner from Jefferies. Can you just remind us of where the parent company guarantees are on TransPennine Express? Have you started to pay into that? And I guess, where does the £106m take you to relative to these parent company guarantees? Additionally, can you just give us a sense of, out of the £111m of free cash flow that you're talking about, how much of that broadly came from the Rail activities? And, to follow on from Joe's questions around exceptionals, presumably there's a risk there in terms of whatever happens on the Greyhound outcome for the restructuring costs, etc., on that side as well.

Matthew Gregory: In terms of TPE, we've got the parent company guarantees, or parent company support, of £189m, of which half is bonded. Clearly there's no cash outflow at that point, that just sits there as a legal commitment and obligation.

So the cash – we would just be expecting to pay out in cash as the losses of that grew over that period. Provided we're paying the cash from our money, then you don't technically call in those bonds or those guarantees. They just sit there as protection. I think that will answer that question.

In terms of the rail cash flow – we don't really get into a great deal of detail on that; clearly we've made a profit, and we largely expect that profit to turn into cash. We've had a little bit of upside from working capital timing – probably £20m to £30m is roughly what we've benefitted from net in the Rail business, but that's probably all I'd want to talk about at this point.

You're absolutely right about Greyhound. The review is out there, but this is a root and branch review, and we're looking at every aspect of the commercial business, the operations of the business, how it's structured, the investments – everything. I don't really want to talk about what may come out of that until we know what's going to happen. So we'll update people at the half year on where we stand with that, and we'll – if there are any exceptional costs or impacts coming from that then well be open on that from that point. But it's a little bit premature to even begin to start estimating what that could be.

Alex Paterson, Investec: Good morning. It's Alex Paterson from Investec. Two questions, please. Firstly, just on First Student, you were saying pricing trends for this year similar to last. Did you mean price increases similar to last or the level of pricing?

And secondly, just on Greyhound, could you talk about the overlap between Greyhound and Greyhound Express in terms of shared facilities, assets, that sort of thing? And is there – on the pension side, can you just remind us what – I think there's a pensions deficit at Greyhound. Is there a difference between what lies at Greyhound, Greyhound Express, US, Canada, that sort of thing, please?

Matthew Gregory: Just to be clear on First Student, when we talk about pricing, I'm talking about the price increases on the 'at-risk' contracts, the same way as we define it for this year. For Greyhound, the network and the asset base serves all of our business. This is part of the conundrum, in that we have a short haul passenger and a long-haul passenger riding the same bus going to the same terminals, buying the same tickets. So, it is all totally shared, and we're just chopping up individual legs to define what a short haul passenger is, versus what a long-haul passenger is. This is what we're trying to work through.

In terms of pension, we do have a US pension deficit in the Greyhound business, and we also have our Canadian pension deficit as well. In total – and that pretty much makes up, when you look at page 35 of the book – the £162m deficit that we've got in the States. But you wouldn't be able to

– again – attribute that between long haul or short haul types of passengers, just a US business and a Canadian business. I think, and we talked before about the pension liabilities in Canada, which, whilst on a valuation basis are not significant, because we put some letters of credit aside to help them [pension trustees] get comfortable about that, if there is significant change to the business, then that could crystallise some significant money there. That's what we're working through on Canada to try and deal with that.

Gerald Khoo, Liberum: Gerald Khoo from Liberum. A few questions. Starting on Rail capex, did I hear correctly that you talked about something in the region of £200m in the new financial year? And on that point, you talked about that being funded. Over what time period is that funded? Is there going to be a mismatch in, say, the £200m going out in the new year and the recovery in later years? And where in the cash flow statement will that show up?

Secondly, you talked about the contract losses in Transit. Can you clarify whether that was just the opportunity disappearing, as in they weren't available, or was that a loss to a competitor?

And finally, on the exceptionals for US insurance costs, how comfortable are you that you are providing the right amount going forwards for insurance and similar costs? And therefore what indications are there for future earned profits and margins if that needs to be correct.

Matthew Gregory: Let me make sure I've got all of those. In terms of the Rail capex, largely that gets funded at the point of incurring the capex. Sometimes if it's funded from a local authority or a county council or whatever, sometimes we get that money in advance. There can be some timing issues, but we're not expecting big timing issues. The Rail team are very good at managing their cash flow, so they know that we're not here to fund these things. Where it comes through in the cash flow is quite difficult to say, because it really depends whether it's a committed obligation, whether it's something that's been funded through the premium line, or whether it's an externally funded piece where it may come through working capital. Ultimately, we'd see most of it going through working capital, frankly.

What we're trying to flag up here is that the gross capex is a number that could look scary when you look at it. If you pull out the accounts next year, you're going to see £350–360m of road capex, you add in £200m and suddenly you're saying, 'they're spending £550m of capex.' We're just trying to flag it so that if you see it on the bit of paper, you're not shocked by it. What we're saying is that it will effectively be funded as it has been this year. We've had significant money going through this year as well and we're relying on the Rail people to, A, do the right contractual things to make sure we legally get the money in advance, and B, they work their way through it and make sure they get the money. There can be some timing issues, but it's a very short-term issue.

Coming on to First Transit, those two contracts were competitively tendered and were lost as a result of a competitive tender. We felt that we went as low as we were prepared to go for those contracts, and someone else was prepared to go a lot lower. It's disappointing, but we're happy with the decision and the outcome there.

The final point on the insurance costs, good point. Our insurance provision is made up of a swathe of thousands of relatively small claims, and then we get maybe 20, 30, 40 bigger claims that might come through. What we're seeing here is a deterioration on some of the bigger claims that we've had, whereas the rump of the sort of the smaller claims are still trending in the way that we've expected them to do. So as we stand today, we're seeing this as effectively a cluster of issues in those particular years. We're having to resolve that right now, but in terms of the swathe of the smaller claims, we're not seeing a general deterioration. We don't try and work this out ourselves, these things are actuarially valued. They work it all out for us. Yeah, of course we get a few bumps and knocks as we get some settlements – still a little bit crazy when you look at the US legal system. But with our Be Safe programme those things are being well controlled and we do this on an actuarial basis as well.

Joe Spooner, Jefferies: Joe Spooner from Jefferies again. Just another one on South Western Railway. To what extent are the profits currently being underpinned by compensatory receipts from Network Rail and I guess as a follow-on, is there a risk to franchise profits when the infrastructure gets sorted out when those payments come to an end? Thanks.

Matthew Gregory: We get compensated if the network was unavailable to us. And if we have – things could go wrong with the network, we can't run the services, we lose the revenue, we get compensated. Over time, we want them [Network Rail] to resolve these problems. We want them to improve the customer experience. We want people to see that the services are working, trains are running on time and they get back on the railway so there is always a tiny bit of a lag there. But in reality, if they improve the performance of the infrastructure, people would get more confident. They'll come back to the railways, we'll all be happier about it. I don't see any great swing one way or the other there but I'm clear that we want the infrastructure to improve so that we can improve the performance of our railway.

Damian Brewer, RBC: Damian Brewer, RBC again. Can I come back to SWR first of all? Just to clarify, the dead-banding on that is due to GDP in Central London employment. Can you be clear that is there any protection against changing travel patterns within that franchise specifically working from home on Fridays or maybe two days a week?

Matthew Gregory: You're absolutely right. It's GDP and Central London employment and we have made our assumptions and assessments of how we think travel patterns change, there is no specific protection there.

Damian Brewer: Just to be clear the contingent's equity there is about £80m or so and your share would be about £50m?

Matthew Gregory: That's right. Exactly right, much better protection all around on that franchise.

Damian Brewer: Okay and then a second wider question. I mean your shares are back down in the mid-90s again this morning. Could you explain why the Board, you dismissed the Apollo bid so quickly? And if there was a future bid coming would you equally dismiss it quickly or what parameters would you look for that would allow you to entertain a bid certainly above the current share price on behalf of your shareholders?

Wolfhart Hauser: First, it hasn't been a bid, it was a highly conditional offer, I think that is an important difference. Secondly, we dismiss no bid at all if it has a reasonable value for our shareholders. And if I'd asked here in the room what would be your opinion on the size where the company should recommend to shareholders to take that, I think I would get very different opinions. You can be sure that I talked to all major shareholders about the bid. Clearly, I cannot talk about the number specifically but just referring to the statement, the first bid was opportunistic, fundamentally undervalued the company and highly conditional.

And the second bid which came at a different time, maybe the share price was where it is. I don't know where it's now exactly, but it has been around 100p. We left out the word 'opportunistic', but we stayed with the two other descriptions and that's all I can say. If there is a bid, which would create value for shareholders we're totally open. As I said, we're open to all options, but it must create value at the end and if we don't see that then we will go for other options which is what we did in that case.

Damian Brewer: The share price performance hasn't kept up with even inflation. What does create value in the group? You've talked about long term changes. But at the moment, we've in real terms gone backwards in the last few years.

Wolfhart Hauser: As we said, we are disappointed about the results of last year and if you look into the trend we're talking about the year before, the share price went up to 155p. That was a different scenario, so we didn't deliver, and with all the discussion which had been there with the share price, the question is, does the share price reflect the inherent value of the company? Would it for example, suggest that you do fire sales of businesses where at the end, you end up when you take out the debt and when you take up the deficit in the pension schemes, where you even diminish the value of shareholders even when the share prices are around £1? But one thing is clear, we're not satisfied where that is and we will do our best and work hard to get a better delivery of value of our shareholders.

Anand Date, Deutsche: Hi there. Could you just say whether your Tramlink operations were profitable in the year and if so what they generated please?

Matthew Gregory: We can say that from an operational perspective they were, marginally. As you can expect, we've had a lot of cost going through that with the investigations going on but marginally from an operational perspective, yes.

Anad Date: I just wanted to ask obviously when Apollo came and it's something you do constantly if you're reviewing the business in the five different areas. I mean one of the issues that's been raised in the past is whether the Group is almost too big for one management team and so whether that is something you looked at? And clearly today you are announcing, you're looking at Greyhound you've got external consultants in. I was wondering whether you'd be able to talk about any of the other things that you looked out maybe as a management team and you said okay, we're not going to explore that. That doesn't make sense that yeah launching this review on Greyhound does make sense. Can you maybe talk about some of the other things you've looked at as well? Thank you.

Wolfhart Hauser: As I said, we're looking, either the Board and the management, constantly into strategies, their specific strategies to businesses, but clearly you also have to look, and the board is doing that, at the overall portfolio. Is it complex? Are there really synergies between the businesses? and so on. What I'm just saying is we have now the opportunity, because also of changes in the overall environment, to take a fresh look into everything, including the portfolio. But the fresh look does not mean that we come right away to direct conclusions on that by assessing Greyhound. Greyhound is a specific study. What we're doing you can be sure we're looking into other divisions in a similar way, we don't always need external consultants for that.

I'm confident that in the not too distant future you will hear about the steps we are taking but it does not mean that we tear the whole portfolio apart. If you look at the slide showing the pie chart, you can group it in very different ways, and clearly we're looking at that without telling you any details. We still have to see that we are a Group with all the obligations in relation to the debt we have, in relation to the pensions we have, and everything that we decide also on the portfolio would have to make sense that at the end there is more value for shareholders than it is today.

Anand Date: Sorry just to add – thanks for that answer, this is a totally separate one. On the UK Bus side, would you be able to say how much of the profit improvement is potentially coming from actually closing some of the loss-making businesses you may have had in the portfolio? And then I was just curious about the point you're making about we're creating a shared service centre in – I think in the past, one of the problems has been potentially kind of an ivory tower mentality. So could you just outline exactly what will be run locally and what will be run substantially?

Matthew Gregory: To comment on your point about what the impact of things like the closures were: that's probably 25–30% of the total £20 million that we've saved. That's pure closing a depot, or closing a particular part of the businesses that's not making money. Other parts are around network rationalisation, pricing, and then these administrative cost savings that we're doing. This is running this division in a way that minimises the back office. We used very old systems in our First Bus business, very old processes, lots of manual spreadsheets and bits of paper flying around; all this kind of stuff is very, very antiquated frankly. This year, we put in some new accounting systems that bring it up to the 21st century almost and that's what we're doing with the shared services. We're just taking a view: what's administrative, what's adding any value, what can we do more efficiently? And just put it all in one place.

I'm not sure about your comment on the ivory tower, but we are running this business in a different way. We're running it – all of the actions we take are local to the operating company, the regions that we're operating in. The medicine we're applying is specific to the regions that we're operating in where we can take an opportunity to group the business together and just run things more efficiently, recruit them, HR, we will do that.

Anand Date: I've just got one more. The slide on trying to cut the business different ways, obviously this year is – it's not a great year, that's fine, we'll go from there. But the Road business return on capital is 6.8% I think under your calculation: A) realistically where can that get to and B) realistically what timeframe would you expect it to get there? So what should we actually be measuring the Board and the management against on a five-year view?

Matthew Gregory: We would expect to be able to improve that at least by 100 basis points, maybe more. In fact, if you look at our incentives, you can see where we were. I think we were at 5.7% last year before some of the write-offs and we had to change some of that, but we're challenging ourselves to stretch 150 basis points of return on capital employed. What we're seeking to do is get it up very much towards our WACC and looking at the high sixes and sevens type of approach.

Anand Date: Time frame?

Matthew Gregory: We're running it as fast as possible and we think if we can get First Student moving, that's the biggest business, and we think we're going to get some better performance this year, within two to three years we should be able to improve it. What's great is that First Student got back to adding value last year. We had a bad year this year, but it's a good strong business. First Bus has got some good momentum and if we can continue with this sort of revenue growth, even at a low half percent, one percent and the cost savings then those two big parts of the business are going to drive it forward. Within two to three years, we should be able to see the benefits of that coming through. But one step at a time.

Joe Spooner: And your biggest competitor in the Student talked about the opportunity in Charter as a kind of low capital, high return opportunity. It's not something that you talk greatly about it. Is that not part of the equation looking forward?

Matthew Gregory: It's part of the equation. Again, you've got to remember that we're double the size of our biggest competitor and we've been doing this for a while. Our Charter business is $200m, so we're not small, we do both types of charter: Student charter, which is the games after school and going off to camps; and then we do the outside charter bit, which is where you want to hire a bus to go to a wedding for example. It's a big business, so a couple of hundred million, we don't talk about it because the biggest part of our business is to get the main part working but we're supplying the buses to the Super Bowl, we're supplying buses to the PGA tournaments, all this kind of stuff. It's a good source of capacity utilisation at reasonable margins, and again, without going into too much detail, we are continuing to improve our performance in that area and yes, they're right and we're right, we'll carry on wanting to improve that business. It's a big marketplace. We just can't talk about everything.