Transcript of FirstGroup's half-year results presentation for the period ending 30 September 2018

Tuesday 13 November 2018

Wolfhart Hauser, Chairman: Good morning everybody and thank you for joining us today for the presentation of our half-year results. I'm going to start with a summary of the changes we have been making over the last six months; then Matthew Gregory, our new Chief Executive, will take you through our half-year period and our plans in more detail, and then we would be happy to take your questions.

We have implemented clear divisional strategies across our five divisions to mobilise their considerable inherent value for the Group. Overall, I am encouraged by the progress the businesses have started in delivering these strategies in the first half. Of course, as you know, we want to maintain this momentum into the seasonally more important second half; of course, the first half is usually delivering perhaps one-third of our annual profit.

But, I'm confident that with today's appointment of Matthew Gregory as Chief Executive, we have the right person to further drive the Group's value mobilisation strategy at pace, without any delay. We conducted a thorough selection process which considered external and internal candidates. With his comprehensive knowledge of the Group, his past experience and the leadership capabilities he has shown since his appointment as COO in May of this year, the Board unanimously concluded that Matthew is the right manager for the role.

We also look forward to strengthening the Board further when we welcome Steve Gunning to the board as non-executive director in January. I know Steve's extensive financial and operational experience from his 20 years at British Airways will be of immense value for the Group.

We are also changing our operating structure to make sure our divisions are as agile, focused and efficient as possible to deliver for our customers. We recognise that the Group's portfolio may need to evolve in the future, as the conditions and opportunities in our markets change and we've taken this into account as we look at our operating structure. Our main focus as we go forward is to do even more to place our customers at the heart of everything we do and everything we say. We must look at our services through the lens of the customer, not only as an operator.

In addition to operational effectiveness and cost savings, we have and we are strengthening the commercial management in our divisions. By putting our customers first, our objective is to grow our business and build more successful partnerships with our stakeholders – all of which is key for being a business that generates consistent and sustainable revenue for our shareholders.

I will now hand over to Matthew, who will tell you more details of the last six months and our plans we have in the future.

Matthew, please…

Matthew Gregory, Chief Executive: Thanks, Wolfhart. Good morning everybody and thank you for joining us here today. I'm very pleased to be able to take you through a review of FirstGroup's half-year results. I'm going to take you through the financial results and I'll also give you some commentary on each of our divisions. For today, I'll be doing most of the talking; but I'm supported here by Rachael Borthwick, who you all know, and Nick Chevis who is also taking on the interim CFO role.

Overall, we're pleased to be able to report results are in line with our expectations and consistent with those outlined at the start of the year. We've seen growth in revenues, operating profits and EPS and again generated cash in the period. Our Road businesses are performing well, with continued delivery expected in the second half.

We're particularly pleased with the progress relating to First Student, where the bid season and start-up have been strong. At First Bus, we're combining revenue growth with cost savings to drive margins. We've also completed our strategic and operational review of Greyhound and are already implementing the necessary plans to improve this business.

As you know, our business is weighted towards the second half, but this first half performance underpins our unchanged outlook for the full year.

Let me take you through the headlines of the half-year numbers to give you some more colour. Overall, the results are in line with our expectations for the first half. Total revenue grew by 22% in constant currency and 6% when you exclude the comparable period effects of SWR. The Road division grew by 2%. Growth is being driven by the strong performance in Student and First Bus.

Operating profits of £92m grew by 9% in constant currency and reflects improvements in the Student, First Bus and Transit performance tempered by the expected decline in Greyhound profitability, with Rail performing largely in line with last year. This improvement in operating profit, when combined with the reduced finance costs and lower tax rates, has driven a significant increase in EPS, up 81% in constant currency. But, let's keep this in perspective – the first half of the year is a relatively small percentage of the expected full-year number.

Further, our cash performance was positive, with £51m of cash being generated in the first half. This is £30m better than last year, after excluding the £75m of working capital inflow from SWR. Again, we're pleased that the business has, for the second time, delivered cash in the first half, demonstrating that the business is able to improve its delivery.

The improving cash performance has driven the net debt to EBITDA ratio down from 1.7 times to 1.6 times, and we expect the leverage level to continue to reduce further for the full year. Overall, this is a good performance with the results in line with our expectations, and cash performance continuing to move forward.

Moving on to the revenue bridge, I am going to run through each of the divisions in detail in the coming slides, but first, let me tell you about the headlines. Moving from the left to the right, you can see that currency reduces revenue by 2%. Then you see that Student grew by 5.5% in the first half, Transit was largely flat, Greyhound declined by 1.6% and First Bus grew by 1.3%, giving us Road growth of 2%. Rail revenue was boosted by the half-year impact of SWR, as well as changes in premiums of at GWR. Like-for-like passenger growth for Rail was 5.5%. Overall, good progress in the Road divisions, and reasonable underlying growth in Rail.

Again, I'll go into more detail on operating profit for each division, but the adjusted operating profit increases from £89m to £92m. Currency reduces profit by £5m, but this is more than offset by the stronger performance in all of the Road divisions bar Greyhound. On a constant currency basis, Road margins increased by 40 basis points and Rail profits fell slightly. And with the introduction of the lower margin on SWR contract, this reduced overall Group margin by 30 basis points.

Turning now and going into detail in the divisions, I'm going to start with First Student. Revenue grew in the half for the first time in ten years and was up 5.5%. Additional operating days growth versus last year contributed around 2% of this growth, so the underlying growth is around 3%. This is largely driven by strong pricing activity where we have continued to maintain pricing discipline achieving pricing in excess of inflation, partially offset by the closeout of the recent academic year, where our 'up or out' pricing strategies continued to be effective in removing less profitable business.

Our recent bid season has been very strong, with retention of contracts up for renewal at 92%, well in excess of the 83% we experienced last year. This strong performance is being driven by the more focused approach to the customer that I discussed in May. Retention on the whole portfolio, which is how some other people measure it, has been 97%. The strong season, combined with new business wins and share shift, means that for the first time in ten years our Student business will be returning to bus growth. Growth in the bus count is a proxy for market share, and indicates that our business can and will start growing again.

We continue to look to complement this new organic growth with bolt-on acquisitions, and we're pleased that we've completed the 70-bus acquisition of CG Pearson in Canada in the half. As you know, at this time of the year the start-up in Student is hugely important to us and the team has navigated this challenge very well, and it's particularly relevant in a period where location numbers and bus count grew instead of declined.

We still continue to see challenges around driver shortages and do not see any reason for this to abate given the strength of the US economy. But whilst we continue to work hard with dealing with driver shortages, our strong pricing action allows us to counteract this challenge – at least from a financial perspective. Overall, Student margin has increased by 160 basis points, but since the first half is such a small percentage of the year's profit, we don't read too much into this. Of course, we don't know what the weather is going to do in the second half. However, the strong bid season, pricing and start-up give us good reason to believe that the full-year margins will be back to the mid-9% level this year. This would give us industry-leading margins befitting our position as the market leader in the sector.

As we go through each of the divisions, I want to take the opportunity to describe some of the exciting commercial activities that we're progressing. In Student, we're seeking to leverage our market leadership to grow largely through new technological innovation. FirstView allows parents to track the bus that their child is travelling on and this app is already available in 75 districts and is being used by 35,000 parents. We've then introduced FirstACTS, which is a conduct tracking website, which simplifies the process for reporting, tracking and analysing any student conduct issues. This has been launched this year and we look forward to supplementing this with other transportation solution services. Finally, we shouldn't forget the charter business, which is approximately 10% of our revenue and which allows us to provide additional services to both school districts and consumers, giving us better utilisation of our fleet.

Moving on to Transit, overall the revenue performance is largely flat and that masks the underlying activity in the business. The loss of business in the Canadian oil sands space that was referenced in May has been offset by inflationary pricing and contract wins in the fixed route and paratransit sectors. Our overall retention continues to be strong at 96%.

The improvement in the Transit margin has been largely driven by the absence of last year's hurricane impact of around $6m. Actual margins were more in line with the guidance we gave in the full-year update, with the loss of two higher margin oil sands contracts having previously been reflected in that outlook. Driver shortages continue to affect this business and we're working hard to offset the impact of this. The business retains its marking leading position in its existing sectors and I remain comfortable with our guidance of mid-5% margins in the Transit business.

When we've talked about Transit, we've highlighted in the past that this division is the one where we see the most opportunities with respect to disruption and this is the division where we're positioning ourselves to understand and be part of any changes in the marketplace. Let's look at some of our core areas of expansion in the Transit business.

We're working with a number of shared autonomous vehicle initiatives, or SAVs as they're known, to trial and test the demand for this innovation. We're also working with stakeholders with the goal of launching the first UK trial for SAVs on public roads near Didcot. We're currently providing shuttle services for more than 30 university campuses across North America, very much leading the way in this market. And finally, a reminder that we've been running a light rail commuter operation in Denton, Texas since 2016, positioning us well in this marketplace.

Let's move on to Greyhound. Firstly, I'm going to give you an update on the performance in the first half, and then I'm going to talk through our recent strategic and operational review.

I'll talk about the first half first and as expected, and in line with the trends Greyhound experienced in the latter part of last year, like-for-like revenue fell by about 1% in this period. The long haul business continues to be affected by airline competition, albeit this is being mitigated by higher recent activity around the immigration centres in the south. The higher pump price in the US has yet to have a significant impact on the business, either by curtailing airline competition or stimulating enough car drivers out of their cars in the period. From an operational perspective, we've seen additional costs coming through the business, from both fuel, cost inflation and also the cost of maintaining an older fleet. This resulted in a reduction of profitability in the first half and margins falling to 2.8%.

You'll recall that Greyhound in Canada has been affected by the economic situation in the country and ridership has dropped by 41% across Canada since 2010. And it's also a more regulated market with a higher cost structure. We're pleased to have been able to execute a plan to stem our losses in Canada and, as a reminder, we lost around $10m there last year. As of 31 October 2018, we have withdrawn from all routes in the West and Central Canada, apart from a very few routes near Vancouver, maintaining our presence in the East. And the rationale for staying in the East is due to the population density and the connection with a number of routes into the US. This action allows us to immediately half our losses in the country, with a path to at least break even in medium-term. As you'd expect, there are some costs involved in taking this action and I'll detail these later in the presentation.

Moving on then into the future of this business, you'll recall in May we announced the strategic and operational review of the Greyhound business. This was in the face of the increasing low-cost-airline competition in our long haul markets, competitive pressures in the North East and the need to expand our dynamic pricing tools outside of the small Express market.

So, stepping back for a second, the key questions that needed answering were
- did ultra-low airline competition present an existential threat to the coach market; and
- would the business be more profitable if it only focused on the shorter haul market – mainly east and west coasts – reducing the infrastructure accordingly?

We have completed our analysis, and I draw the following conclusions:
- Whilst low-cost airline carriers will continue to be a challenge, there is a significant proportion of our marketplace where the only competition is the car.
- And focusing solely on short haul will not be enough to drive profitability or returns forward. This is due to the 'override' effect, where the same bus carries both long and short haul passengers at different points in the same journey. Many passengers make multiple changes within our network, making it difficult to concentrate the infrastructure around specific routes. This is a complex network with around 190,000 connected city pairs, and therefore, we've concluded that our unique network does have value.

It's also worth noting that our long haul business tends to be more profitable than our short, due to the higher levels of competition and reduced barriers to entry in the short-haul market, particularly in the northeast.

So, I conclude that there is a clear ongoing attractive market for us, and we need to leverage our market position and network to derive profitability from this space.

The solution is to drive pricing activity, and there is no doubt we have to accelerate higher pricing in certain parts of the network. We also have to continue to reduce costs to bring the business back to health. Now, at a more granular level, we have already begun to increase the intensity of our pricing activities to target routes based on the competitive threat. This will be taken forward by a new commercial head. From a cost perspective, we're targeting the reduction of management layers, optimising our brand structure and also improving maintenance operations to drive down costs. We're already well underway with these activities and we expect the business to return to at least mid-single digit margin in the medium term.

So, let me move on to the UK. Moving to First Bus, we've seen continued progress in this business with like-for-like passenger revenue growing by 1.5%, maintaining last year's momentum. We're pleased to see the commercial passenger volume grew by 0.7%, and commercial revenue per mile is up 5%. We believe that our actions to improve the customer offering and also our focus on selective price increases have been instrumental in us growing at industry-leading levels. Being the first national bus operator to enable contactless payment on its entire fleet has helped bring our payment offering up to date and enhance the customer experience.

Now, while we were pleased with the performance in this business, we recognise that the good weather over the summer had a positive impact on the propensity to travel. Whilst revenues increased, overall volume fell by 0.6%, reflecting continued pressure from congestion and issues in the high street. We will not, therefore, allow ourselves to become complacent and will continue our focus on improving the customer experience.

Margins have continued their positive momentum, with margins in the traditionally lower half of the year reaching 5.7%, 200 basis points ahead of last year. And we continued to move forward with actions to optimise the network, rationalise the depot structure, introduce more efficient working practices and integrate more functions into our shared service centre. So, these activities generated £10 million of savings in the first half.

We continue to focus our investment where we have strong partnerships with the local authorities. And working together, we've been able to secure significant funding that helps with the air quality targets and also participate in programmes to improve congestion and social mobility. Whilst there are uncertainties around demand within the industry, we remain confident in further progress being made to margins for the rest of the year.

We have been focused on margin restoration the last couple of years, but we've also been focusing on ways to improve the customer experience. In terms of innovation, we're pleased to be launching 75 low-emission vehicles in compliance with a new Glasgow city-wide Low Emission Zone, which comes into effect in December. And by the way, these buses also have USB points, e-leather seating and free Wi-Fi. We're running a variety of non-diesel buses, with 11 battery-electric buses increasing to 30 running on our Park & Ride contract in York. And we also run biomethane buses in Bristol and hydrogen buses in Aberdeen. So, the business has been working and successful in securing funding for more than 500 retrofits for Euro VI compliance, and all new buses that we've been buying have been Euro VI compliant for a number of years.

I've already talked about being the first regional bus operator to have contactless capability across the entire fleet. And not only does this modernise the customer experience but, by taking cash off the bus, we're also able to speed up journey times.

And finally, we're also piloting a potential Mobility as a Service 'first mile/last mile' concept in North Bristol with a third party, since the spring of this year. And this did give us more understanding of this type of service and its potential.

Let me move onto rail. Overall, rail revenue grew by 81% in the first half. This half, we've had the full six periods with SWR, where last year, we only had four weeks. And when this is removed, Rail revenue grew by 18% driven by continued growth in passenger revenues but also the anticipated switch of GWR from being a premium to subsidy-based TOC (train operating company).

It's probably easier to look at the like-for-like passenger growth for each TOC. GWR grew by 4.6% demonstrating the impact of new Hitachi Intercity Express Trains being progressively implemented on this railway. TPE growth moderated slightly to 9.4%, mainly due to impact of May's big timetable changes on other TOCs in the area, affecting our ability to provide the service. And SWR's passenger growth was 3.2%, an improvement on prior period performance but still being affected by infrastructure issues and industrial action.

Margins are down this year with the improvement in GWR performance being offset by a loss being incurred in SWR in the first half. SWR has been affected by issues regarding the network performance in this period, which is being addressed by actions arising from the Holden Review, and continued industrial action has been damaging, in particular to our customers' experience.

In addition, we had to make payments in accordance with revenue risk sharing mechanisms. However, we continue to work hard with our industry partners to improve the network performance and our customers' experience, as well as introducing new trains to increase capacity. TPE has performed in line with financial plans set out at the full year, and, as a reminder, Rail profit does not have any TPE impact within.

Going forward, we expect that the Rail division will continue to trend towards the low single digit margins, and we'll continue to play our part in this industry as a strong operator, in delivering the largest investment in capacity in the market for many years.

So, a clear focus in our Rail business is the introduction of new capacity with significant fleet introductions across the network. By the end of 2020, almost all of our passengers will be travelling on trains that are less than five years old. In GWR, 93 Intercity Express Trains started in service in

2017. With Hull Trains, we'll have five new Intercity Express Trains in service in 2019. And TPE will be introducing 51 refreshed Class 185 trains before the full fleet of Nova trains arrive. And all this investment will deliver much needed Wi-Fi, power sockets, refitted toilets, air conditioning and other improvements for the customer experience.

Finally, you can see that we've introduced new ticket options for our SWR smartcard users. This launches a caret – 10 tickets at a 5% discount – giving flexibility to part-time workers. We also launched auto-renewal monthly season tickets – buy 11 get one free. And both of these are exclusively available to customers signed up to SWR Touch smartcards.

So, having talked you through the divisional performance, let's review the adjusting items that we're reporting this half. And I won't talk about amortisation which always get pulled out separately. The only significant item that we're pulling out to better explain the results of the business is the cost of restructuring in Greyhound. Our decision, in July, to formally withdraw from providing Greyhound services in Western Canada has crystallised certain closure costs, but will also generate a number of gains, particularly in relation to the sale of related properties. The accounting standards require us to provide for all of the costs related to closure, but we're not immediately able to accrue for profits that we expect to generate from selling properties. To this end, we've got a chart at the bottom of the page:

Now, the overall costs of closure are expected to be around £29 million, of which around £14 million relates to a long lease – 50 years plus – of one property in Winnipeg, and this is what's being accrued. Over time, we expect to generate around £10 million of profits from the sale of property. So a net cost in this half of £29 million but over time this will reduce to £19 million. But more importantly, the cash cost of closure is expected to be £25 million, and we expect to generate cash proceeds of around £19 million from the property sales. That means overall cash cost of withdrawing from Canada is around £6 million. Now, this excludes any impact on pensions, but we believe there will not be a significant change to our pension cash flows over and above what was required through normal reviews.

The only other adjusting item I pull out relates to interest charges from the TPE provision, but we see this is an accounting unwind. Our original provision remains unchanged.

So, let me now take you through the bottom half of the profit and loss. Interest costs are £8 million or 14% lower than last year, mainly due to the start of the refinancing programme, lowering average interest costs for the business.

The tax rate has fallen from 30% to 22.5%, in line with our previous guidance. As you all know this is all due to US tax reform driving down federal tax rates. We reiterate our guidance that the natural tax rate for the business is between 24-25%, but for this year the tax rate will be around 23%. And as a reminder, on a cash basis it remains low and will remain a similar number to last year's £12 million. And a final reminder that with SWR, we have a minority partner – MTR – who own 30% of the franchise. Taking all of this into account, EPS has grown by more than 80% in constant currency, albeit it off relatively small numbers.

Let me move on now to the cash flow. Net cash inflow was £51 million, which compares favourably to last year's operational cash flow of £22 million. Remember, this excludes the £75 million of working capital that came in with SWR in last year's first half.

Now working from the left-hand side, you can see that cash capex is £192 million versus £194 million last year. There's more detail in the Appendix, but it's worth pointing out the following: looking at overall capex, you can see that we continue to invest in the business this year. Gross capex has increased versus last year by £64 million, reflecting the return to growth in First Student as flagged, continued investment in First Bus, and the need to re-commence investment in fleet for Greyhound. And we've also made a small acquisition in First Student this year. We continue to maintain our discipline around capital investment and have taken the decision to put some of our capital spend onto operating lease this year. This is generally being driven by our desire to have more flexibility around alternative fuel buses. At this point, I would reiterate our guidance for the year that we expect to invest between £350-£360 million cash capex in our Road business this year. And the final point I'll make with capex is that IFRS 16, the new accounting standard on leasing, will be introduced to FirstGroup for the 31 March 2020 year end, and we'll be giving a more detailed update on this at the year end. I'm sure you'll all be looking forward to that.

Coming back to cash, we've seen a large working capital increase, mainly due to the timing of rail receipts and leasing payments. As you know, given the size of our balance sheet and the complexity of our Rail business, it can happen. These are a combination of timing relating to franchise payments on GWR, as well as normal operational cashflow timings for SWR. Given that most of this is timing I'm not upgrading our view of cash for the full year.

Operating cash is similar to last year, and the conversion rate is 146%. I think it's worth pointing out that we delivered cash in the first half for the second consecutive year after a six-year absence, and I'd reiterate that we have confidence that we'll generate significant cash for the full year.

I'd like to take a couple of slides before I close up to talk about financial position and our balance sheet. Our financial position has improved and remained strong with headroom under our committed facilities being in excess of £700 million. The net debt to EBITDA ratio has improved from 1.7 times to 1.6 times on a headline basis, which is 2.2 times when Rail ring-fenced cash is excluded. The long-term bond programme remains in place, and our average debt maturity is four years. Our ratings agencies, Standard & Poor's and Fitch, have confirmed our investment-grade status and they currently have us at BBB-/stable.

Last week, we were pleased to announce that we extended our RCF arrangement by a further two years, giving us security until November 2023. We thank our banking syndicate for their confidence in the business and for the very smooth process that this was.

Over 40% of our net debt is denominated in US dollars through US private placement and currency swaps, and 80% is at a fixed interest rate. So, the financial position is strong and it's improving.

The second slide on the balance sheet is related to pensions. I think it's worth spending a little bit of time looking at the issue of pensions and making sure that everyone understands how our deficit is made up.

You can see we have, largely, three pension areas. We've got the First Bus and Group schemes. We've got the legacy Greyhound schemes, and you've got Rail schemes. We currently account for the Rail schemes on the basis that the liabilities are handed back at the end of the franchise. The Greyhound schemes are handled under US and Canadian regulation and we currently have an agreed plan for bringing it back into surplus over time.

And it's the UK scheme that I really want to focus on. As you know, we took over pensions from the time of deregulation and the time of creation of the Group, and it's only in March 2018 that we've been able to close the First Bus and Group schemes for future accrual. The accounting deficits on these two schemes is £130 million. We have a clear deficit reduction plan and have fully agreed with the UK Pensions Regulator and trustees a path to clear the deficit; and this results in us paying nearly £22 million a year in debt reduction payments to these two schemes.

So, there are two clear points that I want to draw out so that everyone is clear about our UK pension position. The first is that there is a difference between the way our accounting deficits and our funding or actuarial benefits are calculated. This results in a funding deficit around £200m higher than the IAS accounting deficit. And it's this deficit, rather than the accounting deficit, that the cash payments are based on. The second point is that both the UK Bus and Group schemes benefit from a FirstGroup guarantee, and this allows the funding deficit to be calculated with more protection. This funding deficit is a lot lower than it would have been if we hadn't got the guarantee in place. I've talked about all this before, but I think that it's important that we're clear about it as we focus intently on driving shareholder value.

So, in summary, the first half of trading has been encouraging, but I'm conscious of our weighting to the second half. There are challenges, but we maintain our view of the full-year outlook, that is to say, broadly stable Group operating earnings in constant currency.; and I'm confident that we will bring in significant cash flow for the full year, continuing our investment and deleveraging agenda.

So, let me close by summarising where we are. We have clear strategies in each of our businesses. Our biggest business Student is returning growth. We can build on our market leading position and margins to provide new innovative services to our customers, as well as augmenting this with bolt-on acquisitions.

Transit continues to focus on growing its core markets, improving operating performance and leading the way with new technologies.

Greyhound has been problematic, but we have an improvement plan in place, and I'm focused on making sure that we deliver on it to restore this business to health.

In First Bus, we have momentum now, and we continue to drive performance in both revenue and costs, pushing our margins to allow us to bring forward the solutions that will continue to attract more people onto our services.

And in Rail, it's all about working with our industry partners to deliver the operating performance that our customers expect, all the while ensuring that we appropriately balance risk and reward.

We have market leading positions in each of our sectors. The Group is returning to growth, the Road margins are improving, and the business will generate further cash.

Now, in the first half of next year, we will host an investor event for you all to further expand on the opportunities that we see for each of our businesses. But until then, our immediate focus is on driving improved performance for our customers, our employees and our shareholders.

With that, I will be happy to take any questions that you might have.

Dominic Edridge, UBS: Firstly, can you just elaborate a little bit on the pricing in Student and the levels? And also, I think you talked about the inflation – about being above inflation – I was waiting for you to talk about probable inflation levels you were looking at.

Secondly, on the dividend, do you think you would discuss some of the different elements there – possibly one area is net debt to EBITDA and credit rating – I'm just wondering if there are any other elements like the statutory loss or other things that may be coming in and maybe causing complications there. And then on the accounting, I do notice that in the first half net debt, the reduction was offset by an increase in restricted cash. Is that due to that element you were talking about earlier on the difference in timing on the rail cash flows? And then, just in theory, assuming continuing very low profitability or losses on SWR and TPE, what does that mean on the restricted cash in general? Will that continue to grow, given the growth in those businesses?

Matthew Gregory: Okay. Quite a few there. So, let me work through them individually. So, coming around to the pricing: Look, we have spent the last four years with our 'up or out' strategy. We've been increasing pricing over and above inflation. Last year, we did 5.3%. This year, we have had a very good performance on pricing. And we've taken the view that as we've now restored the business to health and we'll continue to be disciplined around pricing, but we're no longer in the period we were before. Therefore it's not right for us to keep publishing those kinds of numbers for our customers. We don't want to be putting it forward in quite such an overt way. But what I can say is that the pricing has been at least as good as it was last year, and happy to leave it at that.

In terms of inflation, we're seeing around 3% on average across the US. So, again, that's give us the comfort that we are beating inflation, as I said during the presentation.

Coming up to the dividend, look, we've said that we believe that FirstGroup should be a dividend-paying stock, but as we reflected on our performance at the year end and continued through to the half-year, we feel that there's better value for us to continue our deleveraging agenda. I think the Board obviously will take account of the statutory loss position, but what we're more concerned about is making sure that we continue to de-risk the Group, and we think that's for the better. We obviously look at all of our metrics and we look at all of the potential ways of measuring debt as well, because I think you can all come up with different ways of adding things in and taking things out. So, it's not just about the headline number.

I think coming around to your point around restricted cash, I think we can probably handle the details afterwards. But in general terms, yes, from the working capital side, you would have seen that contributing to the increase in restricted cash. We don't sit here and particularly forecast our restricted cash, but we expect the Rail business to be profitable going forward. And therefore, over time, we'll be able to use that cash that's generated from the Rail business. The restricted cash piece is quite difficult to forecast and it does move around depending on what's going on in the timing of every individual TOC.

Damian Brewer, RBC First of all, can I turn attention to UK Bus where mileage seems down about 5% with 3-4% capex to revenues in H1: you haven't said much about – what is the plan there and clearly you can't just rely on [inaudible]. Is it just slowly attrition – cutting networks bit by bit or is there a bigger strategy there, and if so what is it?

On the Rail side, it looks like you lost about £28m in TransPennine and somewhere in the single-digit millions in South West Railway. Given that, how much contingent equity, if any, did you contribute to these franchises if any and how does this colour your thinking in terms of interest in future bidding etc.

And then very finally, congratulations on your performance so far Matthew – and here comes the apology - but this is the twenty-first one of these presentations I've been to and I've heard promises of this turnaround so many times before. What's different about this one? What do you think will make the execution take place, turning words into financial action?

Matthew Gregory Sure. Okay, well, I'll answer the first two questions, which will give me time to think about that last one!

In Bus, it's difficult for the first half, to take any great sort of store in the capex numbers, because it depends on the timing of when we're putting new buses in. And in terms of the mileage, I don't think it's quite down as much as that, but let's look what we have said about First Bus: Firstly, we are looking to improve our customer offering to make the customer experience as easy and convenient as possible, to encourage more people onto the bus and to use those services. The long-term trends when you look at congestion and you look at the environmental issues – more people should be going for the bus. Now clearly, the industry hasn't demonstrated that in the short term, but we're seeing some positive signs. Our view is that we're looking at each of our individual businesses separately. So, the issues and the medicine and the approach to each of those businesses is tailored to the local authority and the customers in that area. But we feel that improving the customer offering will increase patronage, will increase the revenue and we look forward to continuing to grow over time. Now, obviously we're cautious about that, but that is really the strategy: to continue improving the customer offering that allows us to grow. We've said that we will invest in the areas where the local authorities are supportive of the bus; and that is where we'll be putting our focus.

In terms of Rail – and the guys in the front row will correct me if I'm wrong – I think we've invested around £12m of contingent capital in TPE this year.

The answer to the next question is around bidding. We are always focused on a disciplined bidding process. We are considering – let me step back. We've got a very strong team in Rail. We're good at Rail, despite some of the issues that the whole industry has had to face, we do a reasonable job at that. We are focused on bidding for opportunities where we can see an appropriate balance between risk and reward. You can see, looking at our recent activity, that we have put in a bid for the West Coast Mainline, with our minority partners Trenitalia, based on the fact that we see this not just as a sort of run-of-the-mill franchise – there are longer-term aspects in terms of the shadow operator for HS2 elements of that as well. And we haven't bid for other franchises. So, we'll take each bid on its own merits. But really we'll be focusing on balancing the risk versus reward. It's a very difficult conversation to have because whilst there are lots of challenges around this business, I still sit here and can say: we have made £300 million profit on our Rail business in the last five years, and we have generated cash in that business in the last five years, pretty much commensurate to that. So, we are having to balance off the opportunity, our ability to deliver and therefore, also, the risks and challenges that we also face in the marketplace.

And then on your final point – I'm glad that you sat through 21 half-years: this is the one that will change your view! Joking aside, we have clear strategies for the business. I think you can see from the half-year performance there is some momentum in some of our businesses. And yes, we have said that before, which is why we've laid out an element of caution, we're not running away with ourselves. But the difference for us is going to be driving each of these individual divisions to improve their profitability, improve their customer experience and maximise the growth opportunities in their individual areas. We'll be giving the businesses the capabilities to do that, and also holding them to account for that as well.

And coming back on a point of detail, from a P&L perspective, the utilisation of TPE provision was £20.7m.

Gerald Khoo, Liberum Three questions. Starting with Damian's question, but the other way round: you have the parent company support (PCS), how much is left or maxed out on both TPE and SWR?

The second thing; you talked about something in Rail relating to the revenue sharing mechanism – I suspect this relates to the Central London Employment adjustor – could you elaborate a bit more, in terms of what's going on there, what your concerns are? You hint that that could be a rather difficult issue for the rest of the franchise.

And finally, on full-year capex, could you just clarify your £360m number, how that's affected by putting more buses on operating lease? Should I view that as an unchanged number, but the number we will see will be lower because of operating leases? Or something else?

Matthew Gregory So – that £350-£360 million is our cash capex, so the element of operating lease will be on top of that; you would add rather than deduct from there.

So on the specific questions on the PCS for the Rail business, The reality is that for SWR, we have the entire PCS there still, because we haven't drawn anything down there. The maximum – it's in the back of the pack – is around £90m when you look at our 70% share. And on TPE, again it's – the maximum is around £190m and we can say that the overall net we've drawn down about £17-£18m on that. So, that says two things. One is that we haven't drawn lots of it down in cash. And the other thing is that, despite people's views on this business, there is a finite calculable worst case. Now again, we're not working to that worst case, we're pushing to try and improve the performance. So, I mean, hopefully that's something very clear there.

And then coming back to Rail on the risk sharing mechanism. In 2013, the Brown Review suggested the franchising environment ought to better share risk and reward and recommended some changes there. In the SWR franchise, when we talked to you and we told you that we thought the risk sharing mechanisms were far better than those that we've seen in the past particularly TransPennine: the SWR franchise introduced GDP protection and CLE protection. Central London Employment is a statistic which attempts to measure the level of employment in specific boroughs that SWR goes into. And all of this was intended to share the risk: so, if there was a huge surge in employment; and lots more passengers going on the train, the Government would partake in some of that. But if there was a downturn, then we would get some protection.

What we've seen in the first couple of periods – and as you know we've only been running this for a year – is that while the statistics show us that CLE is increasing, we are not seeing that: that's not our experience on the actual railway. That is also affected by other things; its affected by industrial action, its affected by infrastructure issues we've got. So, we're flagging that as an issue, and as we do on many other things with all franchises, we are having conversations about that. We'll update if there's anything further to say on that.

Alex Paterson, Investec You also mentioned about the timetable impacts of winter on the three franchises, given what we saw on timetables in May. How do you – can you give us an indication of the magnitude of the potential impact there? Also, would it be naïve to think of it as straightforwardly as you say, 'we were going to do these and we will do them brilliantly – you are not allowing us to, therefore here is the compensation we are due?'

And then, secondly, just on SWR, you've had losses in the first half: can you give us an indication of what we think the profile of that business will be? What kind of things need to happen for you to break even; what kind of levers do you have left to pull?

Matthew Gregory Thank you. Again, I'm happy to talk about Rail, although obviously we could also focus on the good performance in some of our bigger businesses! But you are of course right to raise some of these issues. So, on the timetable change, it's not naïve to think that we could go back and ask to be compensated for the changes. We put forward a very detailed bid based on all the things we were going to do, and that will drive the business forward, will generate growth, increase the capacity – all these good things for the customer. If, for whatever reason, the Government decides it doesn't want us to make those timetable changes, then we're absolutely within the franchise and our contractual rights to have a discussion with them about that, so I don't think it's naïve to say that. It's not really right to scale it, because, as you can imagine, the entire industry is having to work through these issues and there's actually quite a lot of Excel spreadsheets working at the moment, trying to work all of this out. But I think I can say that we would expect to be compensated. It's unfortunate, but we expect not to suffer financially because of that.

On SWR and what do we need to do: the Holden Review suggested how to improve the infrastructure and the operational performance; there's a number of recommendations that we're working through with Network Rail and DfT on improving the resilience of the infrastructure, which will improve the operational performance. And then we need to – to the best of our ability – improve the service and introduce the trains that we want to. The trains are going to come on – are on order – and will arrive. We're not going to sit here and say, 'Well, we can't put them in because of the timetable.' We're going to work, as we have done in other franchises, to find as many solutions as we can to improve the situation.

So, in terms of how will we make South West Railway a success – we will be improving the operational performance and delivering the capacity to the best of our ability, as much as we're allowed to.

Joe Thomas HSBC You talked about the pension deficit. Can you give us more context around that?

Matthew Gregory The context is that we're continuing to review all of our options, and we'll continue to review the business. I just wanted to be clear that there are some structural issues around some of the options that we might consider. I just want to be absolutely clear to people, that as the Group stands today, we have a very clear and agreed mechanism for dealing with our pension deficit and we take our responsibility there very seriously. What we want people to understand is that if we decided and felt it was right to do other structural things with the Group, then we would have to take that into account. So, I can't tell you how much that would be or what it would be – there's a lot of assumptions that go into it. But it's important that everybody understands that these are complex issues.

Joe Thomas In terms of UK Bus, we have seen slightly more positive noises coming out from other operators recently as well; I was just wondering if you can helps with which areas are performing better than others

Matthew Gregory Sure. I mean, we don't really want to go into the detail of particular areas because, obviously, that can be commercially sensitive to us. But, I think it's fair to say that our southern business are performing much better than the ones in the north of England and Scotland.

Joe Thomas And that's a demand issue, rather than an issue of competition?

Matthew Gregory It's less a competition issue, than very specific to the individual area. So, it will be down to whether there's particular congestion, particular economic environment in certain areas. So, it can be very specific to those issues. But I think what we're trying to say is that we saw some good growth last year and, again, we're showing like-for-like revenue growth this half. But we're not getting carried away. We recognise that you can't exactly quantify what the weather effect would be. I don't want people to be sitting there saying, 'You're up 1.5%, off we go, it's going to be more and more' – I just want to make sure that we continue to work to improve the service, and we'll see as we go through the second half how that really develops.

Joe Thomas Finally one on school buses. You're talking about 3% inflation – is that wage inflation?

Matthew Gregory That's right.

Joe Thomas How do you seeing that developing, with [companies like Amazon raising their wages] and of course a difficult market environment, a tight labour market generally in the US, do you think there is a risk that goes up further?

Matthew Gregory There is a risk. We're not seeing any abating of the inflation. I think Amazon – those kinds of noises will be an issue for us, but that will obviously depend on where the specific operations are. A big part of our business is very specific – if you want to work in a specific kind of way, three hours in the morning, three hours in the afternoon. But, you raise a valid point. There's potential for higher inflation there. It really does depend on how the US economy does go in the future, there are different versions of what the outlook's going to be. I will say, too, we've got ourselves positioned where we're renewing each of our contracts pretty much a third every year, and we've got stronger than inflation price increases. And look, I think I responded before that obviously we don't want to rub our customers' noses in this issue, but if we got to a stage where we had to put more in then we would do that, and that's the good element of our pricing discipline.

Daria Fomina, Goldman Sachs Quick question on the US Student operation. Can you talk a little bit about – going forward – your growth expectations? If you think about it [inaudible] what are the targets you're setting for yourself in that business?

And also, I just have one final question on your debt, obviously interest historically is at higher rates – what would be the costs if you tried to completely refinance today – what would be the decisions that you would have to make?

Matthew Gregory On that point, it would still be in the tens of millions of pounds that we would have to pay to extricate ourselves, particularly from the longer-term bonds. It's still a significant amount of cash that would be going out of the business, although it would be – you could come up with some kind of calculation that's NPV positive to some extent, we just don't think that's a good use of our cash. You know, we've got cash coming in from the business. Everyone understands it and we're comfortable with that.

I think on the growth, I don't want to anticipate too much what we might say next year in terms of outlining where we are going with the businesses, but it's fair to say that from an organic perspective in Student, you can expect a low single digit organic growth potentially, now that we've got the bus count stabilised. You'd expect to get some growth from share shift potentially. And then it's about these bolt-on acquisitions that we're looking to increase the pipeline. But to be honest I don't want to get tied down to a particular target at this stage, if that's okay.

Good. Any other questions? There we go…sorry. Didn't see you there.

Ralf Jainz, Centricus Two accounting questions. The first one relates to the insurance claims (inaudible) …I think there seems to be an issue in the U.S: Your provision for insurance comes to

£20 million more than the year end number – what is the driver of this growing and what can you do to mitigate it over the coming years?

And the second one, you refer to a recent ruling on the -- an equalization of guaranteed minimum payments in the [pension could be significant] – can you be more precise or potentially provide a best-case range? And when will you communicate your (inaudible)?

Matthew Gregory Yes, so let me pick up that one. Every single UK PLC is – all those who have a defined benefit scheme are being affected by this, so this is not a just FirstGroup issue, just to be clear on that. We only got this judgment on October 28, so I think it would be unwise for me to try and size it now. We'll be working through all of the specifics across all of our schemes, so we'll update on that when we have something that we can share. I think it's -- it would be unwise to come and try and put a number on that now. But again, there are a lot of people in our pensions department working through these numbers, as I suspect there are in many other UK companies trying to work out the impact on their DB schemes.

Coming back to your other point about insurance: obviously, we have seen some increase in the provision. The drivers on that are – look, we have some big claims, we always have a number of claims going through the business, and we can have some claims which settle in a way that we don't think is necessarily logical, in particular when you look at it from a UK perspective, it's just not how we'd expect them to run out. That's the US legal system. The way that we mitigate this is through our safety program, and – I guess a little bit early to be saying that it's entirely effective but we have our Be Safe programme across the whole of our organization, which is a cultural program that aims to address the collisions and the incidents that cause claims, because this is all about where we've hit people or we've injured people. And the way you deal with it is by driving the incidents down and reducing the cost of the claims. And the other thing – a big chunk of the provision increase is because of foreign exchange as well because that's a balance sheet number. It's pretty much all U.S. dollar-based because it's all based on the claims in the US…
[inaudible]

Ralph Jainz Just in general, is it that the number or the cost of the incidents [are growing]?

Matthew Gregory It's more that the cost is going up because actually -- and again, I don't want to call it too early – but we've seen some encouraging safety stats in this first half by the number of incidents has been coming down slightly. But again, it's a big portfolio, that provision is based on claims that are going back 5, 6, 7 years, so I don't want to get tied down to a claim that it's all sorted. But the reality is, if we have fewer incidents and we have a better safety performance, we will have fewer claims, and that will overall improve the performance of the business.