

Principal risks and uncertainties

Our risk management approach

We take a holistic approach to risk management, first building a picture of the principal risks at divisional level, then consolidating those principal risks alongside Group risks into a Group view.

Risk management structure

Whilst some risks such as treasury risk are managed at a Group level, all of our businesses are responsible for identifying, assessing and managing the risks they face with appropriate assistance, review and challenge from the Group functions as necessary.

Areas of focus

We seek to continue to improve the quality of risk management information generated by our businesses. In 2018 we will implement a new risk management system across the business, and refresh our risk appetite.

The current structure is as follows:



Risk management structure



Principal risks and uncertainties

Our risk management methodology is aimed at identifying the principal risks that could:

- adversely impact the safety or security of the Group's employees, customers and assets;
- have a material impact on the financial or operational performance of the Group;
- impede achievement of the Group's strategic objectives and financial targets; and/or
- adversely impact the Group's reputation or stakeholder expectations.

The Group's principal risks are set out in the table on page 36 onwards. These risks have been assessed taking into account their potential impact (both financial and reputational); the likelihood of occurrence, and any change to this compared to the prior year and the residual risk after the implementation of controls. Further information on our risk management processes is contained in the Corporate governance report on page 57.

Strategic objectives

To deliver our strategy, it is important that we understand and manage the risks that face the Group. The table below outlines our principal risks and identifies which of our strategic objectives may be affected by those principal risks.

Risk	Change in year	Link to strategic priorities
Economic conditions	◀▶	① ② ③ ④
Political and regulatory	▲	① ② ③ ④ ⑤
Contract businesses including rail franchising	▲	① ② ③ ④ ⑤
Competition and emerging technologies	▲	① ② ③ ④
Information technology	◀▶	① ② ③ ④ ⑤
Data security (inc. cyber & GDPR)	New	① ② ③ ④ ⑤
Treasury and credit rating	▼	① ③ ④
Pension scheme funding	◀▶	① ③ ④
Compliance, litigation and claims, health and safety	◀▶	① ② ③ ⑤
Labour costs, employee relations, recruitment and retention	▲	① ② ③ ④ ⑤
Disruption to infrastructure/operations	◀▶	① ② ③ ⑤

Link to strategic priorities

- ① Focused and disciplined bidding
- ② Driving growth through attractive commercial propositions
- ③ Continuous improvement in operating and financial performance
- ④ Prudent investment in our key assets
- ⑤ Responsible partnerships with our customers and communities

Principal risks and uncertainties continued

Risk and potential impact

Economic conditions including Brexit implications

Changing economic conditions affect our different businesses in different ways.

A less positive economic outlook could have a negative impact on our businesses in terms of reduced demand and reduced opportunities for growth or to retain or secure new business. Our First Rail businesses are particularly sensitive to movements in key economic indicators. The same factors could also affect our key suppliers.

An improving economic climate, particularly when combined with lower fuel prices, may result in reduced demand for public transportation in our Greyhound and First Bus businesses as alternative modes of transport become relatively more affordable.

Improving economic conditions may also result in a tightening of labour markets resulting in employee shortages, rising pay, or affect the availability of public funding for transport services.

Political and regulatory

The political landscape within which the Group operates is constantly changing. Changes to government policy, funding regimes, infrastructure initiatives, or the legal and regulatory framework may result in structural market changes or impact the Group's operations in terms of reduced profitability, increased costs and/or a reduction in operational flexibility or efficiency.

Contract businesses including rail franchising

Approximately half of the Group's business is contracted, which is dependent on the ability to renew and secure new contract wins on profitable terms. Failure to do so would result in reduced revenue and profitability and incorrect modelling or bid assumptions could lead to greater than anticipated costs or losses.

Failure to comply with contract terms could result in termination, litigation and financial penalties and failure to win new contracts or non-renewal of existing contracts.

Competition for new rail franchises is intense. We bid against rail operators from both the UK and other countries. Failure to win franchises in the future will result in a lower First Rail division contribution and profitability.

The GWR, TPE and SWR franchises cover a period during which there will be significant change including major infrastructure work, electrification and resignalling as well as the introduction of new trains, which require careful planning and management. Failure to manage these risks adequately in accordance with our plans could result in financial and reputational impacts to the Group.

Mitigation

To an extent, our First Bus and Greyhound operating companies are able to modify services to react to market changes.

All of our businesses focus on controlling costs to ensure they remain competitive.

The Group has dedicated legal teams in the UK and North America who advise on emerging issues.

The Group actively engages with the relevant government and transport bodies and policy makers to help ensure that we are properly positioned to respond to any proposed changes.

Our continued focus on service quality and delivery helps to mitigate calls for structural market change.

The relevant divisions have experienced and dedicated bid teams who undertake careful economic modelling of contract bids and, where possible, seek to negotiate risk sharing arrangements with the relevant customer or contracting authority.

The Group also has a comprehensive review process for rail bids as they are developed and finalised involving a number of divisional and Group functions as well as final Board sign off.

Compliance with our rail franchise agreements is closely managed and monitored on a monthly basis by senior management and procedures are in place to minimise the risk of non-compliance.

Comment and movement during the year



Low oil prices have adversely affected our Greyhound and Fort McMurray First Transit businesses.

The UK departure from the European Union (Brexit) may adversely impact the UK's economic position which in turn may have an adverse impact on the Group's UK operations.



The political landscape in the US and the UK continues to present both risks and opportunities. For example, in the UK we have continued to invest in our fleet to meet the challenge of tighter environmental regulations.



We continually review our contracts to take account of changing circumstances such as economic environment or infrastructure changes. Our rail franchise contracts are examples of this.

Risk and potential impact	Mitigation	Comment and movement during the year
<p>Competition and emerging technologies</p> <p>All of the Group's businesses (both contract and non-contract) compete in the areas of pricing and service and face competition from a number of sources.</p> <p>Our main competitors include the private car and existing and new public and private transport operators across all our markets. Airline competition impacts demand for bus travel, especially in Greyhound's long haul business. Emerging services such as Uber, ride sharing apps and price comparison websites make access to alternative transport solutions easier. However, emerging technologies such as autonomous vehicles and on demand schemes also provide opportunities to grow and develop our market segments.</p> <p>Increased competition could result in lost business, reduced revenue and reduced profitability.</p>	<p>The Group continues to focus on service quality and delivery as priorities in making our services attractive to passengers and other customers, across our portfolio of businesses.</p> <p>We have a dedicated cross-divisional Consumer Experience Team focused on improving our service to customers and improving access to our services. In our contract businesses, a competitive bidding strategy and a strong bidding team are key.</p> <p>Wherever possible, the Group works with local and national bodies to promote measures aimed at increasing demand for public transport and the other services that we offer.</p>	<p>▲</p> <p>In North America, Greyhound has implemented new pricing technology tools to allow for a more rapid response to an increasingly competitive marketplace driven by low cost airline competition.</p> <p>We currently have a number of autonomous vehicle pilot projects in the US and are working on one in the UK. We are also running pilots for on demand technology both in the USA and UK.</p>
<p>Information technology (IT)</p> <p>The Group relies on IT in all aspects of our business. Any significant disruption or failure, caused by external factors, denial of service, computer viruses or human error could result in a service interruption, accident or misappropriation of confidential information. Process failure, security breach or other operational difficulties may also lead to revenue loss or increased costs, fines, penalties or additional insurance requirements. Prolonged failure of our sales websites could also adversely affect revenues.</p> <p>Continued successful delivery and implementation of the Greyhound IT transformation plan is required to improve yield management and drive future growth.</p> <p>Failure to properly manage the implementation of new IT systems may result in increased costs and/or lost revenue.</p>	<p>The Group has increased its focus on asset management and further enhanced its IT security processes and procedures.</p> <p>The Group has further strengthened its IT project management capability during the year, particularly within Greyhound.</p>	<p>◀▶</p> <p>No material change in the year, however, web and mobile sales channels are of increasing importance across many of our businesses.</p>
<p>Data security (including cyber security & GDPR)</p> <p>All business sectors are targeted by increasingly sophisticated cyber security attacks. Across our divisions we are seeing increased use of mobile and internet sales channels which gather large amounts of data and therefore the risk of unauthorised access to, or loss of, data in respect of employees or our customers is growing.</p> <p>A failure to comply with the General Data Protection Regulation (GDPR), which came into force in May 2018, could result in significant penalties and could have adverse impact on consumer confidence in the Group.</p>	<p>We have threat detection systems across our business but continue to remain vigilant to security improvements when identified.</p>	<p>New</p> <p>In the year we appointed a Data Protection Officer to oversee the completion of our GDPR compliance project. From May 2018, the Data Protection Officer will undertake the tasks set out in the GDPR, including monitoring compliance.</p> <p>We have also implemented a number of staff training initiatives to raise awareness of data security risks and responsibilities.</p>

Principal risks and uncertainties continued

Risk and potential impact

Treasury and credit rating

As set out in further detail in note 24 to the financial statements on pages 130 to 134, treasury risks include liquidity risks, risks arising from changes to foreign exchange and interest rates and fuel price risk.

Foreign currency and interest rate movements may impact the profits, balance sheet and cash flows of the Group.

Ineffective hedging arrangements may not fully mitigate losses or may increase them.

The Group is credit rated by Standard & Poor's and Fitch. A downgrade in the Group's credit ratings to below investment grade may lead to increased financing costs and other consequences and affect the Group's ability to invest in its operations.

Mitigation

The Group's Treasury Committee manages treasury policy, and delegated authorities are reviewed periodically to ensure compliance with best practice and to control and monitor these risks appropriately.

The Group is continuously focused on improving operating and financial performance as part of our strategic objectives as outlined on page 11.

Comment and movement during the year

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The continued reduction in the Group's leverage from 1.9 times net debt: EBITDA to 1.5 times at the end of the financial year as a result of strong cash generation and the bond refinancing has further reduced refinancing risk.

Pension scheme funding

The Group sponsors or participates in a number of significant defined benefit pension schemes, primarily in the UK.

Future cash contribution requirements may increase or decrease based upon financial markets, notably investment returns and valuations, the rates used to value the liabilities and through changes to life expectancy, and could result in material changes in the accounting cost and cash contributions required.

Diversification of investments, hedging of liabilities, amendment of the defined benefit promises and the introduction of defined contribution benefits for new starters in First Bus, FirstGroup corporate functions and our Canadian businesses have reduced these risks.

The Group also seeks to remove liabilities from the balance sheet where it can be achieved cost effectively.

Under the First Rail franchise arrangements, the Group's train operating companies are not responsible for any residual deficit at the end of a franchise so there is only short term cash flow risk within any particular franchise.

◀▶
The Group has closed the UK Group and First Bus Pension Schemes to future accrual from April 2018, and consolidated other First Bus legacy schemes. This will further reduce the size and volatility of the pension funding risk over the longer term.

During the year, The Pensions Regulator ('TPR') has been in discussion with the Railways Pension Scheme (the 'Scheme') regarding the funding assumptions which could result in changes to contributions. The Scheme is the industry-wide pension scheme. The outcome of the review, which could impact all rail operators, is not yet known. The Rail Delivery Group is engaging with rail operators to understand and assess TPR's concerns and to develop an industry-wide solution.

Compliance, litigation and claims, health and safety

The Group's operations are subject to a wide range of legislation and regulation. Failure to comply can lead to litigation, claims, damages, fines and penalties.

The Group has three main insurable risks: third party injury and other claims arising from vehicle and general operations, employee injuries and property damage.

The Group is also subject to other litigation, which is not insured, particularly in North America, including contractual claims and those relating to employee wage and hour, and meal and break, matters.

A higher volume of litigation and claims can lead to increased costs, reduced availability of insurance cover, and/or reputational impact.

Increased frequency of accidents, clusters of higher severity losses, a large single claim, or a large number of smaller claims may negatively affect profitability and cash flow.

Compliance with Group and divisional policies and procedures.

The Group has a very strong focus on safety and it is one of our five values. The Group self-insures third party and employee injury claims up to a certain level commensurate with the historical risk profile. We purchase insurance above these limits from reputable global insurance firms. Claims are managed by experienced claims handlers.

Non-insured claims are managed by the Group's dedicated in-house legal teams with external assistance as appropriate.

◀▶
The legal climate in North America, particularly in the US, continues to deliver judgements which are disproportionately in favour of plaintiffs, and at times unpredictable. The costs of dealing with this challenging legal environment is factored in the budgets. Due to the scale and scope of our operations, risk mitigation in this area continues to be an area of focus for the Group.

Risk and potential impact

Labour costs, employee relations, recruitment and retention

Employee costs represent the largest component of the Group's operating costs, and new regulation or pressure to increase wages could increase these costs. Competition for employees, particularly in an improved economic climate, can lead to shortages which increase costs and affect service delivery.

High employee turnover could lead to higher than expected increases in the cost of recruitment, training and labour costs and operational disruption.

Similarly, industrial action could adversely impact customer service and have a financial impact on the Group's operations.

Mitigation

The Group seeks to mitigate these risks via its recruitment and retention policies, training schemes and working practices.

Our working practices include building communication and engagement with trade unions and the wider workforce. Examples of this engagement include regular employee communication, satisfaction surveys, and the presence of Employee Directors (who are voted for by the employees to represent them) on many of the Group's UK operating company boards and the FirstGroup plc Board.

Where increased wages and incentives are necessary to attract and retain employees, those extra costs are factored into our bid models, where possible, to ensure appropriate returns are achieved.

Comment and movement during the year



Strong economic conditions, particularly in North America, continue to impact retention and recruitment.

During the year, we have refreshed our recruitment approach and offer in First Student and First Transit to reflect local market conditions.

Disruption to infrastructure/operations

Our operations, and the infrastructure on which they depend, can be affected by a number of different external factors, many of which are not within our control. These factors include terrorism, adverse weather events and, potentially, climate change or pandemics.

The threat from terrorism is enduring and continues to exist in all of our markets. Public transport continues to be regarded as an attractive and viable target, and has previously been subject to attack. Across our businesses, we take all reasonable steps to help guard against such activity on the services we operate. An attack, or threat of attack, could lead to reduced public confidence in public transportation, and/or specifically in the Group's security and safety record and could reduce demand for our services, increase costs or security requirements and cause operational disruption.

Greater and more frequent adverse weather could lead to interruptions or disruption to service performance and reduced customer demand with consequent financial impact, potential increased costs and accident rates.

As a leading transport provider, we face the challenge of addressing climate change, both through managing its impact and reducing emissions.

We continue to develop and apply good practice, and provide guidance to our employees to help them identify and respond effectively to any potential threat or incident.

We maintain close working relationships with specialist government agencies, in relation to terror threats, in both the UK and North America.

We employ dedicated security specialists in the UK and North America.

The geographic spread of the Group's businesses offers some protection against specific incidents. In addition, some of our contract-based businesses have *force majeure* clauses in place.

We have severe weather action plans and procedures to manage the impact on our operations.

The Group continues to target reductions in our emissions, including through behaviour change initiatives and investment in new technology.



No material change during the year, although severe weather has led to service disruption in both our North American and UK operations.

The risks listed are not all of those highlighted by our risk management processes and are not set out in any order of priority. Additional risks and uncertainties not presently known to us, or currently deemed to be less material, may also impact our business. Indication of a movement in a risk may not indicate a change in the overall net risk position after taking into account risk mitigations.