FirstGroup 2019 winter trading update
9am 19 February 2019 call transcript

Matthew Gregory (Chief Executive, FirstGroup): Good morning everyone and thanks for joining the call today. I'm joined by Nick [*Chevis, Interim Chief Financial Officer*], Rachael [*Borthwick, Group Corporate Services Director*], and Faisal [*Tabbah, Head of Investor Relations*], and I'm going to take you through a quick summary of the Group's trading performance since our half year point at the end of September, before we open up to Q&A.

So, the **headlines**: our overall trading performance in the October-January period has been in line with our projections. Revenue metrics are growing, led in the period by our largest business First Student, and we've been working hard to improve our financial performance and our service for passengers. Reported Group revenue is up 14% year to date (YTD), benefiting from the inclusion of the South Western Railway (SWR) franchise, and partially offset by a small net headwind from foreign exchange. In constant currency and excluding the SWR impact, revenues are up by 5.5% YTD, and our Road divisions have grown revenue by 1.9% YTD in constant currency.

Looking ahead, although overall conditions in our markets remain uncertain, and poor weather always has the potential to affect our performance, our trading performance to date supports our unchanged outlook for 2018/19. And finally, we're on track to deliver higher cash flow this year, with a stable underlying cash flow performance, boosted by the benefit of some phasing in our Rail division – some rail cash inflows, which will unwind over time – as well as some property disposals.

Let's go into the divisions in more detail.

In **First Student**, our revenue performance in the period, at 6.2% growth, reflects the price increases and higher contract retention rates we achieved in last summer's bid season. The recruitment and retention of drivers remains the biggest challenge we face in Student, given the persistent strength of the US employment market. However, we continue to refine and improve our processes and this helped us deliver a solid start-up of the school year for our school board customers and our passengers. Together with our ongoing cost efficiency actions, our performance in this key period underpins our confidence in delivering profit growth in First Student for the full year.

First Transit's revenues were slightly stronger in the period, but YTD were essentially in line with last year. Contract starts and organic growth are offsetting the end of some relatively large contracts – such as the high margin business in the Canadian oil sands that we've previously spoken about – and which completed at the end of last year. We continue to build our expertise in the autonomous vehicle space, with pilot projects in California, Florida and Texas getting underway in recent months. In November we were selected to be the operator of the X Train, which will be the first luxury train service to connect Southern California to Las Vegas in over 20 years. Meanwhile, our productivity and cost efficiency improvement programmes continue to offset the challenging US driver cost environment.

Finally in North America, we turn to **Greyhound**. As you will remember, we set out a plan towards the end of last year to respond to the very difficult trading environment in some of Greyhound's markets: particularly those with significant low-cost airline competition, and in parts of Canada where demand has been in decline for years. The difficult conditions persist and, if anything, the recent fuel price reductions increases the challenge, as this makes the airlines and passenger cars we compete with more cost competitive. However, we're beginning to see early signs of improvement from the commercial and operational changes we've made across our network. Meanwhile, in Canada, our withdrawal of service in significant parts of the country from the end of October has proceeded to plan. We'll continue to take opportunities to unlock value where possible, such as the sale in January of our maintenance facility in Chicago, for $38m.

Let me move on to the UK. In **First Bus** like-for-like passenger revenue grew by 1.3%, with higher revenue per mile from our fares and other commercial actions more than offsetting a like-for-like passenger volume decrease of 1.9% in the period. This reflected the subdued footfall on the high street this Christmas that many retailers have reported on, as well as some network restructuring actions. We're also continuing to improve margins, by modernising our operating procedures and work practices, while keeping our cost base and operating footprint under review. As you know, we're focusing our investment in those areas where we have strong partnerships with local authorities who support our ambitions to deliver thriving and sustainable bus services. In the period, for example, we announced another 75 new ultra-low emission vehicles for Glasgow in 2019, coming on top of 75 last year. And in Leeds, we've now taken delivery of more than 100 new ultra-low emission buses in the last twelve months, representing the first third of our £71m investment in the partnership with the city. We've also announced this morning the sale of one of our Manchester depots to Go-Ahead for £11m, an example of our continued focus on optimising our footprint and investment strategy. The sale moderates our exposure to a market which has been challenging for us, as a result of mounting congestion issues, and some structural uncertainties as to Transport for Greater Manchester's future plans for the delivery of bus services.

Moving on to **First Rail:** overall revenue is up 45% YTD, in large part reflecting the SWR franchise. Adjusting out SWR, the like-for-like passenger revenue growth is 5% YTD and 4.2% in the period, principally reflecting significant infrastructure challenges which resulted in disappointing operating performance for passengers towards the end of 2018. We're working hard with Network Rail and our other industry partners to improve our operating performance and are encouraged with the improvements made since the beginning of this calendar year. Great Western Railway (GWR) continues to roll out the Hitachi Intercity Express train fleet and to manage customer journeys around the substantial infrastructure upgrades undertaken by Network Rail. You'll remember that TransPennine Express (TPE) has had a difficult summer due to the knock-on effects of May's big timetable changes on other TOCs (train operating companies) in the region. But in the period, TPE made several amendments to the timetable that have significantly enhanced service reliability. And SWR has been affected by several operating incidents in the period that caused significant disruption, as well as the reduced services and damage to our customers' experience caused by strike action.

Moving away from the divisions, we've **refinanced** the £250m 6.125% coupon bond due in January 2019 from cash on hand and our bank facilities as we'd previously indicated, although this will not have a significant effect on the group's overall interest cost going forward as the bond had previously been swapped to a floating rate. Our next major refinancing is now in April 2021.

So, in **summary**, our overall trading in the period was in line with expectations. Conditions remain uncertain but our unchanged outlook for the full year is supported in particular by First Student's strong bid season last summer and the momentum in First Bus. We're getting on with the delivery of plans to improve service to our customers, improve our financial performance and to unlock the value within our portfolio of businesses.

Thanks very much for listening to all that. With that, I'll hand you back to the operator, who will manage any questions.

Damian Brewer (RBC): Good morning, I've got a couple of questions please. First of all involving Manchester: could you give us some idea of what sort of contribution or loss the depot was running in the last year; and if it's just one one-off sale or whether there's a succession of others, either in Manchester or elsewhere, you'd look at? If you do, will those two also see the defined benefit pension obligations retained within the company, or would you look at trying to sell those with the businesses?

And then the second question, on UK Bus: volumes down 1.9%, so price/mix up – is that part of a shift now towards more price-focused revenue growth, or is that just a result of the way things have shaken out in the quarter?

Matthew Gregory: Morning Damien, thanks for that. Okay, well, let me start off with Manchester. This is one of three major depots that we have in Manchester and I'd say that this business is around a third of the overall Manchester business. I won't go into the details of the contribution for each of our depots but it's fair to say that it's a relatively small contribution that we get from that depot.

You won't really be expecting me to talk about any other depots, or any plans that we may have there, other than to say – to reiterate what we've said before, which is that we constantly keep the portfolio under review. We've taken this decision because of our position in Manchester and we think it's right to reduce our exposure there, but clearly we keep all of our businesses under review and we'll update people with any progress that we make on that at the right time.

I think – and again, I think in the same spirit – it's not really right to comment on pension issues in that respect. I would say that the existing defined benefit obligation [relating to the Manchester depot] will remain with us in FirstGroup, and as you'd expect, we'll continue our obligations towards that defined pension scheme, so nothing really changing significantly there.

I think in terms of the point around the volumes and the price and what does this signal: I think what this signals is that clearly there's been a difficult trading period over the winter period and we've seen that across the whole of the high street, but what we've been saying for the last 12–18 months is that we are looking at each of our businesses as separate operating companies, each of them having separate requirements and needs – and therefore, this is a reflection of specific pricing action we may have taken but also specific network changes that we have made in response to the demand for services in those businesses. so this result just carries on our existing policy of adapting our commercial and operating structure to reflect the demands of each of the businesses we have.

Damien Brewer: Okay, thank you, but can I just follow up? With respect, almost a year ago the Board talked about strong prospects for shareholder value creation as you fell out of or disengaged from discussions with Apollo, and the shares are now about 20% below that, so I think it's fair to ask, is Manchester just a sort of opportunistic one-off [disposal] or is there more in process in the business as a whole?

Matthew Gregory: Damien you're right, it's fair to ask those kind of questions; I think when you talk about where we were last year, we were very clear at that stage around that whole Apollo discussion.

I think it's not really right for us to talk about our individual [disposal] plans; what we have said is that we're open to assessing our portfolio and we're looking at any opportunities we have to unlock value. And what we think this does is – rather than being a negative, I think this demonstrates that we are moving forward with plans to unlock value where we feel it's appropriate. But it's not right for me to sit and say what else we might be doing or what else we might be looking at. You can see that – again, we're talking very heavily about the UK – but you can see that in Chicago, for example, in Greyhound: we've taken the opportunity to sell our maintenance facility there. We've got a large facility, we're going to downgrade it, put it to another location, significantly smaller, and again it's a way that – we're trying to find ways of unlocking the potential in the portfolio.

Damien Brewer: Okay, thanks very much. We'll see what develops. Thank you.

Gerald Khoo (Liberum): Morning everyone, three from me, if I can. Starting in Rail: how comfortable are you with the current revenue growth rates – and maybe putting it another way, at the current run rate would you feel a need to provide for SWR in terms of an onerous contract? And, also, what revenue growth projection do you actually need to achieve to stay within the provision you've already taken on TPE?

Secondly, on UK Bus, are you going to be recognising a profit or loss on disposal there?

And finally, just following up on this Greyhound Chicago disposal: you talked about moving to a smaller facility – is there a reinvestment requirement out of that $38 million that you've realised? Thanks.

Matthew Gregory: Sure. Thanks Gerald. I think on the rail situation, what I'd say is that we're not comfortable with the performance of a couple of our franchises; you talked about TPE where we've been significantly affected by the timetable changes and the impact that the performance of one of the other TOCs in that area has had on our business – but again: you know that when things like that affect us, we have the opportunity to have discussions, according to our franchise agreements, with the government about the effect that that is having on us. So I think the key thing for us is to focus, particularly in TPE, on improving the service and our expectation is that at the point that the service improves, the revenue growth will improve as well.

I think you talked about SWR: again – that is a franchise that's been significantly affected by performance issues, it's been affected by industrial action, it's been affected by a lot of issues: and our focus is very much on improving the performance and improving the customer experience. And frankly from an accounting perspective we'd update people at the appropriate time if we felt that there was something to say about that franchise – but really our focus is all about improving the performance. Now, what I would say is that, since January, performance has started to improve so we'll be looking for revenue growth to improve off the back of that at the appropriate time.

Moving on to Bus, I mean, on the Manchester depot, there may be some ups and downs on the P&L; but it won't be a significant number in terms of a profit or loss we may have made on that depot.

And then you talked about the Greyhound disposal: we're looking at roughly half of those proceeds to be reinvested back into a much smaller site, a much more efficient site in the Chicago area. Chicago is one of our bigger hubs that we have in the network, with a lot of buses coming in and out of that, so we will be reinvesting in something more suitable for the business.

Gerald Khoo: Okay, just a follow up: where are you in terms of goodwill on the balance sheet in relation to both UK Bus and Greyhound, please?

Matthew Gregory: Well, on Greyhound obviously we wrote that off at the end of last year, if you recall, as a major adjusting item there, so we don't have anything in terms of goodwill on the balance sheet. In terms of goodwill in the Bus business, it's a much smaller number – I'm sure we can come back to it in…

Nick Chevis: It's around about £80 million.

Matthew Gregory: Does that help?

Gerald Khoo: Yes, thanks.

Dominic Edridge (UBS): Yes, hello, thanks for taking the question. It's more focusing just on the cash flow. I know that you made the commentary about better cash inflows and apologies if I missed any more details on that, but I was wondering, could you just elaborate? Is that just to do with the asset disposals that obviously we know about, that have been commented upon in the statement, or are there any other pieces we should be thinking about?

And on the back of that, could you make any comments about the net debt situation at the end of the year? Thanks so much.

Matthew Gregory: Sure, let me comment on that: what we're saying is that the cash flow or the cash in-flows that we're expecting for this year will be higher than we may have expected previously. There is an impact coming in from the Greyhound disposal; I think you'll find that the Manchester sale won't really affect this financial year, as there's a period of transfer that's got to happen there, so that's unlikely to fully complete until after our financial year end. And then what we're saying on top of that is that we're seeing some timing impact on our Rail business, where we've had some higher inflows than we were expecting but we'd expect that to go back out over the next year or so. So underlying cash flow is as we'd expected, but we've got these one or two additional benefits boosting the cash flow for this year.

In terms of net debt, I think you'll find that it'll be in the 1.5x [net debt:EBITDA] range, maybe slightly better than that.

Dominic Edridge: Okay, thank you very much.

Alex Paterson (Investec): Morning everyone, congratulations on the trading. Sorry to labour the point on Manchester: I just wonder if you can tell us anything about the fleet there – is that fleet you've sold in line with the average age for the group as a whole, or Is it a bit older than that? And then secondly, I just wondered, could you say on Greyhound what would the reported change in revenue be, please?

Matthew Gregory: Sure. Yes, thanks for that Alex. in terms of the fleet from Manchester, the average age of those buses would be slightly higher than the average age of our overall fleet but obviously it's a relatively small number.

In terms of the reported revenue number, we don't really give that out at this quarter stage, we can update you on that when we get to the full year. Clearly from a reporting perspective, as we've closed Canada, or rather a big chunk of Canada, there's been an impact coming through on the Canada business during this four month period, but I think it's probably better that we give you that once we've seen the full year numbers come through.

Alex Paterson: Okay, thank you.

Joe Thomas (HSBC): Morning, gents. Firstly, wage inflation, the UK and the US: I'm guessing you are still running at the sort of 2, 2.5% range in the UK, but could you confirm that? And in the US, you touch on it in Transit and of course Student: can you just say, is it getting any worse?

And what are the actions that you've taken, the processes that you've implemented to manage that, and is it all being fully offset?

And then finally the US, you had been talking about M&A in the past. Has there been anything done, or are there any more opportunities that you see in the short term?

Matthew Gregory: Thanks, and thanks for bringing it back to the US; it's always good to talk about the big part of our business. Let me start with the last question first: so from an M&A perspective, we are building the pipeline, we're having a number of discussions; but had we done anything, we would have made that pretty clear to everybody. I'm expecting in the next six months that we will have something to talk about: we’ve got double-digits of prospects out there on the pipeline, but as always with M&A, it's a question of getting people into the right place, getting the right value, making sure it's all working out for us – because, as we've said before, this is all that kind of bolt-on, 'mom-and-pop' type operations.

Then coming back to your first question around the wages, I'd confirm that the UK is between that 2-2.5% level of inflation. I think in the US, we are more at the 3-3.5% range, but with our pricing we have been able to offset that; across the US businesses, we are able to do that.

In terms of how we're dealing with the improvements, it comes down to a very specific location-driven issues. So the type of things that we're doing is talking to the local authorities or local school boards, looking either to negotiate higher wage levels for the drivers if there's areas where we're competing against the transit authority, for example. We're doing all the things you'd expect us to do around sign-on bonuses, getting staff members to refer people, we've got new recruitment people coming in to give an almost SWAT-team type focus on some of the more difficult areas. But it's the stuff that we have been doing over the last couple of years, just really focusing on the areas that are causing us issues. But overall, I would say that we're keeping it under control, the inflation's not getting worse but it's not getting any better, as we see it at the moment.

Joe Thomas: Thanks. Just going back to the acquisition point, maybe I noted this down incorrectly but did you say double-digit prospects in the pipeline? I wasn't quite sure what you mean by that?

Matthew Gregory: Yes, that was the pipeline that our M&A team are generating in the US. So, that's not deals ready to go or even negotiated, but prospects – people that we've identified that we can talk to in areas that we want to do acquisitions. And, there's a lot of work going on in that pipeline to bring some of those from prospect status to something more tangible.

Nick Chevis: So its the number of businesses he means!

Joe Thomas: Yes okay, right. Got you, thank you.

Damien Brewer: Yes, good morning again. I just want to follow up on Gerald's question: just on SWR, could you just give us a feeling of how far advanced your discussions are on the CLE [Central London Employment] issue and where the next waypoints are? And just give us an idea of – in the first half, SWR was heading towards a loss; is that continuing, or have the improvements in growth there managed to change that around? Thank you.

Matthew Gregory: Yes, thanks for that Damian. I'm sorry but I'm afraid I can't actually – I can't really give an update, Damien, I mean, these are commercially confidential conversations that we have, and we continue to have, with the DfT [Department for Transport]. And at the point there's anything to say about that, we'll update people. So really, to be honest, I can't really say much more about SWR, other than our focus is on improving the performance.

Damien Brewer: Okay, and has the intensity of those discussions increased, decreased, or is it at the same tenor?

Matthew Gregory: As I said, I can't really say much more, Damien, sorry.

Damien Brewer: All right, thank you.

Matthew Gregory: Thank you everyone for your time today, for your attention to our trading update, and we'll let you get back to your day. Thanks very much.