



FirstGroup plc

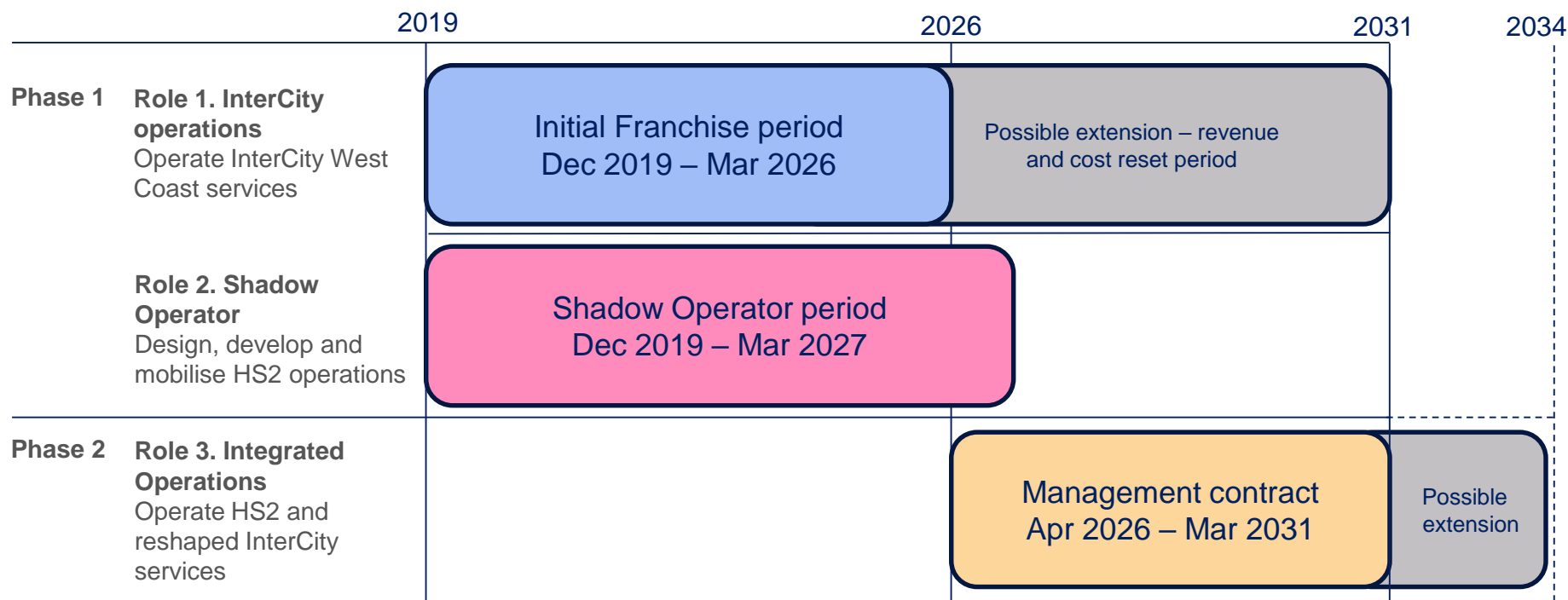
**West Coast
Partnership
award**

14 August 2019



- First Trenitalia (70:30 FirstGroup:Trenitalia partnership) selected by the Department for Transport (DfT) to operate the West Coast Partnership from 8 December 2019
- Unique opportunity in two phases:
 - Phase 1: Operate InterCity West Coast, one of the most consistently successful intercity mainline franchises, for an initial franchise period to 2026 (role 1) and act as Shadow Operator to design, develop and mobilise High Speed 2 ('HS2') operations (role 2)
 - Phase 2: Management contract to run integrated operations of HS2 and reshaped InterCity services on the West Coast Mainline from 2026 to 2031 (role 3)
- More appropriate balance of risks and rewards:
 - Mid-single digit revenue growth expectations, with strengthened revenue protection mechanisms during the initial franchise period
 - Robust bid margin during initial franchise period, supported by HS2 'shadow operator' incentive payments based on performance against pre-defined criteria
 - Transitions into a management contract ahead of start of integrated operations in 2026
- Our InterCity West Coast services plans include significant passenger benefits, new and refurbished trains, more direct services and station investments

Phases of the partnership



Single Agreement – 11.3 years with 3 year extension at Secretary of State (SoS) discretion

Reset Period - SoS has discretion to extend Initial Franchise period up to 2031 on the basis of a reset of revenue – the switch to the management contract must take place at least 6 months before the launch of HS2

Phase 1 InterCity West Coast operations

- Services to Manchester, Liverpool, Birmingham, Glasgow and North Wales from London Euston
- 39m passenger journeys in 2019 – 69% leisure, 22% business, 9% commuter
- **Key statistics (current franchise):**
 - Passenger revenue (2018/19): £1.2bn; ave yield £31 / journey
 - Revenue CAGR (2010-2019): 6.6%
 - c.300 services per day, 76 trains
 - 49 stations (16 directly operated)
 - c.3,300 employees
 - P4 2019 Public Performance Measure (rail measure of punctuality): 84%
 - Spring 2019 National Rail Passenger Survey satisfaction: 91%
 - 75% of the West Coast network is electrified
 - 97% of train miles are run under electric traction

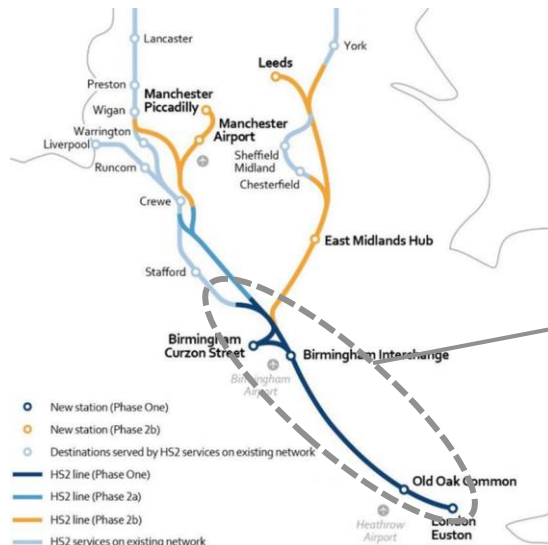


- **Exceptional customer experience:** 56 Pendolino trains completely refurbished, incorporating 25,000 brand new seats and additional luggage space. Better and more reliable free Wi-Fi and at-seat power, with wireless charging and onboard entertainment. Catering upgraded with at-seat service for all
- **Clearer fares:** Simpler fares with mobile tickets and smartcards covering all fare types. Easy and rapid refunds when things go wrong
- **More services:** More than 260 extra services each week by December 2022, increasing seat miles by more than 10% compared with 2017/18. New destinations and more stops at current stations
- **Better stations:** Refreshed waiting rooms, better facilities, 900 more car park spaces, and greater accessibility. Working with partners to deliver major upgrades including Coventry and Birmingham International. New solar panels and energy efficient air conditioning will reduce environmental impact, alongside an 80% reduction in non-recyclable waste
- **Investment in more efficient, lower emissions trains:** Introduction of modern trains, entirely replacing the diesel-only Voyager fleet and reducing CO₂ emissions by 61%. Ten new electric trains enabling two Liverpool-London trains per hour Monday to Saturday. Thirteen new lower emission bi-mode trains for North Wales services
- **People and communities:** Enhanced apprenticeships and 50,000 training days including accessibility awareness training. Community investment fund; independently-chaired Economic Development and Integrated Transport forums, and regional customer panels to be introduced

- Shadow Operator is on a cost reimbursement basis for agreed activities, with incentive payments based on performance against pre-defined criteria
- Working as key partners to HS2, the DfT, our stakeholders and customers to develop world-class high speed services and maximise the benefits of the very significant investment in the infrastructure
- As Shadow Operator we will both design, develop and mobilise high speed service operations including timetables, fares, service patterns etc
- We will also design and deliver the reconfiguration of the InterCity West Coast services as an integral part of the role
- Shadow Operator for HS2 is a complex and high profile role, with a constantly evolving programme, with our bid reflecting the need for significant resource to manage the activity and engage with key clients
- To ensure robust service delivery the organisation for the Shadow Operator activity will have a dedicated Managing Director. The team will utilise skills from our existing rail bid team, Trenitalia high speed expertise and external resource

Phase 2 Integrated Operations

- First Trenitalia will operate HS2 and the reshaped InterCity West Coast rail services together as an integrated operation in the second phase, under a management contract
- Revenue and cost risk will transfer to DfT and First Trenitalia will earn a management fee equivalent to a low single digit margin per annum, with additional incentive payments for good performance
- When completed, 345 miles of high-speed track connecting London, Birmingham, Manchester, and Leeds, with HS2 trains crossing over onto existing railway to serve further towns and cities in the north of England and Scotland
- Focus on successful delivery for passengers and taxpayers recognised in the bid process and terms



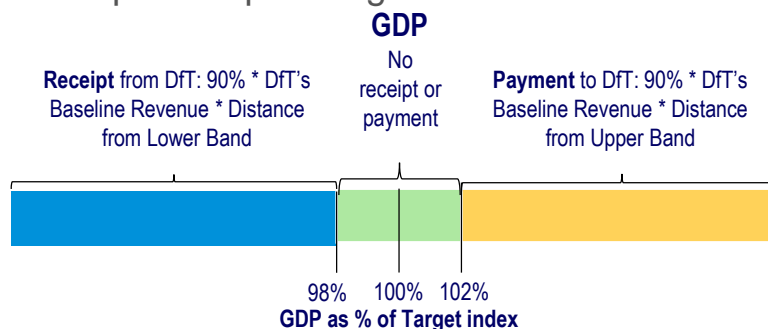
- Revenue growth during InterCity West Coast ‘traditional’ franchise operation:
 - Mid-single digit revenue CAGR from £1.25bn baseline in 2018/19, lower than the historic growth rate over the last ten years
 - Supported by 1.2% CAGR in seat miles from additional rolling stock, timetable and other initiatives
 - GDP revenue protection mechanism
 - New Forecast Revenue Mechanism (FRM) provides significant downside protection – back-testing on TPE and SWR we believe these contracts would have remained profitable overall
- Robust margin expectations, towards the high end of recent industry range of 0-4%
- Incentive payments for HS2 Shadow Operator role
- Total premium of £1.6bn NPV in real terms* to Government
- Contingent capital commitments of c.£106m for FirstGroup in initial franchise period (details in appendix)
- Working capital inflow into ring-fenced cash of c.£8m at start, expected to grow to c.£60m in first year
- First Trenitalia will fund directly with its own cash £11m of residual value assets. Premium deductions will fund direct investment of £252m, with a further £453m funded by rolling stock leasing companies for new trains, enhancements and refurbishments
- Profit share threshold starts at 7.5% margin

* Net present value of forecast premium payments over the expected initial franchise period, expressed in 2019 prices and discounted using the DfT's 'real' discount rate of 3.5%

Key terms – Phase 1

GDP protection mechanism

- GDP is a well established measure of economic performance, GDP forecast used in the mechanism is produced by Office for Budget Responsibility (OBR)
- Target GDP index set by DfT in the bid, after each year Actual GDP compared to Target index
- Current GDP index broadly in line with target
- Payments/Receipts are made if actual GDP is sufficiently different to Target index: 2% upper and lower bands, at 90% of the GDP impact on passenger revenue



- Payment based on DfT's Baseline passenger revenue – not our bid revenue. GDP calibration factor for passenger revenue elasticity is set at 0.82
- Payment is 90% x Calibration Factor 0.82 x Change in GDP in excess of 2% x DfT Baseline passenger revenue
- For West Coast Partnership, all DfT Baseline passenger revenue is included in mechanism (unlike the SWR mechanism which only included 45% of DfT baseline passenger revenue)

- Forecast Revenue Mechanism (FRM) provides an overall level of revenue protection
- Shortfall and Surpluses are shared whatever the cause once the franchise FRM revenue falls outside of a 4% band of our Bid revenue
- FRM Revenue includes passenger revenue, performance receipts and GDP mechanism
- Payments/Receipts are made when actual FRM revenue is 4% higher or lower than the Bid FRM revenue, at 80% of the revenue difference
- FRM is available from the second full Franchise year – April 2021
- In order to benefit from Revenue Support it needs to be called six months prior to start of a franchise year
- FRM can be called for individual years
- In a FRM Revenue Support year the profit share bands are tighter with profit share starting at 1.5% margin, with a capped margin of 3.3%

- First Trenitalia not on revenue risk
- Management contract with annual cost budget setting
- Fixed management fee equivalent to a low single digit margin on existing revenues, with incentive payments based on performance against pre-defined criteria
- Significant step down of contingent capital from £106m to c.£46m reducing downside exposure for FirstGroup (details in appendix)

- Initial bids submitted in July 2018 after external validation and extensive review by both JV partners
- DfT bid assessment on weighted price and quality scores
- Assumptions have been kept under rigorous internal review, as well as back-tested against the performance of current ICWC franchise
 - JV partners particularly focused on the potential financial performance of the contract under a broad range of potential scenarios and uncertainties, given challenges elsewhere in UK rail
 - The growth rate in passenger revenue assumed is lower than the historical rate
- Pensions: Reviewed various scenarios in our modelling of risks on a prudent basis, with external advice and priced the bid accordingly
 - In line with previous contracts, First Trenitalia is only responsible for pension contributions and deficit payments whilst we hold the contract. Based on prudent external advice we have factored our expectation for these charges into the bid. In phase 2 of the contract 'Integrated Operations' the risk is transferred through the move to a management contract
 - Pension risk is part of the overall downside risk 'cap' – not in addition to it

- JV agreement with Trenitalia: complementary skillsets; condition of entry to the process that bidders could demonstrate experience in operating high speed rail networks
 - Trenitalia planned, launched and operated high speed networks in Italy which have delivered significant growth over the last decade
 - Binding JV agreement signed in November 2016
 - First Trenitalia is owned 70:30 by FirstGroup and Trenitalia respectively
 - All costs, risks and rewards shared accordingly
 - FirstGroup financial presentation: will consolidate 100%, with Trenitalia's share of profit and cash flowing out to 'non-controlling interests' in the accounts

- Total revenue in 2018/19 was £1.25bn
- Mid single digit revenue CAGR assumed, lower than historical growth rates, and principally economic fundamentals-driven (RPI and GDP)
- Premium payments to government on first phase of £1.6bn real NPV
- First phase margin towards the high end of recent industry range of 0-4%
- Second phase management contract equivalent to a low single digit margin on existing revenue
- Working capital inflow of c.£60m
- Contingent Capital £152m, FirstGroup share (70%) £106m, reduced by approximately half in the management contract period
- First Trenitalia will fund directly with its own cash £11m of capital expenditure, the balance of investments funded through Franchise premium deduction and Rolling Stock companies
- Start Date 8 December 2019
- Cash positive, earnings accretive from first stub year
- No credit rating impact anticipated

- Unique opportunity and contract with our strong partners Trenitalia
- More appropriate risk/reward balance
- Committed to delivering this partnership successfully for our customers, shareholders and other stakeholders
- With our rail portfolio strengthened through today's award, we will not be bidding for additional rail franchises for the foreseeable future, other than continuation of discussions on further GWR direct award
- Now our focus is on actively managing our rail portfolio and its risk and reward profile to deliver sustainable shareholder value

Appendix

Commitments and bonds

Real Funding Commitments, £m	Initial Franchise period		Management contract		Comments
	100%	FirstGroup Share (70%)	100%	FirstGroup Share (70%)	
Parent Company Support (PCS)	£102m	£71m	£45m	£32m	For the management contract, any drawdown at the end of the Initial Bid Period will be added to the minimum £45m that must be held for the management contract period
Agreed Funding Commitment (AFC)	£30m	£21m	n/a	n/a	Bidder voluntary option to cover any additional funding required to support initial financial ratio / working capital / investment requirements. Bid assumed repayment in years 3-5, this is effectively the closing down of a facility
Performance Bond	£20m	£14m	£20m	£14m	Indexed at RPI
Contingent capital	£152m	£106m	£65m	£46m	
Season Ticket Bond	c.£10m	c.£7m	c.£10m	c.£7m	Increases in line with season ticket revenue
Contingent Capital (incl. Season Ticket Bond)	c.£162m	c.£113m	c.£75m	c.£53m	

2 Nov 2016	Joint Venture agreement signed with Trenitalia	
19 Jan 2017	West Coast Partnership prospectus published	
22 Jun 2017	Shortlisted bidders announced	
13 July 2018	West Coast Partnership original bid submission	
23 Nov 2018	Binding re-bid submitted	
14 Aug 2019	West Coast Partnership awarded to First Trenitalia (10 day standstill commences)	
8 Dec 2019	West Coast Partnership commences	
Dec 2019 – Mar 2026 (Initial Franchise period)	InterCity West Coast franchise operator (revenue risk)	HS2 'Shadow Operator' activities (cost reimbursement and incentive payments)
Apr 2026 – Mar 2031 (Management Contract)	Initial Franchise period extension – up to 2031 if HS2 delayed (switch to management contract minimum of 6 months before HS2 start)	Integrated Operations – operate and manage HS2 and reshaped InterCity West Coast services (management contract)
Apr 2031 – Mar 2034	Potential for up to three year extension period at DfT option	

- Customary 'standstill period' of ten days before award formally confirmed and contracts signed
- Competition and Markets Authority will carry out a 'phase one review', as with other UK rail franchises
- Initial Franchise period may be extended beyond March 2026 for up to five years if required, subject to the agreed revenue and selected cost reset mechanism
- Management Contract may be extended by up to three years at the DfT's option

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