FirstGroup plc Q3 Interim Management Statement

OPERATOR: Good morning, and welcome to the FirstGroup plc Quarter 3 Interim Management Statement. Today I'm pleased to present Jeff Carr. For this call, all participants will be in listen-only mode, and afterwards, there will be a question and answer session. I will now hand you over to Jeff.

JEFF CARR: Thank you. Good morning, ladies and gentlemen, my name is Jeff Carr, Group Finance Director, and with me today is Rachael Borthwick, the Corporate Communications Director. I'm going to run through a short commentary on the trading statement which we issued this morning, and following that, we'll go straight into a question and answer session.

So in summary, overall the group continues to trade in line with expectations. We remain on track to deliver our earnings and cash targets. The team remains focused on delivering £200 million of cost reductions, which obviously are critical as we look to mitigate the impact of high fuel costs this year, and the effect of the recession. Now, on fuel, as you will recall, our hedge position for 2009/2010 is around £100 million higher than last year, and that's a position which will reverse next year.

In terms of cash, we remain on course to generate about £100 million of free cash in the current year, which obviously will be applied to reduce our net debt position. So looking at each of the operations in turn, and let me start with UK Bus. In the period, like for like passenger revenues grew by just under 1%, and the recent weekly trends are pretty encouraging in terms of showing signs of stability in that area, albeit this has been interrupted in the recent quarter in the last couple of weeks by the difficult weather conditions across the UK. However, despite that, we do expect like for like passenger growth for the full year to remain unchanged to the guidance we gave in November, which is around 1% to 2% of growth for the full year.

Again, as discussed in November, in response to some reducing demand, we've continued to take a little bit of mileage out of the system. We've continued this process in the current period and we're currently running at around 5% less mileage than last year. Now, this action and the benefit of our cost reduction programme means that we now expect to see a positive trend in our UK Bus margins in the second half of the year.

Now, during the period, we have seen some industrial action in our UK Bus operation. However, we have made some good progress, and in key areas such as South Yorkshire, Leeds and Manchester, we've now agreed pay deals. Generally, these are two-year deals with pretty much holding wages at zero this year, around 2%, 2.5% for next year. At the moment, the discussions are now focused on London, and we're hopeful for a resolution in that area in the next two weeks.

Now, in terms of other news, as expected last week, the OFT decided to refer the UK bus industry to the Competition Commission. Now, we don't feel this is justified, and we do regret the cost and resources which will now be expended over the next couple of years by the whole industry in addressing the issues raised, and these are issues that we believed could be dealt with within the existing regulatory framework and the Local Transport Act. This is a highly competitive market, and I think over the next couple of years in the course of the inquiry, we'll be able to demonstrate that.

Now, moving on to UK Rail, like for like passenger growth on UK Rail was around 1.7% in the period, and again, we're encouraged by not just the revenue performance, but also the cost performance in UK Rail. But again, quarter 3 results are pretty much free of weather issues, but there has been a little bit of an impact, though not material, in the first two weeks of quarter 4.

During the quarter, and with the exception of Hull Trains - which obviously is a relatively small operation - all our operating companies showed positive revenue growth, with First Great Western being up just under 1%.

In terms of highlighting specific areas, on first TransPennine Express, our Anglo-Scottish services have been particularly strong, delivering double-digit growth in the period, and as a result, we've been adding new services between Manchester Airport and Edinburgh and Glasgow. The revenue support structure continues to provide substantial insulation from the effects of the recession, and as you know, the contractual revenue support mechanisms are providing 80% support for First Great Western and First Capital Connect, and we continue to make good progress in reducing costs as we look to make sure that our addressable cost base is as lean and efficient as possible.

During the period, PPM performances remained high across most of the network, with First Great Western running over 90%. The key exception has been First Capital Connect, where PPM has been impacted by industrial action in relation to the rest day working practices, which has obviously coincided with the pay negotiations. Now, I'm happy to say that we are moving towards a resolution in this area, and as of yesterday, we had a positive ballot with our Capital Connect drivers voting in favour of accepting our pay award, and I hope that services will get back to the standards we expect on that line fairly shortly.

Now, moving on to talk about our North American contract business, revenues in that area at constant currency were up slightly in the period, 0.7% versus last year. Now, as discussed in November, the core student contract revenues remained resilient, and for the second half, student revenues will be broadly in line with last year. However, as we stated in November, we have seen a reduction in the growth of discretionary areas of spend, such as school trips and charters in the new school year, which has resulted from the continuing budgetary pressures faced by many of the school boards. Our experience of that market, the North American bus market, does indicate that we will not see a return to organic growth until we see some economic recovery in North America. Notwithstanding the recessionary impact on discretionary revenue though, we do fundamentally believe in the medium term that there are significant opportunities in this market, and we are pursuing new business aggressively in the current bid season for the next school year.

In transit, we've been winning new contracts, and we've won contracts recently to provide transit management services in San Diego and Portland, Oregon, and First Vehicle Services has won a new contract - significant contract for them - to provide fleet maintenance services in Florida. Despite the challenges of the current trading environment, we expect our US dollar margins for the contract business to be broadly in line with last year, and in the context of the current trading environment, I do believe this is a credible performance, albeit slightly down on previous expectations.

Now, moving on to Greyhound, Greyhound revenues continue to track in line with our forecast and expectations, which are slowly recovering from the low points of last summer. Our full-year expectations haven't changed. As we said at the half-year in November, we expect the full-year passenger revenues to be down around 14% versus last year. In this most recent quarter, which included Thanksgiving and Christmas, trading was in line with where we expected, down about 11%. However, revenue per mile is now showing a positive position versus last year, and in the current quarter, quarter 4, for the US, we're seeing passenger revenue trading now broadly in line with last year, so we're continuing to see good trends in that area.

During the period, we've been making some good progress in our negotiation with the Canadian provinces, as we look to secure mileage reductions and/or financial support in that area.

As a result of the recovering topline, our rapid actions to reduce mileage and good overall progress on cost reductions at Greyhound, we now expect Greyhound's full-year margins to be ahead of our previous expectations and forecasts. We're optimistic that due to the changes to the business model position at Greyhound, Greyhound is well-positioned to take advantage of the future economic upturn, and during what's been a difficult year for Greyhound, we feel that we've demonstrated that the business model can be managed and continue to drive improved performance.

Now, in terms of the outlook, in summary, just let me say the current weather conditions have had an impact on some of our businesses, not least here in the UK for UK Bus and Rail. However, our employees are rising to the occasion to ensure that we keep the operations running, and I don't see this impact as being material on the group results. Therefore, the group does remain on course to achieve its earnings and cash targets for the year.

Now, I'll finish there and just open up the session to questions and answers.

OPERATOR: Thank you very much. We'll now begin our question and answer session. If you have a question, please press 01 on your telephone keypad now. You will enter a queue, and after you are announced, you may ask your question. If you find your question has been answered before it is your turn to speak, you may press 02 on your telephone keypad to cancel. And our first question comes from Jamie Rowbotham of Morgan Stanley. Please go ahead.

JAMIE ROWBOTHAM: Morning, Jeff. Morning, Rachael.

JEFF CARR: Morning.

JAMIE ROWBOTHAM: First question to kick off, and then a couple of follow-ups, if I may. Jeff, it's clear from the statement that there's an upgrade at Greyhound, but management's expectations at the group level are unchanged. Presumably there's an offset in downgrade elsewhere? It sounds like it's in the contract-based business, which you just said is down a bit on previous expectations. Can you clarify that's the case and please expand on what's driving that?

JEFF CARR: Yes. I mean, basically, you know, I am a little bit disappointed that the margin improvement that we were looking to get out of the North American business, the contract business, hasn't come through. However, you have to put it in context with the current trading year, and the fact is that the revenues are going to be pretty much in line with last year. With our operating profit, operating profit margins are going to be pretty much in line with last year, which I think in the context of the current position with the school boards, is a pretty good performance.

Since September, I've been over to the States a few times and I feel comfortable with this guidance. I think it's realistic. The change isn't in the revenue performance. Revenues have remained pretty much in line with where we were talking about in November, and that's in line with our discussions. The change is really being a bit more realistic about the expectations on cost performance. We are delivering good cost savings in North America. However, with the background of the increase in the fuel costs, with some increases in labour taxes, in SUTA in North America, some of the wage claims coming through in the new school year, which are running higher than we'd like, I think we have to just pull back a little bit on the cost expectations, and we've done that in coming down to the guidance that we're now giving, that we say that operating profit will be in line with last year.

I still think there's a lot of opportunity going forward in North America to look at the cost base and to proactively improve that, improve efficiency, but I think this is a realistic position to be in for this year.

JAMIE ROWBOTHAM: Thanks. Just on that point on wage claims running higher, I mean, given 10% unemployment in the US, labour cost pressure seems a bit counterintuitive. Can you expand a bit on that kind of anomaly?

JEFF CARR: Well, we're not talking about significant increases, we're talking about fairly low level awards. However, we're not getting zero away in the US. We're getting very little opportunity to improve on our contract pricing, and so therefore when I guess it's around about 60% of our cost base is in salaries in North America, even a 1% or 2% increase is significant, and we're seeing increases come through. You know, it varies. They're all negotiated locally and it varies by contract, but we have been seeing increases coming through at 2% and 2.5%, and again, that's ahead of where we'd like them to be; it's ahead of where we're coming out in the UK.

As I mentioned, UK Bus is for this year pretty much coming out at 0%, but clearly that's the situation we're in. We're going to have to deal with that and continue to drive efficiencies in terms of our labour costs in North America. So we have projects in place, which we've talked about in the past, such as the Focus Project, which is based on GPS tracking of the buses and hourly reporting, which we think will drive efficiency out of the system, but again, that's a project which has taken a little longer than we expected to implement.

JAMIE ROWBOTHAM: Thanks. Just two more then, quickly. The comment of no return to growth in schoolbus, is there still an extent to which FirstGroup will be upping and outing lower margin contracts, or is that all done now, and this is purely a reflection of the market? And final question, Jeff, after that, I think in December, you planned to sit down with the board this month to reaffirm FirstGroup's sort of targets for the year. I just wondered if that's happened and if there are any key takeaways, anything key to come out of that? Thanks.

JEFF CARR: Yes, I think on the up and out of projects, the key actions following the Laidlaw acquisition are pretty much all done. However, that is managing the mix of contracts. We have 1,500 contracts, roughly 1,500 contracts. A reasonable proportion of them come up for bid each year, and managing that mix of contracts is a normal, ongoing part of the process. In terms of the growth for next year, what we're saying is we don't see the sort of charter and supplementary revenues coming back next year. I think things are still going to be very tight in the US. However, we will be aggressively bidding for new work, so we will bid for new contracts, and we're in the middle of that bidding season; it's very early, it's not really the middle, it's early in that bidding season for next year, and we will be aggressively bidding for new contracts for next year. So there is still growth opportunities, but I think it's right at this stage to be cautious about the future in terms of 2010.

Just in terms of the balance sheet and the work we did, the board, yes, we have been through a process of talking capital structure. The board is comfortable where we're at and with our plans. I think the purpose of that was to get the right balance between debt reduction and growth plans, certainly for the next 18 to 24 months. I think we can beat the plans we've put out in terms of debt reduction. We've talked about £100 million for next year. I think there's opportunities, and we demonstrated to the board where the opportunities are to improve on that. You know, if we're generating nearly £800 million of EBITDA, we should be able to convert more of that to cash to pay down the debt, and we'll talk more specifically about targets for 2010 probably in 2010/2011, probably in March or May. But I think, you know, basically the board was comfortable with the plans to reduce the debt levels. We do see opportunity to get those levels down significantly in the next couple of years, and that was the main focus of that process and, you know, we'll talk in more detail about that in March.

JAMIE ROWBOTHAM: Great, thanks very much.

OPERATOR: Our next question comes from Paul Hickman of KBC Peel Hunt. Please go ahead.

PAUL HICKMAN: Good morning. I've got two questions, first of all on UK Bus, the like for like of 0.7% positive, that seems to be a bit of a reduction compared with 2.4% in the first half, although I see that you're reiterating the 1% to 2% guidance for the second half. Could you talk around that a little bit, any particular reason for the dip just now?

JEFF CARR: Well, I think, you know, first of all, let me just say that we haven't changed our outlook from November. Things are quite stable, but we have seen some reductions in demand and I think the third quarter was probably the low point of that, and I think if you look towards the fourth quarter, and try to back into 1% to 2%, you'll see the fourth quarter probably showing a little sign of improvement, or at least stable. There's no more decline in the system. We feel comfortable about that. So that hasn't changed since November and we feel pretty comfortable about that. So UK Bus, we're not chasing growth at the moment. We've been focusing on maintaining our margin; we've been focusing on actually taking mileage out, and as I mentioned, we've taken about 5% in the recent quarters of that mileage out of the system to make sure that we can match the demand and the capacity in the system. That, along with the cost reduction programmes, means that we should see an improvement in margins in the second half, certainly versus the first half.

PAUL HICKMAN: Yes, thank you. And the other one was about First Capital Connect, and I wonder if you are able to quantify the financial impact of the PPM shortfalls there?

JEFF CARR: Well, we've been working pretty closely with the DFT since the disruption started, and we've been agreeing the planned cancellations to ensure that we're not in breach, for example, with the franchise agreement.

RACHAEL BORTHWICK: Yes, we've put in place a reduced timetable in December.

JEFF CARR: Yes, so the reduced timetable we've been operating to, but the industrial action combined with the weather effect has meant that the PPMs have been pretty awful, down to sort of 70% levels. Now, I'm optimistic that based on the results of the ballot that we got yesterday that we should be returning to more normal levels on First Capital Connect fairly shortly, and I think we need to just, you know, put this behind us and get the system up and running to the levels that we expect. But we have had some other issues in terms of weather-related damage to the fleet, some components which have failed, which are not substantial in themselves, but has meant that the engineers have been working around the clock to repair that, not with a huge cost, but again, that is by and large underway now, and we do feel that the levels will get back to normal levels. The rest of the operating companies are all running at around or above 90% and we should be back at those levels fairly shortly.

PAUL HICKMAN: Well, that's reassuring, but there must have been a one-off impact from the PPM shortfall, and also the other issues you mentioned.

JEFF CARR: It's not significant, no.

PAUL HICKMAN: Very good. Thanks.

JEFF CARR: But actually, the impact, it hasn't been a significant impact.

PAUL HICKMAN: Yes, thank you.

OPERATOR: Our next question comes from Gerald Khoo of Arbuthnot Securities. Please go ahead.

GERALD KHOO: Morning, all. A couple of questions. Firstly, in UK Bus, looking ahead to next year, what are your thoughts with regard to what you might do to mileage? It sounds like if Q4 demand is stabilising, you might not take more out, and therefore what implication does that have for CAPEX?

And secondly, going back to North America, if wages are slightly higher than you expected this year with where unemployment is, what do you think the outlook is going into next year? Do you think you're going to have more problems keeping wages down?

JEFF CARR: Well, let's start with bus first. I think what we've been able to demonstrate, both in UK Bus and in Greyhound, that quick action to match the capacity with demand is something which does pay dividends in these areas, and that helps to protect our margin in tougher economic times. And I think we'll continue to do that next year. If we see the demand is flat or starting to get better, we can quickly put mileage back in. That in itself won't have significant impacts on our capital expenditure plans. The capital expenditure plans are developed over sort of longer-term expectation of maintaining an average bus life and average age of the fleet, and replacing the fleet over a much longer term. So that short-term flexing of the capacity to match demand won't have a significant impact on CAPEX.

In terms of wages in North America, look, it's a continual process. It's what a lot of businesses deal with year in, year out, managing the cost base and making sure that we manage it efficiently and match the cost with our ability to maintain margins, and that's not a new challenge. It's something we'll face every year and we just need to make sure that we manage that efficiently.

GERALD KHOO: Okay. Sorry, just to follow up on UK Bus and CAPEX, it was my understanding that you have shrunk the fleet this year, and therefore that you've had a reduction in CAPEX as a result, or have I misunderstood that?

JEFF CARR: Well, CAPEX is down a little bit. I mean, this year, we've not bought the same number of buses as we bought in the previous two years.

RACHAEL BORTHWICK: We cleared out at the end.

JEFF CARR: Yes, and obviously because we've been reducing mileage, we've been able to clear out some of the older buses in the fleet, but if we're putting 3% or 4% or 5% of that capacity back, we have that flexibility in the current fleet. Now, the CAPEX plans, as I said, are determined over longer-term plans, and this next financial year, I expect UK Bus will be spending a bit more CAPEX, but it won't be up to the sort of levels of 500, 600 buses per annum which we had in 2007 and 2008, I believe.

GERALD KHOO: Right, okay. Thanks very much.

OPERATOR: Our next question comes from Roger Elliott of Citigroup. Please go ahead.

ROGER ELLIOTT: Morning, Jeff and Rachael. I've got three short questions on Greyhound, firstly about the revenue improvement in 3Q. Could you just comment on basically whether it was volume yield receipt or both; secondly, what forward bookings are looking like; and thirdly, if you reach agreement with the Canadian provinces for financial compensation or you elect to cut mileage, how material is that to the EBIT contribution from Greyhound going forward?

JEFF CARR: Well, let me deal with them in reverse order. Canada is not our most profitable division in terms of Greyhound, and Canada needs a lot of work to get up to US standards. We hadn't, over the history of Greyhound, made much progress with the Canadian provinces at all. We've put a lot of effort, and the Greyhound management team have put a lot of effort in over the last nine months at least talking to the provinces, talking to the national government in Canada, really putting the case that, you know, we are not able to subsidise this public service in some of these states to the level that we have been. We need to have more of a partnership, where they understand and allow us the flexibility, and we've made some good progress. We've made some good progress in most of the provinces, which have allowed us either to reduce mileage, or to get a sort of financial subsidy to allow us to continue with the routes that we're being asked to continue with.

Now, you know, obviously it's a relatively small part of Greyhound. I'm trying to think what the revenue percentage is of Canada as a percentage of the total business. I'm just looking at the numbers in terms of revenues; just bear with me a second. Yes, it's probably about 20% of the Greyhound business, 20%, 25% of Greyhound business, so clearly if that's underperforming in terms of margins, fixing that is important. So, you know, it is important to Greyhound, but it's not hugely material to the North American business.

In terms of Q3, the total revenue performance was still 11% down versus last year in our passenger revenue. Now, in the US, if we just focus on the US, the US was 9% down. That 9% was basically we did see positive yields, so we are seeing positive revenue per mile in the US in quarter 3, so that implies that volume is still down, you know, quite significantly, but it's coming back. But yield is positive, and I expect Canada yield, Canadian yield, to be positive in the fourth quarter. They're developing that way and they're starting to be slightly positive in terms of expectations.

In terms of forward bookings, you know, it's not like a low-cost airline. Most of the business is still walk up.

RACHAEL BORTHWICK: Some AB.

JEFF CARR: Some advance booking activity. It's in the region of 15%, something like that. So it's not hugely indicative in terms of giving expectations of trends, but look, all I could say is since I've joined this business, I've been here now three or four months, the Greyhound sales forecasting has proved to be a pretty robust process. I, certainly in my first week, was a little bit sceptical, but they've shown that they have a very good handle on their business, and I'm confident in the fourth quarter they'll be trading in line, or if not ahead of last year, which from the 20% down that we had in the summer, 20% plus down we had in the summer, is a good performance.

ROGER ELLIOTT: So overall, you'd still say you're on track for a material pick-up in the profitability in fiscal 2011?

JEFF CARR: Yes, I think operating margins in fiscal 2011, we should expect a return to where they were, closer to where they were in 2009. Yes, absolutely.

OPERATOR: Our next question comes from Damien Brewer of JP Morgan. Please go ahead.

DAMIEN BREWER: Yes, good morning and thanks for taking the question; sort of a couple to three related. First of all, can you just be a little bit more specific about what you mean by bidding aggressively in the current bid season for schoolbus contracts? Are you bidding on the basis of price or are you more quality metrics, or exactly what way do you mean by aggressive?

And then secondly, there's a follow-on from that: obviously if you're bidding aggressively in one means or another and you're taking on new contracts, does that have any implications for the sort of kind of CAPEX levels we should be pasting in for 2010/2011 in the North American business?

And then very finally, and sort of related, if you're facing these kind of pressures, and albeit it looks like you're still on track to deliver some relatively solid numbers, what's happening with the smaller competition? Is there any scope for M&A within the space, particularly on the small and medium-sized companies, and how do you view that opportunity versus the commitment to pay the 10% dividend growth?

JEFF CARR: Okay. Yes, maybe I'm aware of using the word "aggressively" with you guys. It's always a bit of a flag. No, all I mean by that is we are the clear market leader, and where we see opportunities to get new contracts, we are participating with a clear mandate. Now, the team is very disciplined in understanding the financial hurdle rates that we have to meet on new contracts, and we've put in some very clear parameters in terms of expectations of margin and return on capital, so bidding aggressively within the guidances and within the financial disciplines we've set. And all I mean to indicate from that is it's not the growth in terms of new contracts has not gone away. We still see the opportunity to bring in new contracts. The growth that we've seen disappear this year has been more the organic growth and the growth from the supplementary areas. What that means is as we get new contracts, and obviously there may well be capital involved, it depends on how we're bidding in terms of whether we're bidding with new buses or with used buses, but capital expenditure in North America will increase next year, and we have made sure in our plans there's an element of capital expenditure to allow us to gain new business. But that's all been within the context of a balanced view for next year which addresses the issues of debt and addresses the issue of growth, so the same with M&A. I mean, yes, we will leave some funds flexible to do some small schoolbus operations if we see attractive operations, but the key focus is obviously reducing debt next year and it won't be focused on significant M&A. The key focus is on bringing the debt levels down, and we've talked about getting the debt levels down to levels of just over two times net debt to EBITDA, sort of multiple levels.

DAMIEN BREWER: Okay. And the 10% dividend growth? I mean, given you are now more than half-life on most of the rail contracts, is that still something you're committed to?

JEFF CARR: Well, the 10% was something which the company committed to for three years. This is the third year of that growth, and therefore, again, one of the key points that we've discussed with the board is where we should go after --

RACHAEL BORTHWICK: The fourth year.

JEFF CARR: Sorry, Rachael's just correcting me. It was a four-year commitment, and this is the fourth year, and that's something the board will discuss, but it will discuss it, you know, later on in this year as to where we go after this year. So we're committed to the 10% growth this financial year. Beyond that, you know, we have discretion to vary that and the board will take that decision. It obviously was part of the recommendations we put together in December, but the board will take that decision closer towards the new year. Now, the board is well aware of the importance of the dividend to many of our shareholders, so I don't think it will be a dramatic decision, but they'll certainly review that as we look to the next financial year.

DAMIEN BREWER: Okay. And could I ask just one cheeky follow-on? Obviously, FirstGroup is a broad range of different businesses with different capital requirements, capital intensities and returns. In your first few months in the group, have you seen any scope to change the emphasis of where capital is deployed in the group and therefore improve the potential for future cash generation to meet that dividend and to obviously generate the growth that sustains the earnings as well?

JEFF CARR: I wouldn't say huge changes in where the capital is deployed. I do think there's been opportunities to improve our disciplines of how we deploy capital, make sure that we review the hurdle rates and that we set a fairly high bar for each of our businesses, and I don't want to get into the specific areas where I feel we've employed a lot of capital which have been making lower returns, but there are areas where I think we probably over-invested, and there's areas which I think have deserved a bit more investment. And what I'm trying to bring is just a little bit more of a disciplined approach, that we apply the right hurdle rates to each of our businesses to maximise shareholder returns.

So, you know, I don't think it's anything dramatic, but I do think there's opportunities to improve those disciplines and get the deployment of capital more properly balanced, or better balanced going forward, without being too specific about specific areas.

DAMIEN BREWER: Okay, thanks very much. That's very clear.

OPERATOR: Are there any further questions? A reminder again: you can press 01 on your telephone keypads to ask a question, or 02 to cancel. And we have a question now from Joel Copp-Barton of Nomura. Please go ahead.

JOEL COPP-BARTON: Oh, hi. Yes, it was really just on the US schoolbus. I wondered if you could talk a bit about outsourcing, if there's been any particular change recently, or as was? I also wondered what proportion of your schoolbus revenues are coming up for renewal in this bidding season, and the last bit was just on you said 0.7%

underlying growth in the contract business. Can you break that out, that number into transit and schoolbus? Cheers.

JEFF CARR: Yes, yes, most of the growth of that 0.7% has come from transit, so the transit is growing slightly ahead of last year; student is just slightly down on last year, but it's fairly marginal, you know, but they're both broadly flat. And we mentioned, for example, a few new transit wins in the release. So, you know, transit is doing slightly better and is actually performing reasonably well.

In terms of the move from the public sector, we haven't seen any change. I mean, obviously the school year runs September to September. This year is now totally bedded in, you know, it's fixed and it's too early really to comment on the new year starting September 2010. As we've said in the past, in each bidding season we see a lot of interest from public-run boards. Converting them is the challenge, but there's no real update on that from November. I guess the best time to talk about that will probably be in May when we've had a clear view of how this year's bidding season has gone and if we've won any significant conversions. In terms of the percentage of renewals, I don't have a number. I think it's probably in line with last year. I don't think it varies.

RACHAEL BORTHWICK: It's always about sort of 20%-ish, isn't it, or thereabouts, because we don't have any reliance, and we've got 1,500, 1,600 different contracts; no reliance of any few big ones. It's always about the same sort of level as every year.

JEFF CARR: And, you know, I know talking to the commercial team in student in North America that, you know, they're optimistic about how they expect this year to go. I don't see any reason to be flagged and that our retention rates will be any different from prior years and, you know, we're quietly optimistic that we can win some contracts off weaker competition.

JOEL COPP-BARTON: Okay, cheers. Can I ask also quickly on pensions, obviously you've had a chance to look at the pension position across the various divisions. Now, should we expect kind of a step-up in the P&L and cash contribution going forward?

JEFF CARR: Well, there will be, yes. I mean, again, for next year, the P&L and the cash contribution will be up in the £10 million to £20 million sort of range. I don't think we're unique in that situation. I think a lot of companies are facing that. We are reviewing it. We're going through a review process at the moment to understand what further actions we can be taking to make sure that we manage that and minimise the exposure, but we do expect to see an increase which is largely driven by the change in the discount rate. I mean, we're at record sort of lows in terms of the discount rate, which obviously has an impact on liabilities, but that does mean there will be a pension cost to absorb next year and, you know, that's one of the challenges that we face in a huge mix, as we said, budgets and targets for next year.

JOEL COPP-BARTON: Okay, and that £10 million to £20 million is across the group, is it?

JEFF CARR: Yes. The biggest percentage of it is probably focused on UK Bus.

JOEL COPP-BARTON: Okay, cool. Thank you.

OPERATOR: Our next question comes from Joe Thomas of Investec. Please go ahead.

JOE THOMAS: Good morning. Well, one of the questions has been answered now, but I was hoping you could also help me or help us to just aggregate the contract profit movements a little bit better. You were talking about US dollar margins being flat year on year. Can you just remind me how much of cost savings you're expecting to come through in 2010 versus 2009, be that through either (a) synergy; or (b) the additional cost savings that were introduced last year?

JEFF CARR: Yes. The cost savings on the contract business that we were talking about are relative to the size of the business. They're relatively modest, and I think at the half-year, we flagged about

£40 million of cost reductions that should be coming through from the North American contract business. This was lower than the UK Bus and Rail, and the reason for that is obviously that group has been through some fairly significant synergy savings and consolidations over the last two years. Synergies were all pretty much annualised by this current financial year, but this was on top of what we'd achieved. So the £40 million was a fairly modest figure for North America, relative to the size and relative to the other businesses, and they've certainly achieved that.
In terms of the fact that margins are not improving is really related to the fact they're not exceeding that. They had some stretch targets in there themselves which they were hoping to exceed, and that's certainly where we're seeing a little bit of under-performance in terms of reaching those stretch targets.

JOE THOMAS: Sorry, can you just clarify, I know that you reached the annualised synergy targets by the end of March 2009, but I thought they would sort of annualise out into a higher number this year than they did last year.

JEFF CARR: I think the majority of the synergy targets came through last year. I know in Greyhound, for example, because Greyhound was running behind the process, we're seeing additional synergies come through this year in terms of Greyhound.

RACHAEL BORTHWICK: And the contract businesses were integrated early on in the process.

JEFF CARR: Yes, the contracts particularly, that was integrated fairly early in the process and pretty much last year's synergies were fully annualised, I believe. I'll look into that and check that, and get back to you if I find that's different.

JOE THOMAS: Okay, thanks. And the £40 million, you said that applied to North America. Did you mean that applied entirely to contract or --

JEFF CARR: Yes, contract.

JOE THOMAS: Yes, okay.

JEFF CARR: Greyhound had its own target of just over £30 million and Greyhound is doing well against those targets. I think there was more to go through for on Greyhound, because of the fact that it had not been integrated as fully as the contract business had in the early stages, for obvious reasons.

JOE THOMAS: Okay, thank you. And just I suppose a similar sort of response to the last question, but I'll try anyway. There's obviously been a lot of noise about schoolbus contracts being changed in nature, with maximum walking distances being increased and so on in the

US. Any indication from the school boards about what their thinking about that might be for the next school year?

JEFF CARR: I mean, again, I'll give you my best response on that. My understanding is that a lot of those changes that were being proposed in September for the new school year actually met with such an outcry from the parents that a lot of the initial feeling, most of those were rolled back as we started up the contracts. So school boards made an attempt in some regions, as you said, to consolidate routes or to make the walking distances further, but actually, most of that was met with quite a lot of parental disapproval, and we found that having been given an original plan, we were then being asked to put more capacity back in, to go back to previous expectations.

So year on year, I don't think we've seen a huge change. What we haven't seen is any growth, i.e. school boards saying, "We'll improve the network and make the distances shorter or we'll add routes" and I think as we look to the next school year, I expect that to be pretty much status quo as well. So the key areas where we are seeing reductions remain the areas of charter and school trips and supplementary sort of trips for schoolkids, where there's been significant cutbacks.

JOE THOMAS: Okay, thanks very much.

OPERATOR: Are there any further questions? A reminder again, if you want to ask a question, please press 01 on your telephone keypads now. And we have no further questions. Jeff, would you like to make your closing comments?

JEFF CARR: Yes, I'd just like to summarise. I think it's fairly straightforward, you know, we remain on track in terms of cash, in terms of earnings. We remain focused on the key tasks that were at hand in terms of managing costs and managing cash, and we'll continue to focus in that area certainly over the next few months, and we'll talk to you again shortly. So thank you very much, everyone.

OPERATOR: This concludes our call. Thank you for attending