

FirstGroup's pre-close trading update call 19.03.09

OPERATOR: Good morning and welcome to today's FirstGroup's pre-close trading update call. Today I'm pleased to present Sir Moir Lockheed, Nick Chevis and Rachael Borthwick. For the first part of this call all participants will be in listen-only mode, and afterwards there will be a question and answer session. I'll now hand you over to Rachael Borthwick.

RACHAEL

BORTHWICK: Hello, everybody. Thank you very much for joining our call this morning. Before I hand you over to Moir and Nick to take you through a short presentation, can I remind you that we do have some slides available on our website to accompany this call. They're on the home page. If you haven't already found them they should be very quick to run off.

Without further ado I'll hand you over to Moir.

SIR MOIR LOCKHEAD: Good morning. Welcome to our pre-close conference call, everyone. Over all, the results to the year end - a strong performance and we expect to deliver results in line with our expectations, so, again, no surprises. I wanted in the part of the presentation here to highlight what I think are the unique qualities of our business and then, of course, we'll get into the detail of how each division has performed.

To start that, I highlight that 50% of our revenues are contracted.

It's a very stable and predictable business and we've got an order book of about \$11.5 billion. In particular, our School Bus division in North America, which is as close as you can get to being immune from recession, and after ten years has a strong track record of stability and I think no matter what happens in the economy in the US, they'll still send their children to school.

Another unique quality of our group is the position we are in with our Rail division. Substantial revenue support is already in place and gives us protection, particularly for Great Western where we've got 80% support, and for First Capital Connect where we will have 80% support from the beginning of next month. Nick will spend some time just taking you through how that works and why we believe it's such a unique picture.

I also wanted to take you through the actions we've implemented at Greyhound and to show you how we flexed our business model there to deliver year on year improvements in profitability. We've reduced mileage and we've maintained revenue per mile, which is a very important measure of the link between supply and demand. We've implemented a significant programme of cost reduction that will deliver about £200 million of savings across our Group, and that's split out roughly around £70 million in our Rail division, £55 million in our Bus division here in the UK and £75 million in North America. That's equivalent to \$112 million and, of that, \$50 million will come from Greyhound.

This includes, over all across our Group, headcount reduction of about 3,500 and 50% of that will be delivered by early summer. So we're on the case, we've taken out a lot of jobs already and that's showing through in the strength of our cash flows. We've continued to generate strong cash - Nick will take you through the details in a minute. We're on course to achieve our targets of £100 million per annum in the next financial year, 2009/10, and a further £100 million in 2010/11.

I'll now hand over to Nick.

NICK CHEVIS:

Thank you, Moir. Looking at UK Rail; firstly, let's talk about what differentiates us from the other TOC Owning Groups out there, and it's revenue support. As Moir said, we are receiving 80% revenue support from the DfT on First Great Western and we'll receive support for FCC at the 80% level from next month.

When looking at the sensitivity to revenue decline, taking in to account the revenue support and profit share schemes, we estimate that a 1% further decline would impact EBIT by only £5 million, so approximately two-thirds washes through the various regimes. This significantly insulates our rail franchises from the economic impact on revenues.

I would stress secondly that our rail business is still delivering revenue growth and is profitable. As anticipated, revenue growth has slowed. However, we are still expecting to be up 7.6% year on year, which is a good result, with passenger volumes also up 4.4% year on year.

Despite the high fixed cost nature of rail which, as you know, is 80:20 fixed to variable, we have done a lot of work on costs and we are implementing actions that will save £70 million. That's about 15% of the flexible cost base. This includes a headcount reduction of 660 jobs in total by March 2010, the bulk of which will be complete by June 2009. It's no surprise that there is evidence of down-trading on First Great Western as people switch out of first class to cheaper ticket alternatives. However, at FCC, season tickets continue to grow, up 6% in value terms. In summary, we are still achieving revenue and passenger growth, we are driving out costs and we are benefiting from substantial revenue support.

Looking at UK Bus. We are very pleased with the performance; it really demonstrates the strength of the business. We are still seeing strong revenue growth and expect to be up 7.3% for the year, with passenger volumes up approximately 2%. The revenues in London are insulated and we are managing costs closely and will absorb the fuel increase in 2009/10. Outside London it's a flexible business. We can closely match services to demand in a pretty short time if we need to.

We've done a lot of work on costs and are reducing headcount, 1,100 in total by March 2010, and aiming to complete 50% by June 2009, really ensuring we are lean and efficient in all operations. We will continue to drive more cost actions and ensure that revenue per mile remains robust. As I said, we are very pleased with the UK Bus performance. The cost actions we

are taking will ensure we continue to be in a strong position going forward.

SIR MOIR LOCKHEAD: Thanks Nick. Just back to North America, I started off by saying that the contracted business in North America is a very defensive business, no dependence on passenger revenues. In fact, North America School Bus and Transit represents about \$610 million of our EBITDA which is over 80% of North America earnings. This business is very resilient with a strong track record over ten years despite recession. As I said at the beginning, the Americans send their children to school in greater numbers.

We have a growing order book of \$11.5 billion with clear visibility of revenues even in these challenging times. School bus bid season is going well. It's still ongoing; we're in the middle of the process, as you will recall. We've got strong contract retention at around 90%, which is good news, and we'll be able to update you at year end when we meet again in May. But we're having a good season. Although conversions are building up, it's a relatively slow process to convert them into real contracts, but nevertheless it's a very good sign.

Transit has done particularly well in this period. We've got \$44 million of extra new business, particularly in paratransit and shuttles.

Delivering the cost reduction against the business, including a headcount of over 400 by March 2010, of which half will have left

the company by June 2009, so there is a real focus there on being able to deliver more and more of a reduced and efficient cost base. That's in addition, I should add, to the integration of the Laidlaw plan that you're very familiar with.

Now to Greyhound. I wanted to bring you up to date on the management actions we have implemented to ensure that Greyhound's profitability is maintained in line with our expectations. The first point to make, I think, on Greyhound is it will deliver year on year profit growth and cash generation and we expect it to deliver a margin of around 8% in this year. Just by way of context, Greyhound is less than 10% of Group EBIT. As we've said in the past it is sensitive to economic trends, however it has a highly flexible business model and we can very quickly take action to mitigate the economic impact on revenues. Variable costs in this business are around 60% and year on year we have taken out, we estimate, 7% of the mileage in the US where we have complete flexibility to do so. We can do that within a matter of days of seeing a change in trend. In Canada it takes slightly longer and we've achieved a 5% reduction there. That's because we have to get approvals, which creates a slight lag effect.

Although we expect revenues will be down by around 10%, we have maintained revenue per mile throughout the year. A significant cost reduction programme has been implemented with headcount reduced by 1,100 jobs by June of this year. A substantial amount of that has already been achieved and we're

budgeting in 2009/10 for a similar level of profit to the year in which we are reporting.

Nick and I have spent time in Dallas with the management team and I'm really impressed by the speed by which they have reacted to take cost out to protect profits. The speed at which Greyhound revenue was impacted by the worse than expected economic position the US took, I think, us all a little bit by surprise, but I am confident we now have firm control of costs and we are driving through management actions that will ensure profitability is maintained.

Alongside that, we've now got a monitoring process for Greyhound and our other businesses that will allow us to take action to maintain revenue per mile as we see necessary. So I'm confident we're building a strong platform for longer-term profitable growth. The effects will be a leaner and stronger business when the economy emerges from the present decline.

RACHAEL BORTHWICK: Just to be clear, that number you gave, Moir, was Quarter 4, wasn't it, not the year?

SIR MOIR LOCKHEAD: Sorry, 10% in Quarter 4, yes.

NICK CHEVIS: Thank you, Moir. The debt maturity profile remains strong following on from the refinancing activities that we've taken throughout the year. The average debt life is now 4.8 years. We continue to generate strong cash flows and are on course to

deliver our target of £100 million per annum cash generation for 2009/10 and 2010/11. This net cash generation will continue to be applied to reduce net debt.

As a result of the management actions we have implemented, cash guidance for this year is in the £50 million to £60 million range. Non-recurring costs will increase as a result of the cost reduction programme. We estimate £30 million this year and £20 million next year. In addition, we expect a charge of approximately £19 million relating to part of our fuel hedge, which won't qualify for hedge accounting. We have higher fuel costs to absorb in 2009/10, but these will recover in 2010/11.

We recently announced a technical amendment to our bank facilities. This will ensure consistency for all currency translation purposes for covenant testing, a prudent action. And you won't be surprised to hear me say that we are well within our banking covenants. Our dollar debt and subsequent interest payments are supported by strong dollar cash flows from our US businesses of \$400 million to \$500 million. As you are aware, when combined with the dollar-denominated fuel purchases for the UK businesses, overall dollar costs and earnings are broadly matched at the EPS level.

SIR MOIR LOCKHEAD: Thanks, Nick. So, really, in drawing the presentation to an end, I'd like to summarise by saying we're very pleased with the strong performance from all businesses, despite the economic environment in which we're all performing. When we met in

November at our results, I talked about our diverse portfolio, and I believe we have demonstrated to you exactly what we mean by balance and by resilience. We continue to closely watch and monitor our network of services for any change in trends, and I am pleased with the quick response to ensure we match demand. Revenue per mile is a key driver across our businesses. The actions we have taken will ensure we are lean and in a very strong position when the economy emerges from decline.

Thanks to everyone for being on the line. We will now hand back to the operator for questions. Thank you.

OPERATOR: Thank you very much. We will 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. That's 01 to ask a question or 02 to cancel.

Our first question comes from Menno Sanderse of Morgan Stanley. Please go ahead.

MENNO SANDERSE: Good morning, everybody. Just two questions if I may. Of the £200 million savings - because it will be partly implemented during the new financial year - how much of those savings with

actually fall in the year to March 2010 and how much will be then carried over to March 2011?

NICK CHEVIS: We anticipate £200 million will be the effect in 2009/10. A lot of it we've done in the last few months and we intend to do in the few months of next year, so there will be a small overhang into 2010/11, probably £10 million or £20 million.

MENNO SANDERSE: Okay, fine. Just drilling a little bit further on Greyhound, the 7% reduction in mileage, is that for the full year of is that what has been implemented in Q4?

SIR MOIR LOCKHEAD: That is the year we're reporting. We've taken more miles out since the turn of the year.

MENNO SANDERSE: Yes, exactly, so that's why the statement is 10% down in revenues in the fourth quarter by revenue per mile flat because the fourth quarter --

SIR MOIR LOCKHEAD: Yes, we've maintained -- what we're doing, particularly in the US, is we're able very quickly -- because we've got a lot of extra vehicles on standby, it's very easy for us just not to run them, and that's what the team are doing. So, yes, it's higher than 7% in this period.

MENNO SANDERSE: Okay, and in terms of the trends. You said you spent a lot of time there, so you must have analysed it to death. If you look at the airline side, December, January, February were absolutely horrendous. Did things deteriorate further at Greyhound in the last two months or is the exit run rate worse than minus ten?

SIR MOIR LOCKHEAD: No, that is the run rate. I'll tell you what we think has impacted some of that - and it's very difficult to tell - in the northeast they've had some horrendous weather. There is an underlying trend loss and we can see that, but it's also been impacted -- the northeast was off further than we'd expected it to be, and we'll see in these next few weeks whether it recovers, particularly leading up to Easter. We saw a change because Easter was at a different time last year and so we'll have to try and take that out, but I think we've got a good handle on it and I think 10% is about the right number.

MENNO SANDERSE: Okay. Finally on the credit rating, Moir, you said last year that it's very important to have your credit rating for government contracts, but obviously very few of your competitors have this credit rating because there are very few have listed bonds, and the smaller ones definitely don't. But do you still feel the same about the credit rating and needing to have an investment grade?

NICK CHEVIS: Yes. I mean, I think the investment grade very much helps us. You know, we're very much an investment grade business and

that's the discussions we have with the ratings agency. I think in terms of -- it's not essential for you to be out there for businesses. National Express out there, they bid without it, and the main competition is 'mom and pops' and of course their covenant is nowhere as --

SIR MOIR LOCKHEAD: It's a reputation thing; it doesn't mean we'd lose any contracts.

MENNO SANDERSE: Exactly, so there's no automatic -- nobody would step away automatically.

NICK CHEVIS: Nothing in the contracts that mean we'd lose anything now. We just think it's an added string to our bow.

MENNO SANDERSE: Okay, very clear. Thank you.

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

DAMIAN BREWER: Yes, good morning, everybody. Just a few questions. First off, can you just confirm -- there was no comments on the dividends, so can we assume that, for the time being, there's no change in the dividend policy?

SIR MOIR LOCKHEAD: Yes, you can.

DAMIAN BREWER: Okay, that one's easy. Secondly, on the capex, a lot about opex savings. Are you looking again at the capex base and is there any change there or do you feel that's already optimised? As a follow on from that, you mentioned that the financing is secure until 2012. Is there still anything that needs to be done between now and 2012 or are you fully secure until then? Then very finally on the debt, can you remind us of a rule of thumb in terms of 1 cent movement has an impact on debt? I think historically it was about 1 cent moves net debt by about £17 million, so even the recent FX change looks like it would have a very minor effect on debt and debt:EBITDA even if one calculated it at spot. Is that still the case?

NICK CHEVIS: Okay, can I take those? Capex - I think in our guidance for next year we will be trimming capex in order to ensure that we continue to generate our £100 million, so I think capex for next year probably around about the £360 million, £370 million sort of level. That's part of the strength of our business that we can flex the growth capex.

DAMIAN BREWER: Is most of the reduction there coming in School Bus or Bus or what is the trimming?

NICK CHEVIS: It's across the piece. Obviously Rail has lost down to its more maintenance capex level where you have about £30 million to £40 million, which is the heavy maintenance and the run-out of

the franchise commitments. The rest is probably spread across all the other businesses. Obviously one of the things we have done is we've trimmed back the Greyhound capex in that.

SIR MOIR LOCKHEAD: And UK Bus capex will be down. We're going to take vehicles out there, so we won't need to renew them. I think we're getting closer to maintenance capex and the surplus cash we can use to take the debt down. I think we always expected that, Damian, so I don't think that is any different. It's just the strong cash we'll use and right now, the best place to use it is to take the debt down.

NICK CHEVIS: In terms of the debt, I think the position remains broadly where we were before. We've got - it depends on what currency you take - about £320 million to £350 million worth to do by the end of 2011. We've already done about £100 million of finance leases since we last spoke to you, which will come off that. That coupled with the cash generation, I think we're confident going forward that we'll do some more finance leases and maybe another bilateral we're in discussions with as well, so I'm confident we'll clear that through.

In terms of the debt sensitivity, I mean, our dollar-dominated debt is about \$2.9 billion or so, so 10 cents is about £140 million on that.

DAMIAN BREWER: Just to be clear, is the 2.9 billion dollars or sterling of dollar debt?

NICK CHEVIS: \$2.9 billion.

DAMIAN BREWER: Okay. I have one sneaky add-on if I can. Obviously I hear what you're saying about the cost reductions in the UK Bus and trimming back capex, mindful of what happened in the early part of this decade. As you're going through that process, what are you doing to make sure that the operated route mileage and the quality of what you're putting into the UK Bus doesn't deteriorate on the back of this?

SIR MOIR LOCKHEAD: The fleet will be better than half life. Secondly, as I mentioned to you when we talked about Greyhound about revenue for mile, there's a full analysis in each company as to where anything has changed and whether we need to ... The best thing about this is because we've got a lot of urban routes we can take a 10-minute frequency to 12. It takes out a considerable amount of cost but protects the revenue that we have. It's really getting down to things that we're doing, reducing overheads. Some people would argue that we should have done it anyway, Damian, but at the moment we're just getting on with it.

DAMIEN BREWER: Okay, great, thank you very much.

OPERATOR: Our next question comes from Douglas McNeill of Blue Oar Securities. Please go ahead.

DOUGLAS MCNEILL: Good morning. I wonder if I could ask two or three questions on the Rail side in the UK, thinking firstly about the revenue support at First Capital Connect, when you say that's eligible for 80% revenue support, is the implication that revenue there is running below 94% of the originally projected level? Is that the right way to understand it?

NICK CHEVIS: Yes, that's the correct way to look at it, yes.

DOUGLAS MCNEILL: Yes. On Great Western, are you in a position to say how much you have received in revenue support in the current year?

NICK CHEVIS: Yes. If you remember, the revenue support this year, we negotiated early revenue support this year, so it's a looser band than what we had last time, but we'll receive about £50 million this year.

DOUGLAS MCNEILL: Okay, and it reverts to the more conventional structure as of next year.

One other thing: am I correct to infer from the numbers that volume growth in the Rail division in Q4 was more or less zero? Is that the right way to understand it?

NICK CHEVIS: Volume growth in Q4 for Rail was a little over 1% and we had a revenue growth of about 4.7%.

DOUGLAS MCNEILL: Okay, thank you very much.

OPERATOR: Our next question comes from Dominic Edridge of UBS. Please go ahead.

DOMINIC EDRIDGE: Hi there. I just had a couple of questions, firstly on ScotRail, because I know you've talked about the other two which you have in the revenue support. Can you just say how that's trading in terms of the 10% bands? Secondly, I suppose, just to find out in UK Bus is there much variation in the performance between London and ex-London? I know obviously a few years ago you had a few issues in London. How is trading continuing there? Thanks so much.

NICK CHEVIS: Okay, ScotRail is trading above target revenue - I think it's around about 104% of the target revenue at the moment, so I think that's means we'd have to -- to fall into revenue support there we'd have to move about £14 million. But that's taken into account when I talked about the overall sensitivity of 1% equating to £5 million across the whole rail division.

DOMINIC EDRIDGE: Okay, so it's included within there, then, is it?

NICK CHEVIS: That's included within there, yes. That 1% - £5 million would be equivalent to losing 1% across the whole of our Rail division, all of our Rail passenger income.

DOMINIC EDRIDGE: Okay, thanks a lot.

NICK CHEVIS: In terms of London, could you just clarify what your question was on London?

DOMINIC EDRIDGE: Yes, I'm just wondering how trading is going there, because obviously I know in the past there have been some operational issues there. Just looking at the league tables, maybe things have -- you know, you had a lot of improvement there 18 months ago and that seems to have drifted a little bit now. Can you just say how you're seeing things there?

SIR MOIR LOCKHEAD: We're winning -- the best test I suppose is we're winning contracts and we were awarded a contract just last week, which was reassuring for us that Transport for London see us as a good operator again. Getting the margins up -- the issue in London is getting the pass through for fuel and getting recovery of fuel with the price that we've currently got. I think we can do it, we just have to - as we've said many times - manage cost and the revenue looks after itself.

Outside of the London it's a combination of both. As we've already said, if we take mileage out, if we can price, but I think it's

going to be very sensitive this year, the pricing, so our focus is on making sure the cost base comes down.

NICK CHEVIS: I think as Moir said -- I mean, the fuel, we're going to take a fuel bump next year in terms of 2009/10, but that very much will reverse in 2010/11.

DOMINIC EDRIDGE: Okay, yes, sure, but in terms -- it sounds as though we shouldn't be assuming too much on price for the next sort of 6 to 12 months or so, then.

NICK CHEVIS: Pricing activity in --

DOMINIC EDRIDGE: Yes, ex London. I mean, have there been any price increases put through recently in any of the businesses?

NICK CHEVIS: Yes, there are always price increases. There are price increases. We tender London on a net-cost basis, so it adds - as wages go up - sorry, gross-cost basis. So when wages go up, obviously gross costs go up, but there's also an index in place for existing contracts and that's continued, on anniversaries, to give inflationary growth.

DOMINIC EDRIDGE: Sure, but I meant outside of London. Have any fares gone up recently? I haven't seen anything announced particularly. You're obviously being cautious there.

SIR MOIR LOCKHEAD: No, he's talking outside of London. Outside of London prices went up - if you remember when we met in November - we said we'd priced during the year to cover the high hedge fuel that we had. We've done that and that's given us the benefit of going in from April to cover that higher fuel cost.

In London our margin is better this year. You remember we were, I think, 3% or 4% last year. This year it's around 5% to 5.5%. Now, I think it can be much better than that but, for the reasons you said, we've had to work on operating performance and now we'll turn our attention to getting costs down.

DOMINIC EDRIDGE: Okay, thanks very much.

OPERATOR: Our next question comes from Arnaud Gibrat of Bank of America Merrill Lynch.

ARNAUD GIBLAT: Good morning, just a question from me. Could you tell us where you're trading relative to your covenants?

NICK CHEVIS: Yes, we're in a good position in terms of our bank covenants. Obviously that is helped by the amendment that we talked about earlier. So in terms of our banking covenants, I'd estimate that -- this year we closed with -- we've got two banking covenants, a net debt to EBITDA covenant and a fixed charge cover ratio. The fixed charge cover ratio we're way, way, way inside. The net

debt to EBITDA I'd estimate we'd be around about 2.9 times at the end of this year against a maximum permitted of 4 times. For next year, March 2009/10, I'd estimate we'd be around 2.8 times and that would be against a maximum permitted of 3.5.

ARNAUD GIBLAT: Thank you.

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

SIR MOIR LOCKHEAD: Thanks for being on the line. There were recorded 44 lines, so thanks very much for your attention. If there's anything else you need, please come back to Rachael or Nick or myself at any time.

RACHAEL BORTHWICK: Thank you.

NICK CHEVIS: Thank you.

OPERATOR: This concludes our call. Thank you for attending.