

IFRS Briefing

12 July 2005

Introduction

- IFRS implemented from 1 April 2005
 - Under EU regulation FirstGroup required to report its half year and full year result for 2005/06 under IFRS
 - one year's comparative data for 2004/05 restated
 - date of IFRS opening balance sheet (date of transition) 1 April 2004

The comparative information may be amended by subsequent changes in IFRS and interpretations thereof and/or industry practice. The information included in this presentation is unaudited.

Overview of IFRS impact

	Full year to 31/3/05		% Change
	UK GAAP	IFRS	
Operating profit (after goodwill amortisation and bid costs)	£177.2m	£204.0m	+15.1
Net profit (after MI)	£89.7m	£107.8m	+20.2
Adjusted basic EPS	28.2p	28.8p	+2.1
Net assets	£358.2m	£216.5m	-39.6
Net debt	£663.1m	£686.7m	+3.6
Parent company distributable reserves	£657.0m	£691.0m	+5.1

Summary

- 2004/05 Group net cash flow unchanged
- 2004/05 Group profit before tax £155.7m (UK GAAP: £128.9m)
- Net assets at 31/3/05 of £216.5m (UK GAAP: £358.2m)
- Group net debt at 1/4/05 of £687m (UK GAAP: £663m)
- Parent company reserves £691m (UK GAAP:£657m)
- Income statement volatility not anticipated to be material

Significant changes

Pensions	IAS 19
Goodwill	IFRS 3 & IAS 36
Intangibles	IFRS 3 & IAS 38
Dividends	IAS 10 & IAS 1
Share-based payments	IFRS 2
Financial instruments	IAS 32 & 39
Taxation	IAS 12

First time adoption (IFRS 1)

IFRS 1 allows some exemptions from full retrospective application of certain standards. FirstGroup has applied the mandatory exemptions and certain of the optional exemptions.

Business combinations (IFRS 3)

- No restatement of business combinations that took place prior to 1/4/04
- Carrying value of goodwill under UK GAAP brought forward unadjusted as cost of goodwill under IFRS as at 1/4/04

Employee benefits (IAS 19)

- All actuarial gains and losses recognised in equity at date of transition

Share-based payment (IFRS 2)

- Retrospective application of IFRS 2 to equity-settled awards not vested at 1/4/05 and granted on or after 7 November 2002

Financial instruments (IAS 39 & 32)

- Financial instruments will not be restated on an IFRS basis for 2004/05
- Hedge accounting to be applied from 1/4/05

Cumulative translation differences (IAS 21)

- Previously accumulated foreign exchange translation set to zero at 1/4/04

Pensions (IAS 19)

Principal differences

UK GAAP

- Income statement charged with long term funding rate with surpluses or deficits spread over the average remaining working lives of employees (SSAP 24)
- FRS 17 values disclosed separately in notes to accounts

IFRS

- Income statement charged with long term funding rate (calculated on a different basis) with surpluses or deficits taken directly to reserves
- Deficit on defined benefit schemes recognised on balance sheet
 - Full deficit for non-rail schemes;
 - Franchise-term deficit for rail schemes
- Actuarial gains/losses recognised directly in SORIE

Pensions (IAS 19) contd.

Impact for 2004/05

- Increases PBT by £4m
- Pension deficit at 1/4/04 of £241m
- Pension deficit at 31/3/05 of £221m

Volatility

- Increased volatility on the balance sheet
- Income statement volatility may arise from changes in key assumptions – discount rate, inflation, expected return on scheme assets

Pensions (IAS 19) contd.

Rail franchise-term deficit

- No liability borne beyond the period of the franchise
- Deficit at each balance sheet date is restricted to the amount to be funded over the remaining term of the franchise
- At date of transition, or at inception of a franchise, an intangible asset is taken onto the balance sheet to match the franchise term deficit
- Intangible asset represents the economic benefit derived from the rail franchise agreement that is attributable to our share of the rail pension deficit
- Rail franchise intangible assets amortised on a straight line basis over the term of the franchise

Retained earnings

- The IAS 19 pension deficit is the largest single item impacting on consolidated reserves
- As at 31/3/05 there is a deficit of £24m in retained earnings in the consolidated group balance sheet
- It is important to note that dividends are paid out of parent company reserves, not consolidated group reserves
- As at 31/3/05, FirstGroup plc had £691m of distributable reserves in the parent company

Goodwill & Intangibles (IFRS 3, IAS 36 & 38)

Principal differences

UK GAAP

- Goodwill principally amortised systematically over estimated useful life of up to 20 years
- FirstGroup did not recognise any intangibles other than goodwill

IFRS

- Amortisation of goodwill prohibited but subject to annual impairment testing
- Introduces policy of acquired intangibles – intangibles previously subsumed within goodwill are reclassified and amortised
- For example contract values are recognised as an intangible under IFRS as they are separately identifiable and can be reliably measured

Goodwill & Intangibles (IFRS 3, IAS 36 & 38) contd.

Impact for 2004/05

- Reversal of £26m goodwill amortisation income statement charge for 2004/05
- No goodwill impairment charge
- Intangible amortisation charge to income statement of £0.6m
- Intangibles previously subsumed within goodwill now capitalised under IFRS 3 £10m (net of amortisation)

Volatility

- To the extent that future impairments arise, there may be volatility

Dividends (IAS 10 & IAS 1)

Principal differences

UK GAAP

- Dividends charged to profit & loss account
- Proposed dividends relating to an accounting period are charged to profit & loss account

IFRS

- Dividends presented as a movement in the retained earnings note
- Only dividends declared during the year are charged to profits

Impact for 2004/05

- Reversal of 2004/05 proposed final dividend of £34m (as this was not declared until after year end)
- Proposed final dividend for 2003/04 of £32m derecognised at date of transition and flows through 2004/05

Share based payments (IFRS 2)

Principal differences

UK GAAP

- SAYE schemes charged directly to reserves, not profit and loss account
- All other shares and share options charged to operating profit based on intrinsic value
- Intrinsic value is the difference between the fair value of shares and the option price

IFRS

- All share options (including SAYE schemes) charged to income statement
- Income statement charge based on fair value and charged over vesting period
- Income statement is adjusted to reflect actual and expected levels of vesting at reporting date
- Fair value at grant date is calculated using a valuation model - FirstGroup have elected to apply principally the Black-Scholes model ¹³

Share based payments (IFRS 2)

Impact for 2004/05

- Income statement charge of £3m before tax

Volatility

- Relatively low volatility is expected

Financial instruments (IAS 32 & 39)

Principal differences for FirstGroup

UK GAAP

- Most derivative contracts not recognised on balance sheet but disclosed in notes to accounts
- Interest on bonds included in accruals and deferred income
- FX benefit from cross currency swap included in value of bond
- No specific standard on hedge accounting

Financial instruments (IAS 32 & 39) contd.

Principal differences for FirstGroup

IFRS

- All derivative contracts (covering fuel price risk, interest rate risks, currency risks) recorded on the balance sheet at fair value with changes in value taken through the income statement unless hedge accounting is effective for cash flow hedges
- Bonds principally valued at amortised cost using the effective interest rate method
- Accrued interest due to application of effective interest rate method added to bond values
- Net debt excludes fuel derivatives and cash flow hedges
- IAS 32 & 39 to be applied from 1/4/05. Prior year exemption relating to 2004/05 taken
- Hedge accounting to be applied from 1/4/05, the date at which the appropriate hedge documentation was put in place

Financial instruments (IAS 32 & 39) contd.

Hedge accounting

- Involves designating a hedging instrument, such as a derivative, to offset changes in the fair value or cash flows of hedged items
- Derivatives recorded on balance sheet at fair value. Effective application of hedge accounting removes volatility from the income statement (i.e. movements in fair values/cash flows either go to reserves or are equally matched off in the income statement) while the ineffectiveness is recorded in the income statement
- A qualifying hedge is one where changes in cash flows or fair values of the hedged item are offset by changes in cash flows or fair value of the hedging instrument (the derivative), so that the offset is within a permitted range of 80-125%. A qualifying hedge which is fully effective will have a 1:1 offset relationship with the hedged item
- Strict criteria to meet in order to apply hedge accounting, including hedge effectiveness testing. This is required at inception, retrospectively and prospectively at each balance sheet date

Financial instruments (IAS 32 & 39) contd.

Impact on adoption of IAS 32/39 (1 April 2005)

- Bond value increased by £37m, due to reclassification of FX benefit in swaps and accrued interest reclassified to bonds
- The fair value interest rate swap increased net debt by £6m
- The cash flow hedge swap increased financial liabilities by £1.6m
- Fuel derivatives increased the financial assets by £31.4m

Volatility

- Hedges using derivatives are expected to be highly effective, any ineffective element will lead to a degree of volatility in the income statement at operating profit level (for fuel derivatives) and finance charge level (for interest rate and currency derivatives). We do not expect volatility to be material.

Taxation (IAS 12)

Principal differences

UK GAAP

- Deferred taxation not provided on capital gains on property disposal where it is anticipated that the proceeds will be invested in new property

IFRS

- Full provision is made for tax arising on all such capital gains

Impact for 2004/05

- Deferred taxation liability reduced by £68.4m (principally pensions adjustments)
- Overall tax charge on income statement increases by £8.7:
 - £7.9m tax charge on reversal of the goodwill amortisation charge
 - tax charge of £1.4m on a lower IFRS pensions charge
 - tax credit of £0.9m on share options charge
 - tax charge of £0.3m due to tax on capital gains
- Effective tax rate will not be materially affected

2004/05 Group profit before tax

	£m's
UK GAAP at 31/3/05	128.9
Goodwill amortisation no longer written off	25.8
Employee benefits net of rail intangible amortisation	4.5
Intangible assets amortisation (non rail)	(0.6)
Share-based payments	(2.9)
IFRS at 31/3/05	155.7

2004/05 Balance sheet net assets

	£m's
UK GAAP at 31/3/05	358.2
Goodwill	25.8
Intangibles	18.8
Dividends	34.2
Employee benefits	(288.9)
Deferred tax	68.4
IFRS at 31/3/05	216.5

Summary

- 2004/05 Group net cash flow unchanged
- 2004/05 Group profit before tax £155.7m (UK GAAP: £128.9m)
- Net assets at 31/3/05 of £216.5m (UK GAAP: £358.2m)
- Group net debt at 1/4/05 of £687m (UK GAAP: £663m)
- Parent company reserves £691m (UK GAAP:£657m)
- Income statement volatility not anticipated to be material

Q&A

Appendix A – Other IAS/IFRS

	N/A	No material impact
IFRS 4 – Insurance contracts		✓
IFRS 5 – Non-current assets held for sale/discontinued operations		✓
IAS 1 – Presentation of financial statements		✓
IAS 2 – Inventories		✓
IAS 7 – Cash flow statements		✓
IAS 8 – Accounting policies, changes in estimates and errors		✓
IAS 11 – Construction contracts	✓	
IAS 14 – Segment reporting		✓
IAS 16 – Property, plant & equipment		✓
IAS 17 – Leases		✓
IAS 18 – Revenue		✓
IAS 20 – Government grants and disclosure of government assistance		✓
IAS 21 – Effects of changes in foreign exchange rates		✓
IAS 23 – Borrowing costs		✓
IAS 24 – Related party disclosures		✓

Appendix A – Other IAS/IFRS (contd.)

	N/A	No material impact
IAS 26 – Accounting and reporting by retirement benefit plans	✓	
IAS 27 – Consolidated and separate financial Statements		✓
IAS 28 – Investments in Associates	✓	
IAS 29 – Financial reporting in hyperinflationary economics	✓	
IAS 30 – Disclosures in financial statements of banks and financial institutions	✓	
IAS 31 – Joint ventures	✓	
IAS 33 – Earnings per share		✓
IAS 34 – Interim financial reporting		✓
IAS 37 – Provisions, Contingent assets and contingent liabilities		✓
IAS 40 – Investment property	✓	
IAS 41 – Agriculture	✓	

Appendix B – Net debt as at 1/4/05

£m's	UK GAAP	IFRS	Impact
Cash	83.8	83.8	-
Rail ring-fenced cash and deposits	70.3	70.3	-
Bank loans & overdrafts	(244.2)	(244.2)	-
Obligations under finance leases	(24.1)	(24.1)	-
Loan notes	(21.0)	(21.0)	-
Interest rate swaps-fair value hedge ³	-	(6.0)	(6.0)
Cross currency swaps ¹	-	20.3	20.3
£300m Bond ²	(296.0)	(315.6)	(19.6)
£250m Bond ²	(231.9)	(250.2)	(18.3)
	(663.1)	(686.7)	(23.6)

Appendix B – Net debt as at 1/4/05 (continued)

1. Cross currency swaps

Under UK GAAP the FX benefit of £16m was netted off against the £250m bond. Under IFRS this is removed from value of the bond and is shown separately within net debt as a financial asset

2. £300m bond

Bonds are stated at amortised cost which includes accrued interest under the effective interest rate method

£250m bond

Bonds are stated at amortised cost which includes accrued interest under the effective interest rate method. The impact is additional £3m interest. The FX benefit from cross currency swap has been removed and recognised separately within net debt as a financial asset

3. Interest rate swap – fair value hedge

This swap is used to hedge fair value interest rate risk of the £250m bond. The £6m fair value of the swap is included in net debt as it relates to the value of the underlying debt

Appendix C – Terminology

UK GAAP	IFRS
Statement of recognised gains and losses 'STRGL'	Statement of recognised income and expense 'SORIE'
Profit and loss account	Income statement
SSAP	IAS
FRS	IFRS
UITF	SIC/IFRIC
FRED	ED