



FirstGroup plc pre close trading update for the six months ended 30 Sept 2010

OPERATOR: Good morning, and welcome to the FirstGroup pre-close trading update call. Today I'm pleased to present Jeff Carr, Group Finance Director of FirstGroup. For 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 Jeff Carr.

JEFF CARR: Good morning, ladies and gentlemen, and thank you for joining our pre-close trading update. As we've now completed the first half of the financial year, trading has continued to develop in line with expectations. Specifically, we remain on track to deliver moderate earnings growth for the full year. Also, I'm pleased to report that we continue to make excellent progress on cash generation, and we remain confident of achieving the group target leverage position of 2.5 times net debt to EBITDA by the end of this financial year. This will be significant progress from the three times reported at the end of March 2010, and demonstrates the highly cash-generative nature of our business. I will now give a quick update on each of the five business divisions, and then we'll move into a question and answer session. Our UK Bus business has continued to perform steadily during the period, and if you recall, in quarter 1 like for like

passenger revenue growth was a modest 0.9%. During the second quarter, we saw this growth advance a little to 1.6%. Overall, however, the trading environment does remain challenging, and while it's probably a little too early to see the improvement as a trend, we are encouraged by the underlying margin improvement and the positive revenue momentum.

In UK Rail, we have seen improving trends across our operating companies, and indeed, across the fare bands, with some encouraging signs of improving first class ticket sales. In the second quarter, like for like revenues grew by just over 5% versus last year, up from 3.7% in the first quarter. Good progress was made at First Great Western and First ScotRail, and TransPennine Express we saw particularly strong growth, up from 4% last quarter to over 7% in the current quarter. We continuously strive to improve our customer service levels, and it's pleasing that we saw significant improvement in performance at First Capital Connect during the year. Average punctuality levels over the period reached just under 92%.

On 1 June, we announced the sale of GB Railfreight to Eurotunnel for a gross consideration of £31 million, and consistent with our stated policy, the proceeds of the sale will be applied to accelerate the group's deleveraging plans.

Like most businesses, we await the outcome of the UK government's Comprehensive Spending Review in October, and along with our peers, we've been active in providing feedback

and ideas on improving value for money both in rail and in the bus industry.

In North America, our student business continues to perform in line with expectations, and as we previously discussed, school boards continue to face budgetary pressures. However, as the market leader in student transportation, we continue to innovate and work with the school boards to maintain excellent service levels, while sharing operational efficiencies to help overcome these budgetary constraints. During August and September, we just completed a successful start up of the new school year, which this year included six new conversion contracts, which represented in total \$24 million of new revenue. Our conversions remain hard work. This has been our most successful year for conversions, and we're continuing to see an increase in the levels of interest in this area.

Our Transit business continues to show good growth, with revenues increasing in the period by 4.5%. Transit operates over 300 contracts throughout the USA and Canada, and these include a wide variety of businesses, including public transit contracts serving commuters in and around LA and San Diego, large paratransit contracts serving disabled communities in Houston and northern New Jersey, managing and operating the North Carolina State University shuttle service, and in New York City, operating a transportation core centre, which plans the movements of over 25,000 paratransit customers daily.

At Greyhound, we continue to make operating efficiency improvements, and expect to see good progress in the year on operating margins. During the period, for example, we launched greyhound.com. Although traditionally a cash business, internet sales are becoming an increasingly important distribution channel, and now account for over 25% of all ticket sales, helping to improve access and reduce the overall cost of sale to Greyhound. Our like for like passenger revenues were up 1.6% in the period. A challenging economic environment and lower consumer confidence contributed to a slowing of growth in the second quarter.

In summary, we've made good progress in the period on cash generation. I'm pleased that this focus means that we'll be able not only to increase our capital expenditure in the year to support our dividend growth policy, but also to deliver on debt reduction, and as I've said, I'm confident in achieving the target ratio of 2.5 times net to EBITDA by March 2011. Trading for the first half of the year remains in line with expectations and, as previously reported, for the full year we expect moderate earnings growth. So thank you, now I'll hand back and take any questions.

OPERATOR: Thank you very much. Participants, if you would like to ask a question, please press 01 on your telephone keypads 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. So that's 01 to ask a question or 02 to cancel.

And our first question comes from Paul Hickman of Peel Hunt.

Please go ahead.

PAUL HICKMAN: Morning, Jeff. I just wondered if you could comment more about bus margins. You talked about their improvement. I think in the statement, you said they would be robust. Is the upturn in margins greater than what you would have expected?

JEFF CARR: No, UK Bus is pretty much in line with the guidance that we've given. The margins are developing the way we expected them. The reason for the margin improvement is twofold. It's partly improved operating efficiencies, you know, we continue to monitor mileage, and this year mileage will be down slightly versus last year, as a result of looking to protect the revenue per mile. Also, we get the benefit of a lower fuel cost this year versus last year, but pretty much margins will be where they were expected in the beginning of the year, but we're pleased that bus though is continuing to operate very well.

PAUL HICKMAN: Yes, thank you.

OPERATOR: Our next question comes from Jamie Rowbotham of Morgan Stanley. Please go ahead.

JAMIE ROWBOTHAM: Morning, all. Morning, Jeff. Three quick questions, if I may.

Firstly, in school bus, in Q1 you talked about maintaining the industry-leading margins there, and at Q2 you talk about protecting the operating margin. I just wondered if you could provide an update on how well that's going, having just heard about UK margins.

Secondly, in terms of the cash generation and the confidence there, can you just give a bit of colour as to what's driving the confidence there, in addition to obviously the GB Railfreight disposal, what work you've done around, say, working capital, and whether any other assets have been identified as non-core with a view to, you know, further disposals like GB Railfreight?

Thirdly and finally, just on rail, I wondered, having read the statement, how much further scope there is to lower that addressable cost base in UK Rail.

Thanks.

JEFF CARR:

Well, in terms of the student business in school bus in North America, there's really been no change. I mean, the contents of this statement are saying the business continues in line as we previously described it, and what we'd talked about margins previously had been, you know, we expect margins to be down slightly this year versus last year. That's a result really of pricing pressure. You know, we've had significant pressure in the bidding season, there's been a lot of competitive bidding, and that pricing pressure, to some degree, we'll offset by operating

efficiencies, but not completely. So in the past we've talked about a few basis points of margin reduction in yellow school bus, but still a robust performance.

In terms of cash generation, you know, it's a very pleasing picture.

I think this is a highly cash-generative business. We've put a lot of focus on all of the lines in terms of the cash flow, including everything from tax and interest, but also obviously we've talked about working capital. We are seeing the benefits of that work coming through now. We've been going through projects in both North America and the UK, looking at our terms and making sure that they're in line with the industry best practice supplier by supplier, looking at receivables process, improving invoice accuracy - because clearly each time you put out an inaccurate invoice, it leads to a delay in payment - and really just focusing on management and making sure everybody's aligned to the importance of working capital. And those are the key areas.

In terms of asset sales, no, GB Railfreight, you know, was identified as non-core and it was sold, but we'll continue to look at other assets, but the board will address that on an individual basis. The guidance that we've given in terms of the 2.5 times and achieving that doesn't include any more requirements for any more asset sales. That's going to be driven from GB Railfreight and the success of the internal operating cash generation. So that's really an organic performance.

And in terms of rail, I mean, I believe in all businesses there's always operating efficiencies that we can strive for as

management, and we've done an excellent job - the team has done an excellent job - of improving efficiency within our rail businesses, both in terms of direct operating costs and overheads, and that's helped the good performance that we've seen in rail over the last few years, and will help in this year. I think that's a continuous process, and I wouldn't ever want to say that we've come to the end of that process.

JAMIE ROWBOTHAM: Great, thanks, Jeff.

OPERATOR: Our next question comes from Tigen Wright of Sky News. Please go ahead.

TIGEN WRIGHT: Hi there, Jeff. How are you? On UK Bus, you talk about reducing mileage to match demand and you said already in this conversation that mileage is down slightly this year versus last year. What percentage terms are we talking about this year? What percentage terms do you anticipate for the period to come, and do you fear that might result in, I suppose, a degradation of service for passengers?

JEFF CARR: No, it's been very much marginal in terms of the mileage reductions. We're talking about something like up to 5% and we're very much focused on keeping good quality service, a good quality product throughout our network, and as I said, the mileage reductions are pretty marginal. It's typically just

changing the frequency slightly. It's not really route cancellation, so we may have extended frequency slightly from five or six-minute intervals up to seven or eight-minute intervals, but we've tried to keep and we have kept it a good-quality service through the network.

TIGEN WRIGHT: Okay, thanks.

OPERATOR: Our next question comes from Mark Manduca of Merrill Lynch. Please go ahead.

MARK MANDUCA: Morning, Jeff. In terms of the issues around school bus, clearly there are a lot of moving parts and I just wanted to get some flavour around the confidence that you have with that flat year-on-year guidance that you're giving. So around the moving parts, obviously the discretionary business, can we get some colour in terms of the deterioration in that business and the recent trends there, and also in terms of how the new school season has started, and the sort of focus that you've had around protecting margin within that business?

And a second question around Greyhound, in terms of Q2 run rate that we saw, to what extent is that related to competitive pressures, because obviously there have been other people in the market saying that, you know, they've been growing like Topsy, for example. If you could just cover those two areas, please, Jeff.

JEFF CARR:

Yes. I think we've talked quite a lot about the school bus market recently. It's been a tough market. The bidding season has been competitive. We've seen, you know, bidding which has been a little irrational, where people have obviously been bidding to win market share. As the market leader, we feel we have a responsibility somewhat to maintain discipline in that market and maintain some capital discipline, so we've walked away from a few contracts where the bidding's gone well below cost of capital. We've seen some bidding which has been off-spec in terms of what the school boards have required, for example, bids have come in with new buses when the school boards haven't necessarily specified that. So we've been a little bit more selective, which means overall, you know, it's been a tough bidding season. We've seen some pricing pressure which has come through on the renewals that we've been successful with. The net impact of that is what we've said, is that we see revenues broadly in line with last year. They'll probably be a little bit down, but they'll be, as I said, broadly in line. You know, we're reasonably confident in terms of both that and our margin projections. Clearly the bidding season is complete. We've started up the new school year and it's gone very well. We've had a good start up of the new school year. You know, there's always one or two small glitches when you're starting up with taking 4 million kids to school each day, but all in all, it's been an excellent start up. So all in all, there's very little change. It's very

much where we talked about it last quarter, and because it's a contracting business, it's remained very resilient. I think we talked about EBITDA margins. I don't have the numbers in front of us, but last year, they were down 0.3 percentage points. I think that's a good performance and does show the resilience of this business.

In terms of Greyhound, you know, within Greyhound obviously we could point to Bolt, which is where we've been growing. Bolt is up double-digit percentages in terms of growth. That's largely volume-related, where we've put in new buses. We've tried to give you an underlying growth number, which doesn't include volume, i.e. new bus expansions. I think if you do look at the competitive numbers that you're talking about and figure out if they include new volumes, I think on a like for like basis - which is the number we've quoted - you'll see that things are pretty tough. I don't really think it's mostly a competitive issue. I do think it's an environmental issue in terms of the background, the market background. The economy in the US remains pretty vulnerable. Unemployment remains high and the average Greyhound customer is obviously facing still tough times. All in all, I think Greyhound will deliver good numbers this year. We'll see good margin improvement, but the growth rate will be probably a little bit lower than we originally expected.

MARK MANDUCA: Understood. Thank you very much.

OPERATOR: Our next question comes from Caroline Mohet of Macquarie.
Please go ahead.

CAROLINE MOHET: Hello, good morning, Caroline from Macquarie. I just had a question regarding your UK Bus business, like could you give us a bit more colour regarding the demand recovery and what you expect for the second half, and also what's happening with the management changes within your UK Bus business?

JEFF CARR: In terms of the UK Bus business, the second half we've seen similar trends now for several quarters, and I've described those trends as bumping along the bottom in terms of growth, so they've been around 1% to 2% for some time now. I think they'll continue at those levels through the second half of this year. I think clearly there's a few uncertainties in the UK market, not least based on the Comprehensive Spending Review, and I think people are quite nervous about that and the impact of that. So I wouldn't expect -- I'm not projecting revenues to grow significantly in UK Bus, but I'm not expecting them to deteriorate further. I think they'll continue around that 1% to 2% sort of level. So they'll be pretty much steady in terms of where we've been over the last few months.

In terms of management, Nicola Shaw left the business, and Mary Grant is running UK Bus along with UK Rail at the moment. I mean, she's supported by a very strong team and I think that's pretty much where we're at with that.

CAROLINE MOHET: Okay, thanks. And just another quick question, could you give us a bit of detail regarding your labour cuts across the businesses and if you have done any recent switch deals or that kind of thing?

JEFF CARR: Well, generally, you know, labour inflation has been fairly well-managed. We talked about UK Bus striking quite a lot of deals last year and this year which have been very competitive, either zero in the first year and maybe 2%, 2.5% in the second year, or that order of magnitude. Obviously in rail, it's a slightly different position, and we continue to see labour costs in line really with CPI, and similar in North America, you know, we see labour costs rising in line with CPI. What we're looking for, especially in North America, is improving our operating efficiency, and I think that's the best way to manage our cost base, and we do see across all of our businesses opportunities to improve our operating efficiency both in terms of labour and in terms of other areas.

CAROLINE MOHET: Thank you.

OPERATOR: Are there any further questions? A reminder again, you can press 01 on your telephones to ask a question or 02 to cancel. And I have a question now from Tim Barrett of JP Morgan. Please go ahead.

TIM BARRETT: Jeff, hi. In your introductory comments, you talked very briefly about the industry lobbying government ahead of the Comprehensive Spending Review. Can you give a bit more flavour on that in terms of how that's going and when you'd expect to hear any outcome?

JEFF CARR: Well, I think at this stage, it's probably best to wait for the output on 20 October. I think clearly, you know, there's an awful lot of speculation flying around, whether it's in relation to UK Bus, BSOG, concessionary fares or whether it's in relation to rail. As we say, we've been working very closely as a business and within the industry groups to put our point of view across and to make sure that we do help to generate value for money, and we do strive to generate value for money and offer better value for money, but at this stage, I think it's just best to wait to see what comes out of the review on 20 October. I think it's so close, it's not really worth speculating any more at this point.

TIM BARRETT: Okay, thanks.

OPERATOR: Our next question comes from Andy Cawker of Insight Investments. Please go ahead.

ANDY CAWKER: Yeah, hi, Jeff. It's just following on from that, on the Comprehensive Spending Review. You said "not far away", but I was just interested really in your comments in the statement on

the commitment to the dividend growth in light of the uncertainty around BSOG and concessionary fares etc, so I just wondered if you could maybe shed a bit of light on the confidence in the dividend growth in the context of that uncertainty?

JEFF CARR: Well, I mean, clearly the spending review may have an impact in those areas, but I don't think that they're material to the group earnings. I mean, the group generates around £800 million of EBITDA, and this year we'll be generating significant free cash flows, and I don't think the spending review is going to have a significant impact on that. Obviously it'll have impacts in certain areas, but we'll be able to counter those areas, I'm quite confident, by adjusting our business and managing our business in the right way. So I don't see anything coming out of the spending reviews which would have any real impact on our ability to meet our cash targets and our ability to live up to and meet those dividend growth plans.

ANDY CAWKER: Okay, thanks.

OPERATOR: Are there any further questions? It seems we have no further questions. In that case, I'll pass back to Jeff Carr for closing comments.

JEFF CARR: Well, I'd just say thank you very much for joining us this morning, and we'll finish the call there. Thank you very much.

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