

Moving forwards

Group Chief Executive's review

Looking at National Express today, I see a business that is being transformed from the one that I joined at the beginning of 2010. Twelve months ago, we set out a two year Business Recovery programme to restore business margins. We said that we would achieve cost reductions, restore the business to a sound foundation and drive forward our performance to deliver value for our shareholders.



Dean Finch
Group Chief Executive

This is a renewed company. Our much improved financial performance provides a platform to drive further growth, continue targeted investment and restore a dividend. With a clear focus on our strategy we are confident in the year ahead.

I am pleased with the progress we have made so far.

We have:

- **delivered margin improvement by embedding cost management and operational excellence across the Group;**
- **established a sound financial foundation;**
- **continued to focus on cash generation; and**
- **started to make selected investment to drive future value creation.**

We are ahead of our plan – and in 2011 we will complete our Business Recovery programme. But our plans do not stop there. Beyond improving our business to industry standards, we have a strategy to deliver industry leading performance, organic growth and, in time, new market opportunities. We are leveraging our unique geographic footprint across all modes of public transport, together with our Group-wide synergies. Despite the economic challenges that we face, we are creating a stronger business to deliver future value to shareholders.

2010 – Delivering margin improvement

Our focus in 2010 has been to restore margin performance. Through cost control, fare yield management and a focus on delivering operational excellence across the business, Group normalised margin rose from 5.9% in 2009 to 9.6% in 2010. Normalised operating profit increased over £44 million to £204.2 million (2009: £159.8m), while normalised profit before tax rose 38% to £160.5 million (2009: £116.2m). Excluding rail operations, normalised profit before tax reached a record level in 2010. We are rebuilding a high quality business, uniquely focused on public passenger transport expertise in international markets.

Cost management and operational excellence

The immediate priority in delivering an improved margin has been controlling cost. Our North American operations have led the way, delivering over US\$30 million of annualised cost savings by simplifying the business, driving operational excellence through local service delivery, and instilling a clear cost management culture. This has been about focusing our school bus business back onto basics – delivering excellent customer service, safely, at the right cost. A new highly experienced North American management team has steadied the ship, ensuring that the Business Recovery programme has remained on target and achieving a 44% improvement in normalised operating profit to US\$57.1 million (2009: US\$39.6m). It also secured 22 new contracts in a successful bidding season, whilst retaining over 90% of its own contract portfolio, delivering cost efficiencies to budget-constrained school board customers.

Spain was already performing strongly as we entered 2010. Against a challenging domestic economic backdrop, ALSA has achieved strong margin growth and a normalised operating profit exceeding €100 million (2009: €85.7m), testament to its flexible and robust business model and the stable regulatory

environment. Cost efficiency has driven this improved performance, with lower fuel costs supplemented by running 2% fewer kilometres. Spain also returned to revenue growth – urban income grew by 9%, with resilient city council revenue boosted by a new contract in Agadir, Morocco. Intercity revenues grew in the fourth quarter of 2010 for the first time since the third quarter of 2008.

Improving yield management

Driving margin through improved yield management has turned UK Bus from one of the worst performing operations in the industry to one of the best performing within the space of 12 months. Normalised operating profit increased 48% to £28.3 million (2009: £19.1m excluding the disposed Travel London business). By rebalancing fares between cash tickets and travelcards, we have improved the revenue mix and managed the bus network more effectively. We are now investing in new fleet. Cost reduction was also a key aspect of improved performance in 2010 – we reduced the number of depots, restructured pay grades and improved engineering efficiency. Our UK Bus business is an excellent asset with a strong footprint. It has catchment areas with high population density and opportunities to better meet future passenger needs. With the management team now strengthened, I am sure we will be able to achieve further progress.

Driving margin through improved yield management has turned UK Bus from one of the worst performing operations in the industry to one of the best performing.

Group Chief Executive's review continued

After strong profit growth in 2009, UK Coach consolidated its position in 2010. Underlying revenue grew by 3% year-on-year, but additional investment saw the margin decrease, from 14.1% to 12.8%, as we invested in marketing, new facilities and in tactical promotional campaigns. Our strong brand and unique business model present opportunities to deliver revenue and profit growth over the medium term. Innovation is key to achieving this. In 2010 we rolled out telematic traffic management and driver safety systems that will improve the passenger experience, and during 2011 new systems and customer service applications will further support financial performance. A new senior management team is driving this change.

Opportunities in Rail

Our goal in Rail has been to move beyond the difficulties of 2009 and ensure that National Express is positioned to participate in profitable future rail operations where risks are both appropriate and manageable. We are delighted that we have secured extensions to both of our current rail franchises; we expect to operate National Express East Anglia until February 2012 and c2c until May 2013. We continue to deliver superior customer service and performance – c2c remains one of the most punctual franchises in Britain – whilst we are leading the industry's investment to reduce commuter overcrowding, in partnership with the Department for Transport ("DfT").

Targeting industry leading margins

Our business improvement plans are well underway. We continue to focus on delivering margin improvement through reduced cost. North America is now achieving an 8% operating margin and we aim to achieve double digit industry-leading margins by the end of 2011. This will be a challenge, but the highly competitive, budget constrained market offers both issues and opportunities. We will deliver the remaining US\$10 million of our Business Recovery programme through the application of GPS technology and centralised procurement. Our UK Bus business is already delivering an industry average margin but we will continue to optimise the network and drive revenue growth to take us towards industry leading performance. We will deliver our remaining business improvement goals in 2011, to achieve strong returns across all our operations.

Creating a higher quality business for the future

In addition to delivering much improved margins, 2010 was also the year in which we resolved a number of historic legacy issues and created a platform for a higher quality business in the future. We also completed the rebuilding of our capital structure – to the extent that the Group is seen increasingly as one of the best financed in the sector. Two bond issues in January 2010 and June 2010 raised £575 million at attractive rates, alongside a £500 million refinancing of our bank facility in July. Consequently, the Group now has long-term committed funding in place until between 2014 and 2020. In addition, the Group has ample facility and covenant headroom.

We have been successful in resolving a number of areas where there has been potential for volatility in profit or in cash generation. We have negotiated a settlement of all outstanding UK corporate tax issues with HMRC, under which the Group will settle £17 million in outstanding liabilities over the next four years, compared with a potential liability of approximately £50 million. This excellent outcome has resulted in a one-off benefit of over

6 pence per share to non-normalised basic earnings per share ("EPS") in 2010. We have also now closed the Group/UK Coach pension scheme in the UK and agreed a deficit funding plan which should see the scheme be self-sufficient in six years. We have reached agreement with the DfT under which both parties have dropped all claims relating to the East Coast franchise exit. We have significantly reduced the Group's future exposure to self-insured incident costs and we have negotiated an exit settlement from National Express' long-held shareholding in Inter-Capital and Regional Rail Limited, which had exposed the Group to heavy losses for many years. Together, these settlements have given us certainty over future cash commitments. In addition, in resolving these legacy issues, the Group is committed to minimising future exceptional operating costs.

These actions should reduce overall future volatility and ensure that EPS growth is more directly linked to operational success and that free cash generation is more stable. This has supported our proposed restoration of the dividend, with a final payment for 2010 of 6 pence per share fully supported by our non-rail earnings and free cash flow. Importantly, a foundation has been established from which we can develop and grow the business.

A framework for development

With a stronger management team in place and a clear focus on delivering consistent operational excellence, we are now achieving significantly improved business performance, with better margins and returns. During 2011, we will move to the next phase of our strategy, further enhancing shareholder value creation.

We are focused on three key areas of improvement:

Structure – we have flattened our organisation structure and shortened the decision-making process, whilst embedding clear, quantitative key performance metrics. For example, the three UK businesses now report directly to me as Group Chief Executive, removing two previous management layers;

Investment in key development areas – we have invested in new talent through 20 core appointments. The five divisional heads bring over 130 years of mass public transport experience between them. With our talent development framework, we are building the capability to manage existing and developing operations. We have specific teams now focused on driving down global procurement costs and identifying new strategic opportunities for the future; and

Culture – we are creating one common culture, with a shared vision and values, and we have improved our performance-based incentive framework.

Nobody will try harder for our customers than we do.

With a stronger management team in place and a clear focus on delivering consistent operational excellence, we are now achieving significantly improved business performance, with better margins and returns.

Our vision is to earn the lifetime loyalty of our customers by consistently delivering excellent value, frequent, high performing mass public transport services.

We have adopted a common set of values across National Express to deliver our vision:

Safety – more than anything else, we value the safety of our customers and our employees. Nothing we do is worth getting hurt for and we will not do anything which risks causing harm. We have launched a major internal programme, ‘Driving Out Harm’, which is designed specifically to educate and instil a safety-first culture at all levels and across all parts of the Group. Employee remuneration is now increasingly aligned with safety performance;

Customers – we place customers at the heart of our business. Nobody will try harder for our customers than we do, particularly when things go wrong. We are working to improve our customer service; for example, we are strengthening our contact centre in Birmingham to provide 24/7 advice to our UK Coach customers if they are stranded or concerned about their travel plans;

People – we behave towards all our employees with the respect and dignity we expect from others. We will strive to enable all our people to reach their full potential and to give their best as individuals and in teams. Our employees are core in enabling National Express to consistently deliver high performing services of which we can be proud. Our new innovation programme, ‘Make A Difference’, has brought groups of employees from all levels of the business together to drive improvement. For example, our UK Bus ‘Routes2Excellence’ scheme has combined the views of customers, drivers and staff to produce an innovative route learning scheme for drivers; and

Community – we are proud to operate in many international communities. Our policies and practices will advance the social, environmental and economic conditions of those communities. I am delighted that our flagship coach station in Birmingham was the first public transport station to achieve the BREEAM standard for environmental performance.

A diversified international portfolio

We have a diversified portfolio of bus, coach and rail businesses operating in international markets. Some of the key strengths of this portfolio include:

Market leadership – in most of our markets we have strong or exclusive positions and compete primarily with other forms of transport, such as the car or plane. We are market leader in West Midlands bus and have a 60% share of the UK scheduled coach market with our National Express brand;

Market knowledge – we have a deep understanding of and expertise in managing regulated concessions, which provide price protection, service exclusivity and stability. In Spain, our long-term concessions provide an ‘order book’ of 7.2 years;

Relationships – we have extensive experience in managing long-term contractual relationships. In North America school bus, our contracted order book is 4.1 years;

Quality international assets – National Express uniquely benefits from a balanced exposure to the UK, Spain and North America, in bus, coach and rail. This portfolio provides a balance – economic growth, political environment and regulation can all vary. For example, recent uncertainty over UK government funding in UK Bus has been offset by benefits in our Spanish and North America businesses. These high quality assets offer access to many mass transport opportunities, as many countries move to liberalise their markets; and

Cash generation – our businesses balance cash generation with capital investment. Whilst North America school bus is capital intensive, for example, UK Rail uses limited capital. We are able to reinvest surplus cash in areas that generate higher returns.

Strategy

Our strategy will develop the unique attributes of this business portfolio in three stages:

1 Margin growth – we will continue what we have started – margin growth in the existing business through an unceasing focus on revenue and cost management:

- **Revenue management** – we will continue to optimise yield management (for example, in UK Bus and Coach), create new services and ways to access the market, and focus on building customer retention; and
- **Cost management** – we will eliminate unnecessary operating costs, optimise our route networks, drive better procurement, remove unnecessary management layers and utilise technology to improve efficiency.

2 Organic growth – we will target volume growth in our existing markets, by offering better products and services which our customers want to buy and by winning new bid opportunities across our bus, coach and rail markets. We have returned to underlying growth in Spain, where there are also a number of new bid opportunities. We believe we can grow the UK Coach business and we will seek to participate in profitable future UK Rail operations under the new, longer term franchising regime;

3 Bolt-on acquisitions – over time we will target opportunities to acquire operators which fit with our existing businesses in the same modes and geographies, and which quickly add scale and synergies to the existing operations. We will apply strict return criteria to ensure that any acquisition adds shareholder value. For example, in December 2010, we completed a US\$13.3 million bolt-on school bus acquisition in New Jersey, USA, which offers strong geographic fit to our existing adjacent operations.

Operating cash generation remained strong and represents 109% profit conversion.

In the longer term, we will look at selected opportunities to grow in both existing and new geographies and take advantage of liberalisation and continued privatisation of mass public transport markets. Our experience in different regulatory regimes could allow increasing value creation as Continental European and other markets are opened up to competition. We have set up a small Commercial Development team with significant international public transport experience to explore such opportunities. We will undertake any such expansion in a measured way and only where we bring clear competence and expertise to leverage the opportunity, adopting a disciplined approach to capital allocation and a clear 'Return on Capital' model to ensure shareholder returns are delivered.

In delivering our strategy, we will focus on achieving superior long-term returns on investments in excess of our cost of capital. The Group's pre-tax return on capital employed ("ROCE") increased in 2010 to 13.2% (2009: 10.7%) and we are targeting to improve this to 15%.

Our strategy will be built around offering excellent value for money prices, frequent services and pleasing our customers. To our bus, coach and rail customers, excellent prices must be a cornerstone of our strategy and therefore our cost base must be lean. Through our unique market position and by ensuring that nobody tries harder for our customers, I believe we have excellent opportunities to drive value creation and deliver strong returns for our shareholders.

Excellent opportunities to drive value creation.

Outlook

Following our strong performance in 2010, we have continued to see good margin progression and revenue growth into 2011. Our cost improvement plans are proceeding, with particular focus on North America and UK Bus, and investment in improved customer services in UK Coach is now underway. Spain continues to deliver a strong performance, with limited adverse impact from the domestic economy, and improving volumes in Intercity travel. UK Rail is performing as expected and we will strive to renew the East Anglia franchise when it is tendered later this year.

2011 will bring a number of challenges, with tough economic and fiscal conditions prevailing in most markets. Increased fuel duty and reduced concessionary income in the UK is expected to impact us by a net £10 million per annum from late 2011 onwards. We are developing plans to offset this adverse effect. We are hedged for fuel usage through 2011 and beyond. With the foundation firmly in place and a clear focus on delivering our strategy, we expect to continue to perform well during the year ahead, whilst building for future growth.

Monitoring our business

The Group is managed using a set of key performance indicators that monitor delivery of performance improvement and ensure that capital is allocated in a disciplined way to support our longer term objectives. The KPIs are set out on pages 2–3.

2010 saw positive progress in all but two of our financial KPIs. Underlying revenue growth returned in most businesses, despite reducing mileage operated in several businesses, and should improve as the Group targets organic growth from improving economic conditions. Strong growth in normalised profit before tax reflected the delivery of margin improvement. Normalised basic EPS declined, however, due to the partial impact on 2009 EPS of the Rights Issue.

Cash generation is a key objective for the Group. Operating cash generation remained strong and represents 109% profit conversion, building on 2009, when low investment and one-off working capital reductions drove a very strong cash performance. As a result of better profitability and cash generation, the Group's debt gearing ratio continues to improve, achieving 2.1 times debt in 2010.

Our non-financial KPIs provide key passenger, network and safety measures. The total mileage operated continued to reduce whilst passenger numbers across most divisions increased, improving our operating efficiency and environmental impact. Similarly, we grew the number of routes we operate in North America, improving revenue.

Our employee lost time injury rate improved or was broadly unchanged across our different businesses and, in rail operations, the number of signals passed at danger declined. The number of preventable vehicle accidents also improved. Further improvement in our safety record is a priority and is the focus for our new 'Driving Out Harm' programme.

Further information on our financial KPIs is set out in the Performance and Financial Review.

Dean Finch
Group Chief Executive

24 February 2011

A clear vision

Driving success

Our vision is to earn the lifetime loyalty of our customers by consistently delivering excellent value, frequent, high performing mass public transport services.

Our diversified portfolio has key strengths:

Market leadership

in most of our markets we have strong or exclusive positions

Market knowledge

we have a deep understanding of and expertise in managing regulated concessions

Relationships

we have extensive experience in managing long-term contractual relationships

Quality international assets

we uniquely benefit from a balanced exposure to regions and modes of transport

Cash generation

our businesses balance cash generation with capital investment

Our strategy will develop the unique attributes of this business portfolio in three stages:

Margin growth

through an unceasing focus on revenue and cost management

Organic growth

by offering better products and services and by winning new bid opportunities

Bolt-on acquisitions

by targeting opportunities to acquire operators which fit with our existing businesses

Take a look at how we are bringing this vision to life in the places where our journey takes us...

Spain

Revenue

£525.6m

Normalised operating profit

£86.2m

Revenue for Spain was £525.6 million (2009: £546.8m) and normalised operating profit was £86.2 million (2009: £76.5m). In local currency, revenue was €612.7 million (2009: €612.9m) and normalised operating profit was €100.5 million (2009: €85.7m).



Market overview

Overview of Spanish market

Market size



€3.5bn

Regulated bus market and Intercity coach revenues

Concessions



161

ALSA has 140 long distance and regional coach concessions, 20 urban bus contracts and one other concession

Market composition



- Leading position in a highly fragmented market in both Intercity coach and urban bus segments

Market trends



- After strong growth reflecting domestic economic expansion, 2009 and 2010 have seen a declining market, due to falling GDP and competition from air/rail
- Urban bus has remained resilient

Market features



- Regulated and highly segmented market, with three levels of regulator: central (long distance coach), regional (regional coach) and city (urban bus)
- Each concession is exclusive to the operator, who must be highly flexible to changing demand

Customers



- Urban: all ages, work and study, multiple trips per week
- Intercity: mostly young people, few trips per year; for leisure, visiting family; on regional services also work and study

Competition



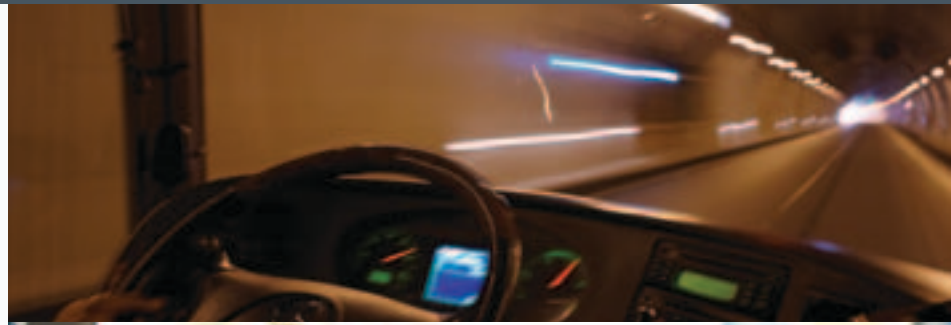
- Strong Intercity competition from low cost air and high speed rail
- Concessions are competitively tendered, typically every ten years

Labour



- Relatively rigid labour market despite austerity impact





Overall performance

The ALSA business proved during 2010 that it is robust, flexible and sustainable, defying tough economic conditions in Spain to produce a good increase in margin, on flat underlying revenue. Revenue trends were much better in comparison to the sharp falls of 2009, set against a backdrop of slight GDP decline and high unemployment in Spain, the latter remaining at around 20% in 2010.

The ALSA business proved during 2010 that it is robust, flexible and sustainable, defying tough economic conditions in Spain.

Revenue in local currency was broadly flat at €612.7 million (2009: €612.9m; in Sterling terms, 2010: £525.6m, 2009: £546.8m). Revenue in Urban bus grew strongly, whilst the Intercity coach business declined for much of the year but saw a positive trend in the final quarter. On current performance, we expect a slow but steady improvement in revenue.

Normalised operating profit was €100.5 million, a 17% increase from €85.7 million in 2009 (in Sterling terms, 2010: £86.2m, 2009: £76.5m). Improved operational efficiencies from reduced mileage operated drove the margin increase, together with reduced fuel prices.

Driving revenue

In Intercity coach, underlying revenue decreased by 3%, with yield down by 1% and annual passenger volumes 2% lower. Revenue trends improved progressively throughout the year, exiting 2010 in growth. The competitive position also improved for ALSA during 2010; since mid-year the national railway operator has had to comply with new EU regulation on subsidies of public services. Some of ALSA's long distance and regional services have seen an improvement in volume as a result. Revenue remained depressed in Asturias and the Mediterranean area, whilst there has been some recovery in passenger traffic in much of the rest of Spain.

Urban underlying revenue growth of 9% reflected both patronage and yield growth. Strong growth was seen in suburban Madrid services. Our new €16 million per annum revenue contract to operate urban buses in Agadir, Morocco started up successfully in September 2010. By mid 2011, the current fleet of 80 buses will have expanded to 160 buses. Overall, urban contracts have seen little or no impact from the public austerity measures in Spain, with most cities retaining solid contracted revenues and only marginal softness in tendered and weekend services.

Revenue in ancillary areas, such as motorway service stations, remained depressed, whilst fuel distribution volumes increased as the recession eased.

Managing costs

The overall improvement in margin was driven by continued excellent ongoing cost control. Lower hedged fuel prices benefited the year by €12 million, supplemented by improving network efficiency in the long distance coach business. Investment in maintenance improvement reduced costs by over €1 million. Strong credit control also saw a reduction in doubtful receivables, with council debt management a key focus.

A good safety performance saw an 8% reduction in the overall accident rate in 2010 and helped reduce insurance and vehicle maintenance costs. With a focus during the year on improving driver training, monitoring and review, there was a 50% reduction in the accident rate of drivers identified to have a higher risk profile.



Developing opportunities

In addition to the major Agadir contract, Morocco remained a key driver of growth, with ALSA adding a tourist transport concession in Marrakech to the existing urban operation. The international coach business carried an extra 20,000 passengers as the Icelandic volcano shut down much of Europe's air travel; this has also provided a longer term benefit to the image of coach travel in Spain and to ALSA, in particular.

ALSA launched an upgraded website during the year and now generates 25% of revenue through this channel, despite lower domestic penetration of the internet. ALSA has also pioneered the use of social media sites to generate customer interest, while its loyalty programme brought 160,000 new customers to the BusPlus card. With over 400,000 members of the scheme, customers benefit from booking priority and flexible travel, and it allows ALSA to increase the sophistication and targeting of its sales and marketing investment. Meanwhile, the executive Supra class coach service continues to be extended, with successful launches in Andalucia and on the Madrid to Barcelona route.

ALSA continues to lead in technological development and environmental management of its services, with 100% of the fleet now operating on a diesel/biodiesel mix, and hybrid vehicles being introduced into urban transport services alongside some LPG vehicles.

We expect the economy in Spain to remain challenging in 2011 but, in the absence of further negative impacts to GDP and unemployment, ALSA should benefit from some organic revenue growth and new tender opportunities. With very few contracts and concessions due for renewal during 2011, ALSA will continue to drive cost efficiency, utilise Group procurement scale and manage services to match closely customer needs.

We believe that the regulated concession model where private operating companies are involved, and in which ALSA is the leading player, will be attractive to other European markets as liberalisation develops, and we expect to be able to leverage ALSA's expertise in selected international tenders and bolt-on opportunities.

Business model

ALSA is the largest private operator of buses and coaches in Spain, with a strong position in the Intercity coach market and in urban bus. Its markets are regulated and supported by long-term concession agreements that provide exclusive rights to operate routes. Concessions run for 10 to 15 years on average and favour high performing incumbents, resulting in low contract churn. ALSA's portfolio provides a balance between long distance coach operations, which receive no subsidy and take revenue risk in return for flexibility over the number of services operated and a regulated maximum fare; regional coach operations which may be subsidised by the autonomous regions; and urban bus operations under which city councils contract for heavily subsidised services, usually without revenue risk to the operator. This stable model benefits from significant political consensus, with public transport seen as essential public service in Spain. There has been flexibility on both sides of concessions, given recent difficult economic conditions, which reflects the close partnership and relationships between the operator and regulatory authorities. Exclusivity results in competition being mostly intermodal; ie with rail, low cost airlines and the car.

ALSA is the largest private operator of buses and coaches in Spain.

North America

Revenue

£459.8m

Normalised operating profit

£36.9m

Revenue for North America was £459.8 million (2009: £444.5m) and normalised operating profit was £36.9 million (2009: £25.3m). In local currency, revenue was US\$712.1 million (2009: US\$695.0m) and normalised operating profit was US\$57.1 million (2009: US\$39.6m).



Market overview

Overview of North American market

Market size



531,000

- Total school bus market in North America represented by 531,000 routes
- 32% is outsourced; 68% remains in-house

National Express market share



14,289

- National Express operates 14,289 regular routes

Market composition



- Top 5 players operate approximately 90,000 routes
- 40 companies operate 200+ buses; rest of market split between around 4,000 players

Market trends



- Growth over past decade driven by CPI, conversion rate (to outsourced) and population growth



Market features

- Local relationships and service delivery important



Customers

- Customers are local school boards, funded largely by property taxation
- Transport is a significant part of local education spending



Competition

- Bigger players have access to capital, geographical reach and some scale advantages
- Potential for some market consolidation



Labour

- Traditionally part-time workforce
- 30% of National Express staff unionised





Overall performance

Our North American operations made significant progress in 2010 in delivering the Business Recovery programme. Retaining only the beneficial parts of the previous transformation project, the business refocused on delivering consistent customer service to its school board customers from a lean, efficient cost base. Under new management, most parts of the business have had to be overhauled and this is still work in progress. However, over US\$30 million of annualised cost have been removed since 2009 and a number of new contracts have been secured with customers. The North American business is well on the road to recovery and is targeting best-in-class industry performance. This market, with its longer term contracts and associated low revenue risk, remains attractive for future organic and bolt-on growth.

Revenue of US\$712.1 million was 2% up on prior year (2009: US\$695.0m; in Sterling terms, 2010: £459.8m, 2009: £444.5m). However, this reflected a 3% decline in the first half of the year, due to bid losses for the 2009/10 academic year, followed by strong growth in the second half with good success in securing new contracts.

Normalised operating profit increased to US\$57.1 million, an increase of 44% on 2009 (2009: US\$39.6m; in Sterling terms, 2010: £36.9m, 2009: £25.3m). Operating margin improved to 8.0% (2009: 5.7%); we are targeting to reach double digit, industry-leading levels by the end of 2011.

Our North American operations made significant progress in 2010 in delivering the Business Recovery programme.

Driving revenue

The 2010/11 bid season was highly successful – with a gross increase of 11% in new routes leading to an increase of over 700 routes on a net basis, 5% of total revenue. With strong local relationships and access to necessary capital investment, National Express secured 19 new contracts from competitors at a similar margin profile to the existing book of business.

In addition, three contracts were secured as conversions from in-house school board operations. This outsourcing is a positive trend, representing real market growth, and reflects the budgetary pressures on school boards and the improvements in service and efficiency that we can offer. This area will be a key target for future growth, although a natural conservatism amongst public sector bodies is likely to make this a longer term process. We also saw slowing of recent declines in organic volumes from existing contract customers, with no significant change in school populations or like-for-like route mileage.

Managing costs

Over US\$25 million of actual in-year savings were delivered in 2010 as part of the targeted US\$40 million Business Recovery cost saving programme. Double running costs, brought about by duplicating field-based and corporate activities, were eliminated, by returning responsibility for customer delivery to local teams. Two of the three corporate offices were closed in April and management of the business consolidated in Chicago. The replacement of a matrix management structure by a flatter, directly managed organisation led to substantial overhead cost savings and a more responsive decision-making approach. The exceptional cost of securing these savings and of writing off unproductive investment in prior years is now complete.

Building on better control introduced in 2009, driver wages improved by a further 0.5% of revenue in 2010. Fuel costs benefited by US\$13 million in 2010 from lower priced hedges. This was partly offset by higher insurance costs, due to increased premia and provisioning to reflect the rising legal costs of claims.



Most new contracts in the school bus business require the provision of new buses. As a result, capital investment, primarily in fleet, increased to US\$126.3 million in 2010 (2009: US\$38.3m). However, the Business Recovery project delivered a thorough overhaul of fleet management systems which will see the improved cascading of buses around the country to maximise returns in this capital intensive business. In addition, almost 2,000 existing buses were removed from the fleet, reducing the proportion of 'spare' vehicles from over 20% to 11% and driving improved efficiency in fleet maintenance, vehicle licensing and storage costs.

Developing opportunities

Safety is paramount in the school bus industry and 2010 saw new management target improvements in accidents, injuries and child safety. Lost Time Injury rates decreased by 26%. This continued focus will ensure a better service is delivered to customers, insurance and legal costs are reduced and fewer employees are at risk of injury.

We are targeting to complete our two year margin improvement plan in North America by the end of 2011. Delivering the remaining US\$10 million of annualised cost savings will be key. Improving fleet management will remain a priority in 2011 with the progressive roll out of GPS systems. This will be combined with an improved procurement process, targeting fleet investment and parts savings.

We are maintaining a high rate of contract retention to reduce churn, with margin discipline maintained. Nevertheless, the challenging market conditions, with their pressure on school board transport budgets, provide opportunity and we will continue to seek conversion of existing in-sourced school board contracts.

We have completed our first bolt-on acquisition for some time, acquiring a privately owned 200 bus operation in New Jersey which has a strong geographic fit with our existing operations, and we will continue to explore such opportunities. With a strengthened management team substantially in place, we are confident that this business has both revenue and margin growth opportunity for the future.

Business model

In North America, the Group's operations are carried out by our subsidiaries, Durham School Services and Stock Transportation. Together, they are the second largest private operator. The outsourced (private operator) market is only around one third of the total, with the remainder being in-sourced; that is, owned and run by the school boards themselves. The outsourced market is highly fragmented with an estimated 4,000 small operators around the country. Contracts typically run from three to five years and contract churn tends to be low. Additionally, once won, operators tend to face almost no revenue risk over the life of a contract. Scale is beneficial but not overarching – economies can be achieved through procurement, centralisation of administration and business development. Access to capital is key as most new contracts require investment in new buses and asset utilisation is lower, due to the part time usage of these specialised vehicles.

We are confident that this business has both revenue and margin growth opportunity for the future.

UK Bus

Revenue

£257.8m

Normalised operating profit

£28.3m

Revenue for UK Bus was £257.8 million (2009: £293.9m) and normalised operating profit was £28.3 million (2009: £20.8m).



Market overview

Overview of UK Bus market

Market size



£4.8bn

- 97% is privatised

National Express market share



1,600

- 1,600 buses operated in the fleet
- Focused on the West Midlands market

Market composition



- Largest five operators represent around 70% of the UK market
- The remainder is made up of a large number of private operators

Market trends



- Short term economic pressures; longer term urban regeneration opportunities
- Stable patronage outside of London over past decade
- Potential for growth from bus being more environmentally friendly than the car



Market features

- Primarily deregulated market but with strong vehicle operation and scheduling regulatory oversight
- Low barriers to entry – flexibility of operations is key



Customers

- Over 90% of West Midlands network is commercial; remainder mostly public service tenders
- Around three quarters of revenue from passengers with remainder concessionary



Competition

- Active competition from international, national and local operators



Labour

- Good industrial relations through longstanding local agreements with trade unions





Overall performance

The UK Bus business delivered a strong performance in 2010, returning to an industry average margin after a period of weak profitability. Cost control improved markedly and better fare and network management was combined with a commitment to invest in new fleet across the core operation.

Revenue in UK Bus was £257.8 million (2009: £293.9m). Excluding revenue from the Travel London operation, which was sold in June 2009, underlying revenue was broadly flat year-on-year. This was a good performance given a 4% decline in network mileage to improve operating efficiency. Prices rose by 4% as the fare basket was realigned in June 2010.

Normalised operating profit, after stripping out the lower margin Travel London results from 2009, increased by 48% to £28.3 million (2009: £20.8m including £1.7m from Travel London). Operating margin was 11.0% (2009: 7.1%) and is now consistent with the industry average, having reached this target significantly ahead of schedule.

The UK Bus business delivered a strong performance in 2010, returning to an industry average margin after a period of weak profitability.

Driving revenue

Fare adjustments during the summer of 2010 delivered a rebalancing of the fare basket. This ensured appropriate incremental journey pricing, whilst driving more efficient network usage. Whilst cash single fares remained unchanged, the pricing of travelcards, which account for 50% of revenues, was increased to better match journey demand with supply.

Passenger volumes remained subdued, down 4% during the year, reflecting lower levels of economic activity in both the West Midlands and Dundee regions. More targeted marketing, together with additional measures to encourage travel, should improve growth in the bus business, whilst enhancing margins further. Working with Centro, the local integrated transport executive, we are investing in 600 buses over the next five years, which will drive capacity and, we expect, patronage on the core network. We are also investing in hybrid buses as part of our commitment to greener vehicles and to promote greater use of more environmentally friendly public transport over the car.

2010 also saw delivery of new benefits for cash-constrained customers. The website was overhauled to provide easier access to route and timetable information, along with a mobile version for customers on the move. It is now easier for customers to purchase tickets on-line, which is proving very popular, and this facility has been extended to include Dundee travelcards. Live information updates helped passengers during the worst of December's weather, with nearly 60,000 visits received on a single day.



Managing costs

During 2010, the business made strong progress in addressing the issues that led to earlier margin decline. The network was reassessed to match capacity to demand, with services and frequencies adjusted to add capacity to the high demand corridors. As a consequence, average revenue per journey increased and fuel efficiency improved, adding to a £3 million fuel benefit. Following a review of depot footprint, one facility was closed, reducing costs by over £2 million per annum, and driver wages were restructured, to help address some of the highest costs in the industry which had resulted from a previous three-year pay agreement. In addition, a new two year wage agreement has been reached in the West Midlands which will see pay rise by 2% per annum from October 2010.

National Express West Midlands is the market leader in the largest single urban network in the deregulated market outside of London.

The Midland Metro tram service made a profit during the year for only the second time since its inception and achieved outstanding service – over 99% reliability and 98.5% punctuality.

Developing opportunities

In October 2010, in its Comprehensive Spending Review (“CSR”), the UK Government announced a reduction of 20% in the Bus Service Operators Grant (“BSOG”) from April 2012, together with a review of the concessionary reimbursement scheme and a cut in local funding for transport. We estimate the adverse impact from BSOG to be approximately £4 million for 2012 and £5 million in a full year. We have made our submissions to the Competition Commission review of the UK Bus industry and await its report, due later in 2011.

We continue to roll out a package of revenue enhancing and cost reduction improvements under the leadership of our new UK Bus Managing Director. We are supporting our fleet investment programme with a campaign to address anti-social behaviour, provide more real-time information to passengers and start to utilise benefits from our new smart card system that was introduced during 2010. Our on-board Traffilog system will be used to reduce fuel costs and engender safer driving behaviours. A ‘Lean’ engineering pilot will be extended across all depots and is targeted to reduce engineering costs, increase fleet availability by reducing time off the road and decrease the total size of the fleet.

Whilst the economic outlook and unemployment in our regions remain challenging, the quality of our UK Bus business is high and the urban density of our customer base offers an attractive platform for improving service and driving stronger performance. We do not anticipate a material impact from recent government cuts. We have targeted delivery of margin improvements towards industry-leading levels in the medium term through investment in new buses and new technology, as well as by securing procurement and engineering savings.

Business model

National Express West Midlands is the market leader in the largest single urban network in the deregulated market outside of London. In this competitive environment, our business can use its scale benefits and infrastructure to operate a region-wide core network, delivering a reliable, affordable service for our customers. Whilst our regional market share is nearly 80%, there is particularly strong competition from a number of operators on high volume routes.

UK Coach

Revenue

£250.3m

Normalised operating profit

£32.0m

Revenue for UK Coach was £250.3 million (2009: £242.9m) and normalised operating profit was £32.0 million (2009: £34.3m).



Market overview

Overview of UK Coach market



Market size

£300m

of contested revenues in the scheduled coach market (almost all privatised)



National Express market share

1,000

- Over 1,000 destinations served
- National Express is the UK scheduled coach market leader



Market composition

- National Express has the only nationwide network of services
- Other competitors tend to focus on regions or corridors



Market trends

- Revenue growth through the recession, reflecting value and convenience of coach
- Some price competition from rail and car



Market features

- Highly deregulated market
- Customer safety and disability access supported by regulation
- Operators able to compete rapidly on selected routes



Customers

- Customer satisfaction important in driving longer term loyalty
- Forthcoming rail fare increases should make coach increasingly attractive



Competition

- Selective competition from large bus operators and localised services



Labour

- Outsourced model, using third party operators for 80% of services
- Consistent service and behaviour standards across all operators





Overall performance

After a record profit in 2009, the UK Coach business consolidated its position this year. Although greater investment in marketing, new facilities and services reduced operating margin by just over one percentage point, the business continues to lead its market and has, under new management, completed a review to identify future opportunities to build this exciting network and brand.

Overall revenue grew 3% in 2010 to £250.3 million (2009: £242.9m), with underlying revenue in the Express coach business also up 3%. Despite the highly competitive pricing environment, as many rail companies continue to heavily discount fares, yields in Express coaches improved by 1% and underlying volume increased by 2%. The division also saw good growth in The Kings Ferry commuter-hire operation and from Eurolines.

Normalised operating profit decreased slightly during the year, from £34.3 million in 2009 to £32.0 million in 2010. The operating margin was 12.8% (2009: 14.1%). This reflected an increase in scheduled operating costs, including fuel costs for third party operators. However, the key drivers were an increase in marketing expenditure, investment in new facilities (including the state-of-the-art Birmingham Coach Station, which opened in December 2009) and tactical campaigns to defend aggressive competition and successfully retain our leading market share.

Driving revenue

The National Express scheduled business enjoyed a strong recovery in airport traffic during 2010, offsetting some cross-country weakness. Customer access continued to improve in 2010 – the website, which now accounts for over 50% of passenger revenue booking, was relaunched in September. Customers tell us that coach station facilities are important to them; in addition to Birmingham, new stations were opened at Milton Keynes, Swansea, Derby and Blackpool, all significantly improving passenger experience. In addition, station facilities at Manchester, Leeds and Liverpool were all refurbished.

The Hotel Hoppa service and The Kings Ferry also saw growth, the latter including high profile executive contracts for football clubs and politicians. Eurolines had a strong 2010; following the Icelandic volcano eruption in April, 28,000 people were repatriated to the UK from continental Europe during the affected period. The value offered and ease of use demonstrated by Eurolines during this period have helped it gain many new customers and this business will provide a platform to support the Group's planned expansion as continental European countries liberalise their domestic markets.

The UK Coach division benefited from a number of contract-based projects during the year. At Gatwick Airport, National Express provided the inter-terminal monorail replacement service through most of 2010. Our co-ordination of pilgrim transport for the papal visit to Birmingham, as well as the ongoing partnership with a number of music festivals, contributed to overall performance. Offsetting this, the impact of Network Rail's reduced engineering programme during the year was seen in lower activity in our Rail Replacement business.

Managing costs

The division's flexible cost base structure continued to benefit cost management. With around 80% of services run by third party operators under long-term contracts, capacity was successfully flexed to meet changing customer requirements, and under-performing operators were replaced without interruption to service. The bus-based, real-time information system called Traffilog has been extended to UK Coach and is already improving fuel efficiency, providing improved route planning and helping to assess driving standards. The fitting of automatic alcohol testing to all express coaches provides a further safety feature.



Developing opportunities

The Coach division has been substantially overhauled in 2010, with a new management team recruited from the transport and consumer goods sectors. The Express coach business has been reorganised around its key segments – Airports, Long Distance, Multi-hopper and Short Distance. This will ensure a sharper focus, create new journey opportunities and improve revenue management. The division will continue to extend its application of new systems, with a new booking platform being developed in conjunction with the ALSA sister business in Spain and better yield management support under development. Innovation is a major area of focus. On-board coach tracking was trialled during 2010 and will be fitted to all coaches by March 2011. This is already providing operational benefits to re-route coaches caught in traffic congestion and is providing customer benefits on the key Stansted-London route, where it is used to ensure customers always find a coach on stand for this 'turn up and travel' service. During 2011, new applications will deliver more real time information to customers through information screens, internet and mobile channels.

Our Airports business has renewed its five year contract with BAA to operate Heathrow Central Bus Station, leading to additional investment and services at this key network hub. We expect other airport contract and rail replacement business to remain at current levels. The UK government's CSR also abolished the funding of the half price over-60s concessionary coach travel scheme from October 2011. This was worth £14 million to National Express in 2010. Through mitigating actions we consider approximately £5 million of this to be at risk.

Through the improved targeting available via better customer segmentation, we expect to make steady progress in the development of new services, allowing us to increase customer retention and frequency of travel. We expect to achieve significant gains from our programmes in the medium term and further develop the strength of the National Express coach brand. Dramatically higher rail pricing in future years, together with the retendering of major rail franchises and the commensurate impact likely on the profitability of rail competitors, should provide further opportunities for the Coach division to leverage its unique network and value-orientated customer proposition.

Business model

National Express is a national coach network, offering great value and accessible travel to all. It is the only scheduled national coach network in the UK and the largest in Europe, running 500 coaches a day serving over 1,000 domestic destinations. With 70% unprompted brand recognition, the National Express coach business benefits from its integrated network and scale, which is built on a flexible, outsourced business model, where third party providers supply 80% of the coaches. With competitors focused on point-to-point services with limited infrastructure, the Group aims to leverage the breadth and interconnectivity of the network to drive growth in the future.

National Express is the only scheduled national coach network in the UK and the largest in Europe, running 500 coaches a day serving over 1,000 domestic destinations.

UK Rail

Revenue

£637.5m

Normalised operating profit

£33.8m

Revenue for the UK Rail division was £637.5 million (2009: £1,190.5m) and normalised operating profit was £33.8 million (2009: £12.0m).



Market overview

Overview of UK Rail market



Market size

£6bn

of contested franchise revenues over next five years (based upon likely pipeline of franchises)



National Express market share

2 franchises

- National Express operates two UK rail franchises: NXEA and c2c
- This represents approximately 9% of UK franchise market



Market composition

- Top four players have around 70% of the market
- 19 UK franchises in total



Market trends

- Growth over past decade driven by passenger volumes
- Market highly dependent on job market and GDP
- Fares will increase by 10% in real terms over next three years



Market features

- Regulatory environment expected to change, with longer franchises and increased operator autonomy
- Highly regulated qualification and operational processes



Customers

- Customer numbers have risen despite increase in proportion of rail costs borne by the passenger



Competition

- Increased international bid interest in UK franchises
- Limited 'open access' operators



Labour

- Relationships are managed within each franchise, with high union representation





Overall performance

After the difficulties of 2009, 2010 saw a steady rehabilitation of the Group in the UK rail industry. With a strong operational performance across its two rail franchises, both have now been extended by the DfT – c2c will run until November 2012 or May 2013 (at the DfT's option) and National Express East Anglia ("NXEA") will operate until February 2012. The Group will actively bid to secure the new c2c franchise when tendered, to build on the record-breaking punctuality delivered in 2010, together with the proposed 18 month extension to late 2013 of NXEA. National Express is now positioned to participate in profitable future rail operations where risks are both appropriate and manageable.

Revenue in 2010 was £637.5 million (2009: £1,190.5m), significantly down on the prior year reflecting the hand-back of the loss-making East Coast franchise in November 2009. Underlying revenue grew by 3%, driven by strong growth in passenger numbers in the second half of the year. Severe weather at the beginning and end of the year had limited impact; both services recovered operational performance quickly through the dedicated efforts of the entire workforce. NXEA remains in 80% revenue support from the DfT.

Normalised operating profit improved strongly to £33.8 million (2009: £12.0m). Continued cost control combined with improving revenue drove operating margin 4.3 percentage points higher, to 5.3%.

Driving revenue

As regulated prices reduced slightly in January 2010, underlying passenger volumes have increased by 4%. An improving Central London employment market helped c2c in particular and the extension of the Oyster card to suburban rail improved revenue. c2c also successfully grew its leisure patronage and its consistently outstanding reliability, achieving punctuality in August of 98.8%, boosted revenues. The franchise also recorded its best ever customer satisfaction results, reaching 91% in both the Spring and Autumn Passenger Focus surveys. Meanwhile, NXEA also improved punctuality, reaching 90% during the year.

Managing costs

Both franchises have managed cost successfully during 2010. Improved procurement reduced utility costs by £2 million and successful rationalisation of staffing agencies delivered wage cost savings.

Improved safety leads to lower costs. NXEA successfully drove down 'signals passed at danger' ("SPADs") by nearly 50% in the year, whilst reducing employee, passenger and contractor accident rates. This was overshadowed by a serious accident at a level crossing in East Anglia, when an unauthorised crossing by a road tanker resulted in a collision with a train, with a number of injuries but, thankfully, no fatalities. The road tanker driver was subsequently convicted of endangering rail safety. We are working actively with Network Rail to ensure that level crossing risks are fully assessed and compliance with procedures enforced with all users. Safety performance at c2c was also strong, with only one SPAD and all employee, passenger and contractor safety targets exceeded.



Developing opportunities

NXEA began the roll-out of its £185 million capacity investment programme, funded in conjunction with the DfT. In December 2010, new services were introduced to the timetable, with a total of over 4,000 extra seats added on Liverpool Street commuter services at peak times. The overall programme includes faster trains, on-board Wi-fi from Norwich to London and, from March 2011, new rolling stock will be introduced to the network. Station and maintenance improvement work has also been carried out across East Anglia and c2c, with two new carriage washers, car park extensions and station upgrades.

The Group is in the process of bidding for the DfT's announced tender of the Greater Anglia franchise (the successor to NXEA's operation), which will run from February 2012 for a period of approximately 18 months. A decision on this franchise is expected in late 2011. The retendering process for c2c will not start until 2012 and the Group expects to bid. At this time, the Group has no plans to take part in either the West Coast Main Line or East Coast Main Line bidding processes. The Group believes it can drive both improved customer service and shareholder returns in UK Rail, subject to the balance of risk and reward available in the DfT's proposed longer franchises.

The overall programme includes faster trains, on-board Wi-fi from Norwich to London and, from March 2011, new rolling stock will be introduced to the network.

Business model

National Express has a strong operational skills base in UK rail, the most deregulated rail system in Europe. The UK rail industry has long-term franchises awarded on an exclusive operation basis to private operators. Prices are predominantly regulated and costs are substantially fixed around track access, rolling stock and franchise payments to the DfT. The Group runs two franchises, now designated Greater Anglia and Essex Thameside by the DfT (operating under the National Express East Anglia and c2c brands), which run until 2012/13. c2c has consistently been amongst the top performers for punctuality and service in the industry and East Anglia has improved considerably over the Group's period of operation. Both franchises are profitable.