

## PRINCIPAL RISKS AND UNCERTAINTIES

In addition to the opportunities we have to grow and develop our business, the Group faces a range of risks and uncertainties as part of both its day to day operations and its corporate activities. The processes that the Board has established to safeguard both shareholder value and the assets of the Group are described in the Corporate Governance Report.

The narrative which follows describes those specific risks and uncertainties that the Directors believe could have the most significant impact on the Group's long term value generation. The risks and uncertainties described below are not intended to be an exhaustive list.

### RISKS INHERENT IN BIDDING FOR CONTRACTS

One of the principal methods of increasing shareholder value is bidding for new contracts. Inherent in bidding for new contracts is a risk that assumptions are made in the bid model that turn out to be undeliverable for any number of reasons. To take UK Train bids as an example, if underlying economic growth falls short of the growth assumed in the bid, the passenger revenue target may not be achievable.

Additionally, when a business is based on winning contracts, there is a requirement for the business to win a minimum number of contracts to retain its existing scale of operations. If that minimum number is not achieved, that division's revenue and profits would be affected.

The division most exposed to this risk is UK Trains, where a robust process is followed to ensure that all bids are subject to sufficient challenge. In addition, UK Bus, North America and Alsa bid for contracts on a regular basis, but no one contract is material to those businesses.

### COMPETITION

With the exception of North America, our businesses are competing with alternative modes of transportation. Our UK Coach, UK Trains and Alsa businesses face competition from a mix of long distance coaches, trains, low-cost airlines and the car. The principal alternative to our UK Bus business is the car, and with the cost of owning it remains imperative to create a more positive operating environment for the bus. In addition to modal competition, the competitive environment between

transport companies remains intense. This is seen both in competition for passengers and when bidding for contracts.

We compete using the key themes explained in the Chief Executive's review: customer service, leading the way, knowing our stakeholders, operational excellence and showing we care.

### ENERGY COSTS

All of our businesses incur energy costs with UK Bus, UK Coach, Alsa and North America predominantly using diesel, and UK Trains using either gasoil or electricity. All energy prices are subject to significant changes driven by international economic and political factors. In recent years, weather patterns such as mild or cold winters and hurricanes have also had an effect on energy prices.

We seek to limit the effect diesel and gasoil costs have on our year on year profitability through a risk management programme using fuel price swaps. In our UK Trains division we are currently negotiating with Network Rail to reach a new agreement on electricity pricing.

### POLITICAL AND REGULATORY CHANGES

Our businesses are subject to varying degrees of regulation and as such, there is a risk that political and regulatory changes could impact their future prospects. At the current time, the highest profile political and regulatory uncertainty is around the UK Bus business where the debate around quality partnerships and quality contracts continues.

To mitigate the risk from political and regulatory changes, the Group looks to service the needs of its stakeholders and lobbies national, regional and local government in addition to passenger, employee and environmental bodies.

### LABOUR COSTS

Our aim to offer high quality services is dependent on recruiting and retaining the right calibre of employees. For each of our businesses, local economic prosperity, employment levels and our image as an employer affect our ability to deliver this aim. Additionally, we incur significant other staff costs such as recruitment and training. Employee costs are the largest single component of the Group's operating costs. We seek to mitigate this risk by securing competitive multi-year wage

agreements where possible, which contain an element of productivity enhancement to ensure that cost increases above inflation are mitigated as far as possible.

### MAJOR INCIDENTS

As our business is based on the transportation of passengers, there is a risk that any incidents that the Group is involved in, directly or indirectly, could result in injury to our passengers or staff. The potential impact on the Group is wide ranging and includes possible damage to our reputation with passengers, financial loss following insurance claims and our ability to win future contracts.

To mitigate this risk, the Board operates a Safety and Environment Committee which reviews the Group's safety practices, procedures and record as described in the Corporate Governance Report. For our employees, this translates itself into our culture of operational excellence that seeks to ensure the safety of all our passengers.

The impact of insurance claims costs is managed through the Group's risk management processes. The current policy is to self-insure high frequency claims with the businesses and then provide protection above these types of losses by purchasing insurance cover from a selection of proven and financially strong insurers. A risk remains that the number or size of the self-insured claims could be significantly higher than expected.

### ECONOMIC CONDITIONS

Changes in economic conditions have an affect on the ability of our customers to pay for our services or an impact on the number of journeys that they make. In particular the Trains division's historic growth has been closely correlated to the growth in the overall UK economy.

We look to mitigate this risk by closely monitoring the affordability of our services and varying the price where appropriate and possible.