

# SUMMARY FINANCIAL REVIEW



**ADAM WALKER**  
FINANCE DIRECTOR

## YEAR AT A GLANCE

We have achieved another strong set of results, increasing profit before tax by 17% to £104.1m (2005: £89.3m), driven by a 29% increase in operating profit to £141.6m (2005: £109.5m). Diluted earnings per share from continuing operations improved 18% to 52.5p (2005: 44.5p).

Our financial key performance indicators are based on normalised results, which we feel reflect the performance of the business more appropriately. Normalised results are defined as the statutory result before the following, as appropriate: profit or loss on the sale of businesses, exceptional profit or loss on the disposal of non-current assets and charges for goodwill impairment, intangible asset amortisation, exceptional items and tax relief thereon as appropriate.

Normalised Group operating profit was up by 19% to £184.8m (2005: £155.5m), on revenue of £2,525.5m (2005: £2,216.0m) resulting in an increased operating margin of 7.3% (2005: 7.0%). Normalised profit before tax increased by 15% to £156.1m (2005: £135.3m). With an increase in the effective tax rate from 21.8% to 25.1% and the loss of rail profits, normalised diluted earnings per share from continuing operations marginally increased to 76.5p (2005: 76.3p). Net debt decreased by £125.0m to £438.4m. The proposed full year dividend per share will be increased by 8% to 34.75p (2005: 32.25p).

## DIVISIONAL REVIEW

Commentary on the divisional results is included in the Operational Review. Other financial points to note are included below.

### ALSA

In local currency, Alsa's results are revenue of €365.6m (2005: €26.7m) and a normalised operating profit of €65.0m (2005: €3.8m).

This year has seen a great deal of work on the financial integration of Alsa, which is now complete. The integration has involved the development of Alsa reporting processes to deliver financial results prepared under IFRS in line with the Group's month end timetable. In addition, the valuation work on intangibles and key assets has been completed and the 31 December 2005 balance sheet updated in accordance with IFRS 3, "Business Combinations".

### TRAINS

Increased fuel costs have added £5.3m to the cost base this year. We expect electricity charges to increase in 2007, although efficiency benefits such as regenerative braking would offset this increase.

Bid costs remain a significant investment for this Division with a total cost of £9.8m (2005: £6.1m) included in normalised operating profit.

As part of the DfT current re-mapping exercise, Central Trains, Silverlink and Midland Mainline will run until November 2007.

### BUSES

On 2 March 2006, we received clearance from the Office of Fair Trading regarding our acquisition of the outstanding 67% share holding in Altram LRT Limited ("Altram"). Completion occurred on 14 March 2006 and the results of Altram have been fully consolidated from this date. A normalised operating loss of £0.4m is included in the divisional result.

### NORTH AMERICA

In local currency, North America increased normalised operating profit to US\$72.3m (2005: US\$63.7m). Revenue has increased by US\$83.5m to US\$524.0m (2005: US\$440.5m). Additional legal costs and a new pay award in Canada contributed to a lower margin of 13.8% (2005: 14.5%). The historic fuel hedges that were in place have ended in 2006, which will lead to a US\$13m increase in the cost base in 2007.

Following the Group's announcement of the planned sale of the operating lease on Stewart International Airport to the Port Authority of New York in 2007, the assets and related liabilities of the disposal group have been separately identified on the balance sheet, in accordance with IFRS 5, "Non-current assets held for sale and discontinued operations". The business does not meet the definition of a discontinued operation, therefore the results, which do not make a significant contribution, are included within continuing operations.

## JOINT VENTURES AND ASSOCIATES

We hold a 40% investment in Inter-Capital and Regional Rail Limited ("ICRRL") and account for a number of associates and joint ventures within Alsa.

The total charge for associates and joint ventures was £29.5m (2005: £8.8m), which comprises our share of the post tax results from associates and joint ventures of £3.8m (2005: £8.8m) and a £25.7m exceptional charge for the designation of the Group's Eurostar contract with ICRRL as an onerous contract. As noted at the half year we have provided for the Eurostar losses to the end of the contract in 2010.

Our share of the operating profit for Altram for the period to 14 March 2006 was £0.1m (2005: loss of £0.2m). The results of the joint ventures and associates within Alsa were a loss of £0.2m (2005: £nil) and a profit of £0.2m (2005: £nil) respectively.

## FINANCE COST

Net interest payable increased to £24.9m (2005: £11.4m), principally reflecting a higher level of net debt as a result of the Alsa acquisition in December 2005. This was offset by the weakening of the US dollar which decreased the cost of servicing our foreign currency denominated financing. After excluding £nil (2005: £5.1m) for discontinued operations, continuing normalised operating profit before depreciation and other non-cash items ("EBITDA") was £264.0m (2005: £212.5m) and continuing EBITDA finance cover was 11.6 times (2005: 20.2 times).

# SUMMARY FINANCIAL REVIEW

## CONTINUED

### GOODWILL AND INTANGIBLE ASSETS

The goodwill and intangible assets arising on the Alsa acquisition in 2005 were provisionally classified as goodwill at 31 December 2005. They have now been reallocated within the balance sheet. This has resulted in £174.2m reclassified as intangible assets representing the contracts acquired with the business. The balance of £294.1m, after further fair value adjustments, remains within goodwill.

Amortisation of £27.8m (2005: £4.9m) was charged on the intangible asset that arises from the Group's right to operate its rail franchises (£1.6m) and on contracts acquired in Alsa (£20.1m), UK Bus (£1.6m) and North America (£4.5m).

The impairment charge for the year on the goodwill arising from the acquisition of Prism Rail PLC in December 2000 was £19.2m (2005: £33.3m); this goodwill is now fully amortised. Although IFRS 3, "Business Combinations" prohibits the amortisation of goodwill, the train franchises acquired with Prism have finite lives, and therefore the goodwill has been impaired over the remaining cash flows.

A goodwill impairment charge of £1.0m has been charged on goodwill acquired with the remaining share capital of Altram.

### EXCEPTIONAL ITEMS

Exceptional items totalled a net income of £4.8m (2005: cost of £7.8m), comprising a credit of £6.7m in relation to defined benefit pension liabilities and charges of £1.9m in relation to the integration of Alsa. The pension credit reflects a negative past service cost that arises as a result of the "A-day" changes to pension legislation which increased the maximum limit on the lump-sum benefits that can be withdrawn tax free on retirement. We believe that to disclose this credit within normalised profit would present a misleading picture of the results.

The profit on disposal of non-current assets of £16.9m comprises £7.5m of profit on the disposal of a car park in Sheffield and £9.4m of profit on disposal of our 14% shareholding in Trainline. Both profits relate to the UK Trains division.

### DISCONTINUED OPERATIONS

An additional provision of £3.2m was booked in relation to the Group's Public Transit business which was disposed of in 2005. This provision reflects the Directors' best estimate of the Group's liability regarding an industry wide employment issue in California, over which the Group provided an indemnity to the purchaser at the time of the disposal.

### TAXATION

The total tax charge of £23.6m (2005: £27.5m) on profit before tax of £104.1m (2005: £89.3m) represents an effective rate of 22.7% (2005: 30.8%). The tax charge on normalised profit of £156.1m (2005: £135.3m) was £39.2m (2005: £29.5m), which represents an effective rate of 25.1% (2005: 21.8%). The normalised effective tax rate has increased due to the higher proportion of overseas earnings in the Group.

The total tax charge includes a tax credit on exceptional items of £15.6m (2005: £2.0m) which includes the deferred tax impact of the Group's non-deductible intangible asset amortisation.

### CASH FLOW

The Group continues to generate strong cash flow with a cash inflow from operations of £182.0m (2005: £79.9m), which includes an outflow of £27.7m in relation to the franchise exits in March. The Group's operating cash flow by Division and reconciliation of net debt are set out in tables 1 and 2.

The increase reflects the full year contribution from Alsa of £40.1m (2005: outflow of £1.2m) and the benefit of various working capital timing benefits in UK Trains and Central functions. This cash flow was used to maintain high levels of investment across the Group, particularly in North America where most of the capital expenditure relates to contract wins.

TABLE 1: OPERATING CASH FLOW

	UK Bus £m	UK Coaches £m	UK Trains £m	North American Bus £m	Alsa £m	Central functions £m	Total £m
Normalised operating profit	40.7	23.7	49.1	39.1	44.3	(12.1)	184.8
Depreciation	15.7	5.7	21.6	25.3	12.9	0.5	81.7
Amortisation of leasehold property prepayment	0.1	–	–	0.5	–	–	0.6
Amortisation of fixed asset grants	–	–	(1.9)	–	(0.1)	–	(2.0)
Profit on disposal	0.2	(0.1)	(2.2)	(0.6)	(0.4)	–	(3.1)
Share-based payment	0.4	0.1	0.3	0.2	–	1.0	2.0
<b>EBITDA</b>	<b>57.1</b>	<b>29.4</b>	<b>66.9</b>	<b>64.5</b>	<b>56.7</b>	<b>(10.6)</b>	<b>264.0</b>
Working capital movement	(15.7)	0.2	34.3	(12.2)	0.3	26.2	33.1
<b>Net cash inflow from operations</b>	<b>41.4</b>	<b>29.6</b>	<b>101.2</b>	<b>52.3</b>	<b>57.0</b>	<b>15.6</b>	<b>297.1</b>
Net capital expenditure	(16.1)	(3.8)	(12.3)	(38.0)	(16.9)	(0.3)	(87.4)
<b>Operating cash flow before one-offs</b>	<b>25.3</b>	<b>25.8</b>	<b>88.9</b>	<b>14.3</b>	<b>40.1</b>	<b>15.3</b>	<b>209.7</b>
Other – Franchise exits							(27.7)
<b>Operating cash flow</b>							<b>182.0</b>

Operating cash flow is intended to be the cash flow equivalent to normalised operating profit. To reconcile the operating cash flow to the statutory cash flow the following items are included: "Cash generated from operations" of £254.5m (2005: £181.1m) plus "Proceeds from disposal of property, plant and equipment" of £24.3m (2005: £8.1m) less "Finance lease additions" of £20.7m (2005: £57.0m) and "Purchase of property, plant and equipment" of £73.5m (2005: £61.7m). The non-operating items are then excluded which comprise £13.0m exceptional property proceeds, £8.4m payment to associates and £2.0m payments in relation to other exceptional items.

The working capital outflow in UK Bus comprises payments to the defined benefit pension schemes in excess of the income statement charge and the losses associated with the onerous contracts in our London business. The working capital movement in UK Trains relates to amounts received in the year in relation to 2005. In North America, a timing difference has contributed to the working capital outflow. The cash flow benefit in Central Functions arises through the restructure of our insurance arrangements. Net capital expenditure was £87.4m (2005: £110.6m) including £20.7m (2005: £57.0m) of additions purchased under finance leases and £6.8m (2005: £8.1m) of proceeds from disposals.

Net interest paid of £20.6m (comprising the cash outflow of £19.7m adjusted for loan fee amortisation of £0.9m) is in line with last year as the 2005 cash flow included the termination of a US\$200m interest rate swap during the year.

The receipt of tax rebates in respect of prior years resulted in reduced tax payments this year.

Acquisitions and disposals includes the acquisitions in the year of £19.8m, deferred consideration of £3.0m, acquisition of associates and investments of £8.7m and proceeds from the disposal of investments and intangible assets of £14.7m. The 2005 outflow includes the acquisition of Alsa for £367.4m.

## DIVIDEND

An interim dividend of 10.75p per share was paid in October 2006 and a final dividend of 24.0p per share will be paid in May 2007, bringing the total dividend for the year to 34.75p. This is a 8% increase in total dividends declared compared to 2005. This dividend is covered 2.2 times (2005: 2.3 times) by normalised profits after tax.

## FACILITIES

During the first half of the year, we refinanced our two existing bank debt facilities into one new £800 million five year revolving credit facility maturing in June 2011. As at 31 December 2006, the headroom under the facility was £247.8m.

**TABLE 2: RECONCILIATION OF NET DEBT**

	2006 £m	2005 £m
Operating cash flow	<b>182.0</b>	79.9
Exceptional cash flow	<b>(2.0)</b>	(7.7)
Exceptional property proceeds	<b>13.0</b>	-
Payments to associates	<b>(8.4)</b>	(1.7)
Net interest	<b>(20.6)</b>	(22.0)
Taxation	<b>(9.0)</b>	(26.7)
Share buy back	<b>(11.6)</b>	(29.3)
Financial investments and shares	<b>15.8</b>	8.4
Acquisitions and disposals	<b>(16.8)</b>	(359.1)
Dividends	<b>(49.7)</b>	(41.6)
<b>Net funds flow</b>	<b>92.7</b>	(399.8)
Foreign exchange	<b>32.3</b>	(27.0)
Funds flow post exchange	<b>125.0</b>	(426.8)
Opening net debt	<b>(563.4)</b>	(136.6)
<b>Closing net debt</b>	<b>(438.4)</b>	(563.4)