

Business review: UK Bus

Resilient performance in a challenging market



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Market overview

The largest five operators represent around 70% of the UK deregulated bus market, with the remainder of the market made up of a large number of private operators. Active competition comes from national and local bus operators, as well as private car and rail. In the short term the market has been impacted by economic pressures from austerity and local unemployment, but in the longer term, economic regeneration and environmentally driven public transport present growth opportunities over the car.

Market size

£4.8bn

(UK excluding London)

Operates

1,670

buses, focused in the West Midlands and Dundee markets

- Increase passenger volumes through investment in vehicles, technology and people and through delivering high quality services
- Low barriers to entry – flexibility and scale of operations is key
- Devolved local transport budgets and services to regional combined authorities may present opportunities to enter new regional markets

| Year ended 31 December | 2016 £m | 2015 £m |
|------------------------|--------------|------------|
| Revenue | 286.8 | 286.4 |
| Operating profit | 35.5 | 37.5 |
| Operating margin | 12.4% | 13.1% |

Overview of 2016

Along with the rest of the industry, we have experienced challenging market conditions during the year with congestion and changing travel patterns affecting revenue and profit. Commercial revenue growth of 2% has been offset by the, as anticipated, reduction in concessionary revenues, with the result that total revenue growth for our UK Bus division was just 0.1%.

| | Growth % |
|----------------------------------|-------------|
| Like-for-like commercial revenue | 1 |
| Mileage | 1 |
| Underlying commercial revenue | 2 |
| Concession and other revenue | (4) |
| Total revenue | 0 |

Normalised operating profit fell by 5.3% to £35.5 million (2015: £37.5m), reflecting weak revenue growth combined with cost inflation. The operating margin has declined by 70 basis points to 12.4% (2015: 13.1%). While we did see a small benefit from lower fuel costs in the year, we expect to see larger benefits in 2017 and 2018 as a result of fuel hedging activity over the past 18 months or so.

| | £m |
|----------------------------------|-----|
| 2015 normalised operating profit | 38 |
| Net impact from revenue growth | (1) |
| Fuel cost | 2 |
| Other cost inflation | (5) |
| Cost efficiencies | 2 |
| 2016 normalised operating profit | 36 |

Cash and returns

Our UK Bus business generates an excellent return on capital, delivering good asset utilisation and profitable returns on investment. We continued to invest in our new Platinum buses in 2016, where we see significantly higher growth in passenger volumes. This capital investment combined with a working capital outflow, in part due to the lower income from concessionary revenues, has resulted in a lower level of operating cash of £8 million.

We will continue to maintain our disciplined approach to investment, targeting areas which will deliver the greatest returns.

Delivering operational excellence

Our continued focus on delivering operational excellence and superior service standards has been recognised with prestigious industry awards, including the pre-eminent National Transport Award for Bus Operator of the Year. In 2016, we also achieved a 4% increase in the willingness of customers to recommend our services in the Transport Focus survey. Our introduction of contactless payment on the Midland Metro tram also received the award for Best Customer Initiative at the Global Light Rail Awards.

We also continued our strong track record of improving safety, for both customers and employees, resulting in a lower number of injuries and assaults, with for example a reduction of 27% in responsible Lost Time Injuries during the year. This also results in a reduced cost of claims. We were delighted to be presented with the prestigious British Safety Council Sword of Honour as well as achieving its five-star rating.

UK Bus has maintained a four-star rating from the European Foundation for Quality Management in its second assessment.

As part of the West Midlands Bus Alliance, we continue to work in partnership with Transport for West Midlands (formerly known as Centro) to improve the customer experience by addressing industry-wide challenges in a targeted way – for example, through the introduction of bus prioritisation measures at key pinch points to speed up journey times, in conjunction with associated investment in our state-of-the-art Platinum buses. We continue to see significantly higher levels of passenger growth on those routes where we offer such ‘express’ services. We are also seeing high levels of customer satisfaction on these Platinum routes, with scores well over 90%. Finally, UK Bus was the first privately-owned public transport company to introduce the Living Wage Foundation Living Wage for all staff.

Deployment of technology

We are increasingly looking to utilise technology to raise customer and safety standards, drive efficiencies and generate sales, margin and cash.

We remain committed to raising safety standards and are rolling out Lytx DriveCam technology to 50% of our fleet by the middle of 2017. This technology enables us to monitor individual driving behaviours and provide tailored training to each driver; over 90% of our drivers who have received subsequent coaching improve their driving behaviours. Our initial pilots have shown this is not only leading to a lower number of incidents but also helping to reduce insurance costs.

We continue to look for more convenient ways for our customers to pay, and have successfully introduced contactless payment for the Midland Metro tram system in 2016 (it already accounts for 20% of on-board transactions). Drawing on this, contactless payment is being rolled out to our buses this year. We have continued to see strong take-up of smart ticketing options,

with growth of over 400% during the year and which now represent around 20% of journeys – the Swift smartcard is now twice as large as the next biggest smartcard outside of London. We have also launched a mobile ticket app, offering yet another innovative and convenient solution for our customers. These ticketing options also help to speed up journey times as well as reduce our sales distribution costs.

We are also refocusing a greater proportion of our marketing effort to digital channels, with campaigns such as our ‘Get more out of Christmas’ campaign, helping us to provide value fares and drive incremental demand, while reducing costs and improving returns.

Creating new opportunities

Following the early positive evidence from recent targeted fare reductions we are implementing a plan to boost passenger numbers. We have extended these reductions to deeply discounted tickets in Sandwell and Dudley, supported by significant marketing activity, to encourage more trips among existing users and attract non-users as part of a granular approach to pricing that better reflects the local markets we are serving. If the pilot is successful we will roll this new approach out across the business.

We are complementing this new pricing with continued investment in technology such as the roll-out of new ticket machines this year to provide the largest network of contactless payment in public transport outside of London. This will simplify ticket purchasing and provide the opportunity to reassure customers through fare capping guarantees. Our tram services have pioneered this technology and already nearly 20% of on-board tickets are contactless purchases. We are also reviewing costs, including opportunities for further timetable efficiencies.

We also believe there is more scope for sales and marketing through our app and other digital sources. Our initial app and enhanced web presence has proven popular with customers, generating increased sales and encouraging signs of additional demand: 39% of app users say its launch is making them use the bus more often. We will shortly roll out a new combined app to bring together journey planning, real-time information and m-ticketing in one place. Following the successful launch of VUER, a free ‘infotainment’ system on services in the UK Coach business, we are also trialling it on our Platinum services, to enhance the on-board experience and drive passenger growth.

We continue to look for opportunities to grow outside of our core bus business and have secured a number of new contracts in 2016, including the provision of corporate transport services for Amazon to their distribution centres around the UK. The extension, in May 2016, of the Midland Metro tram service to the recently refurbished Birmingham New Street Station and new Grand Central shopping complex has helped drive record growth in passenger journeys of 29% in the year and we expect to see further strong growth this year.