Strong bid season and high returns from acquisitions

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Chief Executive,
National Express Corporation

Market overview
National Express is the second largest player in the North American school market with a 13% share of the outsourced school bus market. 33% of the market is outsourced with recent increases in outsourcing conversion being driven by pressure on public funding. This trend is likely to continue as school district budgets remain constrained. Typically customers are local school boards where local relationships are key and service delivery is very important. National Express also operates in the North American public transit market, 32% of which is outsourced and where there is an increasing demand for accessible public transportation services, for fixed route, paratransit and employee shuttle services.

Market size
$24bn

Operates
22,800
school buses

- Bolt-on acquisition opportunities in School Bus and Transit
- New business growth from winning contracts in school bidding season and through new transit contracts

Tragic accident in Chattanooga
The tragic accident in Chattanooga, Tennessee, has taken six children far too soon, has injured others, and left families and friends grieving. We are profoundly sorry that such an accident should happen on one of our school buses.

We sought to move quickly, but respectfully, to offer appropriate support to the families and local community. We have – and will continue to – provide any assistance to the ongoing investigations. While we have accelerated existing pilot programmes – the installation of Lytx DriveCam and a cloud-based communications portal with customers – we will also learn any lessons identified and implement appropriate changes.

Overview of 2016
Our North American business has delivered strong growth in revenue and operating profit. On a constant currency basis* revenue grew by 14.3% with operating profit increasing by 11.9% to $113.9 million (2015: $101.8m). Since 2009, our North American division has grown profit by 188%.

We continued to focus on driving profitable growth and improving the quality of our portfolio, through acquisitions, winning new business that generates attractive returns and exiting those contracts that fall below our minimum return criteria (an ‘up or out’ strategy). We have had another successful bidding season, achieving price increases of 7% on those contracts up for renewal and an average price increase across the entire portfolio of 3.7%. This has offset increased costs from ongoing driver wage pressure and regulatory requirements such as Obamacare. These trends of increasing prices and wage pressure have continued into the current bid season. We continue to maintain a relentless focus on costs and the streamlining of operations with the benefits of the ‘up or out’ strategy helping to offset pressure on drivers’ wages.

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<th>2016 m</th>
<th>2015 m</th>
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<tbody>
<tr>
<td>Revenue</td>
<td>£877.2</td>
<td>£683.2</td>
</tr>
<tr>
<td>Operating profit</td>
<td>£84.0</td>
<td>£66.8</td>
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<tr>
<td>Revenue</td>
<td>US$1,189.0</td>
<td>US$1,040.6*</td>
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<tr>
<td>Operating profit</td>
<td>US$113.9</td>
<td>US$101.8*</td>
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<tr>
<td>Operating margin</td>
<td>9.6%</td>
<td>9.8%</td>
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* Revenue and operating profit at constant currency, adjusting for Canadian Dollar to US Dollar foreign exchange rate movement in the year.
Insurance costs have increased following a thorough review of our open claims by our new Group Director of Insurance and Risk and as a result of providing the full deductible for the claims associated with the accident at Chattanooga.

During the period we have seen a strong contribution from the acquisitions we have made in the past two years. We are very pleased with the level of returns we are achieving, with the acquisitions made in 2015 achieving around 15-20% return on capital. We also generated operating cash flow of $133 million in North America which was nearly twice the cash consideration paid in year for our bolt-on acquisitions.

### Delivering operational excellence

Our North American operation already delivers best in class margins. Traditionally, the school bus industry is a capital-intensive, low-cash generation business. In the past year we have continued to focus on increasing the return on capital across our portfolio of more than 500 contracts. Where we are not able to obtain financial returns above our minimum criteria, we have exited the contract – in the 2016/17 school year bid season we relinquished nine such contracts amounting to 550 buses. We continue to cascade buses where they meet the appropriate age criteria, thereby increasing fleet utilisation.

We have added a further 590 buses from new contract wins in 2016 in both School Bus and Transit operations. We had another successful year in Transit, growing annualised revenues by 60% to around $200 million with three new contracts wins and through bolt-on acquisitions, while maintaining a 100% customer retention rate.

In line with our strategy to increase investment in new growth opportunities in North America, we have made eight small bolt-on acquisitions, with four of those made in the final quarter of the year. Over the period we have added a net 1,030 buses, with the new business wins and acquisitions more than offsetting the contracts we regretted losing or chose to exit.

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<th>Change in school bus numbers – 2016 bid season</th>
<th>Number of buses</th>
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<td>Regretted losses</td>
<td>(670)</td>
</tr>
<tr>
<td>Exited per ‘up or out’ strategy</td>
<td>(550)</td>
</tr>
<tr>
<td>Acquisitions</td>
<td>1,560</td>
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<tr>
<td>Conversion and share shift</td>
<td>590</td>
</tr>
<tr>
<td>Organic growth</td>
<td>100</td>
</tr>
<tr>
<td>Change in buses operated for 2016/17 school year</td>
<td>1,030</td>
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Our relationship-based approach continues to deliver superior service standards, with over 90% of our customers willing to recommend us on the basis of quality of service, safety and value. It is also securing an industry-leading contract retention rate of 97% for the last bidding season, excluding those contracts which we chose to exit.

We were delighted that our commitment to excellence and our pursuit of continuous improvement has been recognised for the second consecutive year with a Bronze Award from the Illinois Performance Excellence Recognition Programme, increasing our score by 50%. This is a North American equivalent to EFQM.
Deployment of technology
We are increasingly looking at how we utilise technology in order 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 across our locations, with the aim of having this technology installed on our vehicles by the end of 2019. DriveCam enables us to monitor individual driving behaviours and provide tailored training to each of our drivers. This should not only result in fewer collisions but also help to reduce insurance and associated costs of claims.

We have also been trialling a cloud-based complaints management portal, enabling our customers to communicate with us more quickly and efficiently, and we are aiming to have this available in all our locations by the end of 2017.

Following a successful trial in 2015 and in response to positive customer feedback, we have continued to roll out the ‘Where’s My Bus’ app, which provides parents with real-time tracking information.

Creating new opportunities
We have been highlighting, for some time now, the attractive growth opportunities available in the North American school bus and transit markets and have significantly increased our level of investment in both of these markets over the last two years. The school bus market remains highly fragmented with over 1,000 private school bus businesses in the US and we continue to believe that there is real opportunity in this market. We also see the transit market as a strong business development opportunity and building on another successful year in 2016.

During 2016, in line with this growth strategy, we invested in eight small bolt-on acquisitions that are either close to our existing business and where we can therefore drive synergies and operational improvements, or provide strategic entry to new markets. The acquisitions were five school bus businesses (two of which included transit operations) and two shuttle, private hire and paratransit businesses. These acquisitions have helped us create new hubs in strategic locations, such as New York, where we now have a presence in the coach, charter, school bus and paratransit market. We also made the strategic acquisition of Ecolane, a planning and scheduling software business in the paratransit market, which provides us with a market-leading bespoke technology platform. Ecolane strengthens our credentials in this attractive market, providing the potential to grow revenues through new third party contracts. With 14 new contracts won in the period since acquisition, it has also increased its success rate in tenders and the Ecolane employees are already discussing with ALSA how their technology could drive efficiencies. This is something we are also looking to apply in other divisions.

In total these acquisitions added 1,560 buses, 1,110 of which were school bus and 450 were transit vehicles. All are expected to be accretive within the first 12 months and have delivered returns between 15% and 20%, demonstrating our discipline and focus on returns. We have developed a real strength in identifying, completing and securing synergy benefits from, acquisitions. We have an active pipeline of further opportunities both in School Bus and Transit and, while remaining disciplined and focused on our strict returns criteria, believe there continues to be significant opportunity for growth and excellent shareholder value in this market.

We will again approach the upcoming bid season in a disciplined manner, including addressing the ongoing wage pressure the industry is experiencing. We will also continue to seek further capital-light opportunities through conversions and further improve the quality of the existing portfolio.