Strong growth in both Spain and Morocco with record passenger numbers

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Market overview

ALSA holds the market-leading position in the regulated and highly segmented bus and intercity coach market in Spain and also operates in four cities in Morocco. Three levels of government regulation apply in Spain: national (long-distance coach), regional (regional coach) and city (urban bus). Each concession is exclusive to the operator, based on compliance with the public service obligation. Inter-city competition comes from state-backed rail and low-cost airlines. Bus and coach concessions are awarded through competitive public tender, typically every ten years.

Market size
€3.7bn

Concessions
171

- 171 concessions: 125 intercity coach concessions, 30 urban bus contracts, 16 others
- Concessional renewal process at early stage
- New contract wins in Spain
- Revenue management generating passenger and revenue growth in Spain
- Continuing urbanisation of the Moroccan economy with rapid migration to the major cities
- Further bolt-on acquisition opportunities

Year ended 31 December	2016 m	2015 m
Revenue	**£597.3**	£502.2
Normalised operating profit	**£84.7**	£71.5
Revenue	**€731.2**	€691.8
Normalised operating profit	**€103.7**	€98.5
Operating margin	**14.2%**	14.2%

Overview of 2016

ALSA has set another record for passengers carried in the year, with strong growth in both Spain and Morocco, helping to drive increases in revenue, profit and margin in the division. Total divisional revenue grew by 5.7% to €731.2 million (2015: €691.8m) and normalised operating profit rose 5.3% to €103.7 million (2015: €98.5m), both in constant currency.

In Spain, revenues rose by 5.7% driven by increased passenger journeys together with the full year contribution from the acquisition of Herranz, the benefit of a new contract to operate transport services for holidaymakers (Imserso) and a small acquisition of a regional bus business in Ibiza. Towards the end of the year, we also started to see the benefits of the newly implemented real-time active revenue management system ('RMS'), contributing 1% revenue growth for the year as a whole. In Morocco we have seen another year of good growth, with revenues up 5.4%, driven by an increase of 6% in passenger journeys, supported by further expansion of services in Tangier and the first full year of operations in Khouribga. Operating margin was maintained at 14.2%, still industry-leading for a Spanish bus and coach operator.

We have successfully renewed two small national franchises ahead of the new concession retendering process which was introduced towards the end of 2016. We believe we are increasingly well placed in the renewal process and do not expect any impact to be felt in 2017 and only minimally in 2018. We also won a new ten-year contract to operate services at Granada Airport.

With the significant weakening of Sterling against the Euro during 2016, reported revenues increased by 18.9% to £597.3 million (2015: £502.2m) and operating profit increased by 18.5% to £84.7 million (2015: £71.5m).

	€m
2015 normalised operating profit	99
Growth	3
Acquisitions	4
Other cost inflation	(10)
Cost efficiencies	5
Fuel	3
2016 normalised operating profit	104

Cash and returns
In 2016, ALSA delivered another strong performance, generating operating cash of €110 million with operating cash conversion of 106%. We have invested in a higher level of capital expenditure year on year, with growth capital expenditure focused predominantly on new fleet to support the continuing expansion of our operations in Morocco and the implementation of the new, more sophisticated RMS.

Delivering operational excellence
ALSA is widely recognised as an industry-leading operator for which it has consistently received awards. In 2016, this included the Best Customer Experience seal for passenger transport, ranking ahead of all other ground transport and air operators in Spain. We have also seen a 3% improvement in our customer satisfaction score and this has helped drive a record year of over 307 million passenger journeys made on our services in Spain and Morocco.

Over the last few years we have made great progress in improving safety standards in our operations in Morocco and in 2016 we were delighted to have received the prestigious Prince Michael International Road Safety Award, which recognises achievements and innovations in road safety management.

We have also delivered further improvements in maintenance standards resulting in a 6% reduction in breakdowns following a 20% reduction in 2015. We continue to reduce fuel consumption through an ongoing programme of consumption improvement measures, including fuel efficient driver training.

ALSA currently holds a four-star European Foundation for Quality Management (‘EFQM’) rating, and is working hard to secure a five-star rating shortly.

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.

As part of our ongoing focus on improving safety standards, we will install DriveCam technology in Spain within three years. Evidence from our pilots shows this technology helps to reduce the number of collisions and insurance costs. During 2016 a strong emphasis on driver assessment and training helped to deliver a 10% reduction in the number of preventable accidents.

In the past year we have implemented a more sophisticated RMS, which operates on over 200 flows. This more sophisticated system significantly enhances our capability to actively manage pricing on a real-time basis and provides a competitive edge against the likes of RENFE and also in future bidding of contracts. In 2016, RMS increased revenue on these corridors by 0.8% and boosted seat occupancy by 1.1%. With the system now fully implemented, this should further drive revenue, profit and incremental demand.

Leveraging UK Coach’s leadership, we have made significant progress in 2016 in increasing our digital capabilities in areas such as customised e-marketing, and the development of new apps offering improved functionality together with personalised journey planners, content and offers. Shorter loading times and more convenient and faster methods of payment are resulting in higher conversion rates. At the same time this is helping to secure reduced costs of sale: in 2016 we drove a further increase in the proportion of sales through our digital channels and ticketing machines, with nearly 40% of transactions now conducted this way. We have seen particularly strong growth in sales transacted through mobile channels, with the launch of the new app driving growth of 40%.

Business review: Spain and Morocco continued

Creating new opportunities

The acquisition of Herranz in 2015 has made a strong contribution to growth and profits during 2016. We have made further bolt-on acquisitions in 2016, with the purchase of a regional bus operator in Ibiza, gaining entry into a new market and increasing our exposure to the tourist market. At the end of the year we also acquired AlpyBus, in Switzerland, serving the lucrative ski and alpine tourist markets. Both acquisitions are expected to be accretive within the first 12 months after transaction and we will consider further bolt-on acquisitions where they meet our strict financial criteria.

We continue to see strong growth prospects in Morocco. Since 2012 we have grown both passengers and revenues by over 70% in Morocco. In 2016, we have extended our services in Tangier and saw the first full year of operations in Khouribga. We also won a six-year contract to operate sightseeing services in Marrakech. As well as continuing to grow our existing operations, we see further growth opportunities with the addition of services in new cities, and have recently submitted a bid to operate the Casablanca Tramway, with the contract commencing in December 2017.

Our continuing focus is to ensure we are well placed for the concession renewal process which we expect to pick up pace towards the end of 2017. However, not only have we won both concessions that have so far come up for renewal where we were the incumbent operator, we have also delivered strong margins post-retendering as our fare reductions generated significant passenger growth.

The terms of retendering competitions have recently been altered to emphasise service quality and competitive yet sensible pricing that reduces the opportunity for speculative, very low-cost bids and plays to our strengths. We believe that our focus on operational excellence and understanding of price elasticities through our upgraded RMS – which will get more sophisticated as it gathers more data and analytical capabilities – gives us unrivalled knowledge of the market and places us at a competitive advantage as concession renewal gathers pace later this year. Further, the geographic clustering of the contracts gives us a further advantage as we are able to secure further synergies and cost savings.

We therefore enter 2017 with confidence in our ability to secure good results from the renewal process. We do not expect any real impact on revenues or profits until 2019, and even then our recent success and the changes to the terms of the retendering competition means we are increasingly optimistic we will deliver a strong result then. With no impact this year, we now expect the worst case scenario for 2018 operating profit to be a reduction of up to €3 million from those contracts up for renewal. While we have always expected there to be pressure on margins on the renewal of contracts, the results of our recent retendering suggests there is the opportunity to maintain good margins through significant passenger growth. Nonetheless, we maintain our programmes to mitigate any impact through, for example: fuel savings; further cost efficiencies; the benefits from a more sophisticated revenue management system in Spain; targeted acquisitions; and additional opportunities for growth in Morocco. We are also looking at other opportunities in new markets in Europe where we can achieve attractive returns.