Delivering significant growth in both profit and cash

Matthew Ashley
Group Finance Director

Presentation of results
We present our financial results on two bases. Normalised results show the performance of the business before intangible amortisation, since the Board believes this gives the reader a clearer understanding of existing business performance. IFRS results include amortisation to give the statutory results. There were no items presented as 'exceptional' in 2016 or 2015.

Following the disposal of c2c to Trenitalia on 10 February 2017, we have also presented financial results on a continuing basis, with 2015 numbers restated to exclude results from UK Rail.

Revenue
Group revenue from the continuing business for the year was £2,103.7 million (2015: £1,753.8m), after excluding c2c, our UK rail franchise. This represents an overall increase of 10.6% on a constant currency basis and up 20.0% on a reported basis, benefiting from a number of bolt-on acquisitions made over the last two years, together with significant foreign exchange tailwinds.

Performance has been particularly strong in our overseas businesses, with North America delivering 14.3% growth in constant currency, benefiting from another strong bidding season where we achieved an average price increase of 3.7% across the entire portfolio and 7% on those contracts up for bid and renewal, together with eight bolt-on acquisitions made during the year. Spain and Morocco also delivered a strong performance, with revenue growth of 5.7% on a constant currency basis. This was supported by record passenger numbers in both Spain and Morocco, with more than 307 million passenger journeys made in 2016, together with the benefit of a full year's contribution from the Herranz acquisition made in 2015, and a further two small acquisitions made in 2016.

Rail also delivered a strong performance, with the first full year contribution of £61 million from our German Rail operations where we commenced services on our RME network in December 2015. Our UK Coach business has delivered a robust performance, with core revenue growth of 1.9% more than offsetting a significant decline in demand for our Eurolines services, following the various terrorist attacks across Europe over the last year or so. UK Bus was flat on the year, with growth in commercial revenues being offset by declines in concessionary income.

Revenue bridge for the continuing operations	£m	Percentage change
2015 full year revenue	1,754	
Currency translation	148	
2015 full year revenue at constant currency	1,902	
Organic growth	48	2.5%
Acquisitions	93	4.9%
German Rail	59	3.1%
Weather	2	0.1%
2016 full year revenue	**2,104**	**10.6%**

Normalised profit
Group normalised operating profit for continuing operations increased by 4.8% to £219.0 million on a constant currency basis; up 14.2% on a reported basis (2015: £191.8m). Growth of £10 million from our existing businesses, together with an £18 million contribution from the 11 acquisitions made in 2016 and the full year benefit of acquisitions completed in 2015, more than offset net cost inflation of £13 million. We also saw a £6 million benefit from lower fuel prices as a direct result of our hedging policy, with further significant fuel cost savings to come in 2017 and 2018. The £10 million increase, year on year, in operating profit on a constant currency basis is also after an increase in bid and acquisition-related costs of £5 million. Our new Group Director of Insurance and Risk has reviewed all historical claims and as a consequence of this review of our growing business together with providing in full for the insurance deductibles for the Chattanooga accident, resulted in costs rising by £7 million.

Group operating profit margin declined by 55 basis points to 10.4%, reflecting a larger contribution from our North American business together with the small loss in our German Rail business and a decline in profit in our UK Bus business.

Profit bridge for the continuing operations	£m	Percentage change
2015 normalised full year operating profit	192	
Currency	17	
Operating profit at constant currency	209	
Growth	10	
Acquisitions	18	
Bid and acquisition related costs	(5)	
Cost inflation	(30)	
Cost efficiency	17	
Fuel price benefit	6	
Insurance cost in North America	(7)	
Weather	1	
2016 normalised full year operating profit	**219**	**4.8%**

Group Finance Directors' review continued

Segmental profit performance
Our overseas businesses were the strongest performers, with North America profit increasing by 11.9% on a constant currency basis and up 25.7% on a reported basis, benefiting from the significant weakening of Sterling against world currencies post the EU referendum result.

Acquisitions made in 2015 and 2016 have delivered strong growth, with those acquisitions made in 2015 achieving ROIC of between 15% and 20%. In Spain and Morocco, operating profit increased by 5.3% on a constant currency basis, driven by a combination of organic growth, acquisitions and cost efficiencies. Reported operating profit increased by 18.5%, reflecting the significant weakening in Sterling.

UK Coach also delivered growth in profits, with operating profit up 3.1%, reflecting growth in new routes together with cost efficiencies. Our UK Bus operations had a challenging year with operating profit down £2.0 million, primarily caused by the £3 million reduction in concessionary income.

Our German Rail operations delivered a small operating loss of £1.5 million in its first full year of operations and we are targeting to make a small profit in 2017.

Segmental operating profit from continuing operations	**2016 Local currency**	2015 Local currency	**2016 £m**	2015 £m
Spain and Morocco	**103.7**	98.5	**84.7**	71.5
North America	**113.9**	101.8*	**84.0**	66.8
UK Bus			**35.5**	37.5
UK Coach			**33.3**	32.3
German Rail	**(1.8)**	(0.1)	**(1.5)**	(0.1)
Central functions			**(17.0)**	(16.2)
Group			**219.0**	191.8

* Operating profit at constant currency, adjusting for Canadian Dollar to US Dollar foreign exchange rate movement in the year.

Income from associates was £1.1 million (2015: £1.8m) and is predominantly earnings from Bahrain.

Net finance costs increased to £50.0 million (2015: £45.2m), reflecting interest costs of £3.2 million on the bridging facilities ahead of the repayment of the £350 million bond in January 2017 together with a slightly higher level of average debt.

Including the results from UK Rail, normalised operating profit rose by 15.7% to £223.9 million (2015: £193.5m) and normalised profit before tax increased by 16.6% to £175.0 million (2015: £150.1m).

Excluding UK Rail, on a continuing basis normalised profit before tax was £170.1 million (2015: £148.4m), an increase of 14.6%.

The normalised tax charge from continuing operations was £31.7 million (2015: £28.2m), a normalised effective tax rate of 18.6% (2015: 19.0%). The tax charge for 2016 included a number of one-off items, with the main ones being the release of tax provisions and recognition of losses. Details of the tax reconciliation are in note 10(c).

Looking forward, and depending on profit mix, new business opportunities and the future tax environment, including new restrictions on tax deductions for interest expense in the UK, we expect the normalised effective tax rate to increase from 2017 and to likely settle around the mid 20's percentage range in the longer term. However, further out, rates may reduce if the new US administration reduces the US federal corporate income tax rate as is widely expected. We would expect the cash tax rate to be less than 15% for the next two years as we utilise brought forward tax losses, mainly in the US, during this period.

Normalised profit after tax for the year was £138.4 million (2015: £120.2m), with a basic EPS of 27.3 pence (2015: 23.4p), an increase of 16.7%. An increase of 10% in the final dividend to 8.41 pence has been proposed, reflecting our long-term dividend policy of ensuring that full year dividends are covered around two times by Group earnings.

Summary income statement	2016 Total £m	UK Rail £m	2016 Cont' £m	2015* Cont' £m
Revenue	**2,279.2**	175.5	**2,103.7**	1,753.8
Operating costs	**(2,055.3)**	(170.6)	**(1,884.7)**	(1,562.0)
Normalised operating profit	**223.9**	4.9	**219.0**	191.8
Share of results from associates	**1.1**	–	**1.1**	1.8
Net finance costs	**(50.0)**	–	**(50.0)**	(45.2)
Normalised profit before tax	**175.0**	4.9	**170.1**	148.4
Tax	**(32.7)**	(1.0)	**(31.7)**	(28.2)
Normalised profit after tax	**142.3**	3.9	**138.4**	120.2

* 2015 results restated to exclude the results from UK Rail.

Exceptional items
There were no exceptional items in the period or the prior year.

IFRS results
Intangible amortisation increased to £33.8 million (2015: £25.7m), reflecting the weakening of Sterling together with recent acquisitions in North America and Spain. Profit for the year, after amortisation, was a record high of £120.0 million (2015: £109.1m), up 10%. Basic EPS, after amortisation, was 23.0 pence (2015: 20.9p), an increase of 10.0%.

IFRS profit	2016 £m	2015 £m
Normalised profit before tax	**170.1**	148.4
Intangible amortisation	**(33.8)**	(25.7)
Profit before tax	**136.3**	122.7
Tax charge	**(20.2)**	(15.0)
Profit for the year from continuing operations	**116.1**	107.7
Profit after tax for UK Rail – discontinued operations	**3.9**	1.4
Total profit for the year	**120.0**	109.1

Cash management

Cash generation is the result of delivering operational excellence and represents a key driver of shareholder value. Our strong and sustainable cash flows allow us to retain a disciplined focus on ROCE while supporting a capital investment programme that maintains fleet age at acceptable levels. Our current target is to invest around 1.1 to 1.2 times depreciation.

In 2016, the Group delivered operating cash flow of £201.3 million (2015: £164.9m), up 22.1%, reflecting the significant increase in EBITDA, up by £46.5 million to £344.6 million (2015: £298.1m). The increase in operating cash flow of £36.4 million is also after an increased level of maintenance capital expenditure, net of disposals, of £134.7 million. This represents 110% of the depreciation charge and was £23 million higher than in 2015. The majority of the maintenance capital investment has been in fleet replacement in the UK, Spain and North America.

This has resulted in £138.6 million of free cash flow being generated over the year (2015: £111.0m), an increase of £27.6 million on the prior year. This free cash flow was well ahead of our £100 million target and in light of our positive momentum, including the disposal of c2c and the discharge of the capital commitments therein, we are now increasing our target delivery to £120 million of free cash flow per annum, which we see as a sustainable level of cash generation going forward.

Free cash flow	**2016 £m**	2015 £m
Continuing normalised operating profit	**219.0**	191.8
UK Rail operating profit	**4.9**	1.7
Total normalised operating profit	**223.9**	193.5
Depreciation and other non-cash items	**120.7**	104.6
EBITDA	**344.6**	298.1
Net maintenance capital expenditure	**(134.7)**	(111.7)
Working capital (increase)/decrease	**(3.1)**	(11.8)
Pension contributions above normal charge	**(5.5)**	(9.7)
Operating cash flow	**201.3**	164.9
Receipts from associates and minorities	**(1.5)**	0.7
Net interest paid	**(47.6)**	(43.4)
Tax paid	**(13.6)**	(11.2)
Free cash flow	**138.6**	111.0
UK Rail franchise exit outflow	**(1.0)**	(2.5)
Exceptional cash expenditure	**(4.9)**	(10.0)
Cash flow available for growth and dividends	**132.7**	98.5

The Group generated cash flow of £132.7 million (2015: £98.5m), up £34.2 million on last year, which was available for growth capital projects, bolt-on acquisitions and dividends. The majority of the £27.0 million growth capital investment has been in growing our fleet on new services such as in Morocco, investment in revenue management systems for our coach services in the UK and Spain, investment in new contactless ticketing machines in UK Bus and investment to support our growth in Rail, both in the UK and Germany.

We have continued our strategy of making selective bolt-on acquisitions where the returns and strategic fit meet our strict criteria. During the year we invested in 11 acquisitions, eight of which were in our North America School Bus and Transit operations, in line with our stated strategy to exploit new growth opportunities in this market. We have also acquired two small businesses in ALSA, one for a regional bus contract in Ibiza and one for a private transfer operator in Switzerland. Our UK Coach business has also made a small bolt-on acquisition of a private hire business. Total net consideration was £122 million for the acquisitions, with a total of £88.8 million being paid in 2016 including £24 million of deferred consideration for acquisitions made in 2015.

Return on capital employed is a key factor in our incremental investment decisions and we are pleased with the progress we have made with the Group's return on capital increasing by 20 basis points to 11.9%.

Net funds flow for the period was an outflow of £132.5 million (2015: £81.2m), with year-end net debt of £878.0 million (2015: £745.5m) reflecting two main factors: investment in acquisitions of £88.8 million during the period and the significant net outflow of £90.5 million, virtually all on the retranslation of foreign currency debt balances and the maturity of some foreign exchange contracts, caused by the significant weakening of Sterling against both the US Dollar and the Euro as commented above.

The Group maintains gearing discipline by matching the currency denomination of its debt to the currency in which EBITDA is earned. Simply put, gains from foreign exchange on EBITDA offset increases in debt due to movements in foreign exchange. As such, gearing at the end of the period was 2.5 times EBITDA, within the Group's target range of 2.0-2.5 times.

Net funds flow	2016 £m	2015 £m
Cash flow available for growth and dividends	**132.7**	98.5
Net growth capital expenditure	**(27.0)**	(36.4)
Acquisitions and disposals	**(88.8)**	(69.4)
Dividends	**(58.9)**	(54.4)
Other, predominantly foreign exchange	**(90.5)**	(19.5)
Net funds flow	**(132.5)**	(81.2)

Dividend
The second half of 2016 saw a significant weakening of Sterling against world currencies with markets forecasting a broad range of future movements. In light of this volatility, our long-term dividend policy remains to pay a dividend covered two times by Group earnings. We propose a 10% increase in the final dividend giving an 8.4% increase in the full year dividend to 12.28 pence, which is 2.2 times covered.

Treasury management
The Group maintains a prudent approach to its financing and is committed to an investment grade credit rating. The Board's policy targets a level of debt that allows for disciplined investment and ample headroom on its covenants, with net debt to EBITDA at a ratio of 2.0x to 2.5x in the medium term. Both Moody's and Fitch have reaffirmed their investment grade ratings in 2016.

The Group's key debt ratios as at 31 December 2016 and 2015 were gearing of 2.5 times and a bank covenant that should not exceed 3.5 times. The interest cover ratio was EBITDA 7.0 times interest as at 31 December 2016 (2015: 6.6x) comfortably exceeding the bank covenant of not less than 3.5 times.

The Group has a strong funding platform that underpins the delivery of its strategy. Core funding is provided from non-bank sources, to provide improved certainty and maturity of funding.

During the year, the Group has been cognisant of market volatility and sought to actively manage liquidity and interest rate risk prior to the refinancing of the Group's £350 million bond maturing in January 2017.

In January 2016, the Group entered into new bank facilities totalling £450 million, comprising a £350 million bridge-to-bond facility, together with a £100 million general corporate purposes facility. This bridging facility gave the Group significant flexibility, enabling the Group to choose the optimum moment to refinance taking into account the prevailing low interest rate environment, without incurring punitive refinancing charges.

Following the EU referendum result and prior to the US election, gilt rates were at historical lows. In September 2016, the Group entered into additional unsecured committed revolving credit facilities totalling £96 million. These new facilities are on the same terms as the Group's £416 million bank facility and mature in November 2021. In November 2016, the Group issued a £400 million seven-year Sterling bond with a coupon of 2.5%. The proceeds were used to refinance the Group's £350 million bond which matured in January 2017 and for general corporate purposes. Both facilities provide the Group with an appropriate level of liquidity and funding headroom together with ensuring significant interest savings going forwards.

Excluding the £350 million bond which was repaid in January 2017, the Group had £838 million of funding at the year end. This funding is primarily from two Sterling denominated bonds comprised of a £400 million bond maturing in 2023 and a £225 million bond maturing in 2020, a private placement of €78 million maturing in 2021 and £159 million of finance leases. The residual debt balance is funded from the Group's £512 million revolving credit facilities, with a margin of 0.6% over LIBOR and maturing in 2021. At 31 December 2016, the Group had £830 million in cash and undrawn facilities available, which included £350 million used to repay the expiring £350 million bond in January 2017.

At 31 December 2016, the Group had foreign currency debt and swaps held as net investment hedges. These help mitigate volatility in foreign currency profit translation with corresponding movements in the Sterling value of debt. These corresponded to 2.1 times EBITDA earned in the US, held in US Dollars, and 2.4 times EBITDA earned in Spain and Germany, held in Euros. The Group hedges its exposure to interest rate movements to maintain a balance between fixed and floating interest rates on borrowings. It has therefore entered into a series of swaps that have the effect of converting fixed rate debt to floating rate debt. The net effect of these transactions was that, at 31 December 2016, the proportion of Group net debt at floating rates was 24% (2015: 34%).

Group Finance Directors' review continued

Group tax policy

We are committed to creating shareholder value through our four strategic goals: a focus on operational excellence; investment in technology; growth through targeted acquisitions; and an active focus on talent. The Group tax strategy supports these goals.

We pursue a cautious approach to our tax affairs which are aligned to business transactions and economic activity. Our approach to tax can be evidenced by the lack of outstanding tax audits as detailed in the Annual Report and Accounts. There are no outstanding tax audits in any of our main three markets of the UK, Spain and the US.

In order to gain as much certainty as possible, tax matters are largely discussed in 'real time' with the tax authorities in the markets in which we operate. For example, the proposed disposal of our UK rail business, which was announced in January 2017, was communicated to HMRC at that time rather than when the tax return is submitted in December 2018. We have a constructive and good working relationship with the various tax authorities. However, due to the complexity of tax legislation, the Group and tax authorities may sometimes have differing opinions. The Group manages risk and accrues for areas of tax uncertainty in line with accounting standards requirements, where appropriate. The Group Tax Department reports on a regular basis on the Group's tax matters, with the Board and the Audit Committee apprised of any significant tax matters.

Pensions

The Group's principal defined benefit pension schemes are all in the UK. The combined deficit under IAS 19 at 31 December 2016 for the continuing operations was £88.2 million (31 December 2015: deficit of £12.6m). The two principal plans are the UK Group scheme, which closed to new accrual in 2011, and the West Midlands Bus scheme, which remains open to accrual for existing active members only. We are currently in negotiations with the trustees of each of these schemes with respect to future deficit payments and anticipate that the overall level of contribution will remain at around £10 million per annum.

The IAS 19 valuations for the principal schemes at 31 December 2016 were as follows:

- UK Bus (under the WM scheme and the Tayside Transport Superannuation Fund): £128.5 million deficit (2015: £60.4m deficit)
- UK Group scheme: £44.5 million surplus (2015: £34.9m surplus)

The net pension surplus for c2c's participation in the Railways Pension Scheme has been transferred following the disposal of the rail franchise to Trenitalia.

Fuel costs

The Group consumes approximately 225 million litres of fuel each year for which it is at risk (ie there is no direct fuel escalator in the contract or concession price) all of which relates to the non-Rail divisions. Fuel costs from non-Rail divisions represented a total cost (including delivery and taxes) to the Group in 2016 of £168 million (approximately 8% of related revenue), at an average fuel component cost of 45.4 pence per litre. The Group has adopted a forward fuel buying policy in order to secure a degree of certainty in its planning. This policy is to hedge fully a minimum of 15 months' addressable consumption against movements in price of the underlying commodity, together with at least 50% of the next nine months' consumption in the contract businesses. Currently, the Group is 100% fixed for 2017 at an average price of 42.6 pence/litre (excluding delivery and tax), 89% fixed for 2018 at an average price of 33 pence, 50% fixed for 2019 at 33 pence and 10% fixed for 2020 at 33 pence. We anticipate fuel savings of around £6 million in 2017 and around £20 million in 2018, assuming the balance of the fuel hedging for 2018 is transacted around the current spot price for fuel.

Where businesses have freedom to price services, this hedge provides sufficient protection to recover fuel price increases through the fare basket. In contract businesses, where price escalation may be restricted by a formula independent of fuel costs, extended cover, up to the life of the contract, may be taken, subject to availability and liquidity in the hedging market. The latter is rarely available beyond three years from the trade date.

Sale of c2c to Trenitalia

This transaction completed on 10 February 2017 and will be accounted for in the Financial Statements for the year ending 31 December 2017. The consideration received was £72.6 million and a further £35 million was received to settle intercompany loans. This transaction, including anticipated costs of right sizing the UK business post UK rail, has resulted in a small profit on disposal.

Finally, I would like to say how much I have enjoyed my time as Group Finance Director and that I am looking forward to my new role within the Group as President and Chief Executive Officer of North America. I would like to welcome Chris Davies to the Group and wish him well in his new role.

Matthew Ashley
Group Finance Director
23 February 2017

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Group Chief Executive's review on pages 6 to 13 and the Group Finance Director's review on pages 38 to 44. In addition, note 2 to the Financial Statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The Group has a formalised process of budgeting, reporting and review, which provides information to the Directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives.

The Directors confirm that they have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. In reaching this opinion, the Directors reviewed assumptions about current trading performance, together with information from the annual budget process, which sets out the Group's plan for 2017, and the strategic planning process which determines the Group's trajectory for 2018 to 2019. Accordingly the Directors continue to adopt the going concern basis of accounting in preparing the annual Financial Statements.

Viability statement

In accordance with provision C2.2 of the UK Corporate Governance Code 2014, the Board has assessed the viability of the Group over a three-year period to December 2019. This takes into account the Group's current position and the potential impact of the principal risks and uncertainties outlined on pages 34 to 37 of the Strategic Report.

The Board has determined that a three-year period is an appropriate period over which to provide its viability statement, as this is the period reviewed by the Board as part of the annual strategic planning process. In making this statement, the Board carried out a robust assessment of the principal risks and uncertainties facing the Group, including those that would threaten the business model, future performance, solvency and liquidity. Sensitivity analysis is applied to the cash flows to model the potential effects should principal risks actually occur; and consideration is given to the availability and likely effectiveness of mitigating actions that could be taken to avoid or reduce the impact or occurrence of the identified risk.

Based on this assessment, the Board confirms that it has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due up to 31 December 2019.