# Record year – acquisitions performing well

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## School Bus and Transit North America

**Our business in North America has two areas of activity: student transportation and transit services.**

**We operate in 38 US states and three Canadian provinces.**

**The student transportation business operates through medium-term contracts awarded by local school boards to provide safe and reliable transport for students, and is the second largest private operator in North America.**

**Our transit business operates a growing number of transit and paratransit services across the USA.**

**Revenue**
**£1,017.2m**
2016: £877.2m

**Normalised operating profit**
**£94.3m**
2016: £84.0m

### Market overview

National Express is the second largest player in the North American school bus market with a 13% share of the outsourced market. Just over a third of the market is outsourced with recent increases in outsource 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 and is the fourth largest player with around 4% market share. One third of the transit market is outsourced and there is an increasing demand for accessible public transportation services, for fixed route, paratransit and employee shuttle services.

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

**School Bus market size**
**$24bn**

**Operates**
**22,800**
school buses

**Transit market size**
**$25bn**

**Operates**
**2,000**
vehicles

| Year ended 31 December | 2017 m | 2016 m |
|---|---|---|
| Revenue | £1,017.2 | £877.2 |
| Normalised operating profit | £94.3 | £84.0 |

| | | |
|---|---|---|
| Revenue | US$1,311.1 | US$1,191.3* |
| Normalised operating profit | US$121.6 | US$114.1* |
| Normalised operating margin | 9.3% | 9.6% |

* Revenue and operating profit at constant currency, adjusting for Canadian Dollar to US Dollar foreign exchange rate movement in the year

## Overview of 2017

North America is now a fundamentally different business to five years ago. It is consistently delivering growth by embedding a culture of customer service, efficiency and technological investment across the business. As well as identifying and integrating high-return businesses, it is opening new avenues of growth. We see significant opportunity for growth in charter markets, and are developing a new model in major cities where we operate a number of different local services.

| | $m |
|---|---|
| 2016 normalised operating profit | 114 |
| Exchange movement (CAD to USD) | – |
| 2016 normalised operating profit at constant currency | 114 |
| Net impact of revenue growth | 15 |
| Cost inflation | (21) |
| Cost efficiencies | 10 |
| Weather | (2) |
| Merger and acquisitions | 13 |
| M&A incentives | (5) |
| Operating days | (2) |
| 2017 normalised operating profit | 122 |

The terrible accident in Chattanooga in November 2016 is a tragedy that still weighs very heavily on us all. We have sought to learn any appropriate lessons and as described in this section, have accelerated enhanced safety measures such as Lytx DriveCam and speed monitoring. We continue to co-operate with all the relevant authorities, including the ongoing National Transportation Safety Board investigation. We have donated to local community groups and funded a new home being built through Habitat for Humanity. We continue to provide support to the families affected by the tragedy. Last year, we had our local school bus contract renewed and received the Federal Motor Carrier Administration's highest safety rating for our national operations.

## Operational excellence

The benefits of our approach so far are reflected in another record year of normalised operating profit (up 6.6% to $121.6 million) and a revenue increase of 10.1% to $1.31 billion (both in constant currency). Our North American business has delivered industry-leading margins for a number of years and has had to absorb the ongoing pressure from driver wages for some time now. In 2017, driver wage inflation increased to five percent, leading to a reduction in our normalised operating margin to 9.3% (2016: 9.6%).

We managed to contain this margin reduction through cost discipline across the business, including $10 million of cost savings, and our prudent bidding. We maintained strong retention rates (96% of those school bus contracts we wanted to retain) and achieved an average of three percent price increases on renewal or retention, or above two percent across the whole portfolio. Our focus on service and strong local relationships, with customer satisfaction scores again above 90%, has helped deliver these results.

This was augmented by our continued 'up or out' strategy, to ensure that we focused on only retaining contracts that are delivering acceptable returns. We relinquished contracts amounting to 190 buses in 2017 – and also exited our first transit contract for this reason as well in the year – and will maintain this discipline in 2018. So far, early bidding this year has been very positive, with our most successful January for contract retention and new business wins in four years, and above inflation price increases secured.

| Change in school bus numbers – 2017 bid season | Number of buses |
|---|---|
| Regretted losses | (856) |
| Exited per 'up or out' strategy | (190) |
| Acquisition | 625 |
| New business wins | 797 |
| Organic growth | 15 |
| Change in buses operated for 2016/17 school year | 391 |

## Deployment of technology

Technology investment is playing an increasingly important role in our determination to drive efficiency, improve standards and deliver growth.

Our investment in DriveCam smart safety cameras is continuing apace, with 6,351 vehicles already fitted in North America, and a target of around another 10,000 installed by the end of the year. We are already recording a significant reduction in the cost of preventable accidents after DriveCam has been installed. Over 90% of our vehicles also have the necessary technology installed to enable enhanced speed management to take place. This is an increasingly important area of our safety management, with a high profile internal campaign being launched shortly.

We are also investing in new business management systems to drive improved standards and efficiency. A new budget management system and a business management system both allow very detailed analysis for local management use but also central review. Fundamentally, we are aspiring to use these new technologies and systems to industrialise service excellence and cost efficiency across the business, with enhanced central management oversight and assurance married with good local management and customer relationships. This will not only deliver more, happier customers but also support a relentless pursuit of safety and service improvement, organic growth and cost efficiency.

We started rolling DriveCam out in 2014 and it is now installed in 46 locations. The results so far show that when comparing the costs of claims from preventable street accidents for the 12 months prior to fitment against post-installation, there has been a 30% reduction. The business management system has already been used to revise our fleet management systems and has helped identify over 750 buses that can be deployed more effectively. This alone will provide meaningful capital savings.

We continue to grow our Ecolane acquisition, a market leader in on-demand scheduling technology. In 2017, Ecolane installed the United States' first cloud-based state-wide paratransit software, in Pennsylvania and won 24 new contracts in its specialist field in 2017. Ecolane is also increasingly becoming a key credential in our other North American bids and we are exploring its broader application across the Group.

## Creating new opportunities

North America remains a very attractive market for further acquisitions. The market is very fragmented – with over 1,000 private school bus businesses in the US alone – and we have a strong pipeline of opportunities. There are very few active buyers in the market and we continue to avoid becoming involved in an auction for a business.

In line with this strategy we acquired another three businesses in North America last year, all in the last six months. These were: a significant paratransit operator in Chicago, the US' largest paratransit market; a school bus and charter operator in Cincinnati, Ohio; and a school bus business (specialising in special education services) in Rochester, New York. Together they amount to over 800 additional vehicles and we continue to target at least 15% returns from these new acquisitions.

Our transit business grew 60% in 2017, with annualised revenues now around $300 million. This is significant growth for a business that has only been in place for five years. We won five new contracts in 2017, at a win rate of 33%, and have already secured our first contract win of 2018.

We see the opportunity for significant nationwide growth in the charter market. We estimate there to be at least a $1.5 billion annualised market available and National Express only captured around 3% of it in 2017.

We have now developed credentials in a number of sectors within North American transport. Drawing on the lessons of our most successful markets, we are building opur presence in the largest cities. By running a mix of school bus, transit, paratransit, charter and employee shuttle services, we have the opportunity to more effectively offer competitive pricing and operational excellence, alongside developing strong local relationships, and generate new growth centres in North America. So while we will continue to pursue acquisitions in North America, we also see exciting growth opportunities in these emerging new models.

While the bid season still has some months yet to run, I am pleased that the early indications suggest that competitors are being disciplined in their bidding. Our focus in 2018 will be to recover the wage inflation we suffered in 2017 through a combination of disciplined bidding, overhead reductions and further cost efficiencies.