Divisional review

North America

Matt Ashley
Chief Executive, North America

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

We operate in 35 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

£1,060.8m

2017: £1,017.2m

NORMALISED OPERATING PROFIT

£96.9m

2017: £94.3m

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 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 5% 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.

Growth drivers

- 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

21,500

Vehicles

$24bn

Market size

TRANSIT

3,250

Vehicles

$25bn

Market size

Year ended 31 December	2018 £m	2017 £m
Revenue	**£1,060.8**	£1,017.2
Normalised operating profit	**£96.9**	£94.3
Revenue	**US$1,416.1**	US$1,311.2*
Normalised operating profit	**US$129.4**	US$121.6*
Operating margin	**9.1%**	9.3%

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

Overview

North America has again delivered a record performance, as the combination of organic growth and strategic acquisitions continues to deliver real benefits. Our transit business continues to grow strongly through a combination of acquisition and new contract wins. The benefits of our investment in technology are being seen in improved operational and service control, with our safety performance particularly noteworthy.

In a disciplined bid season we prioritised protecting returns above retention. We sought sufficient rate increases to mitigate driver wage inflation. This discipline saw us retain fewer contracts than in recent years but our remaining business is stronger. With our increasingly granular focus on driver wages we are targeting a modest reduction in inflation this year.

	$m
2017 normalised operating profit	122
Exchange movement (CAD to USD)	–
Operating profit at constant currency	122
Growth from continuing business	14
2018 acquisitions	13
Fuel	9
Drivers wages	(15)
Maintenance/safety investment	(16)
Other	2
2018 normalised operating profit	129

Operational excellence: driving organic growth

The benefits of our approach are reflected in another record year of normalised operating profit (up 6.4% to $129.4 million) and a revenue increase of 8.0% to $1.42 billion (both in constant currency). This is despite driver wage inflation coming in slightly higher than we projected, at 3.5%, as the tight North American labour market continued. We are currently projecting that school bus driver wage inflation will moderate, but only slightly, during 2019.

During a disciplined bid season in the context of near full employment in North America, we applied our 'up or out' strategy to all contracts up for renewal to protect returns. This approach led to significant rate increases of 6.5% on those contracts up for bid or renewal (2017: 3.7%), which translated to 3.7% on the portfolio as a whole (2017: 2.2%).

Our strategy of protecting returns inevitably led to our retention rate dropping to 90% of all contracts up for renewal. We did recover the significant majority of these lost vehicles through new business wins, acquisitions and organic growth in existing contracts, so that by the year end our net bus count was down 132. We are continuing to apply this disciplined approach to this school bid season, with the early results encouraging.

As previously guided we also increased investment on areas like maintenance, Lytx DriveCam and Domo management systems, with $16 million extra spent in the year. This has already brought a number of vehicles back in to service that were otherwise under-utilised, reducing new bus capital expenditure and generating positive returns in future years.

It also helps improve customer service. Our detailed surveying of customers has also shown that those with the highest satisfaction score are not only likely to retain us, but also more willing to pay a premium for quality services. In the last year, for example, four customers in one state alone have renewed our contracts around a year early. A new programme to increase the proportion of our customers on the highest satisfaction score (currently around 50%) started last year and we hope to start realising the benefits of this during the year. We believe this investment will deliver sustainable margin improvement over time.

While the higher rates achieved in the bus bid season helped mitigate the impact of driver wage inflation, when combined with increased spending on maintenance, normalised operating margin fell to 9.1% (2017: 9.3%). We have taken action to address this, with $7.5 million of annualised overhead costs removed from North America's headquarters in December 2018.

Our transit business added 650 vehicles in the year, and it now has annualised revenues of over $350 million. We added two major new contracts won through open bids in the year: a 147 bus paratransit contract in Massachusetts; and, a 115 bus fixed route contract in California (our largest ever by revenue won in open

Peace of mind for parents

Parents of children who use our school buses in North American can now have complete visibility of when they are due home with the introduction of our new Bus Tracker.

The app, which parents can use for free, allows them to see live bus location information and an estimated arrival time. The app draws on the vehicle location data being supplied by the on-board telematics.

Currently operational in 74 locations covering more than 19,000 routes, the app is now being used by 78,000 parents to check the location of their children. Each parent logs in using a unique student number for their child.

competition). We also recently secured a one-year extension to our single largest contract, paratransit services in Chicago as well as a two-year extension to important casino shuttle work in New York. With these contract successes and acquisitions set out below, we are also diversifying the transit business in to new segments such as employee shuttle.

Technology investment to underpin excellence, efficiency and innovation

As outlined in the previous section, North America increased its investment in key strategic projects during 2018. This investment is enabling a more granular control of the business and is identifying areas for further cost saving and operational improvement. We are absolutely determined to realise these opportunities. Our first goal will be to re-invest any efficiencies secured as this will drive customer satisfaction and more sustainable margin improvement. Nonetheless, the gap in the financial performance between our best and worst performing locations in terms of customer satisfaction reveals a significant opportunity.

Lytx DriveCam is already a clear example of the benefit of the investment. In the second half of 2018 alone, North America doubled the number of vehicles fitted with DriveCam (to 15,395). The benefits of this investment can be seen in our improved safety performance as well as the average and total cost of injury claims from collisions declining 22.4% and 17.4% respectively in 2018.

Another area of increased investment is in improved business systems and management control across this continent-wide business. Through our investment in Domo we are modernising our management systems to provide granular-level data on key metrics that can be monitored in real time. This is driving improvements in operations and crucial areas such as vehicle utilisation rates, where we have an enhanced central system to identify the opportunity for real-time cascading of under-utilised vehicles to high demand areas. It is also enabling a more forensic approach to both our wage and hour rates and the tracking of customer billing. Equally, in using these data and systems to compare locational performance, local cost inefficiencies are exposed and efficiencies secured as good practices are spread more quickly across the business. This area of investment is a key part of our programme to improve the proportion of customers on the highest satisfaction score.

Beyond these internal systems, we are also actively looking to use new technologies to improve our customer experience. Pleasingly, we are leading the industry through our investment in Bus Tracker. This app allows parents to track their children's vehicle. The app currently covers 19,000 routes, with 486,000 students assigned to vehicles operating these services. We have started already rolling out this app to our transit customers.

We are leading the industry as the only private operator currently running fully electric school buses, with our pilot in New York. We are also operating electric buses in two transit contracts. With air quality a global issue, particularly in large urban areas, we are pleased to be playing a role in this important area.

Targeted growth through strategic acquisition and market diversification

North America remains a very attractive market for further acquisitions. The market remains very fragmented – with over 1,000 private school bus businesses in the USA 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 any business. We continue to target returns of 15% on acquisitions.

We made seven acquisitions in the year, all of which either consolidated our positions in local markets or helped us enter new strategic segments. In line with our Group strategy, we are building multi-modal hubs in large, rich cities. In New York and Chicago, we have made acquisitions and won contracts to both open new markets and develop a presence that allows the efficient use of vehicles in a number of segments. In the year we won 20 small 'tuck in' contracts, within our transit business to develop this presence efficiently. An acquisition in Nashville, also provides the opportunity to develop a charter network between Tennessee and our hubs further north.

Charter and Charter Schools both remain areas of growth and interest for further expansion in the coming years. Indeed, a number of the acquisitions made in the year have helped grow our presence in these markets. These again fit with this strategic approach: we are often able to use existing vehicles when they would otherwise be sitting empty and they build our presence in local markets, providing a scale that means we are able to secure further work at competitive rates.