

The re-negotiated West Coast rail franchise is benefiting from good revenue growth and increased market share which results in a positive outlook for the year ending 30 April 2008. The CrossCountry franchise terminates in November 2007 and VRG is awaiting the outcome of its bid for the New Cross Country franchise.

3.10 Principal risks and uncertainties

Like most businesses, there are a range of risks and uncertainties facing the Group and the matters described below are not intended to be an exhaustive list of all possible risks and uncertainties.

Generally, the Group is subject to risk factors both internal and external to its businesses. External risks include global political and economic conditions, competitive developments, supply interruption, regulatory changes, foreign exchange, materials and consumables (including fuel) prices, pensions funding, environmental risks, strikes, litigation and the risk of terrorism. Internal risks include risks related to capital expenditure, acquisitions, regulatory compliance and failure of internal controls. Details of risk management procedures are given on pages 28 and 29.

The focus below is on those specific risks and uncertainties that the Directors believe could have the most significant impact on the Group's long-term performance.

3.10.1 Sustainability of rail profits

A significant element of the Group's revenue and profit is generated by UK rail franchises. There is a risk that the Group's revenue and profit could be significantly affected (either positively or negatively) as a result of the Group winning new franchises or failing to retain its existing franchises. In June 2007, the Group was awarded the new East Midlands franchise, and will begin operating the East Midland Services in November 2007.

The Group was awarded the new South Western franchise, which combines the former South West Trains and Island Line franchises, in September 2006. The new 10-year franchise, which commenced on 4 February 2007, will result in lower annual profits than those earned under the previous franchises. In June 2007, the Group was awarded the new East Midlands franchise, and will begin operating the East Midlands services in November 2007.

The Group's joint venture, VRG, currently operates the CrossCountry rail franchise, which is due to expire in November 2007, and the West Coast rail franchise. VRG is one of four shortlisted bidders on the New Cross Country franchise which replaces the current CrossCountry franchise operated by VRG. There is a risk that VRG does not win the New Cross Country franchise or wins it on unfavourable terms. The West Coast rail franchise was renegotiated with new commercial terms being agreed in December 2006. The renegotiated West Coast franchise runs through until 2012.

Stagecoach Group is also bidding with Virgin and GNER Holdings for the InterCity East Coast rail franchise.

In order to manage the risks, the Group has devoted significant management resource and financial investment to bidding for new rail franchises. Appropriately experienced personnel are retained to work on rail bids and third party consultants are engaged to provide additional expertise. The Board approves the overall rail bidding strategy and the key parameters for each bid.

3.10.2 Breach of franchise

The Group is required to comply with certain conditions as part of its rail franchise agreements. If it fails to comply with these conditions, it may be liable to penalties including the potential termination of one or more of the rail franchise agreements. This would result in the Group losing the right to continue operating the affected operations and consequently, the related revenues and cash flows. The Group may also lose some or all of the amounts set aside as security for the shareholder loan facilities, the performance bonds and the season ticket bonds. The Group can do more to prevent breaches of franchise where it has sole control than where it has joint control. As the holder of a 49% joint venture interest in VRG, the Group has less control over the joint venture's operations and that means the Group's management may be less able to prevent a breach of the VRG franchise agreements.

Compliance with franchise conditions is closely managed and monitored and procedures are in place to minimise the risk of non-compliance.

3.10.3 Pension scheme funding

The Group participates in a number of defined benefit pension schemes. There is a risk that the cash contributions required to these schemes increases or decreases due to changes in factors such as investment performance, the rates used to discount liabilities and life expectancies. Any increase in contributions will reduce the Group's cash flows.

Decisions on pension scheme funding, asset allocation and benefit promises are taken by management in consultation with the pension scheme trustees, trade unions and suitably qualified advisors. A Pensions Oversight Committee has been established comprising the Finance Director, a Non-Executive Director and other senior executives, to oversee the Group's overall pensions strategy. The Board participates in major decisions on the funding and design of pension schemes.

As described in section 3.8.9 of this Annual Report, significant progress was made during the year ended 30 April 2007 in managing pension scheme risks.

3.10.4 Insurance and claims environment

The Group receives claims in respect of traffic incidents and employee claims. The Group protects itself against the cost of such claims through third party insurance policies. An element of the claims is not insured as a result of the "excess" on insurance policies.

There is a risk that the number or magnitude of claims are not as expected and that the cost to the Group of settling these claims is significantly higher or lower than expected. In the US, in particular, there is a risk that given the size of the "excess", that a small number of large-value claims could have a material impact on the Group's financial performance and/or financial position.

The Group has a proactive culture that puts health and safety at the very top of its agenda and this helps mitigate the potential for claims arising. Further details on the Group's management of health and safety are provided on page 17.

Where claims do arise, they are managed by dedicated insurance and claims specialists in order to minimise the cost to the Group. Where appropriate, legal advice is obtained from appropriately qualified advisors. The balance between insured and retained risks is re-evaluated at least once a year and insurance and claims activity is monitored closely.

3.10.5 Regulatory changes and availability of public funding

Public transport is subject to varying degrees of regulation across the locations in which the Group operates. There is a risk that changes to the regulatory environment could impact the Group's prospects.

Similarly, many of the Group's businesses benefit from some form of financial support from government including direct financial support, the provision of equipment, government contracts and concessionary fare schemes. There is a risk that the availability of sufficient government financial support differs due to regulatory or other changes.

In May 2007, the UK Government published a draft Local Transport Bill setting out its legislative proposals to help tackle road congestion and improve public transport. The Group welcomes proposals to promote intelligent car use and improve the operating environment for buses. There is, however, a risk that legislative change could impact the Group's financial performance, either positively or negatively.

Management closely monitors relevant proposals for changes in the regulatory environment and communicates the Group's views to key decision makers and bodies. The Group actively participates in various industry and national trade bodies along with domestic and international government forums. The Group seeks to maintain good, co-operative relationships with all levels of government, including the introduction of ideas that offer cost-effective ways of improving public transport.

3.10.6 Management and Board succession

The Group values the continued services of its senior employees, including its Directors and management who have operational, marketing, engineering, technical, project management, financial and administrative skills that are important to the operation of the Group's business.

Succession planning for the Directors and senior management is an important issue and as such is considered by the Nomination Committee and the Board. The appropriate level of management deals with recruitment and retention of other staff.

3.10.7 Catastrophic events

There is a risk that the Group is involved (directly or indirectly) in a major operational incident resulting in significant human injuries or damage to property. This could have a significant impact on claims against the Group, the reputation of the Group and its chances of winning and retaining contracts or franchises.

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The Group has a proactive culture that puts health and safety at the very top of its agenda in order to mitigate the potential for major incidents. In the unlikely event that a major incident did occur, the Group has procedures in place for responding to such incidents.

3.10.8 Terrorism

There have been multiple acts of terrorism on public transport systems and other terrorist attacks that whilst not directly targeting public transport have discouraged travel. There is a risk that the demand for the Group's services could be adversely affected by a significant terrorist incident. Such a fall in demand would have a negative effect on the Group's revenue and financial performance. The Group has plans in place designed to reduce the financial impact of a terrorist incident and these plans take account of the Group's experience of managing the North American business during the period of depressed demand following the major terrorist attack on 11 September 2001.

3.10.9 Treasury risks

Details of the Group's treasury risks are discussed in note 28 to the consolidated financial statements, and include the risks arising from movements in fuel prices.

3.11 Corporate social responsibility

We pride ourselves on delivering high-quality local services to local communities by local people. As well as providing a range of economic and environmental benefits, our bus and rail services support social inclusion and bring people together. We are committed to attracting more people to public transport. It is central to our growth strategy, to the future success of our Group, and also important to the future of the communities in which we operate around the world. We are committed to working in partnership with the many stakeholders our services touch to achieve our mutual long-term goal of sustainable development.

Stagecoach has a strong culture of meeting its wider corporate responsibilities, from the way we do business and our approach to safety and the environment, to how we treat our customers, our local communities and our own people. Like the best businesses, we measure our performance and always strive to improve the delivery of our service to customers. By building trust with our stakeholders, we believe we can make an increasingly positive impact on society and the environment. Here we have provided an overview of some of our people, safety, accessibility, environment and community initiatives.

3.11.1 Stakeholders

Stagecoach Group works in partnership with a range of bodies in each of the markets where we provide public transport services. Further information on our stakeholders and how we build relationships with them can be found on page 5.

3.11.2 Our People

The strength of our business is built on the high quality of our management teams and frontline employees, from drivers and engineers to customer service and support staff. These are the people that ensure we can deliver a first-class quality of service day in, day out, and encourage more people to use public transport. By investing significant time and resources, we are able to have the right people on board to deliver for our customers.

We respect and value our staff, and we have a strong commitment to equal opportunities and partnership working with trade unions. Stagecoach also offers its employees the opportunity to join an excellent pension scheme as well as providing attractive pay and conditions packages.

As a major employer, we also recognise the need for ongoing training and development, not just so our people can do their job, but so they can develop individually. In our UK Bus division, we have one of the best vocational training programmes of any operator, designed to raise standards among and recognise the key contribution of our drivers. We continue to focus closely on recruitment and retention of drivers through improved pay, better training and mentoring schemes. We have also established links overseas, as part of the expansion of the European Union, to recruit drivers to complement our employment campaigns in the UK. Stagecoach has also won a national award for the high standard of its UK Bus training team, taking the Centre of the Year Award for training providers and employers at the Scottish Qualifications Authority Annual Awards 2006.

At South West Trains, our centralised Recruitment Centre and the state-of-the-art Operations Training Centre are continuing to deliver benefits

to our employees and better service to our customers. We also have in place vocational training, support for managers, employee recognition programmes and round-the-clock open learning access for our staff. South West Trains spends an average of more than 1,600 employee days a month training its people in addition to its three 24-hour open learning centres.

In North America, our centralised driver training school has improved the quality and consistency of provision. Our Canadian business has focused closely on harnessing the power of the web to attract new employees and has been working in partnership with Workopolis, Canada's leading internet recruitment service.

We are also looking to develop the managers of the future through our graduate recruitment initiative. One of Stagecoach's managers received the Chartered Institute of Logistics and Transport (CILT) Young Manager of the Year award, while one of our other former graduate trainees is now part of our management team in North America. Stagecoach is working with the Department for Education and Skills and the Learning and Skills Council to deliver a new two-year Young Apprenticeship programme. The programme enables Stagecoach to help shape the workforce of the future by offering able and motivated 14 to 16-year-old pupils the chance to get a taste of work alongside their school studies.

Stagecoach wants to be there to help our people when they need it most. Our South West Trains and North American businesses have care schemes, which offer an employee assistance programme that includes a 24-hour confidential counselling service. South West Trains runs regular health fairs across its network, offering employees the opportunity to have a cholesterol check, free flu vaccination or general check-up.

We are one of six employers across the UK involved in a cutting edge pilot scheme that aims to research and test various ways to improve financial capability in the workplace. The multi-agency project - co-ordinated by the Financial Services Authority (FSA), the independent financial watchdog - involves offering our staff one to one surgeries and hard copy material. The workplace is seen as an ideal way to get information and education on finance to adults and active participation by employers is vital. The pilot is part of a national strategy to improve access to information, advice and personal finance education, so that consumers are better equipped to make sound choices when looking after their money and their future financial security.

3.11.3 Improving accessibility

Accessibility is crucial in providing attractive public transport services and we recognise that every customer we serve is unique, each with their own specific individual needs. As far as possible within the resources we have available, we are making it easier to use our bus, rail and tram services.

Over the last year, we have invested in over 500 new low floor buses in the UK and are on target to beat government deadlines for compliance with disability legislation. We have announced a further investment of £65m in new accessible vehicles in the UK for 2007/8. Earlier this year, we invested £11m in Britain's longest coaches as part of a drive to attract people out of their cars and away from low-cost airlines. The fleet of 45 state-of-the-art 15-metre coaches, now in operation on megabus.com and Scottish Citylink services, are fully accessible and have a special lift for wheelchair passengers. We are also helping provide new demand responsive transport services, which are meeting the needs of those with mobility problems who require a service from their front door.

Significant investment is also taking place in our North American business in partnership with federal agencies. This year, our New York Sightseeing business introduced 13 new open-top double-decker vehicles with improved wheelchair access ramps for disabled customers.

On the South West Trains network, we operate an assisted travel line to encourage disabled travellers to book ahead so we can make arrangements to ensure their journey runs smoothly. Induction loops are provided at our ticket offices and large print timetables are available to assist independent travellers with special needs. We provide station-based ramps to enable wheelchair users to board and alight our new accessible Desiro trains with maximum convenience. To support the access of wheelchair users to our network, we are now committed to providing wheelchair users with accessible taxis at no extra charge to and from stations with no step-free access.

Access for all is also about staff training and we continue to maintain links with disability groups to ensure both the needs of our passengers and employees are considered. At Sheffield Supertram, for example, we are currently refreshing the interiors of our vehicles, which will feature textured grab rails and improved seating layouts to help passengers with visual