

Principal activity and business review

The group's principal activity is the provision of public transport services in the United Kingdom and overseas.

A review of the group's activities and developments during the year, together with future prospects, is set out in the Chairman's Statement on pages 2 and 3 and in the Chief Executive's Review on pages 4 to 28 of the Annual Review and in the Finance Director's Review on pages 1 to 7 of this document.

Group results and dividends

The results for the year are set out in the consolidated profit and loss account on page 18.

An interim dividend of 1 pence per ordinary share (net) was paid on 18 March 1999. The directors recommend a final dividend of 2 pence per ordinary share making a

total dividend of 3 pence per share for the year. Subject to approval by shareholders, the final dividend will be paid on 14 October 1999 to those ordinary shareholders on the register at 13 August 1999.

Directors and their interests

The names, responsibilities and biographical details of the current directors appear on page 29 of the Annual Review. All served throughout the year.

Brian Souter, Keith Cochrane and Ewan Brown retire by rotation in accordance with the Articles of Association and being eligible offer themselves for re-election. Brian Souter and Keith Cochrane have service contracts with a rolling 12 months' notice period. Ewan Brown does not have a service contract.

The table below sets out the interests of the directors and their families in the share capital of the company:

		Number of shares	
		30 April and 30 June 1999	30 April and 30 June 1998
Ordinary shares of 0.5p each			
Brian Souter	beneficial	163,341,225	163,341,225
	non-beneficial	19,415,840	19,415,840
Ann Gloag	beneficial	131,640,818	131,640,815
	non-beneficial	20,903,190	20,953,190
Mike Kinski		24,160	2,125
Keith Cochrane		32,417	30,095
Brian Cox		573,342	527,105
Barry Hinkley		710,159	709,545
Ewan Brown		Nil	Nil
Barry Sealey		125,000	125,000
Robert Speirs		15,000	Nil
		Number of shares	
		30 April 1999	30 April 1998
Share options held by Directors			
Brian Souter		2,601	2,590
Ann Gloag		14,246	14,185
Mike Kinski		634,002	631,300
Keith Cochrane		1,414,087	1,009,765
Brian Cox		1,018,701	995,580
Barry Hinkley		1,102,996	995,580
Full details of options held as at 30 April 1999 are contained in Note 7b to the accounts.			
The following share options were granted on 16 June 1999			
	Number of shares over which options granted	Exercise price £	Period in which options may be exercised
Mike Kinski	365,998	2.1825	16 June 2002 to 16 June 2006
	300,000	2.1825	16 June 2004 to 16 June 2006
Keith Cochrane	72,997	2.1825	16 June 2004 to 16 June 2006
Brian Cox	68,188	2.1825	16 June 2004 to 16 June 2006
Barry Hinkley	85,277	2.1825	16 June 2004 to 16 June 2006

Substantial shareholdings

On 24 June 1999, the following disclosable shareholdings in excess of 3% (other than certain directors' shareholdings) had been registered:

Mercury Asset Management	5.11%
Standard Life	3.60%

Employment policies

The group strives to meet its business objectives by motivating and encouraging its employees to be responsive to the needs of its customers and to maintain and, where possible, improve operational performance. The group is also committed to providing equality of opportunity to current employees and potential employees. This applies to appropriate training, career development and promotion opportunities for all employees regardless of physical disability, gender, religion or ethnic origin.

The group recognises its obligations to give full and fair consideration to applications from disabled persons for all group vacancies, in keeping with the statutory medical requirements applicable for certain grades of staff and according to the skills and capabilities of applicants. Wherever reasonable and practicable, the group will retain an existing employee disabled during their period of employment and provide fair opportunities for their career advancement.

The group is committed to employee participation and uses a variety of methods to inform, consult and involve its employees. An Inland Revenue approved Employee Share Ownership Plan ("non-statutory ESOP") was introduced for UK employees in 1991. The group has since 1994 also allocated up to 3% of relevant profits to allot free shares to the majority of UK employees under approved profit share schemes. Employee trusts under approved ESOP share schemes held 2,383,999 ordinary shares, representing 0.2% of the issued share capital at 30 April 1999. Since flotation in 1993, there have also been two invitations to UK employees to subscribe to the group's sharesave ("SAYE") scheme, both of which have met with encouraging levels of response.

The group has also established a European Works Council in 1998, bringing together representatives from senior management and trade unions in European Community member states where the group has significant business interests and numbers of employees. The group also produces a range of internal newsletters and information circulars which keep employees abreast of developments. Employees are encouraged to discuss matters of interest to them and subjects affecting day to day operations of the group with management. Discussions also take place regularly with the trade unions representing the vast majority of the group's employees on a wide range of issues.

Directors' responsibilities

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the group, and of the profit or loss of the group for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and of the group, and enable them to ensure that the accounts comply with the Companies Act 1985. The directors are also responsible for safeguarding the assets of the company and of the group, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

A resolution to re-appoint Arthur Andersen as auditors of the company, at remuneration to be fixed by the directors, will be proposed at the Annual General Meeting.

Supplier payment policy and practice

It is the group's policy to agree appropriate terms of payment with suppliers for each transaction or series of transactions, and to abide by those terms based on the timely submission of satisfactory invoices. The policies followed by each of the major UK operating subsidiaries are disclosed in the accounts of those companies. The trade creditors outstanding at the year end represented 44 days' purchases (1998 – 40 days).

Close company status

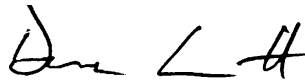
The directors are advised that at 30 April 1999 the company was not a close company within the meaning of the Income and Corporation Taxes Act 1988.

Charitable and political contributions

Group companies made charitable commitments of £1,050,000 (1998 – £798,000) during the year. This is in line with the group's policy of setting aside 0.5% of pre-tax profits for charitable purposes.

It is the group's policy not to make political contributions and, accordingly, there were no payments for political purposes during the year.

By order of the Board



Derek Scott

Company Secretary

30 June 1999

The group has recognised since before its flotation and continues to recognise the importance of, and is committed to, high standards of corporate governance. The Hampel Committee and the London Stock Exchange issued the Combined Code on corporate governance in June 1998, and therefore the provisions have not been in effect for the full financial year. The principles of good governance contained within the Combined Code have been applied in the following way:

The Board

The Stagecoach Board is accountable to shareholders and others for the group's activities and is responsible for the effectiveness of corporate governance practices within the group. The Stagecoach Board currently comprises the Chairman, Chief Executive, four other executive directors and three non-executive directors: the offices of Chairman and Chief Executive are held separately. Their biographies appear on page 29 of the Annual Review and illustrate the directors' range of experience, which ensures an effective Board to lead and control the group. The non-executive directors bring an independent viewpoint and create an overall balance operating in the interests of both the group and the shareholders. The executive and non-executive directors have a complementary range of financial, operational and entrepreneurial experience that ensures no one director or viewpoint is dominant in the decision-making process.

All directors meet regularly with other senior management and staff of the group, have access to confidential advice from the company secretary and may take independent legal or other professional advice at the group's expense where it is considered necessary for the proper discharge of their duties as directors. All directors submit themselves for election by shareholders at the Annual General Meeting following their appointment and one-third of directors are required to stand for re-election by shareholders each year. Each director receives training on appointment and subsequently as is considered necessary to keep abreast of matters affecting their duties as directors. The number of full Board meetings during the year was nine. The full Board also meets once a year at an operational location and regular communications, both written and verbal, are maintained by the Chairman to ensure all directors are briefed on strategic and operational issues.

Non-attendance at the Board or committees occurs only in exceptional circumstances. The Board has a number of matters reserved for its consideration, with principal responsibilities being to agree the overall strategy and investment policy, to approve major capital expenditure and vet acquisitions or disposals, to monitor performance of senior management and to ensure that there are proper internal controls in place. All directors have full and timely access to information with Board papers distributed in advance of meetings. The Board intends to carry out an annual formal review of the effectiveness of the Board as a whole and the contribution made by each director. To provide effective and proper control, certain of the Board's powers have been delegated to committees.

The operational management of the group is delegated by the Board to the Chief Executive and executive directors who meet regularly as the executive group. Non-board senior management supports them. There are over 12 autonomous business units, each headed by a chairman or managing director who is responsible for the day to day performance of the business unit. The UK bus division is headed by a chairman with the individual UK bus companies reporting to him through three regional chairmen. The UK bus division has its own management board which comprises three executive directors, three regional chairmen and other senior management. The Chief Executive is responsible for the overseas bus division with each business headed by a chairman or managing director who is responsible for the performance of the business unit. At South West Trains, an executive director is chairman and this role is separate from the managing director who is responsible for the performance of the business unit. They are supported on the South West Trains board by three non-executive directors. One executive director is a member of the Porterbrook board where again the offices of chairman and managing director are separate. The group holds periodic meetings with its principal shareholders and welcomes all shareholders to its AGM. Formal notice of the 1999 meeting is enclosed within this annual report.

Audit Committee

The Audit Committee comprises the three non-executive directors and met three times during the year. Barry Sealey chairs the Audit Committee. It receives reports from management and from the group's internal and external auditors relating to the scope and results of the audit, the interim and annual accounts and the accounting and

internal control systems in place throughout the group. The Audit Committee reviews the cost effectiveness, independence and objectivity of the external auditors. The Audit Committee approves the audit fees and reviews significant non-audit related services provided by the auditors and affiliated firms. The Committee has unrestricted access to the auditors.

Remuneration Committee

The Remuneration Committee also comprises the three non-executive directors and is chaired by Robert Speirs. The Remuneration Committee met two times during the year. It is responsible for reviewing the scale and structure of the remuneration of the executive directors and the terms of their service contracts and is also responsible for approving grants of and changes to the company's performance-related incentive schemes and executive share option schemes.

Nominations Committee

The Nominations Committee comprises the three non-executive directors and is chaired by the Chairman. The purpose of the Committee is to propose to the Board any new executive and non-executive director appointments.

Directors' remuneration

The Remuneration Committee makes recommendations to the Board for ensuring that the directors' remuneration is appropriate to attract, retain and motivate executive directors of the quality needed to run the group successfully. The Committee believes that remuneration packages should contain significant performance related elements. Performance targets are established to achieve consistency with the interests of shareholders, using an appropriate balance of long and short term targets. The constitution and operation of the Remuneration Committee complies with the principles and provisions of the Combined Code and this is detailed in the remuneration report laid out on pages 15 and 16.

Relations with shareholders

The Board considers communications with shareholders, whether large or small, external or employees, to be extremely important. The group holds periodic meetings with major institutional shareholders, other fund managers and representatives of the financial press. The programme of investor relations includes presentations in London of the full year and interim results and meetings with institutional investors in the

UK and overseas. Investor and analyst feedback is sought after presentations to ensure principal issues are being effectively communicated and shareholder objectives are known. During the year written responses are given to letters or e-mail received from shareholders and all shareholders receive Interim and Annual Reports or the summary financial statement. In order to provide a more focused communication with shareholders and to meet their varying requirements, the Annual Report and Accounts are split into two separate sections. Section one contains the Annual Review and Summary Financial Statement and section two contains the Report and Accounts. Information is also available on the company website (<http://www.stagecoachplc.com>). Private and institutional shareholders are encouraged to attend and participate at the AGM. The chairmen of the Audit, Remuneration and Nomination Committees are available at the AGM to answer questions. The AGM provides an opportunity for shareholders to question the Chairman and other directors on a variety of topics and further information is provided at the AGM on all the group's principal business activities. The Chairman formally announced details of all proxy votes lodged for each resolution after each show of hands at the 1998 AGM and this practice will continue.

Accountability and audit

The Board endeavours, in all its communications with shareholders, to present a balanced and understandable assessment of the company's position and prospects.

The Board considers acceptance of appropriate risks to be an integral part of business and unacceptable levels of risk are avoided or transferred to third parties. Internal controls are used to identify and manage acceptable levels of risk. In accordance with Internal Control and Financial Reporting guidance the directors acknowledge their responsibility for establishing and maintaining the group's system of internal control. Although the system can provide only reasonable and not absolute assurance of material misstatement or loss, the group's system is designed to provide the directors with reasonable assurance that any risks or problems are identified on a timely basis and dealt with appropriately. The group has established an ongoing process of review and certification by the business heads of each operating unit. They identify with their line managers the business risks most important to their unit, consider the financial implications and assess the effectiveness of the control processes in

place to mitigate these risks. The group considers risk assessment to be the most effective method of ensuring adequate internal controls are in place. Business risk matrices are presented to the Audit Committee and include a consideration of regulatory, political, reputational and financial risks to which the group is exposed.

In reporting on provision D.2.1 of the Combined Code which deals with internal controls, the group has adopted the approach permitted by the London Stock Exchange in its letter to listed companies of 10 December 1998 which permits companies to refer only to internal financial controls. The Board has also considered guidance on internal controls contained in the consultation draft issued by the “Turnbull” working party of the ICAEW.

This process, together with the key procedures noted below, enables the directors to confirm that they have reviewed the effectiveness of the system of internal financial control of the group during the year. The key procedures, which the directors have established, are as follows:

- an internal audit function which reviews key business processes and financial controls, reporting directly to the Audit Committee.
- a Year 2000 project team which has assessed Year 2000 compliance within the group and monitors progress on achieving Year 2000 compliance on critical business systems (a Year 2000 report is contained in the finance director’s review on page 7).
- a decentralised organisation structure with clearly defined limits of responsibility and authority to promote effective and efficient operations.
- a performance management appraisal system is in place which covers over 100 of the group’s senior management and is based on agreed financial and other performance objectives many of which incorporate identifying and managing risk.
- an annual budgeting process with regular reforecasting of outturn, identifying key risks and opportunities. All budgets are presented to a panel of the executive directors by each business unit’s management team, before being approved by the Board prior to the commencement of the financial year.
- four-weekly reporting of financial information to the Board encompassing profit and loss, cash flow and balance sheet and key operating ratios. All results are monitored throughout the year by the group executives.
- significant emphasis is placed on cash flow management. Bank balances are reviewed on a daily basis, cash flows are compared to budget on a four-weekly basis and any material variances between earnings and expected cash flows are investigated.
- regular Board reporting on specific matters including insurance, treasury management, foreign exchange, interest and commodity exposures. The Board regulates treasury management policies and procedures.
- defined capital expenditure and other investment approval procedures, including due diligence requirements where material businesses are being acquired or divested.
- each operating unit maintains controls and procedures appropriate to the business. It is a key requirement of the procedures that a written certificate is provided annually by the managing director and financial manager of each business confirming that they have reviewed the effectiveness of the system of internal financial control during the year. As might be expected, a number of minor internal financial control weaknesses were identified by this procedure, all of which have been, or are being, addressed. None of the weaknesses has resulted in any material losses, contingencies or uncertainties that would require disclosure in the group’s Annual Report.
- a commitment to best practice in external reporting.
- a competition compliance programme which has been approved by the Board and which is subject to regular monitoring.

The Audit Committee considered the external auditors' performance during the year to be satisfactory and recommended re-appointment. The audit fees of £0.5 million and non-audit related fees of £0.6 million were discussed at length and considered appropriate given the current size of the group and the level of corporate activity undertaken during the year. The Committee believes the level of non-audit services does not impair the objectivity of the auditors and that there is a clear benefit obtained from using professional advisors who have a clear understanding of the group's operations.

Compliance with the Combined Code

The group has complied with the provisions of the Code throughout the financial year except the following:

- Provision A.2.1. – During the year there was no formally recognised senior independent non-executive director. Barry Sealey was formally appointed the senior non-executive director on 14 May 1999.
- Three of the nine directors have service contracts that are terminable by the group with two years' notice. The Board believes it is in the best interests of shareholders to retain key executive directors. The length of directors' service contracts will be reviewed on an annual basis having regard to prevailing market conditions and practice amongst UK public companies.

Furthermore, the group has acquired a number of businesses during the year and the group is identifying any additional procedures that may be necessary to bring these companies into line with the group's corporate governance procedures.

Pension schemes

The assets of the group's pension schemes are totally separate from the assets of the group and are invested with independent fund managers. There are ten trustees for the principal UK scheme of whom five are employee representatives nominated by the members on a regional basis. Three of the executive directors are trustees together with two senior management colleagues. Derek Scott, who is an elected member of the NAPF's investment committee, acts as chairman of the board of trustees and in 1998 was also re-elected to the 16-member board of the industry-wide Railways Pension Scheme. The auditors and actuaries of the principal UK pension scheme are both independent of the group. Similar arrangements are in place for the SWT, Island Line and Porterbrook sections of the Railways Pension Scheme. The Newcastle office of Arthur Andersen audits the Railways Pension Scheme.