



Chief Executive's review

'The strategy remains firmly focused on our core bus and rail businesses in the United Kingdom, North America and the Asia Pacific region'

During the last financial year, my priority has been to consolidate our existing operations and put in place a firm foundation for growth. The strategy remains firmly focused on our core bus and rail businesses in the United Kingdom, North America and the Asia Pacific region. The successful disposals of our non-core interests in Glasgow Prestwick International Airport and Portugal were consistent with this strategy.

My primary focus during the year has been the continued restructuring of Coach USA. While the overall trading performance during the year has continued to be below expectations, in the second half we have seen some improvement in underlying cost and revenue trends. I am also encouraged by the progress that has been made in a number of areas across the business. Our taxi and transit divisions have performed well, our scheduled line run businesses have continued to achieve good organic growth and each of the acquisitions completed in the last 18 months has performed strongly.

Our priority has been to increase our return on capital through improved fleet utilisation and increased operational efficiency.

We have rolled out our restructuring programme across all regions and we have also concentrated on the individual under-performing business units in our portfolio which represent in total some 25% of revenues yet only contribute 1% of operating profits. We have reallocated or retired over 400 vehicles across the business and a number of operating units have been targeted for sale or closure. Clear action plans have been identified for all under-performing units and the implementation of these is progressing. We are also now seeing the benefits of scale emerging from the restructuring programme, particularly savings in the North East region where significant cost reductions have been achieved in procurement.

I have now implemented significant management changes at Corporate, Regional and Company level. We have been successful in attracting a number of experienced and knowledgeable managers from both inside and outside the motorcoach industry in North America. We have also appointed some of our most experienced UK Bus managers to key positions at Coach USA. Frank Gallagher

has indicated his desire to retire as an executive at the forthcoming AGM and we are at an advanced stage in the search for a new CEO for Coach USA.

Improved performance at Coach USA is not just about cost reductions but also delivery of revenue growth. Key initiatives in the last year include the recent launch of a new sightseeing product in New York City that will see the introduction of 40 new double deckers. The response to the launch has been very positive and we are optimistic for the future. A similar initiative has been launched in Chicago and we plan to roll out this product to other major cities in North America in the next 12 months. In Anaheim, California, we have been working closely with the City Council to provide a new comprehensive bus service network to support the new and enlarged Disneyland theme park that opened earlier this year. Our transit division continues to win new contracts and has achieved year on year revenue growth of over 10%. We are encouraged that, despite heavy competition, Coach USA continues to win and retain contracts on sound commercial terms. Our taxi division continues to see strong revenue growth and good profitability and has achieved positive results from the introduction of wheelchair accessible cars in a number of markets.

We have made a small number of acquisitions in the current year, most of which have been in the taxi division, and all of these acquisitions have outperformed our original expectations. There remains a significant number of acquisition opportunities in the highly fragmented North American market but we will continue with our strategy of only making selective acquisitions that meet our rigid financial and non financial investment criteria and that are able to be integrated easily within our existing management structure.

Our UK bus division continues to operate in a challenging labour environment but remains very well positioned to support and take advantage of the Government's 10 year transport plan which I believe offers a number of exciting opportunities to re-invigorate the UK Bus market. We intend to play a leading part in meeting the Government's objective of at least a 10% increase in passenger volumes over the period to 2009.



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Excluding those business units that were impacted by industrial action during the year, we estimate that passenger volumes increased by around 1%. We have experienced strong passenger growth within particular regions during the year, notably in London, Manchester, Cambridge, Oxford and Cheltenham. For UK Bus as a whole, the effects of industrial action and declining passenger levels in rural areas have, however, resulted in a small overall decline in passenger numbers.

The industrial action during the year combined with cost increases ahead of inflation have put pressure on our operating margins. Our strategy is to target investment and deployment of our operating assets in those parts of the business where we can maximise shareholder value. Management focus is on achieving revenue growth and a number of commercial initiatives are underway to support this strategy with an emphasis on the development of core routes. There remain many opportunities for obtaining organic growth and each UK Bus operating company has identified its core routes and has developed a clear strategy for further developing these routes. A programme of implementation for these strategies has already commenced.

We have already redeployed a number of vehicles to parts of the network where we believe we can generate additional organic growth. As part of this strategy we also disposed of four depots in the North West of England and we are continuing to review the portfolio mix to ensure that we achieve the best use of capital.

In London we have been encouraged by the progress made by Transport for London, with a renewed emphasis on quality rather than price in evaluating tenders. We anticipate growth in the London bus market as a result of the initiatives being introduced by Transport for London. Our two London companies are ranked highly for punctuality and reliability and we are therefore well positioned to benefit from the many opportunities in this market. Of our 18 contracts that were re-tendered during the year we retained 14, all at improved operating margins. We also won a further four new contracts.

Our growth strategy is being supported by the introduction of smartcard technology through Prepayment Cards Limited, in which we are a shareholder. Our first Smartcard project is due to be implemented in Manchester later this year.

Our Citybus operation in Hong Kong has again outperformed the expectations set at the time of our acquisition in 1999 and continues to show strong organic revenue growth and margin improvement with the full benefit of our restructuring programme being realised in the current year. I am also pleased to report that we have been advised by the Hong Kong SAR Government that there are no plans to carry out a mid-term franchise review at this stage and they have encouraged us to seek a renewal of our franchised operations over the coming months.

Our operations in New Zealand have seen good revenue growth and are still achieving acceptable operating margins helped by a fares increase and further passenger volume growth in Auckland. Our New Zealand operations have now achieved their eighth year of passenger volume growth. As a leading bus operator in New Zealand we are greatly encouraged by the New Zealand Government's funding support for public transport and we are working with the regional councils on a number of specific initiatives to further increase the use of public transport.

The Group announced on 18 June 2001 the disposal of its Portuguese bus operations. Portugal has been a good market for the Group over several years but the scale of the operation and its geographic location was no longer consistent with Group strategy and we felt that the price offered represented good value for our shareholders.

Our UK Rail division remains totally committed to providing a safe operating environment for passengers and employees alike. We continually review our safety standards and processes throughout all of our operations and regularly conduct extensive internal and external safety audits.

Operating performance at South West Trains and Virgin Rail Group was significantly affected by the extensive disruption to the national rail network following the imposition of emergency and temporary speed restrictions by Railtrack after the accident at Hatfield. Great credit goes to the management and staff at both businesses for their sterling efforts in trying to provide the best possible service in very difficult operating conditions. I would also like to acknowledge the continued support of all of our passengers.

However, I am pleased to report that at South West Trains, train operating conditions have improved and the rate of growth in passenger volumes is now returning to the levels being achieved before the disruption occurred. Despite the operating difficulties, continued passenger volume growth has underpinned strong revenue growth and we are able to report operating profits ahead of last year.

The underlying performance of South West Trains reinforces our view that the demand for rail travel to and from London will continue to grow in the years ahead. Innovative solutions to service this growing demand formed a key part of our bid for a new 20-year franchise for South West Trains and we were extremely pleased to be selected as preferred bidder for the new franchise by the Strategic Rail Authority. The basis of our bid is a substantial investment package of incremental improvements to increase capacity to match this growing demand with increased capacity at Waterloo station a key priority. Our challenge and priority is to deliver passenger benefits as early as possible but with minimum disruption to the service that we provide and no compromises on safety. We have already taken an important first step with a £1 billion order for new rolling stock. We are now working with the Strategic Rail Authority and Railtrack to finalise the new franchise agreement as well as adding to our strong Rail management team to meet the challenges ahead.

Like all the other major inter-city train companies, operating performance of the Virgin Rail Group franchises of West Coast and Cross Country was significantly affected. The effect on passenger

numbers and related revenues has had an impact on the financial performance of Virgin Rail Group during the year. As a result, we have had to bear our share of operating losses for the year ended 30 April 2001. However, a satisfactory agreement regarding compensation for the disruption has now been reached with Railtrack.

The inter-city rail network has still not fully returned to normal and while we are encouraged that passengers are returning to the railway it is still too early to fully evaluate what the long-term impact of Hatfield might be. The success of the Virgin Rail Group franchises is dependent on long-term passenger volume growth arising from major new investment in trains and infrastructure. The first steps in meeting this challenge have now been achieved with the introduction of the new trains on the Cross Country franchise in May 2001. On West Coast, the first Pendolino tilting train is now on test and management is committed to delivering better service to passengers. Virgin Rail Group is working closely with Railtrack on the necessary infrastructure improvements and we are confident that they will honour their contractual obligations.

thetrainline.com, Virgin Rail Group's national rail ticket distribution company was also impacted by the rail disruption during the year. Virgin and Stagecoach have continued to support the business during this difficult trading period because we believe that the ticketing solutions provided by thetrainline.com are an integral part of providing a modern and efficient rail network. The business continues to benefit from technical support from Cap Gemini – Ernst and Young who have made significant investment to support the business and I am pleased to report that a revised contractual framework necessary to underpin the future profitable development of the business in the short to medium term has been agreed.

In summary, there are many opportunities in each of our markets and I believe that the outlook for the Group is positive. Nevertheless, there are undoubtedly a number of challenges facing our management teams. The overall trading performance at

Coach USA since our acquisition has clearly been disappointing. The reported operating results, while below expectations, are the base from which we must now move forward to improve margins to a satisfactory level. While the economic environment in the USA remains uncertain, I have outlined a number of our ongoing initiatives across the business and I am confident that we will see benefits from this effort in the current year. I believe that we can now move forward in the expectation that sustainable profit improvement and revenue growth can be realised. Bolt-on acquisitions will continue to be made at Coach USA where these complement our operating strategy.

The award of a preferred bidder status for a new 20-year rail franchise at South West Trains provides the Group with a leading role in the UK rail industry with all of the opportunities that this can bring. The Group has been shortlisted for the Thameslink franchise renewal and will actively bid for the new Wessex franchise where we believe we are well placed to take advantage of economies of scale with the South West Trains franchise. The management of Virgin Rail Group will be working hard in the coming months to fully recover from the effects of Hatfield. With new trains already being introduced we remain confident about the future and would anticipate that Virgin Rail Group will be profitable in the current financial year. We believe that together with Virgin and Bechtel, we have put forward a strong bid for the new 20-year East Coast Mainline Franchise and eagerly await a decision from the Strategic Rail Authority.

We now move forward with the confidence and knowledge that we have the management capability and financial resources to deliver on the opportunities and challenges ahead.



KEITH COCHRANE
Chief Executive