Finance Director's review

'The financial results for the year ending 30 April 2001 continue to demonstrate the underlying cash flow generation of the Group'

Overall

The financial results for the year ending 30 April 2001 continue to demonstrate the underlying cash flow generation of the Group. The financial statements reflect the first full-year results following the acquisition of Coach USA in July 1999 and the disposals of Swebus in January 2000 and Porterbrook in April 2000. These transactions substantially changed the shape of the Group and the financial results reflect this.

Turnover for the year was £2,083.5 million (2000 – £2,179.1 million). Excluding discontinued operations (principally Swebus and Porterbrook), this represents a growth in turnover of 17.4%. Earnings before interest, tax, depreciation and goodwill charges ("EBITDA") were £313.5 million (2000 – £623.0 million) for the year, £310.1 million (2000 – £587.0 million) before exceptional items. Pre-tax profits before goodwill amortisation and exceptional items were £122.9 million (2000 – £244.3 million), a decrease of 49.7%. As a result of the impairment of Coach USA goodwill, we reported a pre-tax loss of £316.5 million (2000 – profit of £182.3 million) after goodwill amortisation and exceptional items.

Adjusted earnings per share before taking account of goodwill amortisation and exceptional items fell from 13.4 pence to 7.8 pence, following the disposals of Porterbrook and Swebus.

The reported results are significantly affected by the substantial charge for goodwill impairment in respect of Coach USA. The charge reflects our view that the future profitability of Coach USA is below that expected at the time that we acquired the business. This charge, which does not affect the Group's strong reported cash flows, will result in reduced goodwill amortisation being charged to the profit and loss account in future years.

The accounts reflect the early adoption of a new Financial Reporting Standard ("FRS") 18, "Accounting Policies", which codifies the principles to be followed in selecting accounting policies. Whilst

FRS 18 has not required any changes to the policies applied by the Group, more extensive disclosure in respect of certain of our accounting policies has been provided to comply with the new standard. A further two new FRSs have been issued (FRS 17, "Retirement Benefits" and FRS 19, "Deferred Tax") but these will not be implemented until future financial years. The Urgent Issues Task Force has issued a number of new abstracts that are effective for these accounts, however none of these materially impact the reported results for the year.

Trading results

Operating profit before goodwill and exceptional items from continuing Group operations increased by 6.5% to £193.0 million (2000 – £181.2 million). Total Group operating losses, after taking account of exceptional items and goodwill, were £250.1 million (2000 – profit of £199.7 million). Total depreciation decreased from £218.7 million to £111.2 million, whilst that element of the charge relating to continuing businesses increased from £95.1 million to £110.2 million, reflecting the continued capital investment and the full-year impact of acquisitions during the current and prior years. Restructuring costs of £7.8 million (2000 – £6.5 million) have been charged against operating profits and include £2.4 million at UK Bus and head office, £0.2 million at South West Trains, £1.2 million in Overseas Bus and £4.0 million at Coach USA. Exceptional goodwill impairment of £376.0 million has been charged in respect of the carrying value of goodwill at Coach USA. The annual goodwill amortisation charge was £66.8 million compared to £47.4 million in 2000. The results also include net property gains of £2.8 million (2000 – £2.4 million).

Our share of joint ventures' and associates' operating profits (excluding all costs associated with thetrainline.com, goodwill and exceptional items) was impacted by the significant disruption to the UK Rail network during the year. Our share of profits was £10.5 million compared to profits of £29.2 million in the prior year.

Our share of thetrainline.com total operating losses was £9.7 million (2000 – £7.6 million), including exceptional marketing and development costs of £4.0 million (2000 – £6.2 million). No further exceptional marketing and development costs will be incurred – any future spend on marketing will be part of the normal operations of the business.

Finance charges

Net interest and financing charges decreased from £144.6 million to £76.0 million. This reflected the impact of the reduction in net debt arising from the disposals of Porterbrook and Swebus. The effective interest rate payable on gross debt for the year was 7.6% compared to 7.1% in 2000. Interest cover (excluding goodwill and exceptional items) was 2.6 times compared to 3.0 times in 2000. EBITDAE (earnings before interest, tax, depreciation, amortisation and exceptional items) to interest was 4.1 times compared to 4.7 times in 2000.

Acquisitions

During the year the Group has completed a number of smaller acquisitions of businesses that are complementary to and integrate with our existing businesses in North America. In total, Coach USA acquired 15 additional businesses during the year, with annualised revenues of approximately £43.6 million, for a total enterprise value of £68.2 million, including net debt assumed. These acquisitions contributed £4.8 million to operating profit in the year.

Disposals

The disposal of Prestwick Airport took place on 20 January 2001 for a cash consideration of £33.4 million including the repayment of inter-company debt of £7.3 million. The disposal resulted in a net gain on sale of £6.8 million being reported in the year. Operating profits of £1.1 million were reported in respect of Prestwick Airport for the period from 1 May 2000 to the date of disposal.

Part of our UK bus business in North West England was disposed of on 15 April 2001 for a consideration of £12.8 million. A gain of under £0.1 million arose on the disposal.

As a result of these disposals, goodwill of £2.5 million that was previously written off prior to the introduction of FRS 10, "Goodwill and Intangible Assets", has been written back from reserves to the profit and loss account during the year.

Taxation

Before taking account of the gain on the disposal of Prestwick Airport and the exceptional goodwill write-off, profit before tax for the year was £52.7 million. The tax charge of £15.8 million represents an effective rate of 30.0% on this profit compared to 22.7% in 2000. The Prestwick Airport gain and goodwill write-off have no tax impact.

The increase in the effective tax rate in the year is principally due to the removal of tax allowances previously enjoyed by Porterbrook from recurring investment in new rolling stock and the increase in the proportion of non tax-deductible goodwill amortisation relative to net profits.

We will implement FRS 19, "Deferred Tax" for the year ending 30 April 2002, which requires provision to be made for most timing differences irrespective of whether these are expected to reverse or not. While this does not impact cash tax payable, it will result in an increase in our reported effective tax rate.

Earnings and dividends

Earnings per share before goodwill amortisation and exceptional items was 7.8 pence, a decrease of 41.8% compared to 2000. Basic loss per share (taking account of all exceptional items and goodwill amortisation) was 24.8 pence, compared to last year's earnings of 9.4 pence. The weighted average number of shares in issue during the year was 1,341.7 million, 10.9% lower than last year principally reflecting 339.2 million shares repurchased since the commencement of the share repurchase programme in April 2000. Under the share repurchase general authorities granted at the 1999 Annual General Meeting and the Extraordinary General Meetings in April and June 2000, 248.1 million shares were repurchased prior to 30 April 2000 at an average price of 65 pence. During the year to April 2001, a further 91.1 million shares were repurchased at an average price of 68 pence. Shares in issue at the year-end were 1,318.6 million.

The Group has authority to repurchase a further 92.2 million shares. This authority expires at the 2001 AGM and we will seek to renew the general authority to repurchase up to 10% of the issued share capital at the 2001 Annual General Meeting.

The total proposed dividend for the year is 3.8 pence, an increase of 5.6% on last year's total dividend of 3.6 pence. This represents dividend cover (before goodwill amortisation and exceptional items) of 2.1 times compared to 3.7 times in 2000.

The final dividend will be paid on 10 October 2001 to shareholders on the register on 7 September 2001. For those shareholders who wish to take dividend payments in the form of shares, this can be achieved through the Dividend Reinvestment Plan (DRIP).

Cash flows

Cash generation across the Group remained strong with free cash flows amounting to £228.1 million. This compares to £283.9 million last year, which included Porterbrook and Swebus. Free cash flow per share declined by 1.9 pence to 17.0 pence.

At 30 April 2001 total cash balances were £160.0 million, a decrease of £655.5 million from 30 April 2000. This decrease resulted from £178.8 million of share repurchases, £574.6 million being used to repay debt, including the redemption of the 2007 Sterling bond and reduction of term and revolving credit facilities. The Group remains in a net borrowing position and surplus cash balances are used to repay debt where possible.

Included in cash at bank and in hand is £30.5 million held in trust in support of SWT's season ticket bond, £41.5 million held as collateral for loan notes, £7.3 million in respect of SWT's performance bond and £1.4 million as collateral for Letters of Credit issued by Coach USA.

Capital Expenditure

Capital Expenditure by division is summarised as follows:

	2001 £m	2000 £m
UK Bus	56.8	66.8
Coach USA	73.5	56.3
Overseas Bus	6.2	7.5
UK Rail	3.2	3.4
Discontinued – Porterbrook – maintenance	Nil	139.4
– capital	Nil	63.6
– Swebus	Nil	27.3
– Prestwick Airport	2.1	5.4
Other	Nil	7.0
Total	141.8	376.7

In the UK Bus division, 427 new buses and coaches were purchased at a total cost of £38.9 million, compared to £51.3 million in 2000. 201 of these new buses were purchased in respect of our London operations. At the year end capital commitments in respect of new vehicles for the UK Bus division were £39.4 million. Coach USA purchased some 422 new vehicles for £55.4 million and capital commitments at 30 April 2001 amount to £7.0 million.

We have also invested £37.9 million in land and buildings, and continue to invest in technology-driven solutions to develop fully the potential of our businesses.

Proceeds from asset disposals in the year were £10.1 million.

Our commitments in respect of railway rolling stock will be funded through operating leases and will not involve any initial capital spend.

Treasury risk management

Management of financial risks is an important aspect in ensuring that Stagecoach creates value for shareholders. Risk management is carried out through risk reviews, internal control systems, a global insurance programme and adherence to a Group Treasury Policy. The main areas of financial risk faced by the Group and managed by Group Treasury are liquidity and funding risk, interest rate risk, currency risk and commodity price risk. The Board regularly reviews these risks and approves the treasury policy, which covers the management of these risks.

The Group holds financial instruments to finance its operations and to manage interest, currency and commodity risks arising from its operations and from its sources of finance. In addition, various financial instruments – for example, trade debtors, trade creditors, accruals and prepayments – arise from the Group's operations.

The Group Treasury function uses financial instruments for financing and treasury management only. Derivative financial instruments such as swaps, caps and floors, forward agreements and options are entered into to manage exposures and achieve greater certainty of future costs. Group Treasury activity is restricted to the underlying cash flows and asset/liability positions of the Group.

Liquidity and funding

Our general policy is to finance the Group through a mixture of bank debt, capital markets issues and retained earnings. Financing is generally raised centrally and on-lent to operating subsidiaries on commercial terms.

The Group policy is that free cash flows generated from operations along with undrawn committed facilities should be sufficient to meet annual debt repayments. At the year end the Group's committed banking facilities were £586.0 million, £119.0 million of which were utilised, including guarantees.

Following the announcement of the Porterbrook disposal the Group issued a redemption notice in relation to its £125 million Sterling bonds, due 2007. These bonds were redeemed on 15 May 2000 at a redemption price of £1.1182 per £1 nominal value.

During the year, the Group repurchased approximately $49 million of the $500 million US dollar Notes, due 2009 and €8 million of the €400 million Eurobond Notes, due 2004.

In addition, on 14 June 2001, the Group arranged the first European Investment Bank funding totalling £40.0 million in relation to its UK Bus capital programme. The Group will continue to look to a variety of funding sources to minimise interest cost and maintain the most appropriate funding sources and maturity.

The Group was the first, and currently is the only, UK ground transportation company to be assessed by three independent credit rating agencies. During the year, the Group has maintained its long-term investment grade credit rating by Standard and Poors, Fitch IBCA and Moody's. On 30 May 2001, Moody's reiterated its view that the Group remains an investment grade credit.
We believe, given the cash generative and stable nature of each of our core businesses along with our strong financial profile, that we can maintain an investment grade rating.

Foreign currency denominated borrowings reduced by £274.4 million. The currency of borrowings is used as a partial, long-term hedge of the cash flows arising from overseas investments and as a hedge against future translation value of foreign currency investments. The Group's borrowings (after swaps and forward contracts) are denominated in the operational currencies of the Group. The maturity of borrowings is shown in note 18.

Total net borrowings at 30 April 2001 increased by 43.0% to £785.7 million compared to £549.6 million as at 30 April 2000. However, excluding the effect of share repurchases of £178.8 million and the impact of currency exchange movements of £74.3 million, net debt decreased by £17.0 million.

Book gearing was 77.9% at 30 April 2001 compared to 39.5% at 30 April 2000. The increase in gearing has largely arisen due to the fall in net assets resulting from the accelerated amortisation of goodwill in relation to Coach USA, and the repurchases of shares.

Interest rate risk management

Interest rate exposure arises from the Group's borrowings and deposits and is managed through the use of fixed and floating rate debt and derivative financial instruments. Derivative financial instruments are used where appropriate to generate the desired interest rate profile and those permitted by our treasury policy are swaps, caps and floors. At 30 April 2001 65.6% of gross debt was fixed or capped. The remaining debt is held at floating rate or protected from significant increases in short term rates through the use of interest rate caps. Interest rate floors are used to reduce or offset the cost of entering into interest rate caps.

The average interest rate payable on gross debt during the year was 7.6% against 7.1% in 2000. The interest rate payable on year end debt was 7.4% and is expected to reduce during the coming year as a result of the recent reductions in global interest rates.

Currency risk management

The Group is exposed to currency risk as a result of the foreign currency transactions entered into by subsidiaries in currencies other than their functional currency. The operations of Stagecoach are such that foreign currency transactions are minimal. Where a major foreign currency transaction is expected or known, it is monitored by the Group Treasury function and forward buying of currencies is carried out where necessary.

The Group has substantial overseas investments in the USA, New Zealand and Hong Kong. The Group does not seek to hedge the impact of exchange rate movements on reported profits as the impact of US$ and HK$ exchange rate movements on operating profits are offset by foreign currency denominated interest and fuel costs. Movements in exchange rates can affect our sterling denominated balance sheet. To minimise the translation exposure the Group aims to fund overseas acquisitions and operations through borrowings denominated in their functional currency or through the use of derivative financial instruments which convert sterling borrowings into borrowings of the functional currency. In addition forward currency exchange contracts are taken out to secure the future translation value of a proportion of foreign currency investments. The Group policy is to examine each overseas investment individually and adopt a strategy based on current and forecast political and economic climates. This policy aims to allow the Group to maintain a low cost of funds and to retain some potential for currency appreciation whilst partially hedging against currency depreciation.

Commodity price risk

The Group is exposed to commodity price risk through its fuel usage. The risk consists of two distinct elements: the actual fuel price that is quoted in US dollars and the exchange rate between US dollars and the functional currency of the operating companies.

The Group policy is to establish floating and fixed priced levels that the Group considers acceptable and to enter into physical supply or derivative agreements where necessary to achieve these levels. During the year 100.0% of the Group's fuel usage was hedged at a fixed price. We have fixed approximately 70.0% of the Group's estimated fuel usage to 30 April 2002. This hedging has occurred over the last twelve months and was carried out during a period of extreme volatility in the oil markets and as a result our fuel price for the next year will be higher than in the year ended 30 April 2001.

Credit risk

The Group Treasury function seeks to invest cash assets safely and profitably and controls credit risk by setting counterparty credit limits by reference to published credit ratings and the counterparty's geographical location. The Group considers the risk of material loss in the event of non-performance by a financial counterparty to be unlikely.

Balance sheet

Net assets have decreased by 27.5% from £1,391.2 million to £1,008.9 million reflecting the impact of the impairment of goodwill at Coach USA, and the share repurchases of £62.0 million. During the year net foreign exchange gains of £55.7 million were recorded primarily as a result of the translation of net foreign currency denominated investments in Coach USA and Citybus. The other significant movements in balance sheet items reflect investments in capital expenditure and acquisitions and disposals made during the year.

Post balance sheet events

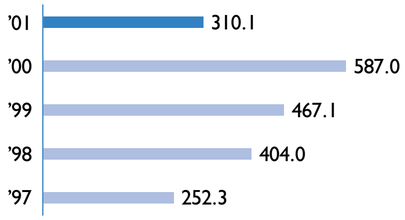
Details of post balance sheet events are provided in the Directors' report on page 45.

Going concern

On the basis of current financial projections and the facilities available, the directors are satisfied that the Group has adequate resources to continue for the foreseeable future, and, accordingly, consider it appropriate to adopt the going concern basis in preparing the accounts.

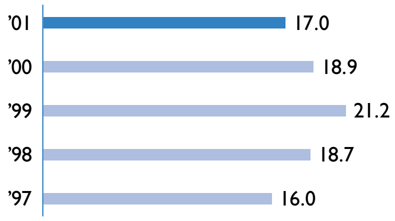
MARTIN A GRIFFITHS
Finance Director
20 June 2001

EBITDA* (£m)



*excluding exceptional items

Free cashflow per ordinary share (p)



Dividend per share (p)