Finance Director's review

Overall

The financial results for the year ended 30 April 2004 reflect a year of strong growth in our continuing businesses and delivery of our strategic objectives.

During the year, we disposed of approximately 60% of our North American business, the Citybus operation in Hong Kong and our non-core investments in Road King Infrastructure Limited and Trainline Holdings Limited.

Turnover from our continuing businesses increased by 4.9% from £1,581.4m to £1,659.4m, and by 5.9% at constant foreign exchange rates. Total turnover reduced as a result of our successful programme of disposals and was £1,792.3m for the year (2003: £2,076.6m).

Operating profit before goodwill amortisation and exceptional items grew from £146.4m in 2003 to £147.5m in 2004 reflecting growth in profits in our continuing operations more than offsetting the impact of disposals. We delivered a significant improvement in the operating margin of our core continuing divisions (UK Bus, North America, New Zealand, Rail and Virgin Rail Group) – the operating margin from these businesses before goodwill amortisation, exceptional items and restructuring costs grew from 6.6% in 2003 to 8.4% in 2004.

The impact of the disposals was offset by growth in profits in our continuing operations and lower finance charges. As a result, adjusted earnings per share (before goodwill amortisation and exceptional items) increased from 6.4 pence to 6.7 pence. It should be noted that prior year earnings per share benefited from non-recurring gains on the repurchase of bonds and non-recurring liquidated damages at South West Trains which before tax together amounted to £23.6m (£16.5m after tax).

Basic earnings per share grew from a loss of 40.0 pence per share to earnings of 7.9 pence per share, which include the one-off benefit of an exceptional tax credit, equivalent to 3.1 pence per share.

Joint ventures and associates

Our share of joint venture and associates' operating profits (before goodwill amortisation) was £17.7m compared to £12.6m in the prior year largely reflecting the increased profitability at Virgin Rail Group (profit £13.5m; 2003: £7.2m). The results include our share of trainline's operating losses which, up to the date of disposal, was £2.4m (2003: £4.3m), our share of profits in Road King, up to the date of disposal, of £7.0m (2003: £10.5m) and our share of operating losses of £0.4m (2003: £0.8m) from our other joint ventures and associates.

Restructuring costs

Restructuring costs of £7.2m (2003: £6.3m) have been charged against operating profits. The majority of the restructuring costs, £5.7m, relate to the re-shaping of our North American business and the Directors expect that restructuring costs in future years will be significantly reduced. A further £0.9m relates to South West Trains, and £0.6m relates to UK Bus.

Depreciation and amortisation

Total depreciation decreased from £105.3m to £67.2m, reflecting the disposals completed in the year and the effect of foreign exchange movements on the translation of US$ and HK$ charges. The annual goodwill amortisation charge was £17.8m compared to £37.6m in 2003, reflecting the disposals completed in the year.

Adding the depreciation of £67.2m to the operating profit before goodwill and exceptional items of £147.5m gives EBITDA (earnings before interest, taxation, depreciation and amortisation) of £214.7m (2003: £251.7m) for the year.

Exceptional Items

Net exceptional charges before tax of £6.6m (2003: £575.5m) were reported, comprising a loss of £7.1m in relation to the disposals completed during the year and a gain of £0.5m on the sale of a property in New Zealand.

Finance charges

Net interest and financing charges decreased from £33.5m to £27.3m. EBITDA before exceptional items to net finance charges was 7.9 times compared to 7.5 times in 2003. The finance charges of £33.5m for the comparative period last year included the benefit of non-recurring gains of £15.1m on the repurchase of our bonds. The reduction of £21.3m in underlying finance charges is as a result of our reduced net debt levels.

Acquisitions

The Group did not make any major acquisitions of businesses during the year.

Disposals

During the year, the Group disposed of a number of subsidiaries and other businesses as set out on page 14. Various parts of our North American businesses were disposed of during the year, being the Transit Division, South East Region, South Central Region, West Region, New England Region and the majority of the taxi division.

Finance Director's review

Disposals (continued)

	Cash proceeds from disposal £m	Decrease/(increase) in net debt from disposal £m	Gain/(loss) on disposal £m
Subsidiary undertakings			
SGC (HK Group) Limited, encompassing "Citybus" operations	128.7	171.8	0.3
Various parts of North America (Coach USA)	135.0	135.0	(12.4)
Other subsidiary undertakings	–	(0.1)	(0.1)
	263.7	306.7	(12.2)
Joint venture			
Trainline Holdings Limited	1.1	1.1	Nil
Associates			
Road King Infrastructure Limited	62.9	62.9	6.2
Hong Kong Kwoon Chung (Chongqing) Bus Investment Limited	0.9	0.9	(1.1)
	63.8	63.8	5.1
Total: subsidiaries, joint venture and associates	328.6	371.6	(7.1)

Taxation

Profit before tax for the year was £95.8m. The tax credit, reported against this, of £8.8m includes an exceptional tax credit received in the year of £41.0m. Excluding this tax credit, the Group's tax charge of £32.2m represents an effective rate of 33.6% on this profit (2003: 33.4% excluding the exceptional operating loss of £575.0m).

During the year, we have reached agreement with various tax authorities on a number of prior years' tax returns and provisions and the exceptional tax credit of £41.0m is as a result of these agreements.

On an ongoing basis we would expect the Group's effective tax rate to be in the range of 25% – 30%.

Earnings and dividends

Earnings per share before goodwill amortisation and exceptional items were 6.7 pence, compared to 6.4 pence in 2003. Basic earnings per share (taking account of all exceptional items and goodwill amortisation) was 7.9 pence, compared to last year's loss of 40.0 pence. The weighted average number of shares in issue during the year was 1,321.7m (2003: 1,314.4m). Shares in issue at the year-end were 1,335.4m, of which 1,325.8m ranked for dividends and therefore are included in determining earnings per share.

The Group has authority to repurchase a further 132,094,601 shares. This authority expires at the 2004 AGM and we will seek to renew the general authority to repurchase up to 10% of the issued share capital.

The total proposed dividend for the year is 2.9 pence (2003: 2.6 pence). This represents dividend cover (before goodwill amortisation and exceptional items) of 2.3 times compared to 2.5 times in 2003.

Return of capital

In addition to the total proposed dividend for the year of 2.9 pence per share, the Directors have proposed to return capital to shareholders equivalent to 18.0 pence per ordinary share.

The return of capital will be achieved through the issue of redeemable B Shares and is conditional, inter alia, on obtaining Shareholder approval at the AGM on 27 August 2004. The B Shares will have a nominal value of 18.0 pence each and the total nominal value of the B shares issued will be approximately £250m. The precise total nominal value of the B shares issued will depend upon the number of Ordinary Shares in issue on the record date.

For every 24 Ordinary Shares held on the Record Date (expected to be 10 September 2004), Shareholders will receive 19 Consolidated Ordinary Shares and 24 B Shares.

Shareholders can have their B Shares redeemed for 18.0 pence each in cash on 22 September 2004. Alternatively they can retain all or some of their B Shares and receive a continuing dividend equal to 70% of 6 months' LIBOR, payable semi-annually in arrears, until such shares are redeemed.

A circular will be sent to shareholders in July 2004 setting out further details of the proposed return of capital.

Cash flows

Cash generation across the Group remained strong with free cash flows amounting to £209.5m (2003: £217.8m). Free cash flow per share decreased from 16.6 pence to 15.9 pence.

At 30 April 2004 net cash balances were £476.5m, an increase of £311.8m from 30 April 2003. This increase in cash largely reflects the impact of disposals of businesses.

Capital Expenditure

Capital Expenditure for the year was:

	2004 £m	2003 £m
UK Bus	**50.5**	34.4
North America (Coach USA)	**23.1**	21.5
New Zealand	**7.0**	7.2
Citybus (Hong Kong)	**3.0**	6.1
UK Rail	**3.2**	1.9
Total	**86.8**	71.1

Treasury risk management

The main areas of financial risk associated with our businesses are managed by our centralised Group Treasury function. The Board regularly reviews these risks and approves the Group's treasury policy, which covers the management of these risks. Financial instruments are held to finance Group operations and to manage the financial risks associated with these operations. Derivative financial instruments are used to manage financial risk exposures and to achieve greater certainty of future costs. The use of financial instruments is restricted to financing and treasury management only.

Liquidity and funding

Our policy is to finance the Group through a mixture of bank and hire purchase debt, capital markets issues and retained earnings. Financing is generally raised centrally and on-lent to operating subsidiaries on commercial terms. As at 30 April 2004, the Group's committed credit facilities were £430.1m, £310.5m of which were utilised, including bank guarantees.

During June 2004 the Group cancelled bank facilities amounting to £195m which were due to expire in the period to December 2004 and replaced these with approximately £440m of revolving credit facilities which mature in 3 and 5 years. These new facilities provide us with significant financial flexibility going forward.

Interest rate risk management

To provide some certainty as to the level of interest cost, it is our policy to manage interest rate exposure through the use of fixed and floating rate debt. Derivative instruments are also used where appropriate to generate the desired interest rate profile. At 30 April 2004, 49.0% (30 April 2003: 41.0%) of the Group's gross borrowings were covered by fixed and capped/floored interest rates. Excluding our Eurobonds, which will be redeemed in November 2004, 73% of our interest cost is fixed or capped.

During the year, we closed out fixed to floating swaps with a notional amount of £334.1m and an expiry date of November 2009. These swaps effectively converted the fixed interest payable on our 2009 US$ bonds to floating interest payable and the close out of the swaps effectively leaves the Group paying fixed interest on the US$ bonds.

Currency rate risk

The Group is exposed to limited transactional currency risk due to the small number of foreign currency transactions entered into by subsidiaries in currencies other than their functional currency. Where necessary, forward buying of currencies is carried out by the Group Treasury function.

The Group now has overseas investments in Canada, the USA, and New Zealand. To minimise balance sheet translation exposure, the Group aims to hedge the sterling book value of overseas 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, and through forward currency exchange contracts. It is Group policy 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. It is Group policy to establish fixed price levels to hedge this exposure for up to four years and, where necessary, to enter into physical contracts or derivative agreements to achieve certainty in the short term as to fuel costs and to reduce the year on year fluctuations over the medium term.

We presently have hedging arrangements in place that effectively fix the unit cost of approximately 40% of our expected Group fuel consumption in the year ending 30 April 2005. We have further hedging arrangements that effectively cap the maximum unit costs of around a further 57% of expected Group fuel consumption.

Credit risk

It is our policy to invest cash assets safely and profitably. To control credit risk, counterparty credit limits are set 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 increased by 23.0% from £317.1m to £390.0m. Net debt decreased by £492.4m or 87.9% from £560.0m as at 30 April 2003, to £67.6m at 30 April 2004, mainly as a result of the business disposals. Based on net assets of £390.0m and net debt of £67.6m, book gearing (net debt divided by net assets) is 17.3% in comparison to last year's level of 176.6%.

Finance Director's review

Pensions

The Group continues to account for pensions on the basis of SSAP 24, "Accounting for pension costs". Under SSAP 24, total pension costs in the year ended 30 April 2004 were £32.9m (2003: £31.2m). The post-tax pension scheme deficit under FRS 17 "Retirement benefits" improved (i.e. reduced) by £50.5m in the year. Under FRS 17, the defined benefit pension schemes in respect of the Group's UK Bus and head office employees showed a net liability at 30 April 2004 of £115.8m after taking account of deferred tax. In addition, the defined benefit pension schemes in respect of the Group's Rail employees showed a net liability of £14.2m after deferred tax. We believe the Rail deficit needs to be considered separately as the franchise payments under the South West Trains franchise take account of increased contribution levels to fund the deficit and we believe that the Group has no liability beyond the end of the franchise.

International Financial Reporting Standards

Being a UK quoted company, Stagecoach Group plc is required to produce future financial statements and annual reports in line with International Financial Reporting Standards ("IFRS") also known as International Accounting Standards ("IAS"). The Group's first full set of IFRS accounts, including comparatives, will be prepared for the year ending 30 April 2006.

In September 2003, the Company established a Steering Committee to oversee the convergence to IFRS. To date the Committee has identified the main differences between IFRS and the current Group UK GAAP policies and is making good progress in establishing the accounting policies or changes that will be required. The convergence project is ongoing and the Committee will continue to monitor evolving best practice and will apply the standards that are required for adoption in due course.

The Company is committed to ensuring it complies with all material aspects of IFRS and until such time as its conversion project is complete, it is inappropriate to provide a comprehensive summary of all of the accounting differences that could impact the Company's financial statements. The most significant areas of difference are expected to be in respect of financial instruments, pensions and goodwill. The Steering Committee is also closely examining the detailed IFRS regulations in relation to leases and government grants.

Accounting policies

The Group has implemented UITF 38 "Accounting for ESOP Trusts" early.

As a result, there has been an impact on the classification of our shares purchased during the year. The adoption of UITF 38 has had no impact on the profit for the year ended 30 April 2004 (2003: £Nil). Had UITF 38 not been adopted, the consolidated net assets would have been £3.9m higher as at 30 April 2004 (2003: £Nil).

There have been no other changes in accounting policies.

Martin A Griffiths
Finance Director