New Zealand

Turnover and operating profit from our New Zealand businesses were in line with our expectations. Turnover was similar to last year at NZ$160.6m (2004: NZ$160.9m). Operating profit was NZ$23.7m (2004: NZ$29.5m). The operating margin of 14.7% (2004: 18.4%) remains satisfactory but does reflect ongoing cost pressures and increased competition from railways in the Auckland market. Converted to sterling, turnover was £59.0m (2004: £58.3m) and operating profit was £8.7m (2004: £10.7m).

Trading in the Auckland region continued to be challenging due to a combination of fewer foreign language students, competition from the upgraded local rail system and a tougher tendering environment for service contracts. However, contracts for services in the North Shore sector of the Auckland region were re-tendered during the year and we successfully retained a similar volume of work to that covered by previous contracts. We have launched a trial of a Unirider pass at Auckland University to encourage the 30,000 students and staff to purchase discounted travel for a year or a semester in advance.

In Wellington, turnover was 9.0% more than the previous year and there has been particularly good passenger volume growth in the Hutt Valley sector. A number of contracts for services in the region were also retained at re-tender. The companies are also adopting the telemarketing programmes that were successful in the UK, and the New Zealand roll-out of the initiative has started successfully in the Lyall Bay area of Wellington.

The New Zealand businesses operate with three-year labour agreements with the trade unions. The labour contracts for Auckland and Wellington are both due to be re-negotiated in the year to 30 April 2006 and in Auckland the process is already underway. The parties have not yet reached agreement and the Auckland business was disrupted by a six-day strike in May 2005. We are continuing negotiations to try and reach agreement but further industrial action cannot be ruled out. This action is likely to impact overall financial performance in New Zealand in the year to 30 April 2006.

Rail

Overview

Our UK Rail division has had an excellent year. We are extremely pleased with the strong growth in turnover and passenger volumes at South West Trains, which has been stimulated by improvements for customers centred on punctuality and the quality of the travelling environment.

Turnover for our wholly-owned rail subsidiaries in the year was £479.4m (2004: £438.9m), with passenger volumes at South West Trains up 4.8% on the prior year. Operating profit was up 10.2% to £48.6m (2004: £44.1m), representing an operating margin of 10.1% (2004: 10.0%). This includes liquidated damages of £2.6m in relation to late delivery of new Desiro trains and reliability of class 458 trains.

Our strong performance at South West Trains has also benefited the taxpayer, with £46.0m (2004: £27.9m) in revenue and profit sharing payments being payable to the SRA in respect of the financial year ended 30 April 2005.

Stagecoach Group has taken a leading role in helping to shape the future direction of the railways during the Government's recent review. A number of Stagecoach proposals on better integration on the network have been put in place and the results are assisting our own measures to improve services for passengers.

South West Trains

The new three-year franchise at South West Trains, which commenced in February 2004, is running extremely well and management has achieved significant improvements in train service delivery and passenger satisfaction. Therefore, we are well placed to continue to operate services beyond the end of the existing South West Trains franchise in February 2007.

New trains and technology improvements

Our programme to introduce 155 new Desiro trains is almost complete. This has been achieved with very few delays affecting passengers. We are the first London operator to have phased out the last of the old Mark I slam door trains and have completed the fleet replacement programme more quickly than any other train company.

We are also working with the SRA, Transport for London, rolling stock leasing company Porterbrook, and the train manufacturer, Bombardier, on a £67m project to refurbish our 91 unit Class 455 fleet. Launched in November 2004, the project will deliver improved reliability and a better train layout for passengers on suburban routes.

A major initiative to update ticketing systems and infrastructure technology is to be implemented at South West Trains in the summer and autumn of 2005. Passengers will benefit from new touch screen ticket machines, faster ticket printing, more ticket machines and acceptance of credit cards at most self service outlets.

Punctuality and customer improvements

South West Trains has achieved a major improvement in train punctuality during the year. Since the introduction of the new timetable in December 2004, punctuality has progressively improved, with over 90% of trains now arriving on time (measured using the SRA's Public Performance Measure). This is one of the best performances of any operator on the London and South East network. We are confident the new improved timetable and its inherent reliability will stimulate further passenger volume growth.

This dramatic improvement for passengers has followed the most radical timetable change for nearly 40 years. The new timetable provides consistency for customers, additional peak time services and capacity into London Waterloo and a series of measures to reduce the effect of incidents and promote better timekeeping.

We are also pleased that the Wessex Integrated Control Centre at London Waterloo, a concept pioneered by Stagecoach and operated in conjunction with Network Rail, is continuing to improve our joint response to incidents and ensure delays and disruption to passengers are minimised.

South West Trains has placed excellent operational management and customer service at the heart of its business during the year and has been rewarded with a number of awards. Our customer service team at London Waterloo was named the top Frontline Customer Service Team at the National Customer Service Awards, which cover a wide range of sectors including transport. South West Trains also achieved its highest customer satisfaction score in the National Passenger Survey, out-ranking most other commuter operators. E-motion, our innovative customer magazine and website, also received a Best in Business award from the National Association of Publishing Agencies.

At the National Rail Awards, South West Trains won Maintenance Team of the Year, London Operational Team of the Year, Major Station of the Year for London Waterloo, and Project of the Year for the introduction of the new Desiro trains with Siemens, while a number of our frontline employees were shortlisted for their own personal contribution.

Further measures have been undertaken to improve passenger and employee safety and security at South West Trains, which already has one of the best records in the UK rail industry. The TravelSafe Officers initiative, our ground-breaking security and anti-crime partnership with British Transport Police, has played a major part in cutting crime on the network by 20% in the last six months of 2004, compared with the same period in 2003. We are also pleased to report that seven more South West Trains stations have received the Secure Station award. This brings the total number of stations on our network with this status to 43 – the highest of any of the UK's train operating companies.

Commercial activity

Marketing activity at South West Trains has been focused on two key areas: developing leisure off-peak travel to increase revenue and a wider campaign to improve customer perception of our services. We have achieved further success with our Apex and SuperAdvance ticket promotions, and our leisure and reduced fare income is increasing at a faster rate than other train operators in London and the South East.

Around 400,000 passengers use South West Trains' services every day and a major newspaper, TV and cinema advertising campaign was undertaken in autumn 2004 to promote our improvements for customers. New Mori research suggests that the campaign to reinforce the benefits of the new Desiro trains, refurbishments to other rolling stock and personal security initiatives has delivered a marked improvement in passenger attitudes.

Island Line

Island Line, the Isle of Wight's rail franchise, is operating on a three-year franchise that runs concurrently with the South West Trains contract until 2007. Island Line remains Britain's best performing railway in terms of punctuality and reliability. Within the SRA's community rail framework, we are working with local stakeholders to find a suitable solution for the long-term future of public transport on the Island.

Sheffield Supertram

Sheffield Supertram, Britain's first state-of-the-art tramway, has achieved further passenger volume growth during the year. The network has carried a record 12.8m passengers during the year and has delivered further growth in profits. Passenger volume growth has been achieved, boosted by the regeneration of residential areas along the tram routes as well as improved leisure and retail facilities in Sheffield. A number of passenger improvements are being introduced across the network, including the roll-out of CCTV technology and the launch of an automated passenger announcement system.

Rail business development

The Group is in an excellent position to expand its rail portfolio and currently has an involvement in three shortlisted franchise bids that are an excellent fit with our strategy of concentrating on long-distance inter-city and high-volume commuter franchises.

Stagecoach is shortlisted for the Greater Western and Thameslink/Great Northern Rail franchises. Covering the West Country to London, the Greater Western franchise includes long-distance, regional and local services in the Thames Valley, Cotswolds, Bristol and the surrounding area and the West of England, with some cross-border services into South Wales. The seven-year franchise will run from 1 April 2006 with a potential three-year automatic extension if agreed performance targets are met. The enlarged Thameslink/Great Northern franchise, serving large numbers of commuters, will cover services between Bedford and Brighton, as well as between Peterborough, King's Lynn, Cambridge and London. The four-year franchise is expected to begin operations on 1 April 2006, with two extra years if agreed performance targets are met. There is also a possible further extension for up to three years to facilitate work on the Thameslink 2000 project.

While we were disappointed that our joint bid with Virgin for the Inter City East Coast franchise was unsuccessful earlier this year, we believe we can develop strong bids for these new franchises that deliver first-class passenger service, excellent value for taxpayers and a good return to shareholders.

We also have a 29.9% stake in the Danish State Railways (''DSB'') bid for the Integrated Kent franchise. The franchise includes routes on the national rail network currently operated by South Eastern Trains throughout Kent, parts of Sussex and South East London. It will also incorporate new domestic services on the Channel Tunnel Rail Link (''CTRL''). DSB operates the majority of passenger rail services in Denmark, as well as franchise operations in other Scandinavian countries, and is one of the best performing operators in Europe. We believe our UK experience of both commuter and inter-city services will help deliver a powerful bid for the franchise.

Virgin Rail Group

Stagecoach has a 49% share in Virgin Rail Group (''VRG''), which operates the West Coast and CrossCountry inter-city rail franchises that link more than 130 stations across the UK. Both franchises continue to operate on the basis of annual budgets set by the SRA.

Our share of Virgin Rail Group's turnover for the year amounted to £315.2m (2004: £288.4m) and our share of operating profit was £12.7m (2004: £13.5m).

Both VRG's franchises operate on the basis of a Letter Agreement signed with the SRA in July 2002. Negotiations will re-commence on the West Coast franchise in September 2005 with a view to agreeing revised commercial terms for the franchise through to 2012. The SRA has terminated negotiations on the CrossCountry franchise and has the right to re-tender this franchise, although it is required to give at least 12 months' notice to VRG if it intends to terminate the existing franchise.

Under the Letter Agreement, the SRA sets an annual budget, including the level of financial support, for each franchise. The SRA has set challenging budgets for VRG's financial year to 4 March 2006. In particular, discussions are continuing with the SRA regarding CrossCountry's requirement for additional cash funding from July 2005.

West Coast

A £1.2 billion fleet of Pendolino tilting trains, operating at up to 125mph, has successfully entered passenger service on what is one of the main arteries of the UK rail network. Journey times for passengers on some routes are being cut by more than 20%, On the key London-Manchester route, journey times have been reduced by more than half an hour, while the frequency of services between the two cities has been doubled.

As predicted, the twin challenges of infrastructure work and introducing new trains impacted performance on the West Coast mainline during the autumn and winter of 2004. However, now that teething issues around the new trains have largely been resolved, West Coast's performance has markedly improved and there is a continuing focus on driving up punctuality.

Increasing numbers of customers have been attracted to travel on the new state-of-the-art trains. Passenger volumes on the West Coast mainline have risen by approximately 20% in the period since the new Red Revolution timetable and faster Pendolino trains were introduced in September 2004.

The new trains and timetables have increased VRG's share of the Manchester-London travel market with an 39% increase in the number of rail journeys from north-west England to London between September 2004 and January 2005. In the same period, the number of passengers using the Manchester-London air route dropped by more than 7%.

VRG will recommence negotiations with the Government in the autumn of this year with a view to agreeing a re-negotiated franchise through to 2012. Earlier this year, VRG and the SRA agreed that more time was required to assess revenue, passenger and operational data. Both parties agreed to allow a full year's impact of the new West Coast timetable to be assessed up to September 2005. In the meantime, VRG will continue to operate the West Coast franchise under the terms of the Letter Agreement signed in July 2002 and is committed to working with all other stakeholders to further improve services to passengers. We believe this sensible and constructive approach will help deliver a re-negotiated franchise agreement that is sustainable and in the long-term interests of passengers, taxpayers and shareholders.

CrossCountry

CrossCountry, which is serviced by a fleet of modern Voyager trains, has achieved further improvement in performance during the year. Since the start of 2005, more than 80% of trains are arriving on time (as measured by the SRA's Public Performance Measure) and, VRG is working hard to improve this further.

The improvements have helped transform travellers' perceptions, with CrossCountry being named the top performer in the InterCity sector of the SRA-commissioned National Passenger Survey last year.

Like the West Coast Mainline franchise, the Virgin CrossCountry franchise continues to operate on the basis of annual budgets set by the SRA, while we await its decision on the future of the franchise. If the SRA decides to put the franchise out to open competition, we are confident that VRG, as the incumbent operator with an excellent track record of sustained improvement, will be in a strong position to win the franchise.

Joint ventures and associates

Our share of joint venture and associates' operating profits (before goodwill amortisation) was £12.3m compared to £17.7m in the prior year. This includes £12.7m (2004: £13.5m) in respect of the Group's share of operating profits in Virgin Rail Group, as referred to earlier in this report. £0.4m (2004: £0.4m) of losses arose from other smaller joint ventures and associates. The prior year's results included our share of trainline's operating losses which, up to the date of disposal, was £2.4m, and our share of profits in Road King, up to the date of disposal, of £7.0m.

Depreciation and amortisation

Earnings before interest, taxation, depreciation, goodwill amortisation and exceptional items (pre-exceptional EBITDA) amounted to £224.4m (2004: £214.7m). Total depreciation for the year was £67.7m (2004: £67.2m). The annual goodwill amortisation charge was £22.5m compared to £17.8m in 2004. Total goodwill amortisation has increased by £4.7m, with the principal movement being a £6.5m increase in the amortisation of goodwill related to the Group's investment in Virgin Rail Group. The Directors reviewed the period over which the goodwill in respect of Virgin Rail Group was being amortised, in light of the status of the negotiations on Virgin Rail Group's franchises and the possibility that the SRA could terminate the CrossCountry franchise with 12 months' notice. As a result, the amortisation of goodwill in respect of Virgin Rail Group has been accelerated, resulting in an increased charge.

Restructuring costs

Non-exceptional restructuring costs included within operating profit amounted to £1.4m (2004: £7.2m). The prior year figure included £5.7m relating to the restructuring at North America. The restructuring costs at North America for the year ended 30 April 2005 were £0.1m as the restructuring programme was largely completed in the prior year.

Exceptional Items

Net exceptional charges before tax of £6.0m (2004: £6.6m) were recorded of which £1.4m (2004: £Nil) is included within operating profit: £0.8m (2004: £Nil) relating to flooding at the UK Bus Division's Carlisle depot, £0.3m (2004: £Nil) relating to costs associated with the return of capital and £0.3m (2004: £Nil) relating to the write-down of an investment. Non-operating exceptional charges comprised a loss of £5.9m (2004: £7.1m) on the disposals and closures of businesses and a net gain of £1.3m (2004: £0.5m) on the sale of properties.

A tax credit of £1.6m (2004: charge of £0.2m) was recognised in respect of exceptional items resulting in net exceptional charges after tax of £4.4m (2004: £6.8m).

Finance charges

Net finance charges decreased from £27.3m to £19.9m as a result of a lower average net debt during the year and favourable foreign exchange rate movements. The ratio of pre-exceptional EBITDA to net finance charges was 11.3 times compared to 7.9 times in 2004, reflecting the reduced finance charges.

Taxation

Profit before tax for the year was £108.3m. The Group's tax charge of £29.5m represents an effective rate of 27.2% on this profit (2004: 33.6% excluding impact of exceptional tax credit of £41.0m).

Earnings and dividends

Earnings per share before goodwill amortisation and exceptional items were 9.0 pence, compared to 6.7 pence in 2004, reflecting the strong performance at each of our core divisions. Basic earnings per share (taking account of all exceptional items and goodwill amortisation) were 6.8 pence (2004: 7.9 pence): the prior year amount of 7.9 pence included 3.1 pence in respect of the exceptional tax credit.

The total proposed dividend in respect of ordinary shares for the year is 3.3 pence (2004: 2.9 pence). This represents dividend cover (before goodwill amortisation and exceptional items) of 2.9 times (2004: 2.3 times). £0.4m (2004: £Nil) of dividends on 'B' shares have been recognised in the year.

Shares in issue

The weighted average number of ordinary shares during the year used to calculate basic earnings per share was 1,154.5m (2004: 1,321.7m). Following the return of capital in September 2004 and the related 19 for 24 consolidation of ordinary shares, the number of shares ranking for dividend at 30 April 2005 was 1,063.0m, with a further 6.5m of ordinary shares held by employee trusts and not ranking for dividend.

The Group has authority to repurchase a further 134,073,290 ordinary shares. This authority expires at the 2005 AGM and we will seek to renew the general authority to repurchase up to 10% of the issued ordinary share capital.

Net assets

Net assets at 30 April 2005 were £219.0m (2004: £390.0m) with the decrease principally reflecting the return of capital and dividends during the year, partly offset by the strong reported profits.

Net debt

During the year, we returned £241.3m of capital to shareholders by issuing new redeemable 'B' shares. Of the £241.3m shares issued, £227.4m have been redeemed for cash during the year and are included in the increase in net debt which has increased from £67.6m to £214.6m. £13.9m of the 'B' shares have yet to be redeemed and are therefore not included in the net debt of £214.6m as at 30 April 2005.

Excluding the impact of the redeemed 'B' shares of £227.4m, net debt reduced by £80.4m. This includes the benefit of ongoing cash generation from our core operations, £30.2m received in respect of joint ventures and £14.7m received from the disposal of businesses including a negotiated early settlement of the deferred consideration from the prior year disposal of Coach USA's West and South Central Regions.

The strong cash generative nature of the Group is once again highlighted by free cash flow of £173.6m (2004: £209.5m). Free cash flow per share decreased from 15.9 pence to 15.0 pence. The prior year free cash flows included one-off tax refunds of £25.6m and £23.6m of one-off cash inflows arising from the close-out of fixed to floating interest rate swaps.

The impact of capital expenditure for the year on net debt was £100.0m (2004: £83.0m), partly offset by proceeds from the sale of tangible fixed assets of £7.1m (2004: £4.2m). This primarily related to expenditure on passenger service vehicles, and comprised cash outflows of £73.8m (2004: £56.0m) and new hire purchase debt of £26.2m (2004: £27.0m).

Capital Expenditure

Additions to tangible fixed assets for the year were:

	2005	2004
	£m	**£m**
UK Bus	**51.4**	50.5
North America	**33.8**	23.1
New Zealand	**10.8**	7.0
Citybus (Hong Kong)	**Nil**	3.0
UK Rail	**7.8**	3.2
	103.8	86.8

The differences between the amounts shown above and the impact of capital expenditure on net debt arose from movements in fixed asset deposits and creditors.

Acquisitions and disposals

Cash of £4.8m was paid on new acquisitions in the year, and £1.1m was paid in respect of deferred consideration on acquisitions completed in previous years.

Cash of £14.7m was received during the year in respect of disposals, which included the negotiated early settlement of deferred consideration on disposals completed during last financial year.

Return of Capital

Following the passing of a special resolution at the 2004 AGM, we have successfully completed the return of £241.3m of capital to shareholders, with 77.2m 'B' shares (£13.9m) still to be redeemed.

Having taken account of the cashflow generation of the Group and the potential bonding requirements on current rail franchise bids, the Board is now comfortable with the Group's current capital structure. The Board will, however, continue to keep the Group's capital structure under review.