

Summary Operating and Financial Review

Important note

This Summary Annual Report, including the summary financial statements, is a summary of the information contained in the 2007 Annual Report and financial statements. It does not contain sufficient information to allow a full understanding of the results of the Group and state of affairs of the Company or the Group. For further information, the full annual financial statements, the auditors' report on those financial statements and the Directors' report should be consulted. All shareholders receive either the Summary Annual Report or the full Annual Report. A copy of the full 2007 Annual Report and financial statements may be obtained, free of charge from the Company's registrar at the address and telephone number shown on page 17. If you wish to receive the full Annual Report for all future financial years you should inform Lloyds TSB Registrars in writing, at the same address.

Cautionary statement

The Summary Operating and Financial Review is a summary of the full Operating and Financial Review contained within the 2007 Annual Report and financial statements. The Operating and Financial Review has been prepared for the shareholders of the Company, as a body, and no other persons. Its purpose is to assist shareholders of the Company to assess the strategies adopted by the Company and the potential for those strategies to succeed and for no other purpose. This Summary Operating and Financial Review contains forward looking statements that are subject to risk factors associated with, amongst other things, the economic and business circumstances occurring from time to time in the countries, sectors and markets in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated. No assurances can be given that the forward looking statements in this Summary Operating and Financial Review will be realised. The forward looking statements reflect the knowledge and information available at the date of preparation.

Description of the business

Stagecoach Group is a leading international public transportation group, with extensive operations in the UK, United States and Canada. The Group employs around 27,000 people, and operates bus, coach, rail and tram services. The Group has three main divisions – UK Bus, UK Rail and North America.

Stagecoach Group plc is a public limited company that is incorporated, domiciled and has its registered office in Scotland. Its ordinary shares are publicly traded and it is not under the control of any single shareholder.

Throughout this Summary Annual Report, Stagecoach Group plc is referred to as "the Company" and the group headed by it is referred to as "Stagecoach" or "the Group".

UK Bus

Our UK Bus division connects communities in more than 100 towns and cities across the UK on networks stretching from the Highlands of Scotland to south-west England. These include major city bus operations in Liverpool, Newcastle, Hull, Manchester, Oxford, Sheffield and Cambridge.

North America

Stagecoach, principally through its Coach USA and Coach Canada brands, is a major provider of transport services in North America. Our businesses include commuter services, tour and charter, sightseeing and school bus operations.

UK Rail

Our principal wholly-owned rail business is South Western, which incorporates the South West Trains and Island Line networks. South West Trains runs around 1,600 train services a day in south-west England out of London Waterloo railway station, while Island Line operates on the Isle of Wight. The South Western franchise is expected to run until February 2017. We also operate Supertram, a 28km light rail network incorporating three routes in the city of Sheffield, on a concession running until 2024. In May 2007, we signed a contract with Greater Manchester Passenger Transport Executive ("GMPTE") to operate and maintain the Manchester Metrolink tram network and expect to commence operations under the 10-year contract in July 2007.

The division will also commence operations of the new East Midlands franchise in November 2007, which combines mainline services from London St. Pancras railway station with regional services in the East Midlands region. The new franchise will run until 1 April 2015 assuming the Group meets agreed performance targets.

Joint Ventures

Virgin Rail Group

Stagecoach Group has a 49% shareholding in Virgin Rail Group ("VRG"), which operates the West Coast and CrossCountry rail franchises. The other shareholder in VRG is the Virgin Group of Companies. The Chief Executive of Stagecoach Group's rail division is Joint Chairman of VRG. The joint venture has submitted a bid for a new expanded Cross Country franchise, which is being tendered by the Government and will run from November 2007. New commercial terms for the West Coast franchise were agreed in December 2006 and the renegotiated franchise runs through until 2012. VRG has a Chief Executive, who reports to the VRG board, which includes Stagecoach Group representatives.

Scottish Citylink Coaches Limited

In Scotland, Stagecoach has a joint venture (Scottish Citylink Coaches Limited) with international transport group, ComfortDelGro, to operate megabus.com and Scottish Citylink coach services. Stagecoach owns 35% of the share capital of Scottish Citylink Coaches Limited and ComfortDelGro owns the remaining 65%. The joint venture is the leading provider of express coach services in Scotland. Stagecoach is responsible for the day-to-day operational management of the business, which is overseen by a joint board.

New York Splash Tours

In North America, Stagecoach has a joint venture, New York Splash Tours LLC, with Port Imperial Duck Charters, LLC. Splash Tours began operating sightseeing tours in May 2007 using amphibious vehicles. The vehicles operate in the Hudson River and on land in the city of New York. Splash Tours complements the Group's wholly owned New York sightseeing tours business, Grayline New York.

Group business objectives and long-term strategy

Business objectives and long-term strategy

The key elements of Stagecoach Group's business strategy to deliver long-term shareholder value are:

- To deliver organic growth across all of the Group's operations;
- To acquire businesses that are complementary to the Group's existing operations, in areas where the Group's management has proven expertise and which offer prospective returns on capital in excess of the Group's weighted average cost of capital;
- In addition to organic and acquisition growth, to maintain and grow the Group's Rail business by bidding for selected rail franchises and to seek to secure new franchises where the risk/return trade-off is acceptable.

A fundamental objective underlying this strategy is the continued provision of safe and reliable services to passengers.

Stagecoach Group has demonstrated particular strength in managing bus and coach businesses that operate scheduled services in a relatively deregulated environment. The Group's focus is on operations with critical mass in their own local markets. In rail, Stagecoach's skill centres on organic revenue and passenger volume growth, the management of significant change projects, the delivery of improved operational performance, and driving up customer satisfaction.

Our overall business strategy is supported by a financial strategy whereby we seek to maintain a long-term efficient capital structure.

UK Bus

Revenue in our UK Bus division, excluding acquisitions during 2005/6 and discontinued operations, increased by 10.3% to £608.0m (2006: £551.1m) and equivalent operating profit* was £82.5m, compared to £65.0m in the previous year. Operating margin was 13.6% compared to 11.8% in 2006. The increased profit and margin reflects the benefits of continued strong revenue growth, stable insurance and claims costs, returns on additional pension contributions and close control of costs generally.

The integration of Glenvale Transport Limited and Traction Group Limited, the regional bus operations we acquired last year, is progressing well. Revenue for the year ended 30 April 2007 for these businesses was £82.4m (2006: £38.5m) and the operating profit was £2.0m (2006: operating loss of £1.9m).

We are particularly pleased to have grown the total UK Bus operating profit in a year where we also collected £267.8m in cash from the sale of our London bus operations. This is illustrated below:

	2007	2006
	£m	£m
Like-for-like UK Bus	82.5	65.0
2005/06 UK Bus acquisitions	2.0	(1.9)
London Bus	5.2	23.6
Total UK Bus	89.7	86.7

The division performed particularly well in the second half of the year to 30 April 2007 reflecting continued strong revenue growth, management action to mitigate increasing pension costs, more stable fuel costs and improving profitability at businesses acquired in 2005/6.

Investment, innovation and growth

Stagecoach was named Bus Operator of the Year for the second year running at the 2006 UK Bus Awards for its West Scotland operations. Our strong track record in operating high-quality bus and coach services has delivered a fifth successive year of like-for-like passenger volume growth in our UK Bus division. New product development, investment and tailored marketing initiatives, combined with concessionary travel schemes in Scotland, England and Wales, has driven a 6.6% growth in like-for-like passenger volumes. We estimate that underlying full fare passenger volume growth was around 2.4% with the remaining growth coming from concessionary travel schemes.

We have invested £58.5m in the year to 30 April 2007 in the continuing modernisation of our UK Bus fleet, delivering more low-floor accessible buses and a more comfortable travelling environment for passengers. Stagecoach has strong confidence in the potential for future organic growth and we have already committed to introduce a further 540 new vehicles in 2007/8 at a total cost of around £65m. This investment and innovation has again grown our customer base as we attract more people out of their cars and on to our public transport services.

We have also progressed the integration of the Glenvale and Traction Group operations into our UK Bus division. Our significant investment in new vehicles and improved services in these businesses is stimulating passenger growth. The integrated bus and tram network in Sheffield is performing particularly strongly.

Our market-leading budget inter-city coach service, megabus.com, has achieved further revenue growth this year, while our joint venture with ComfortDelGro to provide inter-city coach services in Scotland has attracted significant numbers of new passengers following the introduction of an improved network of services.

megabus.com, the UK's market-leading inter-city bus service, has generated increased revenue during the year and made an operating profit of £0.2m. We have a network of services covering around 40 locations in the UK. Around 2 million passenger journeys have been made on megabus.com branded services during the year and we have improved both the average load factor and average fare. More modern double-decker coaches and a

comprehensive package of press, billboard, radio and web-based marketing emphasising the environmental benefits of coach travel have helped drive further passenger growth during the year.

Provincial and city networks

Growth in our provincial and city networks has been supported by our focus on customer profiling research and targeted marketing. Our expanded telemarketing unit at our headquarters in Perth has encouraged non-users, including motorists, to switch to bus travel through a package including the offer of a week's free travel. We have now completed more than 50 projects in the UK, covering around 500,000 potential customers. In addition, we are now working with a number of local authorities, Passenger Transport Executives and bus operator partners on similar telemarketing initiatives.

London

In August 2006, Stagecoach completed the sale of its London bus operations to Macquarie Bank Limited for £267.8m in cash, resulting in a consolidated gain on disposal of £132.2m. The cash proceeds and gain on disposal are higher than reported in our results for the six months ended 31 October 2006 principally as a result of the impact of finalising and agreeing the disposal completion accounts in January 2007. Stagecoach London provided bus services on routes within and from London, principally under contract from Transport for London. The London bus operations were a highly successful part of Stagecoach's UK Bus division since 1994. After assessing Macquarie's offer and the prospects for the London bus operations, the Board concluded that the disposal was in the best interests of shareholders. The sale of the London bus business has allowed the UK Bus division to focus on its successful growth strategy outside London. The Group's results for the 12 months ended 30 April 2007 include profit after tax (before the exceptional gain on disposal) from the discontinued London bus operations of £4.0m (2006: £17.4m) for the period up until disposal.

Partnership

Stagecoach continues to work closely with a range of stakeholders at local and national level to increase the quality of bus provision for our customers. We believe strong partnerships are the key to improving services for passengers. Buses have a crucial role to play in meeting the transport challenges facing our country and we have been engaging with the DfT and other stakeholders as part of the UK Government's current review of bus services. Stagecoach has consistently attracted more people on board its buses in both metropolitan areas and shire counties for the past five years. It is crucial that any new legislation recognises the strengths of the private sector in delivering and improving public transport, avoids unnecessary regulation and works in the best interests of passengers, taxpayers and the future of the bus industry.

In Scotland and Wales, we continue to work with the devolved administrations to successfully deliver national concessionary fares schemes. Stagecoach is also working with local authorities in England to deliver the Government's commitment to free local bus travel for senior citizens and people with disabilities. We believe it is crucial that these schemes are fully funded and bus operators are properly reimbursed in line with the legislation.

Our bus companies have built close relationships with the National Transport Agency for Scotland and Regional Transport Partnerships. We are also helping make travel easier for customers by partnership with local authorities on smartcard, multi-operator ticketing schemes and real time information. Several of our companies also have close links with businesses and educational establishments to encourage travel by public transport and help reduce congestion in our towns and cities. In Cambridge, we are working with the county council on timetables, ticketing and other operational issues linked to the development of the world's longest bus-only route, a 25km guided busway between Cambridge and St Ives, due to open in 2009.

Park and ride

We believe there is major opportunity to develop park and ride around the UK as a solution to the problem of increasing congestion in and around our main towns and cities. Stagecoach is a partner with local authorities in a number of high-quality park and ride sites where there has been significant growth. We

* References to the operating margin, profit or loss of a particular business in the Summary Operating and Financial Review refer to margin, profit or loss before interest, taxation, restructuring costs, intangible asset expenses and exceptional items.

Summary Operating and Financial Review

believe there is also a significant untapped potential in metropolitan areas to use a network of bus-based park and ride sites to tackle urban traffic congestion.

Kickstart

Stagecoach is continuing to achieve excellent passenger growth from a series of Kickstart schemes around the country. We are involved in a range of successful projects using the pump-priming model in partnership with local authorities in Scotland, England and Wales. These partnership projects have achieved particularly impressive growth in areas such as Ayrshire, Fife, North-east Scotland, Teeside, Tyne and Wear, Lancashire, Greater Manchester, Lincolnshire, Oxfordshire, Gloucestershire, Hampshire, Kent, Surrey, Sussex, Devon and South Wales.

North America

North American trading continues to be encouraging and has benefited from good revenue growth. While the insurance claims environment in the United States remains challenging, we anticipate growth will continue in the year ahead.

Revenue for the year was US\$463.6m (2006: US\$439.5m). On a like for like basis, excluding closed businesses, constant currency revenue was up by 9.1%. Operating profit was US\$34.6m (2006: US\$30.0m), resulting in an operating margin of 7.5%, compared to 6.8% the previous year. Converted to sterling, revenue for the year was £242.7m (2006: £247.6m). Operating profit for the year was £18.1m (2006: £16.9m). Excluding the early-stage North American megabus.com operations, which reported an operating loss of US\$2.0m (2006: US\$1.5m) on revenue of US\$4.7m (2006: US\$Nil) for the year, the operating margin was up from 7.1% to 7.9%.

Our highly successful sightseeing businesses in New York and Chicago continue to experience strong revenue growth, up 12.7% on the prior year. We have continued to invest in the quality of our fleet, strong marketing and the development of new and innovative tours. Through our Splash Tours joint venture with Port Imperial Duck Charters, a new amphibious bus tour is being added to our product offering in New York for the current season.

We have seen continued revenue and passenger growth in our express, commuter and scheduled airport services. Revenue growth has been particularly strong in our US scheduled service businesses, with a like-for-like increase of 9.8% over the prior year. Charter revenue growth also continues to be encouraging.

Our budget coach operation, megabus.com, was launched in the United States in spring 2006. It has now carried around 400,000 passengers, attracted by fares as low as US\$1, and has generated more than US\$4.7m in revenue. The success of our initial trial network between Chicago and eight other Midwest cities resulted in the extension of the concept to an additional five cities in April 2007. megabus.com, which is ahead of our original business plan, now covers the states of Illinois, Indiana, Kentucky, Michigan, Missouri, Ohio and Pennsylvania. We have attracted significant numbers of passengers from the car, budget airlines, the train and competing coach operators and we believe there is significant potential to develop the brand. As part of our development plans, we are looking at other areas of the US suited to the budget inter-city coach model, including states in the south west where we can franchise the megabus.com concept. We are also continuing to invest in the quality of our megabus.com fleet in the US and we expect to introduce new vehicles on the network later this year.

Student transportation services in Wisconsin have continued to perform well and we have been awarded a number of district contract renewals for an additional three years.

In Canada, Canadian dollar revenue has grown by 10.7% despite a very competitive environment. During the year, we secured a nine-year contract to provide employee transport at Trudeau International Airport in Montreal. Charter and scheduled service revenues have seen satisfactory growth.

UK Rail

The Group's rail division has had another excellent year. Revenue from our UK Rail subsidiaries for the year ended 30 April 2007 was up by 12.8% to £571.5m (2006: £506.7m), which includes some recovery from the impact of the terrorist bombings in London in July 2005. Operating profit was £58.8m (2006: £58.9m), giving an operating margin of 10.3% (2006: 11.6%) - this includes 12 weeks' results from the new South Western franchise where, as

we expected, the operating margin is less than that we earned under the previous franchises.

Rail bid costs of £13.0m (2006: £11.7m) were expensed during the year ended 30 April 2007 in arriving at the UK Rail operating profit of £58.8m (2006: £58.9m).

South West Trains

Stagecoach Group began operating the new 10-year South Western franchise, which is made up of the South West Trains and Island Line networks, in February 2007. Management is fully focused on delivery of our commitments to passengers, Government and our shareholders.

Passenger volumes at South West Trains are continuing to grow strongly and were up 8.9% in the year. UK rail has continued to benefit from a strong economy, new housing developments, modal shift as passengers prefer the train to their cars and from the impact of inward migration to the UK.

We are continuing to deliver high operational performance across what is arguably the most complex rail network in the UK. The delay minutes caused by South West Trains are now less than half the level they were before the GNER train accident at Hatfield in 2000. It is disappointing that delay minutes caused by Network Rail to South West Trains services remain above the pre-Hatfield level. In the year to 30 April 2007, while South West Trains' delay minutes fell 16.3%, Network Rail's increased 13.9%. We will continue to work closely with Network Rail to help deliver the improvements to infrastructure performance that allow our customers to experience the high level of service they deserve.

Our fleet of state-of-the-art Desiro trains, which have delivered a step-change in passenger comfort, is running well. Our focus on providing a safe and secure travelling environment has also resulted in significant cuts in crime on the network.

South West Trains has already taken a number of initiatives to improve services to passengers in line with its commitments under the new franchise. The plans include £20m of car parking improvements, refurbishment of 14 major stations, installation of ticket barriers at 13 more stations, and the introduction of Smartcard ticket technology, compatible with the Oyster system in the London area. We are also committed to providing 21% more mainline peak seats and a 20% increase in peak suburban capacity.

megatrain.com, the Group's innovative budget rail initiative, has now attracted more than 200,000 passenger bookings. Up to 1,000 customers a day are taking advantage of the bargain off-peak fares from £1 on offer on the South West Trains and Virgin CrossCountry rail franchises, covering around 20 destinations across the UK. The website has also been integrated with megabus.com to make access to low cost bus and rail travel even easier for customers. We plan to extend megatrain.com to the new East Midlands franchise, which we will begin operating in November 2007. Making the best use of capacity within existing infrastructure is a critical challenge and under the new franchise we are committed to providing 21% more mainline peak seats and a 20% increase in peak suburban capacity.

Island Line

Island line, which is now part of the enlarged South Western franchise, became the first rail operation in the UK to be designated as a Community Rail route by the DfT. Designation changes the approach to running the line, with greater emphasis on local management and meeting local needs. In March 2007, Island Line's six two-car Class 483 electric trains were bought by Stagecoach for a nominal sum from HSBC Rail, which previously leased the trains to Island Line. The trains, which provide 68 services a day between Ryde Pier and Shanklin, are now being repainted, along with some of the stations.

Supertram

Passenger volumes at Sheffield Supertram continue to grow and the tram operation is now carrying a record 14 million people a year. A major three-year project is underway to refresh the livery and interiors of the 25-strong tram fleet and 10 improved vehicles have entered service. The programme is improving comfort and accessibility for passengers, as well as helping to maintain the fleet's high standard of reliability. Stagecoach's integrated tram and bus network in Sheffield, which offers joint tram and bus ticketing, has succeeded in attracting more passengers to both modes of transport.

Rail franchising opportunities

Stagecoach is continuing to target rail franchise opportunities where we believe we can develop high quality, innovative, value-for-money and deliverable proposals that can add value to passengers, Government and our shareholders.

During the year, we won the new 10-year South Western rail franchise, which will allow us to build on our record of achievement at South West Trains and Island Line in driving up operational performance and customer satisfaction, as well as introducing new ideas to attract more people to rail travel.

In April 2007, Stagecoach Group plc was selected by Greater Manchester Passenger Transport Executive ("GMPT") to operate and maintain the Manchester Metrolink tram network. Nearly 20 million passengers travel every year on the 37km Metrolink network. The contract will run for a 10-year term and is expected to commence shortly. It will include managing a number of special projects sponsored by GMPT to improve the trams and infrastructure to benefit passengers. Stagecoach will also be responsible for operating tram services on the new Metrolink lines to Oldham, Rochdale, Droylsden and Chorlton.

On 22 June 2007, we welcomed the decision by the DfT to award the Group the new East Midlands rail franchise. The new 7-year and 4-month franchise, which is worth £235m in annual revenue, will run from 11 November 2007. The last 16 months are dependent on meeting performance targets. We engaged with more than 80 local, regional and national stakeholder organisations in developing our proposals for East Midlands, which combines the current Midland Mainline franchise and regional services transferred from Central Trains.

We have an interest in other bids for rail franchises where we believe our expertise and ideas can improve services to passengers. VRG, where Stagecoach has a 49% shareholding, submitted its plans earlier this year for the New Cross Country franchise, which is expected to start in the autumn and run until March 2016. The DfT is expected to make its decision in summer 2007. We have also partnered with Virgin and GNER Holdings to bid for InterCity East Coast, one of the UK's flagship franchises. The Group would have a 45% interest in the business if the joint venture's bid is successful. The franchise operation involves the running of regular services between London King's Cross, Peterborough, Doncaster, Leeds, York, Newcastle, Edinburgh and Glasgow, with a limited number of services extending to Inverness, Aberdeen, Hull, Bradford, Skipton and Harrogate. The DfT anticipates that the new franchise will commence in late autumn 2007 and will continue until March 2015. The DfT is expected to make an announcement on the successful bidder later this year.

Joint Ventures

Virgin Rail Group

Our share of VRG's profit after tax for the year was £18.9m (2006: £5.5m), after taking account of costs associated with VRG's bid for the New Cross Country franchise. This includes an exceptional gain of £5.4m in relation to our share of the gain on disposal of Trainline. Our share of operating profit, excluding the exceptional credit, was £12.4m (2006: £5.3m), our share of finance income was £3.7m (2006: £1.7m) and our share of taxation charges was £2.6m (2006: £1.5m).

We were pleased that in December 2006 VRG and the DfT agreed new commercial terms for the West Coast franchise through to March 2012. Passengers will benefit from enhanced frequencies, continued focus on further improvements to punctuality as well as extra seats and a major increase in daily train services from December 2008. Separate proposals being discussed with the DfT would provide further extra seats by lengthening VRG's 53 nine-car Pendolino trains.

VRG has launched a major marketing campaign to attract more travellers, emphasising its value-for-money fares and the environmental benefits of travelling by rail compared to car and air. This has resulted in significant growth, with customers taking advantage of lower cost advance purchase tickets.

Passenger volumes on Virgin West Coast are continuing to grow and have increased by a further 11.1% over the past year. During 2006, Virgin's Pendolino services have continued to win market share from the airlines, particularly on the London-Manchester and London-Liverpool routes.

Similarly, the Virgin CrossCountry franchise has grown passenger volumes by 11.0% over the past year and now handles in excess of 23 million passenger journeys a year.

Scottish Citylink Limited

Our share of Citylink's profit after tax for the year was £0.9m (2006: £0.1m). The improvements made by our inter-city coach joint venture have marked the return of the coach as a real alternative to the train and the car. Citylink has achieved significant passenger growth on its inter-city coach service in addition to new journeys under the Scottish Executive's national concessionary travel scheme. This is as a result of better connections, faster services and lower fares. Total like-for-like passenger volume growth in the year was 36% (compared to the equivalent period last year including the period prior to the formation of the joint venture), which we estimate represents full fare passenger growth of 20% with the remainder coming from growth in the concessionary travel scheme.

Under the Scottish Citylink joint venture, the Scottish coach network has benefited from a simpler, integrated timetable, faster and more frequent journeys, and excellent value-for-money fares.

Although it has a minimal financial impact for the Group, we were extremely concerned about the principles of the decision of the Competition Commission requiring the divestment of some routes operated by the joint venture. The findings were out of step with the majority of evidence presented to the Commission by a range of independent parties, inconsistent with a number of previous inquiries into the Scottish public transport market, and contrary to Scottish Executive transport policy.

However, while we continue to disagree with the ruling, we are now working with the Commission to implement its decision.

Other financial matters

Depreciation and intangible asset expenses

Earnings from continuing businesses before interest, taxation, depreciation, intangible asset expenses and exceptional items (pre-exceptional EBITDA) amounted to £229.6m (2006: £194.0m). Depreciation from continuing businesses for the year was £68.3m (2006: £61.0m). The income statement charge for intangible assets decreased from £20.5m to £14.7m. This reduction of £5.8m principally reflects the £8.0m decrease in the goodwill charge for Virgin Rail Group, which totalled £5.1m (2006: £13.1m) for the year. The reduced goodwill charge for Virgin Rail Group is because the prior year amount included additional charges due to the status of negotiations on VRG's franchises.

Exceptional items

Net exceptional gains before taxation of £169.6m (2006: £17.4m) were recognised in the year. This included a gain of £132.2m on the disposal of the Group's London bus operations, an adjustment to the gain on the prior year sale of the Group's New Zealand operations of £0.6m, a non-cash gain of £28.9m relating to a past service pensions adjustment on the Stagecoach Group Pension Scheme, a £5.4m gain being our share of VRG's gain on the disposal of its investment in Trainline Holdings Limited and £1.1m of other losses relating to disposed operations. Also, a gain of £3.6m (2006: £0.8m) was recognised on the sale of properties.

A tax charge of £8.7m (2006: credit of £2.8m) was recognised in respect of exceptional items resulting in a net exceptional gain after tax of £160.9m (2006: £20.2m).

Net finance income/costs

Net finance income from continuing operations was £0.7m compared to net finance charges of £15.9m in the previous year, because of a lower average net debt during the year principally as a result of the disposal of our London bus business. The Group now has a more efficient capital structure that has resulted in a lower number of ordinary shares but will mean a significant increase in financial charges in the year ending 30 April 2008.

Earnings per share

Overall earnings per share before intangible asset expenses and exceptional items increased by 10.4% to 11.7p, compared to 10.6p in 2006, reflecting the

Summary Operating and Financial Review

strong trading performance at each of our core divisions. Basic earnings per share increased sharply from 10.7p to 25.4p, reflecting the net exceptional gains in the year.

Return of value

Following the Group's disposals of its New Zealand and London bus operations in November 2005 and August 2006 respectively, and the Group's continued strong cash generation, net debt was eliminated during the first 6 months of the financial year and the Group was subsequently left in a net cash funds position at 31 October 2006. At that point, the Board announced it would be reviewing its capital structure and intended to return not less than £400m to shareholders. A thorough review of the Group's position and prospects ensued during which time the West Coast mainline rail franchise (in which the Group has a 49% interest via VRG) had been renegotiated, fuel prices had decreased and continued strong revenue growth had been experienced in the Group's UK Bus and Rail divisions. These factors coupled with the ability of the Group to borrow at attractive rates led the Board to announce on 14 March 2007 that Stagecoach would return approximately £700m to shareholders, which equated to 63 pence per ordinary share in issue at the Record Date, being 11 May 2007. The return of value was approved by shareholders at an Extraordinary General Meeting on 27 April 2007 and was completed in June 2007. Since the balance sheet date, 277,777,735 B shares and 823,220,972 C Shares were issued in connection with the return of value. 253,584,435 B Shares were redeemed at 63 pence each and the remaining 24,193,300 B Shares are redeemable in the future at 63 pence each. A special dividend of 63 pence per C Share was paid or waived on 458,001,388 C Shares which then converted to Deferred Shares of negligible value. The remaining 365,219,584 C Shares were bought by Credit Suisse for 63 pence each and were later bought by the Company for 63 pence each and immediately cancelled.

For every 14 ordinary shares held on the Record Date (being 11 May 2007), shareholders received 9 new ordinary shares and 14 B or C shares.

The holders of the remaining B Shares are entitled to payment of a non-cumulative preferential dividend paid twice yearly in arrears on 31 May and 30 November calculated at a pre-specified annual rate expressed as 70% of LIBOR for six month deposits in pounds sterling on the nominal amount per B Share.

All of the C Shares and Deferred Shares issued in May 2007 have now been cancelled.

Current trading and outlook

The current financial year to 30 April 2008 has started strongly and trading is in line with our expectations. There are a number of exciting opportunities across the Group and we are confident of achieving our objectives for the year.

In UK Bus, the continued revenue growth, integration of acquired businesses, stable fuel costs and returns on additional pension contributions should result in further strong progress for the year ending 30 April 2008.

In North America, the claims environment remains challenging, but subject to effectively controlling claims costs, further growth is anticipated.

We expect, based on our forecasts for the new South Western rail franchise, profit from our wholly owned rail businesses to decrease in the year ending 30 April 2008. South West Trains, along with the majority of the UK passenger rail industry is experiencing better than anticipated revenue growth. While this has been partly offset by cost increases, we remain confident of meeting our profit expectations for the ten-year South Western franchise that commenced on 4 February 2007.

We shall begin operating the Manchester Metrolink tram network from July 2007 and the East Midlands rail franchise from November 2007, and expect both contracts to contribute to the Group's profit.

The re-negotiated West Coast rail franchise is benefiting from good revenue growth and increased market share which results in a positive outlook for the year ending 30 April 2008. The CrossCountry franchise terminates in November 2007 and VRG is awaiting the outcome of its bid for the New Cross Country franchise.

Corporate social responsibility

We pride ourselves on delivering high-quality local services to local communities by local people. As well as providing a range of economic and environmental benefits, our bus and rail services support social inclusion and bring people together. We are committed to attracting more people to public transport. It is central to our growth strategy, to the future success of our Group, and also important to the future of the communities in which we operate around the world. We are committed to working in partnership with the many stakeholders our services touch to achieve our mutual long-term goal of sustainable development.

Stagecoach has a strong culture of meeting its wider corporate responsibilities, from the way we do business and our approach to safety and the environment, to how we treat our customers, our local communities and our own people. Like the best businesses, we measure our performance and always strive to improve the delivery of our service to customers. By building trust with our stakeholders, we believe we can make an increasingly positive impact on society and the environment. Here we have provided an overview of some of our people, safety, accessibility, environment and community initiatives.

Stakeholders

Stagecoach Group works in partnership with a range of bodies in each of the markets where we provide public transport services.

Our People

The strength of our business is built on the high quality of our management teams and frontline employees, from drivers and engineers to customer service and support staff. These are the people that ensure we can deliver a first-class quality of service day in, day out, and encourage more people to use public transport. By investing significant time and resources, we are able to have the right people on board to deliver for our customers.

We respect and value our staff, and we have a strong commitment to equal opportunities and partnership working with trade unions. Stagecoach also offers its employees the opportunity to join an excellent pension scheme as well as providing attractive pay and conditions packages.

As a major employer, we also recognise the need for ongoing training and development, not just so our people can do their job, but so they can develop individually. In our UK Bus division, we have one of the best vocational training programmes of any operator, designed to raise standards among and recognise the key contribution of our drivers. We continue to focus closely on recruitment and retention of drivers through improved pay, better training and mentoring schemes. We have also established links overseas, as part of the expansion of the European Union, to recruit drivers to complement our employment campaigns in the UK. Stagecoach has also won a national award for the high standard of its UK Bus training team, taking the Centre of the Year Award for training providers and employers at the Scottish Qualifications Authority Annual Awards 2006.

At South West Trains, our centralised Recruitment Centre and the state-of-the-art Operations Training Centre are continuing to deliver benefits to our employees and better service to our customers. We also have in place vocational training, support for managers, employee recognition programmes and round-the-clock open learning access for our staff. South West Trains spends an average of more than 1,600 employee days a month training its people in addition to its three 24-hour open learning centres.

In North America, our centralised driver training school has improved the quality and consistency of provision. Our Canadian business has focused closely on harnessing the power of the web to attract new employees and has been working in partnership with Workopolis, Canada's leading internet recruitment service.

We are also looking to develop the managers of the future through our graduate recruitment initiative. One of Stagecoach's managers received the Chartered Institute of Logistics and Transport (CILT) Young Manager of the Year award, while one of our other former graduate trainees is now part of our management team in North America. Stagecoach is working with the Department for Education and Skills and the Learning and Skills Council to

deliver a new two-year Young Apprenticeship programme. The programme enables Stagecoach to help shape the workforce of the future by offering able and motivated 14 to 16-year-old pupils the chance to get a taste of work alongside their school studies.

Stagecoach wants to be there to help our people when they need it most. Our South West Trains and North American businesses have care schemes, which offer an employee assistance programme that includes a 24-hour confidential counselling service. South West Trains runs regular health fairs across its network, offering employees the opportunity to have a cholesterol check, free flu vaccination or general check-up.

We are one of six employers across the UK involved in a cutting edge pilot scheme that aims to research and test various ways to improve financial capability in the workplace. The multi-agency project - co-ordinated by the Financial Services Authority (FSA), the independent financial watchdog - involves offering our staff one to one surgeries and hard copy material. The workplace is seen as an ideal way to get information and education on finance to adults and active participation by employers is vital. The pilot is part of a national strategy to improve access to information, advice and personal finance education, so that consumers are better equipped to make sound choices when looking after their money and their future financial security.

Improving accessibility

Accessibility is crucial in providing attractive public transport services and we recognise that every customer we serve is unique, each with their own specific individual needs. As far as possible within the resources we have available, we are making it easier to use our bus, rail and tram services.

Over the last year, we have invested in over 500 new low floor buses in the UK and are on target to beat government deadlines for compliance with disability legislation. We have announced a further investment of £65m in new accessible vehicles in the UK for 2007/8. Earlier this year, we invested £11m in Britain's longest coaches as part of a drive to attract people out of their cars and away from low-cost airlines.

Significant investment is also taking place in our North American business in partnership with federal agencies. This year, our New York Sightseeing business introduced 13 new open-top double-decker vehicles with improved wheelchair access ramps for disabled customers.

On the South West Trains network, we operate an assisted travel line to encourage disabled travellers to book ahead so we can make arrangements to ensure their journey runs smoothly.

Access for all is also about staff training and we continue to maintain links with disability groups to ensure both the needs of our passengers and employees are considered. At Sheffield Supertram we are making vehicles more accessible to the visually impaired.

Stagecoach Group's website, www.stagecoachgroup.com, has been developed in line with accessibility guidelines drawn up by the Royal National Institute for the Blind. Our consumer-facing websites are also designed to maximise ease of use by customers with visual impairment.

We have also taken further steps to improve the online purchase of tickets for our transport services. Stagecoach has launched the UK's first integrated budget coach and rail online booking service. Customers using the market-leading megabus.com and megatrain.com budget travel sites can get both coach and rail options in one easy search, giving them access to 530 daily departures to around 50 UK locations from just £1, plus a 50p booking fee.

Health and Safety

Stagecoach has a proactive culture across the Group that puts health and safety at the core of our operations. Bus, coach and rail travel is significantly safer than similar journeys by car, and the safety and security of both our customers and our people are fundamental to our business.

Health and safety is monitored and reported on across Stagecoach Group and immediate action is taken to address issues in our business processes. Safety is part of a well-defined risk management process across our business. A main Board executive director, Brian Souter, has specific responsibility for safety issues across the Group and the Board is updated on safety matters at each of

its meetings. Safety matters are also considered at the Board and management meetings of each of our businesses.

Our Group Health, Safety and Environmental Committee, chaired by our non-executive director Janet Morgan, reports regularly to the Board on these matters. They have access to internal safety executives and external consultants.

In our UK Bus division, we are working in partnership with the Government and other agencies to improve bus safety and security. While crime and vandalism are relatively low, we are aware they can discourage people from travelling on buses. We continue to invest in CCTV technology and all of our new buses are fitted with security cameras. In addition, we use driver safety screens and other measures to protect our passengers and our people. We have a number of joint programmes in place with schools and the police to deter anti-social behaviour and educate the next generation of public transport users. Stagecoach is also working with a number of local authorities in areas such as Oxford, Mansfield, Cheltenham and Gloucester to develop late night bus networks to help reduce town centre crime.

At an operational level, we have in place a process of route risk assessments to identify potential safety issues. As well as our own investment in ongoing driver training, we are supporting the work of the Road Operators' Safety Council to drive up standards in the industry. Stagecoach has also helped fund safety campaigns focused on other road users, including cyclists and drivers of agricultural vehicles.

Rail travellers on the South West Trains network are benefiting from a safe environment on our state-of-the-art Desiro trains and on our refurbished Class 455 trains, which are fitted with CCTV technology. All South West Trains rolling stock is fitted with the Train Protection Warning System. The company's commitment has seen it twice win the Robert Horton Safety award at the National Rail Awards.

Our award-winning TravelSafe Officers partnership with British Transport Police - which helps ensure passenger safety - has been extended further in the past year to cover more routes and stations on the South West Trains network. South West Trains also has 51 Secure Stations - the highest of any train company. Under our new 10-year franchise, we are committed to retaining the presence of a guard on every service. Work is also continuing with Network Rail and British Transport Police to identify hot-spots and ensure effective measures are taken on both trains and at stations to reduce incidents of assault, trespass and vandalism. Our conflict avoidance training for employees has helped cut physical assaults on staff by more than 10% in the last 12 months.

In North America, we carry out regular safety audits of our facilities to ensure high standards of health and safety are maintained. Along with other major operators, we have assisted national bodies to put in place processes to address the impact of potential terrorist attacks on public transportation. In the United States, for example, we are working with the Federal Government to take part in anti-terrorism workshops for our employees and are beginning to put in place anti-theft and GPS tracking, monitoring and communication systems. In Canada, we have a dedicated Occupational Health and Safety Policy Committee whose members are drawn equally from management and workforce representatives.

Public transport by bus, coach and train is the safest way to travel. Stagecoach Group itself has a good safety record, but there is no room for complacency. We constantly keep our safety arrangements under review and are committed to putting in place any improvements required to our safety governance arrangements.

Community involvement

For more than 25 years, Stagecoach has been a key part of communities around the world. As well as providing lifeline transport services and significant job opportunities, our Group is an integral part of local communities in the UK and North America.

We help local people share in our success by funding the vital work of local, national and international charities. During the year ended 30 April 2007, £0.7m (2006: £0.6m) was donated by the Group to help many worthwhile

Summary Operating and Financial Review

causes, including many health charities and local community projects in areas where Stagecoach provides lifeline bus and rail services.

Stagecoach is providing £500,000 through a major four-year sponsorship to fund a gym at the new Oasis Academy in Grimsby. The Academy, which will have around 1,100 students, is a partnership between the Oasis Trust, North East Lincolnshire Council and the Department for Education and Skills to improve choice for parents and raise the overall standard of education in the local area. The Grimsby curriculum will be enhanced by a specialism in sports and health.

Stagecoach's support for the community is not just about money. Hundreds of our employees devote their own time every day to local projects that make a real difference in their area. Many make financial donations personally through "give as you earn" schemes. Our businesses provide much needed in-kind support, while our people also give charities the benefit of their expertise during secondments.

Much of the backing we provide is focused on education and young people. We work closely with schools and police on local crime prevention initiatives and education of youngsters about the dangers and consequences of anti-social behaviour. Our support also assists many local initiatives that help provide opportunities for young people.

At South West Trains, much of our focus is on projects designed to give young people alternatives to anti-social behaviour, through schemes such as our Eastleigh Street Sport sponsorship and our long-term support for the Carroll Youth Centre. We are also heavily involved in highlighting the dangers of trespassing on railway lines, getting the message across to around 50,000 children a year. In addition, we have also been involved in a scheme to assist with the rehabilitation of ex-offenders.

Stagecoach is also helping promote social inclusion with our communities and help those who are the most vulnerable. We have a national agreement with Guide Dogs for the Blind that allows the dog trainers free travel on our buses and trains. We have also contributed to several homeless shelters, providing funds for equipment and new dormitories. South West Trains is a regular supporter of the Railway Children, a charity which helps runaway youngsters.

We have continued to support the UK educational charity businessdynamics, which provides courses designed to build the skills and confidence of young people as they prepare to enter the worlds of work and further education. We have also supported a number of arts initiatives and this year marked the 10th anniversary of our sponsorship of the Mari Markus Gomori children's concerts, which have been attended by more than 40,000 schoolchildren.

Overseas, our businesses support the work of chambers of commerce, arts foundations, tourism associations, educational groups and other key services. We have again provided transport facilities to assist the annual Tartan Day celebrations in New York, while similar support has been provided to a group of British police officers that make an annual visit to the city to honour the Britons killed in the September 11 terrorist attacks.

Supporting the community. Working with the community. Part of the community. That is the cornerstone of our business philosophy and the key to building positive relationships with our stakeholders.

Building a sustainable environment

Public transport is key to the future of our communities. As well as making a major contribution to social inclusion and the quality of life in our towns and cities, bus, coach, rail and tram services are an important part of the solution to the global challenge of climate change.

Buses and trains are five times more energy efficient than cars and produce significantly less emissions per passenger journey. However, Stagecoach is acutely aware that any form of transport has an impact on the environment. That is why we are committed to making our own business as environmentally-friendly as possible.

We have published a Group Environmental Policy that sets out our commitment to good environmental stewardship and for a number of years

we have put in place stretching targets to reduce emissions, cut water and energy consumption, minimise waste and identify opportunities for recycling.

By focusing on technological innovation - such as trials of cleaner fuels - improved environmental management and training, and continued investment in our products and services, we have made further progress this year.

Our environmental initiatives

Stagecoach has undertaken a number of initiatives and new ways of working over the past year to improve our own environmental performance and encourage people to take the green public transport option. We are proud of our record of achievement, but despite the huge progress and investment we have made in the area of environmental sustainability, we realise that this is only a start and we have a long way to go.

Buses

Stagecoach continues to make significant investment in modern vehicles with improved environmental performance. We have invested around £80m in the year to 30 April 2007 in the continuing modernisation of our fleet, which meet and often exceed the latest environmental standards.

We have conducted the first UK trials of a bioethanol-fuelled bus outside London to evaluate the technology that can use sugar beets to power vehicles. The pilot study covered Liverpool, Barnsley, Sheffield, Newcastle and Manchester. Ethanol-powered buses are already in operation in Sweden, Spain, Italy and Poland, delivering significant reductions in carbon dioxide and particulate matter.

Stagecoach has further expanded the use of biodiesel to more than 4,300 vehicles in its UK Bus fleet as part of our drive to reduce greenhouse gas emissions and improve fuel efficiency. The biodiesel we are using is a blend of 95% diesel and 5% bio-matter, which can be derived from sources such as soy, palm, rape, sunflower and used cooking oil. Our use of biodiesel now covers around 60% of our UK bus fleet.

Emissions from dozens of Stagecoach workplaces across the UK have been cut significantly after the introduction of a hi-tech energy management system. Gas consumption at 80 depots has been slashed by an average of 36%, while carbon dioxide emissions have been cut by more than 6,200 tonnes a year. The technology - now in place at 80 Stagecoach bus sites in Scotland, England and Wales - uses self-learning predictive programming, coupled with high accuracy temperature sensing. It takes over the control of the existing heating and delivers improved control, staff comfort and dramatic reductions in energy consumption.

We are continuing with our megabus.com marketing campaign to encourage budget travellers to switch from "gas guzzler" airlines to low-cost inter-city coach travel to minimise damage to the environment. Our analysis shows that, on a per passenger basis, travel by megabus.com can be more than six times more fuel efficient than flying with a budget airline, producing seven times less carbon dioxide emissions.

In the United States, we have continued to replace older vehicles in our fleet with coaches that feature reduced emissions engines with the latest technology. During 2006-07, we replaced 40 coaches and 13 sightseeing double deckers with new models.

We also have an action plan in place to comply with Federal US Environmental Protection Agency (EPA) policies and procedures by creating Storm Water Pollution Prevention Plans and Spill Containment and Countermeasure Plans in all our operations in the United States.

In Canada, we have taken further steps to reduce direct emissions from our operations. As part of our compliance with engine emissions requirements under Ontario's "Drive Clean" programme, 200 vehicles were tested during the 12 months to 30 April 2007, resulting in a 93.5% pass rate on first test. A total of 20 coaches were replaced with new vehicles, equipped with the latest engine technology, and all of our locations have converted to ultra-low sulphur diesel.

Trains

Environmental management is central to our approach in our rail operations. As part of our commitment, all of our traincare depots have now achieved ISO14001 accreditation. Clapham, Wimbledon, Bournemouh, Salisbury, Farnham and Fratton depots achieved the status six months ahead of target.

We have developed an industry leading waste segregation and recycling operation at our South West Trains Wimbledon Traincare Depot, called Garbology. Waste is sorted into different types, with items such as cardboard and paper taken away for recycling. A culture of "re-use" and "recycle" is gathering pace to reduce waste being turned into landfill. Recycling schemes have been set up at nine pilot locations in partnership with waste management and recycling company SITA.

South West Trains has taken part in a trial of low sulphur gas oil fuel on one of its Class 159 diesel trains in conjunction with the Association of Train Operating Companies and the Rail Safety and Standards Board. If the trial involving our Salisbury depot is successful, we expect to switch to this type of fuel for the diesel fleet in 2008/9.

In partnership with the Carbon Trust, South West Trains has focused on four sites to strengthen our energy and water management strategy. Initiatives under consideration include the installation of automatic meters to monitor water usage and highlight leaks or fluctuations in demand.

A massive environmental improvement has resulted from the introduction of controlled emission toilets to all but a handful of trains in the South West Trains fleet. Effluent is collected in tanks, emptied at special depot facilities, and transferred hygienically into the national sewage network. From the end of 2007, all South West Trains units will be fitted with controlled emission toilets.

South West Trains recently replaced its carriage washing machines with new modern washers, which use alkaline instead of acid wash and often recycle water. Northam, the base for the state-of-the-art Desiro fleet, has a carriage wash with a sophisticated filtration system. The system deals with grease, chemicals and oil, ensuring 75% of the water can be recycled. While limited space has prevented water recycling at every facility, all machines are fitted with tanks that hold one month's detergent supply, reducing the frequency of deliveries.

As well as ensuring it meets its own standards, South West Trains has taken steps to ensure high standards of supply chain management by using the ISO 14001 environmental management standard in its selection criteria.

VRG our joint venture with Virgin Group, has launched a 'Go Greener. Go Cheaper' marketing campaign, part of a consistent push to take on domestic airlines on speed, price, frequency and environmental credentials. The company's Pendolino trains emit at least 76% less carbon dioxide than cars and planes. The state-of-the-art Pendolino trains also minimise their carbon footprint by returning 17% of electricity used back to the National Grid every time they brake – enough to provide power for 11,825 homes for a year.

Our performance

We have reviewed our approach to environmental performance measurement this year to focus on core key performance indicators ("KPIs") specific to each business and better aligned with our management system.

At the heart of our approach is a commitment to continuous year-on-year improvement, with a focus on moving annual averages. The KPIs for each of our divisions will be published on our website.