

Operating review

The year to April 2002 has been uniquely challenging as a result of unparalleled acts of terrorism in North America, lengthy disruption to the UK rail infrastructure and an uncertain global economic environment.

The year ahead will be a challenging time for the Group but we have begun the year with actions that should secure our long-term interests in South West Trains and Virgin Rail Group. At Coach USA we will be undertaking a full business review of our portfolio of businesses and will report the results of this by December 2002.

We are committed to modernising public transport and playing a leading role in achieving passenger growth in each of our markets. In the year ahead, we will continue to focus on enhancing business performance and improving the quality of our services by further investing in our core operations.

Across the Group, we have a portfolio of valued and trusted brands and we are working hard to develop these even further in our bus, coach and rail markets. On the ground, we are providing improved easy-to-understand networks and information, attractive value-for-money ticketing, friendly and well-trained staff, and increased comfort from new modern vehicles to ensure our customers keep coming back.

Safety remains paramount across all of our businesses and is an integral part of the culture of our organisation. Each of our management teams has clear monitoring and reporting processes in place and immediate action is taken to address any issues. A key element of our safety programme is the training of staff and the promotion of a strong safety culture.

UK Bus

Our UK Bus business, the traditional core of the Group, remains a strong source of cash flow and retains a significant share of what is a highly competitive marketplace. As one of the biggest bus operators in the UK, we are committed to playing a major role in delivering the objectives of the UK Government's 10-year Transport Plan.

Financial results

Turnover for the year in UK Bus was £567.9m, compared to £547.6m in the previous year. The results for the previous year included a full year's trading from four depots in East Lancashire, which were disposed of in April 2001. Excluding these four depots, turnover increased by 6.2%.

Underlying UK Bus passenger volumes increased by 1.4% in the year, with particularly strong growth in London. Our targeted commercial and marketing plans are generating volume growth in a number of key towns and cities, and the bus market in the UK continues to offer good organic growth opportunities, particularly in urban areas.

Operating profit was £71.1m¹, compared to £73.4m in the previous year. This represents an operating margin of 12.5% (2001 – 13.4%). The reduction in operating margin principally arises from above inflation wage increases.

Commercial development

We believe that the future of the bus industry and ultimately the long-term interests of passengers, are best served by operators, Government, local authorities and customers working together to improve our public transport system. Our common goals of passenger growth, improved reliability and reduced congestion in our towns and cities can be achieved without the need for increased regulation.

Achieving passenger growth, one of the UK Government's key transport objectives, is central to the relationships we are building with local authorities. We now have some 50 partnership schemes in place across the UK with a further 30 schemes under discussion, most of which we expect to be in place in the next 12 months. These schemes provide tangible evidence that Quality Partnerships can assist in achieving the Government's transport objectives.

¹References to "operating profit" in the Operating review refer to profit before interest, tax, goodwill amortisation and exceptional items.

One of the Group's most comprehensive bus investment projects outside London is in the Cambridge area. Close partnerships with local authorities have delivered a 20% growth in passenger numbers over a six month period, while the environment and quality of life in one of the country's most historic cities have been improved. This growth has been achieved by the introduction of more than 40 new low-floor buses, together with improved and simplified routes and fare structures. We have also focused closely on recruiting, retaining and training staff as part of a commitment to improved customer service and reliability. The project has been achieved through a strong partnership with the local authorities, Cambridgeshire County Council and Cambridge City Council. They have invested in infrastructure for the new city centre routes, including bus gates and priority bus lanes and high specification park and ride sites. The new prominent "citi" branding, combined with a major marketing and advertising campaign using the Internet, door-to-door postcard deliveries and leaflets, has transformed the perception of public transport in Cambridge.

A similar partnership approach and targeted investment, supported by improved infrastructure provision and more bus priority measures, has improved services and generated passenger growth in many other areas of the country, including in the Blackwater Valley area in Hampshire, Exeter, Portsmouth, Nuneaton and Brackley.

We are confident that this model can be applied in many areas of the country, delivering a sustainable balance of network services, value for money for customers and growth opportunities for bus operators. The bus plays a key role in achieving social inclusion, particularly for those who have no access to other means of transport. As a result, we will continue to work closely with our local authority partners to make the bus the transport mode of choice for increasing numbers of people.

In London, our passengers are benefiting from our continuing substantial investment in new vehicles and the commitment of Transport for London to improving public transport. Passenger growth in London across all transport providers is running at

around 6% per annum and we expect this to continue in light of demographic and transportation trends. Our two London bus companies have been ranked consistently high amongst the operators for reliability and punctuality in Transport for London's performance tables. We now have approximately 16% of the London bus market and are very well placed to benefit from continuing growth opportunities in the city such as the future introduction of congestion charging.

Following the success of "easy access" lo-liner buses, we have continued to invest in low-floor vehicles and have worked with local authorities in improving bus stops with level kerbs, shelters and information. In time our entire UK Bus fleet will feature lo-liner facilities.

We continue to place significant management emphasis on staff recruitment and retention to ensure we can offer the high quality of service that our passengers expect.

Marketing

Within the framework of our overall UK Bus branding, we have developed and rolled out new marketing kits for each of the individual operating companies with a consistent approach being adopted across the division. Dedicated route branding and promotion, such as "Coastliner" between Portsmouth and Brighton, is also generating additional volume growth.

We are continuing to roll out *The Guide*, the biggest commitment of any operator to improved passenger information, which was launched in November 2001. This pocket-sized publication provides an attractive and comprehensive guide to routes, times and prices of services, and is being developed for our key town and city networks across the UK. It is being delivered to every household in these areas with a guarantee to update and distribute it for at least the next three years. Areas to benefit already from *The Guide* include Cheltenham, Cambridge and Perth.

Our ticketing strategy has focused on developing simple, easy-to-understand tickets, including the Dayrider, Megarider

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and Goldrider products. These represent excellent value for money and suit a range of consumer lifestyles, from pay-as-you-go tickets for casual users to products devised for specific types of passengers, such as students.

We have also undertaken specific targeted marketing initiatives and have been particularly successful in encouraging more students to travel by bus. In Manchester, for example, which has the highest student population in the UK, we re-launched the Unirider student ticket range with particular focus on a route which captures traffic from three local universities. The campaign resulted in a 48% increase in ticket sales, with many students taking advantage of our online early booking discount. Similarly, in Fife, we launched a special ticket that was sold on site to attract students travelling between locations on the split Lauder College campus.

Since its launch last year, we have continued to develop and expand our UK Bus website, www.stagecoachbus.com. Offering online timetables, ticket offers and latest news of service developments, the site is now attracting more than 40,000 visitors each month.

Disposals

Further to the disposal of four depots in East Lancashire in April 2001, we sold our Eastbourne operations in April 2002.

This is consistent with our strategy to target investment and deployment of our operating assets in those parts of the business where we can maximise shareholder value.

Management

UK Bus remains an important part of the Group and, together with our other businesses, offers the potential for future revenue and earnings growth. We are committed to developing strong managers who can drive the business forward. The streamlining of the businesses into twelve operating companies and the reorganisation of the management team is now complete and is adding value. As part of this process, we have made a number of new senior appointments to strengthen our UK Bus management

team, with particular emphasis on commercial development and service delivery. New commercial teams are also in place throughout the UK.

Brian Cox retired as Executive Director – UK Bus in July 2002. Les Warneford, our UK Bus Managing Director, continues to have overall responsibility for our UK Bus operations.

Coach USA

Some of the major challenges the Group has faced over the past year have been in Coach USA. The attacks of September 11 and the continuing soft US economy have had a significant effect on the travel and transport sectors, including our North American businesses. Substantial annual cost savings have been achieved and costs remain under control. As a result of the disappointing trading at Coach USA in the first two months of the new financial year, a full business review will be carried out of our North American operations. The findings of this review will be reported to the Board by December 2002.

Financial results

Coach USA's turnover for the year was £682.3m compared to £686.4m in the previous year. Operating profit was £41.2m, compared to £67.1m in the previous year. This represents an operating margin of 6.0% (2001 – 9.8%).

We were encouraged by the financial performance of Coach USA during the early months of the financial year. Coach USA's revenues increased by 4.1% (excluding foreign exchange rate movements) in the four months to 31 August 2001. However, as we have previously reported, our progress and the results for the year were impacted by the terrorist attacks in the USA on September 11.

We took immediate action to reduce our cost base, including reducing non-driver headcount by 10%, cutting Houston head office staff by 40%, and taking 330 buses out of service. The \$25m cost reduction programme was implemented within six weeks.

The business is now operating from a lower and more efficient cost base, although revenues were down approximately 5% in the year and continue to be below prior year levels. The international tour and charter market remains weak, particularly on the West Coast. There has been some improvement in the domestic charter market, however we have still to see a full recovery in the school overnight trip market. In our taxi operations, we have seen a decline in fleet utilisation levels and increased car repossessions consistent with a post September 11 reduction in business travel and tourism, particularly evident over the winter months in Texas and Florida.

Commercial development

The outcome of the business review will determine the future direction of Coach USA. However, within each of the individual businesses, our management teams continue to evaluate a range of initiatives to support the commercial development of each business. While overall trading results are disappointing, a number of the businesses within Coach USA have had notable success in stimulating demand for selective products.

We have begun to refocus our Coach USA business by prioritising development of our line run, transit and sightseeing services, while reducing our dependence on tour and charter.

Coach USA has recently launched a new City Express scheduled service network, following our acquisition of Vectour's operations in Chicago. We are beginning to see some growth in passenger volumes following refurbishment and re-branding of the City Express fleet, enhanced schedule frequencies, additional services to the Midway airport from Wisconsin, and an advertising campaign focusing on our quality and service value to the customer.

During its first year of service, a new casino line service from George Washington Bridge Terminal in New York has carried 80,000 riders to Atlantic City, New Jersey and generated over \$1.5m in revenues.

We have been successful in securing new contract and corporate business. We continue to bid for a range of new contract work,

with our pricing determined by a set of rigid tender criteria. A seven year contract was signed and renegotiated with the Anaheim Resort to provide resort-wide shuttle services. Since May 2002, a network of eight routes have serviced the area which includes the Disneyland theme parks and hotels. Almost all of the hotels have signed up for the service and are expected to stop their own private shuttle services by the end of this year. In addition, new contracts were signed with Royal Caribbean Cruise Lines, Destination America and Sportmark.

The sightseeing market has been a particular area of focus for our Coach USA marketing team. Our "hop-on hop-off" double deck Sightseeing USA buses are already proving to be the preferred choice for tourists in New York. These services are now being rolled out into other key sightseeing locations. Going forward all Sightseeing USA locations will be marketed as a network to take advantage of cross-selling opportunities in both domestic and international markets.

Coach USA continues to undertake targeted sales and marketing to ensure that we take full advantage of current market opportunities in our core tour and charter business. For example, we have recently embarked on a direct mailing programme aimed at corporate travel, corporate contract and various university groups, including athletic directors, alumni and student affairs, and business development directors. This is principally intended to generate new business for campus shuttle services, team charters and campus event charters.

A new Coach USA website was launched in May 2002. This will be a useful marketing tool and is expected to attract even more than the one-million visitors to the former site last year.

Acquisitions and disposals

We believe that the bus and coach market in the USA will see some major long-term changes. Coach USA will look carefully at possible opportunities that this may provide. During the year, we have completed acquisitions in North America with a total enterprise value of £22.7m. These were tuck-in acquisitions of

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coach and taxi businesses. In March 2002, for example, we acquired high quality bus operations in San Francisco and Chicago from Vectours, which had been placed into Chapter 11. These complement our existing line run and sightseeing businesses.

As previously reported, we have also sold and closed a number of businesses during the year. The annualised turnover of these businesses was £14.0m.

Overseas Bus

Our Overseas Bus division, which encompasses operations in Hong Kong and New Zealand, continues to perform well. The strong public and government support for passenger transport in these locations has underpinned the growth of our Overseas Bus businesses.

The results for the year include a contribution from our former operations in Portugal, which were disposed of in June 2001 and our Australian operations, the final part of which was disposed of in June 2002.

Financial results

Turnover for the year in Overseas Bus was £194.7m, compared to £195.4m in the previous year. Operating profit was £34.1m, compared to £35.8m in the previous year. This represents an operating margin of 17.5% (2001 – 18.3%). The fall in turnover and operating profit in the year is largely as a result of the disposal of our Portuguese operations and reduced revenue in Hong Kong due to the impact of severe weather in the first six months of the year.

Nevertheless, our Overseas Bus businesses have continued to report good underlying growth. Under our ownership, both our Hong Kong and New Zealand businesses have been able to report strong organic growth in passenger volumes. This growth has been achieved through a commitment from both government and Stagecoach to the continuous improvement of public transport.

Passenger volumes in New Zealand grew by 5.2% in the year, while local currency revenues grew by 12.2%. This growth has been achieved by the development of new products with the support of the local authorities. The New Zealand Government has provided "kick start" funding to encourage bus operators to begin operating new services and we have worked closely with the Auckland and Wellington Regional Councils in designing and delivering leading examples of these services.

Passenger volumes and revenues in Hong Kong were impacted by 2 days of typhoons (2001 – Nil) and a further 30 days of severe rainstorms (2001 – 14). After excluding the impact of the severe weather, passenger volumes on the Hong Kong Island Franchise grew by 1% and on the Airport Franchise by 10%. The underlying growth on the Airport Franchise has been achieved against a background of a global decline in passenger air traffic during the year. Our proven track record in operational performance puts us in a good position to bid competitively for new bus franchise tender opportunities which have recently been announced.

Commercial development

Together with investment from government, we continue to invest in infrastructure, vehicles and technology in our overseas bus markets. In Hong Kong, we have commenced work on a new bus depot that will enhance the infrastructure and underpin the long-term development of the franchise. The new depot is planned for completion in 2003 and will provide facilities for over 800 vehicles as well as becoming the main office of Citybus. The estimated cost of the new depot is approximately £27m of which £3.3m has already been spent. In New Zealand, we have taken delivery of the first part of a significant order of new diesel buses to replace the existing fleet and allow expansion of our services. We are also about to commence a programme of rebuilding the 60 trolley buses that operate in Wellington.

Building on our experience of operating the trolley bus network in Wellington, performance trials are continuing in Hong Kong with Citybus' new trolley bus. The trolley bus is partly a response to increasing concerns over noise levels and emissions from

conventional buses, and the trials have proven to be very successful. Citybus has also enhanced 500 of its double-decker buses by installing four flat LCD screens on each vehicle, which allow passengers to watch a range of material during their journey. Further initiatives are aimed at developing new opportunities for longer-term growth in our core overseas markets.

Our Overseas Bus businesses have undertaken a number of marketing initiatives during the year. A promotional campaign incorporating television, radio and on-bus advertising, a free phone information line and information packs with free trial use tickets was recently piloted in Wellington. The early results of this campaign have been positive. We have also entered into sponsorship agreements with Embassy Theatre in Wellington and the Starship Children's Hospital in Auckland.

In Hong Kong, we opened the Admiralty Customer Service Centre in July 2002 as part of our ongoing commitment to improving customer service. In addition, a number of special ticketing schemes were launched during the year, including a concessionary fare for senior citizens travelling at weekends and public holidays at certain times of the year.

Disposals

Our operations in Portugal were disposed of in June 2001, generating a gain on disposal of £6.0m. As part of our strategy to focus on core growth routes in our key geographic markets, we have also exited from small operations in Cairns, Australia and Mainland China. In June 2002, we disposed of our remaining Australian business in the Sunshine Coast allowing our overseas bus management to focus on our core operations in New Zealand and Hong Kong.

Rail

Our Rail division encompasses our two wholly-owned UK rail franchises – South West Trains and Island Line – and Sheffield Supertram. In addition, our rail business includes our joint venture, Virgin Rail Group, which operates the West Coast Main

Line and CrossCountry franchises. The division is also responsible for evaluating other opportunities in the heavy rail and light rail markets.

In the UK, the continuing instability over infrastructure and Railtrack being placed into administration have affected every part of the rail industry, including investor sentiment, and no train operating company has been immune. Our rail division has sought to continue to deliver on our commitments and business plan within this difficult operating environment. However, with a new team and strong direction from the Strategic Rail Authority, and the emergence of Network Rail, we believe the industry can now move forward and work together in delivering a much improved service to passengers.

The quality and performance of our rail services will improve markedly over the coming years with the delivery of new trains. South West Trains and Virgin Rail Group have now arranged more than £3 billion of new trains. By the end of 2004, the entire Virgin Rail fleet and around half of South West Trains' rolling stock will have been replaced by modern, air-conditioned coaches giving quality and reliability – a clear and unambiguous statement of our belief in the future of Britain's railways.

Financial results

Turnover for our wholly-owned rail subsidiaries in the year was £402.8m (2001 – £403.7m), and operating profit was £31.3m (2001 – £45.6m). This represents an operating margin of 7.8% (2001 – 11.3%).

The operational performance at South West Trains is now slowly improving as the network benefits from some improvements in engineering reliability. Trading was, however, affected by the RMT industrial dispute earlier in this calendar year, which resulted in six days of industrial action. This has reduced reported operating profits by approximately £9m in the second half of the year and was in addition to three days of industrial action in May 2001.

Overall turnover decreased 0.2% on the prior year with passenger volumes down 2.2%. This is largely as a result of the industrial

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action. However, we continue to believe that South West Trains offers good prospects for further passenger volume growth but the speed of recovery depends on a positive economic outlook combined with a sustained infrastructure improvement that will restore passenger confidence in rail travel.

Commercial development

In June 2002, we signed a deed of amendment to the existing South West Trains franchise, which is due to end in February 2003. The deed of amendment provides for additional funding to be paid by the Strategic Rail Authority to South West Trains to facilitate work on a number of new projects that will form part of the new long-term franchise. The signing of a new long-term franchise agreement for South West Trains is expected later this year and will allow us to implement new measures to improve quality, service and value to passengers and to meet targets set by the Strategic Rail Authority.

Our programme for new rolling stock for South West Trains is progressing with the delivery of Class 458 trains. Discussions are continuing with Porterbrook and Alstom over continuing reliability issues related to the new rolling stock. Of the original rolling stock order, a large number of units have now been delivered with the majority entering service in the six months to 30 April 2002.

The manufacture of new Desiro trains by Siemens – Britain's biggest ever train order – is progressing well, with the first of the vehicles on test at Wildenrath, Germany. We remain on target to replace all slam-door rolling stock at South West Trains by the end of 2004 and the new trains will help increase capacity at peak times.

Marketing

Our marketing strategy at South West Trains during the year was designed to encourage incremental business in the off-peak travel market. This was primarily aimed at customers travelling on leisure journeys. Marketing is focused on two main aspects: travel to London and the convenience of Waterloo station (the main London terminus for South West Trains' services) as a

centre within walking distance of many attractions; and other attractions in the South West Trains area.

In July 2002, we launched a major promotional campaign offering a free ticket give-away. This was designed both as a "passenger dividend" for customers in our area and as an encouragement to travel by non or infrequent users.

Customer Service

We continue to recognise the importance of improving all aspects of customer service within South West Trains. Our joint £15m investment with Railtrack on passenger information is leading to a step change in the quality of information available to passengers and we have continued with our award winning employee development programme. One of our stations, Andover, won the National Rail Award for Station of the Year in September. We have appointed a dedicated Customer Services Director to ensure that passengers remain at the heart of South West Trains. In June 2001, we appointed Sir Alan Greengross as a non-executive director to represent passengers' interests. We also established a Passengers' Panel, including representatives from major rail users' groups, as well as eight regular passengers, to give passengers a greater say in how their railway is run.

Safety

Safety remains our highest priority and the tragic events of Potters Bar remind all of us that there is no room for complacency. We are on target with our fitting of Train Protection Warning System (TPWS), which offers enormous benefit and reassurance to passengers. We are encouraged that the number of signals passed at danger (SPADS) remains well down on historic levels despite the large increase in new drivers. We continue to take the personal security of our passengers and employees seriously and were pleased to receive our thirtieth secure station award from HRH the Princess Royal.

Island Line

During the year, Island Line was awarded the renewal of the coveted Charter Mark Award for excellence in the provision of

public services and remains the best-performing train operating company in the UK.

The SRA has issued a consultation document on the future of the railway system on the Isle of Wight after the end of the existing Island Line franchise in September 2003.

Virgin Rail Group

Financial results

Our share of the Virgin Rail Group's turnover for the year was £261.2m (2001 – £232.8m). Our share of operating profit for the train operations was £10.8m compared to a loss of £2.8m for 2001.

We are pleased that Virgin Rail Group has returned to profitability during the year, although both the West Coast Main Line and CrossCountry franchises continue to experience poor infrastructure reliability and ongoing engineering work. Passenger numbers have been gradually recovering since the disruption experienced in the period following the accident at Hatfield. We announced on 22 July 2002 that Virgin Rail Group has reached agreement with the Strategic Rail Authority with regards to revised commercial terms on both its franchises that will secure their long-term viability.

Commercial development

Under the agreement with the Strategic Rail Authority, both the West Coast Main Line and CrossCountry are to be fully funded by the Strategic Rail Authority until March 2003. The Strategic Rail Authority intends to renegotiate new franchise terms with Virgin Rail Group by March 2003 for the West Coast Main Line franchise. Until new franchise terms are agreed, Virgin Rail Group will run the franchise under a management contract for a fee of 2% of revenue. The CrossCountry franchise terms are to be renegotiated with Virgin Rail Group by March 2004. Similarly, until new franchise terms are agreed, Virgin Rail Group will run the franchise under a management contract for a fee of 1% of revenue, or alternatively the Strategic Rail Authority may offer the franchise to other bidders. Once the terms of both franchises are renegotiated, they will operate on the basis of a normal railway franchise risk with an appropriate rate of return.

Virgin Rail Group's exciting programme of introducing new rolling stock is progressing well and is improving the experience of passengers through better reliability, performance and comfort. During the year, 34 new "Voyager" trains entered service on the CrossCountry franchise and are performing well. In addition, 44 new "Super Voyager" trains will be brought into service during the current year. The Super Voyagers will begin tilt operation once the safety approvals have been obtained and the infrastructure is made ready.

On the West Coast Main Line franchise, the new Pendolinos are currently on test and driver training programmes are underway. The new trains will start to take over some existing services during 2002 travelling at 110 miles per hour as non-tilting trains. Services will be upgraded to tilt operation when the infrastructure is made ready. The inaugural journey of a Pendolino will take place on 23 July in readiness for the Commonwealth Games.

After several years of work and consultation, the current irregular timetable that exists outside the corridors to London is being replaced by a "clock-face" timetable in September 2002. This will unlock capacity bottlenecks and give passengers the simplicity of a regular interval, hourly timetable combining speed and frequency. This improved timetable is the biggest national timetable shake-up for a decade and, combined with the new trains, will provide a substantially improved service to our customers.

Rail business development

We continue to evaluate and bid for a number of heavy and light rail opportunities, particularly in markets where we see synergies with our existing operations.

In the UK, our key priorities are to finalise the commercial issues around the West Coast Main Line modernisation and to finalise the agreement for the new long-term franchise at South West Trains. We are also involved in bids to operate light rail projects in Manchester, Portsmouth, and Leeds based on our experience in running Sheffield Supertram.

In New Zealand, we have been named as a joint venture partner with Wellington Regional Council to purchase and operate the

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New Zealand capital's passenger rail services. The next stage is to form a joint-venture company and then proceed to negotiate with Tranz Rail, the current owners of the rail network.

We have also been short-listed as a bidder to run the heavy rail services of the Massachusetts Bay Transportation Authority, the commuter railway serving Boston and surrounding areas. The bid, in partnership with Herzog, one of the most experienced private rail firms in the US, is for a five-year management contract to operate a vertically-integrated railway, including operation and maintenance of both rolling stock and infrastructure.

Investments

thetrainline.com

thetrainline.com now has over 6.6m registered users and offers scope for considerable growth going forward. The business is now clearly established as the market leader in direct rail retailing in the UK, and the business model is underpinned by the necessary contractual framework to produce profitable growth in the near term.

As a direct result of the growth in users and revenues, our share of trainline's operating losses has reduced from £5.7m to £4.4m.

Trainline.com Limited was de-merged from Virgin Rail Group during the year. This will allow the management of Virgin Rail Group to focus on the business of running passenger rail services and trainline management to develop the Internet and telephone retailing business. We continued to hold 49% of both businesses, with Virgin holding the remaining 51% in each of the businesses.

Road King

Our Group results for the year ended 30 April 2002 include our share of Road King's results for the year ended 31 December 2001. Our share of operating profits for the year was £12.9m (2001 – £13.8m). We are pleased that despite a reduction in certain minimum income undertakings from joint ventures during the year, Road King has maintained its strong profitability.

In September 2001, Road King received HK\$1,023m for the disposal of its interests in the Jieyang Highway network project. This has further strengthened its financial position and has resulted in a very low net gearing ratio of 5% at 31 December 2001. Excluding the impact of the disposal, total traffic and toll revenue increased by 9.3% and 11.0% respectively in 2001.

The outlook for the business remains encouraging. With the benefits of the People's Republic of China's accession to the World Trade Organisation, the sustained growth in GDP and the ongoing economic development of the inner provinces, we expect there to be further opportunities for the expansion of Road King's PRC infrastructure business.

Current trading and outlook

In our Rail division, the progress we have made on a new franchise at South West Trains and in resolving the commercial issues on the West Coast Main Line and CrossCountry franchises helps ensure the future success of these operations. Both South West Trains and Virgin Rail Group offer good growth potential in the longer term.

Overall passenger revenues for the 8 weeks to 22 June 2002 are up 10.3% on the prior year at Virgin Rail Group (the prior year revenues were impacted by a heavily discounted fares promotion campaign) and were consistent year on year at South West Trains.

At Coach USA, revenues have not yet recovered to pre September 11 levels and in the first two months of the new financial year, revenues were approximately 8% below prior year levels. This reflects a softening US economy and an increasingly competitive market. We are now in the peak summer period and the disappointing start has prompted us to undertake a detailed review of the Coach USA operations. At this stage, we do not anticipate trading to improve and expect operating profits for Coach USA to be no better than 2002.

In UK Bus, we are examining a range of initiatives intended to deliver future organic growth and we have continued our success in recent Transport for London contract tenders.

Our Overseas Bus businesses continue to perform well. Despite high unemployment and the sluggish economy in Hong Kong, Citybus continues to see revenue and passenger growth. Our New Zealand business is now achieving high levels of organic growth.

The Wider Community

Stagecoach is committed as a Group to taking its wider corporate responsibilities seriously and making appropriate contributions to all our stakeholders and the wider communities in which we operate. Our long-term commitment to modernising public transport embraces customers, shareholders and the environment.

Our commitment to our wider corporate responsibilities has been recognised by a number of interested parties. For example, we are part of the Dow Jones Sustainability Indexes which track the financial performance of the leading sustainability-driven companies world-wide. We are also a constituent of the FTSE4Good index service which aims to set a global standard for socially responsible investment.

We intend to issue a more comprehensive social responsibility report during 2002/03, which will cover all of our operations world-wide.

Safety

Safety and security are of paramount importance across all of our businesses. High profile rail accidents in the UK have re-emphasised the importance of maintaining constant attention to all issues affecting safety. We are committed to ensuring the highest standards of safety for our passengers and improving health and safety standards for our employees. This area is monitored and reported on across all of our businesses and immediate action is taken to correct any perceived weakness in our business processes.

A Main Board Executive Director 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 business units.

In the UK, we welcomed the guidance issued recently by the Department of Transport, Local Government and the Regions, which sets out safety measures that can be taken by bus companies and local authorities to improve personal security for bus staff and passengers. We are actively addressing this area of growing concern. In Manchester, for example, we have set up a crime prevention unit, including the deployment of a number of vehicles with covert CCTV cameras and a management unit which ensures tactical deployment of resources and follow-up with the police, schools and parents. We are also working in partnership with schools as part of schools citizenship programmes designed to discourage anti-social behaviour.

We also welcome the announcement that extra police and traffic wardens will be introduced to patrol some of London's most crime and congestion-hit bus routes. This is another clear step towards ensuring that our passengers and employees can travel in a safer environment as well as keeping bus lanes clear for use.

At South West Trains and Island Line, safety remains a key management priority. A health and safety plan is in place, which includes specific objectives against which performance in this area can be monitored. A key element of this programme is the training of staff and the promotion of a strong safety culture throughout the organisation. We have reiterated our commitment to retain a guard on every train and not to move to driver-only operation. The fitting of the Train Protection Warning System to our fleet is on course to be completed in advance of the statutory deadline and the introduction of the new Desiro fleet will bring major safety benefits to our customers. We are using the opportunity of the introduction of this new fleet to upgrade our driver-training programme including the purchase of four "state of the art" simulators.

Our joint venture, Virgin Rail Group, is equally committed to creating a safe and secure environment for its passengers, workforce and the general public. Management has made good progress on its shorter-term initiatives which form part of a longer term plan. These include:

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- the introduction of Train Protection Warning System on all new trains;
- maintenance of a close safety partnership with Railtrack on the management of Possessions and Signal Sighting as route modernisation is undertaken;
- the use of driver training simulators and introduction of interactive computer based training (CBT) assessment tools for improved safety, training and off-line experience.

At Coach USA, comprehensive training and monitoring programmes on safety are continuously updated and improved upon. Safety Managers have been appointed at all locations who are in turn supported by a Regional Safety Manager, all of whom are overseen by a Vice President of Safety at Coach USA's head office.

At Citybus, a safety officer was employed to strengthen management of safety-related issues within the organisation and in service delivery. The engineering and operations staff work together to increase safety for drivers and passengers. Regular occupational safety training for workshop staff and road safety seminars for drivers is also held to constantly remind the workforce of the importance of safety.

Our New Zealand bus and ferry operations have robust procedures in place, involving formal employee participation, to ensure the health and safety of our staff and customers. The Accident Compensation Corporation, which is the statutory provider of accident insurance for employers in New Zealand, has audited our procedures and safety record and awarded "secondary status" to Stagecoach New Zealand and Fullers Auckland. This is a rarely awarded accolade, which places our operations in the top 1% of New Zealand companies as regards health and safety.

The Environment

We believe that business needs to play an important part in the movement by societies to build a sustainable future.

A responsible attitude to the environment is a central component of Stagecoach's activities. Throughout the Group we endeavour to interact with the environment in a responsible manner.

Stagecoach is specifically aware of the impact of all forms of transport on the environment. We believe that integrated public transport systems will form the central core of future efforts to reduce pollution levels, alleviate congestion on the roads and free up our towns and cities in particular, allowing unfettered transit for all.

Across our businesses we offer customer-focused solutions to traffic congestion and pollution. Trains are one of the most energy efficient forms of transport, able to carry large numbers of people without the burden to the environment generated by other modes of transport such as private cars. Increased and effective promotion of our rail services will contribute both to shareholder value and to the wider environment.

Our continual re-investment in new bus fleets with improved energy consumption and reduced emissions is an important example of the Group taking its wider responsibilities seriously. Environmental considerations are included in all capital investment decisions taken by the company. All new Stagecoach vehicles meet tough Euro III emissions standards and in the UK all our buses have changed to use low sulphur fuel.

Stagecoach New Zealand is taking delivery of 120 new MAN buses that will comply with Euro III emission standards. This industry-leading initiative will significantly reduce exhaust emissions in New Zealand's two main centres.

We are active in developing new forms of transport which will complete our Group's portfolio offering and continue to lessen adverse impacts on the environment. An example of this is the Sheffield Supertram operation which is both reducing car use in the city and opening up previously neglected areas for development.

We are also playing a leading role in a major European project set up to harness solar energy to drive hydrogen powered fuel

cell buses. The Urban Integrated Solar to Hydrogen Energy Realisation Project ("USHER") is being driven by Cambridge University and consultant engineers Whitby Bird and Partners. By October next year, a state-of-the-art hydrogen-powered Stagecoach bus is expected to be transporting students, staff and international visitors from the centre of Cambridge to the university's new science and technology campus at West Cambridge. We believe that the USHER project has huge potential to generate significant energy savings and avoid damaging emissions and it is further evidence of our commitment to reducing the impact of our operations on the environment.

In Wellington, Stagecoach New Zealand is also planning to rebuild its 60 existing electric trolley buses with new super low floor bodies, in a stylish new design. This programme will ensure that the backbone of Wellington City's bus service will continue to be operated with zero emission vehicles for another 15 years. A prototype trolley bus is currently under construction.

In Auckland, Stagecoach New Zealand intends to trial a hybrid electric bus developed in New Zealand. This vehicle will have a battery pack powering a computer controlled electric drive motor. The batteries will be topped up during operation by a generator, driven by a small gas turbine engine. This vehicle will comply with Euro IV emission standards.

Coach USA is playing a leading role in the United States in meeting the latest air pollution control rules and regulations for its purchases of all new vehicles. We are working with local and state governments to improve commuter and line haul services to encourage more people to use our coaches instead of their cars.

In Hong Kong, Citybus is making a notable contribution to reducing pollution levels by fitting catalytic converters to some engines and upgrading others. The entire fleet has been using ultra-low sulphur diesel since 2001. Over 50% of the Citybus' fleet complies with Euro II standards. The first Euro III bus joined the company's fleet in December 2001. Citybus is also pilot testing Continuous Regenerative Traps for Euro I and II engines

to further reduce emission levels as well as investigating opportunities to use "zero emission" electric trolley bus technology in Hong Kong and has converted a diesel bus to electric propulsion in an ongoing test programme.

Community Activity

We view our businesses as an integral part of the communities in which they operate. We seek to provide convenient and affordable public transport for all with the long-term aim of making public transport the first choice of the majority.

In addition to the contribution made by improving and modernising local public transport systems, we recognise a responsibility to share our success with the local communities. During the year £0.5m was donated to a wide range of local, national and international charities. In addition our management and staff are involved in a large number of local community projects.

Within South West Trains we sponsor a programme of school visits to make school age children aware of the dangers of railway trespass and we support this programme with targeted charitable giving which seeks to encourage child and youth activities.

In New Zealand, our businesses have been active for some years in providing significant sponsorship funding for prominent community organisations. In Wellington, we have this year commenced a three-year sponsorship of the refurbishment of the Embassy Theatre, a landmark community owned art deco style theatre. Also this year, in Auckland, we have commenced a three year sponsorship of the Starship Children's Hospital. This hospital serves children from all over New Zealand who require particularly difficult specialist care. Stagecoach's funding will initially provide extra specialist equipment for the hospital's intensive care unit.

We will endeavour to continue our work with local communities and provide transport solutions that offer mutual benefit.