Uphill struggle: First's flagging profits threaten investment in the fleet. Pictured are two recent additions to the fleet at the Millbrook test track

Profit plunge threatens First bus investment

FirstGroup's 2016/17 financial results show that the operating profit margin for the UK bus business has dropped to just 3%, after restructuring costs

FirstGroup's UK bus division has reported a further large fall in profits, raising concerns over its ability to fund future fleet investment and questions over whether a new programme of business closures and disposals could be forced on the company.

The group's full year results for 2016/17 showed that operating profit at the UK's second largest bus business declined to £37m at a margin of just 4.3%, down from £52m the previous year. After restructuring costs, including closure of the Rotherham depot, operating profit fell to £26.1m at a margin of 3.0%. If investment in new buses had matched transport groups' usual levels, profits would effectively have been wiped out.

First's chief executive Tim O'Toole blamed traffic congestion, economic uncertainty, a shift from High Street to online shopping, and local authority funding cuts for falling UK bus revenue, which declined from £870.9m to £861.7m. He added that costs remained higher than at other transport groups' bus divisions with cost rises outstripping savings from efficiency plans.

> "Despite yet more restructuring, performance has become worse"

The performance saw longstanding City transport analyst Damian Brewer, of Royal Bank of Canada, question whether First's UK bus division will be able to generate sufficient funds for fleet replacement across the business as a whole. He noted that alongside falling profits, First's investment in new buses in 2016/17 was significantly below standard industry requirements.

"Despite yet more restructuring and depot exits, performance has become worse," Brewer said in a note to RBC clients. "To us, this raises the likelihood of more business exits or alternatively a cash flow negative business as capital expenditure needs rise."

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FirstGroup's size and range has been an asset, says chief exec

FINANCIALS

FirstGroup chief executive Tim O'Toole has indicated that he would resist any new shareholder pressure to break up the company.

Under questioning from City analysts during presentation of the company's full year results last week, O'Toole denied that selling off large parts of the US business, particularly the school bus business, could create better value for investors.

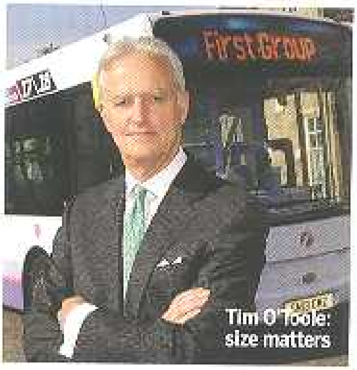
Instead, he said the current Anglo-American structure of the group was providing significant benefits for customers and when competing for international contracts in new countries.

Examples of technology which had been transferred from the US to the UK included customer service apps developed at the Greyhound coaching business which had been immediately transferred to First's UK bus and rail companies without the need to prove separate concepts.

FirstGroup's size and range of businesses had been an asset in competing in new markets such as Panama. O'Toole said it had convinced clients that "this is a company that really can deliver transport services by any mode under any contract".

"As of right now, we continue to believe that the current [First] structure makes sense and we derive value from it," he added.

The full year results saw a strong profit rise at FirstGroup's American companies compensate for continuing falls in profitability in the UK. The group's full year results for 2016/17 showed operating profit rose 12.7% to £339m on the back of strong performance at the large US school bus business. Profits in the school bus division rose 34% to $222m despite no increase in revenue. The rise was due to increased profit



Tim O'Toole: size matters

THREAT TO FIRST BUS INVESTMENT

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The implication is that First may plan to 'underinvest' in its low-profit and loss-making companies while funnelling the limited investment available into businesses with most potential to raise profits, in the hope that this will generate sufficient funds for catch-up fleet replacement elsewhere in future years. Alternatively, First could seek to dispose of more low profit and loss-making subsidiaries to create a smaller, more viable bus business.

David Leeder, chief executive of consultancy TIL and a former managing director of First's UK bus division, said the situation meant O'Toole should consider selling a significant part, or all, of the UK bus business following the failure of successive turnaround plans. "That's the logical conclusion," he said. "There aren't many options. They need a new plan that will work or to think about selling it to someone who does have such a plan."

However, he pointed out that developing a successful new approach would require new types of partnerships with local authorities that would not be simple or cheap. "Work we have done in the industry shows it needs significant additional investment in the early years and serious work to define how costs and returns should be allocated with local authorities and other operators in the partnership," he commented.

Other industry sources doubted whether First would find buyers for any meaningful operations due to the scale of the task required to turn businesses around and significant pension deficits at some companies. Overall, First's UK pension deficit is £140m. Depot closures and route withdrawals were considered more likely.

A FirstGroup spokesman told

"There aren't many options. They need a new plan that will work or to think about selling it to someone who does"