CORPORATE PARTICIPANTS

Chris Davies National Express Group PLC - Group Finance Director & Executive Director

Dean Finch National Express Group PLC - Group CEO & Executive Director

CONFERENCE CALL PARTICIPANTS

Alexander Paterson Peel Hunt LLP - Non-Designated Member

Damian Brewer RBC Capital Markets, LLC, Research Division - Analyst

Joseph Philip Thomas HSBC, Research Division - Analyst

PRESENTATION

Operator

Hello, and welcome to the National Express Group PLC Third Quarter Trading Update. (Operator Instructions) And just to remind you, this conference call is being recorded.

Today, I'm pleased to present Dean Finch, CEO; and Chris Davies, Finance Director. Please go ahead with your meeting.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Good morning, everybody, and thank you for joining the call today. As usual, I'll just say a few words and then open it up to Q&A.

I've got 3 key points I want to make. Summer trading, Spanish concession renewal and where we are on certain contract retentions and wins.

Starting then with summer trading. We had a good summer trading period. I was very pleased with our performance. The performance in Spain was fabulous. And as you can see from the numbers, the passenger growth was incredible. And that was across the board, really. I mean, obviously, we had a boost from start-up in Rabat in Morocco, but Spain was also very strong. And we saw strong underlying demand, excellent improvements in vehicle utilization and good fare management. So that was all very, very encouraging.

In terms of the U.K., pleasing to see a good U.K. performance off of a strong 2018 comparative. Focus on pax growth is very pleasing.

And then in North America, we saw good disciplines around route scheduling and driver wage management, which helped us deliver a small margin improvement which, as you know, is absolutely key. And overall, the return to school performance was good, so that's also pleasing. Q4 is key in terms of our performance in North America, so that set us up for a strong base. We've got much to play for, in my view, over Q4 in terms of delivery in North America, but this is a good start.

Turning to my second point. Spanish concession renewals have again been canceled as a result of an appeal by an operator. The court overruled the ministry. So the process will have to be redesigned and have to be launched once again. I anticipate this means that the redesign and the relaunch will take place at, best guess as I can call it, at some point at the first half of next year, which means that there will be another year at least with no financial impact on the group, possibly two. So as we've been doing for some years now, we will watch that space, position ourselves as best as we can and continue to grow the rest of our ALSA business and diversify away from long haul.

And then my final key point is about contract retentions and win. First of all, let's start in the States. Boston renewal is excellent. Good performance to existing customers being rewarded with renewals and volume growth, which is exactly what we're about as a company. And you will see more of this to come over Q4.

But probably the most important piece of news is following our win in Rabat. We started this contract flawlessly over the summer. It was an exceptional performance in terms of start-up. Now Rabat is Morocco's royal city and I believe the King noticed how the buses were performing. So therefore, shortly thereafter, we have been awarded Casablanca. This is an exciting contract for us. It's got revenues of starting, we believe, at around €70 million a year. Its margins are a tickle above ALSA's average margins. The CapEx is around about €70 million. It is on paper, at least, a 10 plus 5-year contract. I will remind you that if we look at our contracts in Morocco, they have longevity. We are in Marrakech, for example, in year '21 of a 10-year contract. So long as we perform, I can't see that we will lose our Casablanca business for many, many years to come.

Obviously, you guys can do the arithmetic better than I can, but the pence per share impact in terms of valuation is not insubstantial. So that's a great win. It's exactly what we are about as a group in terms of focusing on strong operations, performing for the customer and seeking growth from that at very good margins.

So all in all, very pleasing.

And for those of you who may have investment concerns about Morocco, you may be right. All I can say to you is I have seen nothing but stability in the 10 years I've been in the group from Morocco, a lot more stability than I've seen in certain U.K. contracts.

So that's it from me. I'll now turn it over to any questions you might have. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Joe Thomas from HSBC.

Joseph Philip Thomas - HSBC, Research Division – Analyst

Dean, Chris, 3 things for me, please. Firstly, on Casablanca. Could you just give us some visibility on the salesl returns that you expect to be making there and how that might compare to the returns that you're making elsewhere in ALSA? I know you said the margins were in line. Historically, I thought the margins in Morocco were a little bit behind.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

No, I didn't say -- no, Joe, I said margins were a tickle above average Spanish margins. They are, they're above. So the returns in Morocco are very good. And the returns in Casablanca are projected to be very good. I laid it out for you -- it's €70 million of CapEx. It's €1 billion of revenues plus. And it's above a 14% margin per annum. It's a good sale returns.

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

If you do a simple ROCE on that, Joe, you should get to about 25%, 26%. Just if you take the average, even with no residual valuation on those buses.

Joseph Philip Thomas - HSBC, Research Division - Analyst

Yes. And presumably those buses would have some residual value up to the 10-year term.

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

They ought to have some. Yes, they won't be 0 at term. But even if you just do the straight simplistic calc, you're at 25%, 26%-plus.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

But the reality of where you should be thinking about is, honestly, those buses will be deployed in Casablanca for the next 15 to 20 years without that contract going back out to tender, I am sure. And then we will renew it.

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

Which then doubles the number I've just laid out.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Doubles the number that Chris laid out.

Joseph Philip Thomas - HSBC, Research Division - Analyst

Yes. Yes. Okay. All right. In...

Dean Finch - National Express Group PLC - Group CEO & Executive Director

So in short, it's an excellent return on our investment.

Joseph Philip Thomas - HSBC, Research Division - Analyst

Separately, the redesign of the Spanish concession system, I mean is there any sort of -- anything that you can give on that? And is it likely to be moved further in -- the latter redesign, as I recall, was more about service quality than about price. I mean would you be expecting further shifts in that direction? Or indeed, how do you see that panning out?

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Well, it's a yo-yo. So it shifted to quality and price and then it shifted back a bit towards price. They also shifted back towards a bit more quality, I think. I suppose it's hard for me to give any sensible guidance on it. 8 years ago, I told you all that I expected the Spanish concession renewals to start in that year. And you roll the clock forward for 8 years and I'm saying it to you again. And every single time these concessions come out, somebody challenges them and the court overturns them. Now I'm going to leave you to fill in the dots to think through what may be behind that, but there's a pattern there, isn't there? And politically, I suppose how I feel is -- this is my guess, it's entirely my guess, it's my hunch and then these are my words and nobody else's words, but there's no political crisis about buses in Spain. They are well run, their fares are competitive and there's a burgeoning demand for them. So if you're a politician, where is the problem? And okay, civil servants in the ministry are looking at these things and faithfully following the due process that is dictated to them by Brussels, and I'm not trying to make some sort of Brexit point there, but they're following EU rules. Then someone, somewhere in the regime stops it. And I can't help but feel it must be connected to the fact that there is no political crisis and politicians have plenty of things to worry about and this is not one of them. So how this will -- how long this will go on for, I can't predict. I don't know. All I can say with certainty now is that I don't think it will affect the business financially for at least the next couple of years thereafter. I'm back to where we were 8 years ago and saying I expect margin progression but I expect that will be after a bumpy few years, also we'll emerge out of it in a stronger and bigger position than it is today. And that's what I continue to believe, that the thing that keeps thwarting that prediction is somewhere -- somebody somewhere shoots the fox every time it comes out of the burrow. If I knew who he was, I'd buy him a glass of wine.

Joseph Philip Thomas - HSBC, Research Division – Analyst

And finally, the U.S. labor costs. You've obviously got them under control. Is that all about scheduling in the U.S.? And to what extent can you continue to make those efficiencies?

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Well, the labor market is still really tight in the U.S. I see no signs of abatement there. Although it's pocketed so probably, I don't know, probably about 2/3 or more than 2/3 of our locations have no problems at all in attracting labor and 1/3 have. The key difference earlier this year is, of course, our rate renewals outpaced wage inflation, and that's the first time we've seen that in maybe 3 or 4 years. And the 2020 bid season is nascent at this point in time. But actually, there are signs that that's going to recur although early days. So that's good. I think there is plenty more that we can do to improve our own efficiencies in this regard where -- as our Transit footprint is increasing, and obviously, we are increasing that.

We have Transit locations adjacent to or 10 minutes away from School Bus locations in major cities. Now we are able to begin to make career progression for drivers more attractive between those locations. We're beginning to see some signs of economies of scale because a School Bus driver stops working over the summer holiday period obviously, but that is typically our peak demand for some of our Transit operations and so we can move them across and so we don't lose them over the summer period. So that's important and I'm excited to see that, where that can go.

An important bottleneck as well is training resources. And again, as our Transit business is growing, we can scale training -- our training capabilities across Transit and School Bus. And that helps us to address some bottlenecks around back-to-school time, which is the key period for driver shortages and it's typically the inflationary point for when the kids go back to school and drivers are taken on. Now a key thing is we've done differently from this year to last year, as last year, we were throwing, as is typically industry practice, sign-on bonuses to people. By and large, we've not done that this year. And we've not really seen much impact of not doing it. So we've been much more disciplined about that and it hasn't hurt us. So that's interesting. Sorry, that's a long-winded ramble there, but this hopefully gives you signs that there's lots of going on there and we are very focused on improving our margin in School Bus and lots of opportunities and levers to pull on.

Operator

And the next question comes from the line of Alex Paterson from Peel Hunt.

Alexander Paterson - Peel Hunt LLP - Non-Designated Member

Congratulations on the bidding and contract wins and so on. Two questions for me, please. Firstly, just on your NEAT initiative, the accessible transport, would you be able to sort of quantify the opportunity in the U.K. and talk a bit about how you can exploit it? Is this more like you've done it in the U.S. bolt-on acquisitions and so on? Or are you just going to target the sort of West Midlands area where you already are?

And then secondly, just on the Boston paratransit renewal. Can you just talk a bit about how you have nearly doubled the revenue on that? Obviously, there's an element of price, an element of volume and so on. Can you just give the breakdown approximately on that, please?

Dean Finch - National Express Group PLC - Group CEO & Executive Director

All right. Thanks, Alex. On NEAT, yes, there is a market out there across the U.K. although I wouldn't want people to get too excited about us chasing that opportunity. It's quite hard to do and it's quite fragmented. The Birmingham opportunity was a very, very specific situation. And for me, I think what you should read into it is more the -- a good sign of the strength of our relationship with our local authority in -- local authority and partners in the West Midlands, which you can contrast with cause and regulation elsewhere than some great strategic shift in our U.K. business. So yes, there's opportunities. But let's not get carried away with those at the moment. Let's see how this one goes and what this brings us to the business next year. We think it's worth about a £1 million for the year to us in terms of EBIT. The more significance for me is the -- what it says about our relationship and how we've helped the city, the region and strength of the relationship, as I said.

In Boston, well, it's really volume driven. We traded a little bit on price because the thing was obviously tendered, but not much, we'll more than recover that back in terms of trading. And I think it's -- I think the extra revenue is worth about $1.5 million-plus to us a year in terms of EBIT. But it's really good. We -- this is now our third renewal of that business. We bought it back in 2012 for about probably $6 million. It's handsomely paid back multiple times over. We've operated the hell out of it. We've got the best stats in the city, that's why they've given us a volume increase. And that -- I can't emphasize enough, that is what we try and do as a business. That's our strategy. Win a piece of business, be a quality operator, be a partner that the operator -- the authority wants to work with. We're not antagonistic. We're not difficult people to do business with, and sure enough, you find you get repeat business or enhanced business, enhanced margins, great, great stuff. Take it every day of the week.

Operator

And the next question comes from the line of Damian Brewer from RBC.

Damian Brewer - RBC Capital Markets, LLC, Research Division - Analyst

Yes, 2 questions, please. Just a clarification more than anything else. First of all, on the utilization, could you say a little bit more whether it's about the passenger load factor of the vehicle or actually amounts of sort of miles or kilometers per day you're getting out of each vehicle? And if so, on the latter, could you give us a feel just what that does to the sort of the capital intensity of new business wins going forward, and therefore, obviously implications to return on capital?

And then secondly, just -- and maybe one more for Chris, could you just update us where you are on sort of hedging on both the FX and interest rate side of the debt of the group, please?

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Damian, it's more utilization, really. And we saw a 2% or 3% improvement in our load factors over the summer, which is very good news for the margin and it's very profitable. So it's more utilization. It's more bums on existing seats than us running extra miles. There's been a bit of that, there's been a bit of that across the piece, but I wouldn't overemphasize the importance of that. Hedging, I'll let you...

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

Yes. On hedging, Damian, I mean, we typically move -- translate that so that it moves in line with EBITDA. So if what you're getting at is do I have any gearing issues coming from the volatility of FX at the moment, the answer is no. We've got -- in so doing, we've got slightly more of the debt now in sterling relative to prior years, which has tickled up the interest cost a little bit. But the key thing I want to do is just make sure we don't trip a -- trip over a basis point or 2 of gearing. So we just keep the hedge so that the debt and the EBITDA moves in line.

Damian Brewer - RBC Capital Markets, LLC, Research Division - Analyst

Okay. Good. And could I just ask you, just a follow-on, thinking about things going forward. When you're thinking about bolt-on M&A and sort of versus the leverage of the business, where is your sort of comfort zone in terms of net debt-to-EBITDA? Or is it still in the sort of 2, 2.5x range? Are you being a little bit more cautious given the current environment?

Dean Finch - National Express Group PLC - Group CEO & Executive Director

We are in the 2 to 2.5x range. Look, we -- the debt itself, I won't try and deemphasize debt, but liquidity is far more important than debt actually. As long as you pay, you're fine. The way we think about it is that our operational risks, by and large, are small. We don't have any one customer that's worth more than 2% or 3% of our EBITDA to us. We have immense flexibility mostly in our operations if we need to. So if we face a threat, we could significantly pare down how we allocate our cash flows a year. We're now generating over £550 million of EBITDA a year and the maintenance CapEx of that is around about £200 million. There's lots and lots and lots of flexibility we've got in that number as well if we needed to, if we were in crisis. So we don't have the operational risk so much. There's no one big rail contract that can come along and kill us with £1 billion of revenues going out the door overnight, doesn't work like that in our business and now we have fragmented customers, all of which, by and large, are open to negotiation. So you can do deals if we got into trouble. So that -- the risk side of the business I see is low.

Chris has just now done the U.S. PP. So we've got there. We've got money going out for as long as 12 years, underscoring the duration of the debt. And our rule of thumb internally is that we will operate with a minimum headroom on our facilities of £ 300 million. I can't see a single event or a -- at this point, a combination of events that would take us into that £300 million -- over that £300 million territory. And of course, within that £300 million, I'm not assuming that we've done any of the things that I said at the outset of this ramble, which is to pare back CapEx, renegotiate, do a bunch of other things that would be radical if we got into trouble. So I feel pretty secure, to be honest, in operating between 2 and 2.5x net debt-to-EBITDA. And frankly, whilst money is cheap and there's great opportunities out there for us to expand the business, I want to go after it. If we take Casablanca, yes, it's going to cost the €70 million of CapEx. That is a business that I feel pretty sure we're going to have our 15%, 16%-plus margins, EBIT margins, in 30 years' time. And we'll buy the fleet. Typically, that fleet will not be renewed, I don't think, for 15 or 20 years, because we're good at maintaining assets. And we will refurbish them as we need to as we go along. It's just a great return to shareholders. So I feel pretty confident, pretty confident about where the business is at the moment.

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

Can I just add 2 quick points, Damian, just to remind everybody that our maintained guidance at 2 to 2.5 times is post IFRS 16. So it is effectively 1.8 to 2.3 times in the money we all used to talk about. And secondly to Dean's point, if you adjust the maths on not even the CapEx holiday but dialing back on M&A from that £550 million EBITDA through £200 million of -- or £150 million, £200 million of free cash flow, that gives us a 0.2 times a year lever that we are deciding between. So the downside risk mitigation should not be underestimated.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

And look, here, I'm talking to the equity markets the. Other half of my day is talking -- I'll spend this week talking to the debt market. The debt investors feel very comfortable with us, very comfortable. In fact, they want to offer us more debt rather than less. So of course, they do when the sun is shining, but I feel comfortable about where the group is operating at the moment.

Operator

(Operator Instructions) As there are no further questions, I'll hand it back to the speakers.

Dean Finch - National Express Group PLC - Group CEO & Executive Director

Okay. Well, thank you very much. I'm sure it's a busy morning for all of you with everything going on in the Brexit world. So thank you for taking an interest and we'll speak to you again soon. Thank you.

Chris Davies - National Express Group PLC - Group Finance Director & Executive Director

Thanks.

Operator

This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.