National Express CMD 2021 Q&A

Ignacio Garat:

We are now happy to take your questions. If you could keep it to one or two questions and then join the queue again for any further questions you may have, that would be most appreciated.

Operator:

First question comes from Jarrod Castle from UBS. Please go ahead.

Jarrod Castle, UBS:

Thank you very much, gentlemen, and very informative. Just to explore kind of one topic, and one or two around it, but just on EV and I guess going to zero, I'm just interested where things currently stand in terms of EV, hydrogen, and in terms of the total fleet, and if you can split in your three main geographic regions.

And then you had some color on economics, but I'm also kind of interested in terms of the providers of the fleet. How competitive is the tender process? Who do you look to? And also for the availability arrangements, if you've got input into choosing the kind of fleet. Just some color around those topics, if you can. Thanks.

Chris Davies:

Hi, Jared. This is a big topic of mine for the last year. Look, we are looking at both EV and hydrogen at the moment. Across the three divisions, we've got well over 100 EVs in service in North America, primarily in Shuttle. We've got a handful of school bus products being tested from different manufacturers. In ALSA, we've got about four or five or now six different pilots underway. And in the UK, we're purchasing our first, we've got 29 in service, EVs, ramping up to 200 through our first availability contract. But we're also looking, in the UK, at hydrogen potentially for Birmingham for next year, which again would be up to around 200 vehicles.

In terms of the providers, it's rapidly changing. If you look at School Bus in North America, last year there was only one real provider. This year most of the major manufacturers are trying to get a product ready. In the Bus business, our traditional diesel bus providers have pretty much now all got an electric offer. Hydrogen's somewhat behind. And for Coach, we've actually run a procurement challenge to our current and prospective coach vehicle partners to say "Look, if you will build it, we will buy it."

In terms of the availability arrangements, look, ultimately, as we're going through the negotiation, putting these packages together, we are being quite precise on what our requirements would be. And for this first one in the UK, that did narrow it down, frankly, to one of two viable OEM products. I would imagine that as this scales over time, more of that choice of product will go to the availability provider, as long as they're providing product which hits all of our criteria.

Jarrod Castle:

Thanks so much.

Operator:

Next question is Alex Paterson from Peel Hunt. Please go ahead.

Alex Paterson Peel Hunt:

Afternoon, everybody. Can I ask two questions, please? Firstly, just continuing the theme of EVs, what is it that makes the EV availability arrangement so much cheaper than outright purchase? Is it that the supplier is buying in greater bulk and that they're getting savings from that? Is it better financing? Or what is it that makes that less?

And then secondly, can you talk a little bit about the price cuts in the UK Bus? You've obviously got good elasticity in order to get revenue growth there. Have the dynamics of that market changed?

I know you tried this a few months ago with some success in, I think it was on weekends in some of the parts outside Birmingham, Dudley, and so on. What's happened there? Is that something that you think you might be able to roll out across the UK if you were successful with Stagecoach? I don't know if you can say any more about that, please.

Chris Davies:

Alex, on EVs, to be honest, the main difference is it's a discounted cash flow life cycle cost we've given you. Obviously, with an outright purchase, you're spending that money right up front. With an availability contract, you're paying as you use it. The lifetime value of money, even at a very conservative discount rate, gives you that benefit over an outright purchase.

Over a more standard lease, of course, you've got the benefit of the guaranteed availability, the guaranteed battery utilisation, the charging infrastructure that comes with it, and all of those kind of things. Fundamentally, they do have bigger balance sheets to play, so their cost of funding will be slightly smaller, but it's not really scale. It's time value of money over purchase, and it's flexibility of, guarantee of appropriate supply over a lease.

Tom Stables:

And in terms of pricing, pre-pandemic we were seeing that the price reductions we had done then were driving volume and revenue growth. As we come out of the pandemic and recover, the same is true, that the price cuts we put in in the summer have driven our growth faster than the rest of the industry, and they're going to help us get back to that revenue position sooner.

Alex Paterson:

Thank you.

Operator:

The next question comes from Owen Shirley from Berenberg. Please go ahead.

Owen Shirley:

I suppose post the Stagecoach deal, UK Bus is potentially half of the business on this, so I was wondering if you could talk about the £3bn number that the government's kind of earmarked for that space. Obviously sounds quite big, but how might that be deployed? What practical things will it sort of be spent on? And in your view, how will it make UK Bus a better, more profitable business to be in? Thanks.

Tom Stables:

Yes. Of course. The £3bn, a huge investment by the government, huge investment by the government. Three or four main areas that it's going to go towards. Revenue support for lower fares, which is a key government policy to encourage growth back into the sector. Support for capital for fleet, to speed that transition.

And thirdly, around bus priority measures for the cities to make the road networks faster and better for busing, which again, will drive patronage in the long term. All three elements, very closely linked, making bus a more attractive proposition as we come out of the pandemic and over the next few years.

Chris Davies:

And Owen, it's Chris again. I think your maths on 50% of the business being UK Bus is a bit off as well. I think even post transaction, that it's closer to 40% max.

And then sort of reducing again over time as we, as Ignacio said earlier, the growth we see is ALSA and North America.

Owen Shirley:

Yes. Sorry. You're right, Chris. I was lumping in coach as well.

That's great. Thank you.

Operator:

The next question comes from Gerald Khoo from Liberum. Please go ahead.

Gerald Khoo:

Hello, everyone. Questions in a couple of areas if I can, starting with the availability contracts. You've talked about how they're not on balance sheet for IFRS16, but as I read it, these are 15 year fixed contracts. I don't know whether there are any rate clauses, how much flexibility there is.

But are these not a sort of fixed obligation? This is something you have to pay to stay in business over the 15 years or whatever the life of the contract is? And therefore, or do you have any sort of flexibility on that?

Secondly, in terms of safety, can you just talk a bit more about why you see it as a sustainable advantage? You're obviously operating constantly. What's the next big step you're going to be making in terms of taking safety technology to the next level?

Chris Davies:

Well, Gerald, why don't I do the first bit of that? First of all, we've already got one of these contracts up and running. The one that we have up and running is indeed a 15-year commitment. It's a 15-year commitment for effectively a certain number of bus days. I'm not primarily focused on the accounting treatment and IFRS 16. We're primarily focused on getting the best economic deal, getting the best, the lowest cash outlay, and defraying the technology risk. Now, that said, it is quite helpful from an optical position to move at pace not having it bought on to the balance sheet. The rationale, the reason it is not is because we don't, we're not guaranteed to get any given bus. It's that substitutability, the fact they can put a bus in and take that bus out to give it to Go-Ahead or a local operator or somebody else that gets it off of balance sheet. So I see that as a helpful side effect from the core, one, is it cheaper to does it differ technology risk?

Ignacio Garat:

The second one, if I understood correctly, where is the next step for safety? Well, I guess the next steps for safety is to continue applying technology. As you know, we have Lytx all over our fleet, which is DriveCam and monitors and identifies where potential issues are, the fatigue monitoring, the speed monitoring, introducing 360 mirrors, virtual mirrors. But I guess it's using the data. Also, we produce millions of data points every single day. What we're achieving with these artificial intelligence and newer reporting systems is to identify where the key issues or opportunities are, and that is what is sent to the management for the day to day management of the operations. It is a continuous training. This is something that we know, and it is not that you do one training and that's it. It's continuous trainings, daily debriefs, weekly debriefs, monthly debriefs, et cetera.

Gerald Khoo:

Okay, thanks very much.

Operator:

The next questioner is Sathish Sivakumar from Citi. Please go ahead.

Sathish Sivakumar:

Good afternoon. Thank you. I got three, maybe I'll just ask questions actually. Firstly, on the safety versus the technology. If you could actually comment that value see for the upside in terms of rolling out new technology or IP platform like improving the operational efficiencies. If you could also touch upon the different segments value esteem that is more upside. Is it more in ALSA or are you seeing more upside to come within the UK division? And secondly, on the German rail, you actually showed a good case study on Chicago, how you actually expanded into a multi-modal service there. You've been operating in German rail for the last, close to five years now. What do you see actually for the potential there in terms of expanding into other services?

Ignacio Garat:

As for the upsides of technology, I think we have many areas where we can apply that. We can apply our technology, as I just mentioned, from a customer perspective. Also, the things that we do in revenue management, we are introducing Salesforce to do a better outcome management, both to win profitable customers and to retain profitable customers. It's all the technology around the contact list for optimisation. The dynamic network planning that we use in different parts of our business is the API integration. It's in the area of employees with all the drivers applications that we have. The simulators that we have to train our drivers. And other different sorts of applications that we have all over them.

Obviously, if you think that we have a 51,000 employees related to more than 32,000 buses, that's a lot of data that we also manage. If we digitise that, it will bring a lot of benefits to the business. In terms of reliability, for example, we're introducing or deploying the system that we have in Spain, Maximo, to control our engineering to the UK, and later to North America. It's, again, digitising that will give us more predictive analytics on the maintenance, have a better control on the proactive plant maintenance. We have other technology, as the ones mentioned by Gary and the team on Bytecurve. This is an integrated platform that we have to integrate from the dispatching, the routing, the optimisation, but also the payroll. Every minute is controlled of every single driver. Again, we have diagnostic telematics, which are linked to our engineering system. As you can see, plenty of upside from technology. As from the German rail question, maybe you want to take it, Tom?

Tom Stables:

Yes. German rail, we successfully launched the franchises over the last couple of years. We're continually looking at the market to see what new opportunities might arise as we go forward. I mean, German rail is a massive market. We're very disciplined about where we'll go and keep that under constant review.

Chris Davies:

I think, Satish, you were asking, do we have opportunities in Germany to go multi-modal the way we've done elsewhere? We've certainly looked at it through this strategy review. There are opportunities. I think, they're slightly further out in our time horizon than perhaps North America and more proximate to ALSA that you've got used to, but we certainly wouldn't rule-out road transport in Germany, if that was behind your question.

Satish:

Thanks, Chris. Would that involve organic opportunities or inorganic opportunities there?

Chris Davies:

Tom, what do you think?

Tom Stables:

Yes, I think so. There's more likely to be organic, particularly, the market is very fragmented in the road sector as well. It would have to be closely aligned to where we are so we've got the same operating basis and overhead structure.

Satish:

Thank you.

Operator:

Next question comes from Ruairi Cullinane from RBC. Please go ahead.

Ruairi:

Yes, good afternoon. Thank you for the presentation. I have a couple of questions relating to your 2022 to 2027 guidance. I'm interested in what we should expect, the capex given your targets for free cashflow conversion and some of the comments you've made on availability contracts. Some of that you commented that you expect margins to improve over 2022 to 2027. Would you be able to say where you expect margins to stand by the end of the period? Then, perhaps finally on that, just what GDP assumptions you've assumed over 2022 to 2027. Thank you.

Chris Davies:

Firstly, Ruairi congratulations on question two. I was wondering when somebody would try and eke short-term guidance out of me. Look, I can't give you any short term guidance, and I'm a little bit worried that if I give you '27, you'll reverse engineer it. But I certainly see by '27, we're at pre-pandemic levels. CapEx, before you start to overlay big inroads into availability contracts, I'm thinking of maintenance CapEx running at about 200 million a year. We ought to be able to eat into that quite significantly in the outer years. I haven't done that in that guidance. So, in the guidance of one and a quarter billion of free cash flow, that is assuming that Tom doesn't buy any buses in the UK, but we haven't made any particular assumptions on any of the other businesses. There's potentially some upside to be had there.

Then, we have assumed that we reinvest for growth in those numbers. If you plug them through your models, you'll see that that throws out somewhere in the region of a £100m-150m a year for growth of either growth CapEx or M&A. Clearly, at this sort of level, we're being a little bit fluid between those two. And GDP assumptions, we just plugged in Economist Intelligence Unit assumptions into each of the models. I couldn't tell you on my feet exactly what those are, but that's where we sourced the data from.

Ruairi:

Great, thank you very much.

Operator:

Next question comes from Owen Shirley from Berenberg. Please go ahead.

Owen:

Hi guys. Just on the availability agreements, I don't know if you could comment on, in say five years' time, what proportion of the currently owned fleet you'd expect to have shifted over to those agreements? And then obviously, Chris, you mentioned that from an NPV perspective, they're beneficial. But without discounting that, what does it look like when you bring in the rent, if you want to call it that? You take out your depreciation, and then you bring in some, the lower operating cost of an EV, what does a net effect of all of those look like? And if it's positive, is there anything stopping you from going faster with these agreements? Thanks.

Chris Davies:

Thanks. Look, it's easier in the UK. So in the UK, we've committed to never buying another diesel. And we've said that we aspire to be fully zero emissions by 2030.

Tom and I have discussed at length the accelerated depreciation impact of that. And it's probably £1-2m a year, so we can handle that. So what's that? You're into the fifth year of nine. So it's probably two thirds of the fleet, at that level.

In the US, it's really going to depend, and for that matter, if in ALSA, where the businesses are contracted, we can't just unilaterally change things. We've got to move with our customers. And in particular for the US, we've got to have, the vehicles need to be there. Now a conversation we're having with vehicle manufacturers in the US at the moment is, unlike in the UK where the surcharge for an EV is about 80%?

I think in the US at the moment, that is north of 200%. And we are trying to create scale. So we are in conversations with all the manufacturers in the US at the moment, saying what kind of volume commitment would allow you to get to some sort of parity on the vehicle cost? Such that we've then got something to wrap up for an availability provider.

And so I really don't know the answer in the US or ALSA. So you've seen what we're aspiring to do, and both of those businesses, we're aspiring by 2040 to be zero emission. And in terms then of the P&L impact, it is very... Forget discounting, the straight switch between depreciation of an owned vehicle, so going out and buying an EV depreciation, versus the availability charge, is pretty immaterial on the one we have just signed in the UK. And let's see, as they scale up. I would think they would only get better as we scale.

Owen:

And just to follow up on that, you then keep the costs, the reduced costs, of running the EV. And fuel, I think, is about 7% of your revenue. So what kind of impact could it have on that?

Chris Davies:

Oh, sorry. I was giving you the straight difference between an EV buying and an EV availability contract. If you're comparing it to a diesel purchase, versus an EV availability contract, those are the numbers we showed on the chart.

So forget discount or anything else, that is P&L beneficial today. And therefore we are not constrained by anything other than having the partners ready and able, the lead time on the EV buses, and the infrastructure at the depots, which is probably the most tricky piece of all of this.

And by the way, that infrastructure, the charging infrastructure, certainly in our first one, and typically we would intend to do this going forward, comes as part of that availability contract.

Owen:

Okay. So very, very simplistically, if I take a diesel bus, take that out, take the depreciation away. I bring in an availability bus. I have the rent charge for it, and I make savings on the fuel, you make more money switching the bus out?

Chris Davies:

Yes. Yes.

Owen:

And sorry to kind of push on this point, but are you able to give any indication on quantum?

Chris Davies:

Not on my feet. And I also don't want you to get carried away with it yet. But it's-

Owen:

No, no. Fair enough.

Chris Davies:

It's not massively material on 200 buses. It gets much more material on a fleet of 1500.

Owen:

Absolutely. Understood that. Thanks very much, Chris.

Operator:

Next question comes from Jarrod Castle from UBS. Please go ahead.

Jarrod Castle:

Thanks. So me again, just in terms of the £1bn increase in revenues, I just want to confirm, that is all organic, so is that correct? Or are you factoring in it any M&A?

And then I don't know if you can, and I know it's a very diverse broad business, but broadly speaking in some of the regions, how are you thinking of price versus volume over the next five years? Thanks.

Ignacio Garat:

So in regards to the pipeline that we have, basically by customer proposition, we have to give more context around £400m pounds of Reinvigorate Public Transport. Multi-Modal Expansion represents £300m, Operational Transformation, £200m. Fill the Transit Gap, £300m. And the Consolidate and Compound is £300m.

Out of this is 47% North America, 38% ALSA, and 15% the UK. And approximately, it's out of £1.5bn of pipeline, we have 1.2, which is bidding and the rest is £300m, approximately, in M&A.

Chris Davies:

So in that billion of growth, Jarrod, you've got both. And it's probably weighted to organic and bidding, with M&A quite a distant second in those early years. And then price versus volume, was his other question. How are we thinking of driving customer growth versus taking price?

Ignacio Garat:

Yeah, well, I guess it different for the different segments. You have just heard how Tom was representing what we have done, specifically together with the council in the West Midlands, to increase patronage and incentivise.

We have, in Bus and Coach, we use a lot of the revenue management. So always it is the right balance between the price and the volume, to come up to the best bottom-line result. But in general, what we are extremely, extremely rigorous and disciplined, and we saw that during the rate increases of last year, is we want to make sure we have profitable growth.

So we will not take, or we will exit businesses that don't make the minimum returns that we expect.

Jarrod Castle:

Thank you.

Operator:

Next question comes from Sathish Sivakumar. Please go ahead.

Sathish:

Yeah. Thank you. Quick one, actually, on the maintenance cost. Is it all done, your engineering and maintenance, is it completely in-house? If that is the case, how does one think about as the transition, say by 2030, everything 100% electric? Are you factored in your margin improvement that moving away from diesel into EV buses? And secondly, within your current portfolio, if at all, if there is anything you see that this division or segment is underperforming needs an either complete re-look in terms of divesting it? Any thoughts on that?

Chris Davies:

Sorry, Sathish. Should I just make sure I got both of those. So your first one was maintenance, is it in-house versus outsourced? What kind of blend? And how do we think about that changing as we go from diesel to EV? And your second piece was, have we got any underperforming segments still?

Sathish:

Yes, that's right. Yeah.

Chris Davies:

So across most of our business, our maintenance is in-house. In the Shuttle business in the US, we do outsource some of that. And that was prior to our acquisition. So that's given us a nice ability to benchmark across in-house versus outsourced. It's a really good question on the availability contracts. And there are some very big infrastructure funds out there who want to provide a turnkey. So they're only interested at very significant scale, if they can also provide the maintenance. We are in conversations with those just as we are in conversations with partners who would prefer us to keep the maintenance in-house. Then just in terms of maintenance of an EV versus a diesel, and I probably ought to hand to one of Tom, Gary or Paco on this, we are early days, but we are seeing the reported maintenance savings of moving to EV. So we're expecting it to be cheaper and we are ambivalent about whether it's in-house or outsourced, as long as they fit our safety standards, we'll take the most value quoting option.

Ignacio Garat:

With regard to your second question on the underperforming segment. As I said, in my introduction, we took during the business review, a very dispassionate look at it, and we looked at every possible scenario and alternatives, and we identified many opportunities for improving of the existing portfolio. For example, with Driving Excellence in North America, we did take actions to exit loss-making contracts in Transit. These were coming from specific acquisitions of the past and they were a specific contract. And we exited that. But no, I can confirm that we don't see any underperforming business that we need to divest, which is good, which doesn't mean that we don’t have room for improvements as we recover from the pandemic in some of the segments.

Sathish:

Yeah, thanks. That's very helpful.

Operator:

Once again, press star one to ask a question. Our next question comes from Ruairi Cullinane from RBC. Please go ahead.

Ruairi:

Hi, thank you for taking my follow up question. It's on UK Bus and I was interested in what level UK Bus passengers you expect to be at in 2022, relative to 2019 levels. And following on from that, when working in partnership with local transport authorities, West Midlands, potentially elsewhere, what measures do you think will be key in encouraging passengers back onto buses and growth from there? Thank you.

Ignacio Garat:

I will pass it to Tom, but before that, I mean, because today we're talking about the long term and the mega trends that we see and we are extremely excited about the structural long term growth opportunities that we have. But if you want to go into the details-

Tom Stables:

Yeah, of course. So next year we see the Bus business pretty much coming back to pre-pandemic levels. Patronage is growing week by week now. I think the real thing driving it is a lot an engagement with the local authority, which makes bus an attractive proposition. You know, the ability to speed up those journeys. We know that's the important factor, we know having great value fares is important. So getting those things right and communicated in collaboration is fantastic. And it's something which is a way of doing bus that we are continually espousing and talking to our colleagues across the industry about it saying, "Look, this is how it can work." I think the government sees our approach, which is why Boris came to our depot at Coventry to talk about the future of busing. And we are lucky at being in a city in the West Midlands, which is young and growing. So, you can see this growth trend continuing in it. And as Ignacio says, mega trend, we can't have the cities full of cars. So a really bright future there.

Ruairi:

Thank you.

Operator:

Our next question comes from Alex Paterson from Peel Hunt. Please go ahead.

Alex Paterson:

Right. Thank you for a chance for a follow up. The question I was going to ask was, or two questions, could you just say, and you did give some numbers earlier, but I couldn't write them down fast enough. What proportion of your fleet at the moment is zero emission? I imagine it's pretty low, but if you could just quantify that, that would be great. And then secondly, just when you were talking about the sort of the infrastructure for the zero emission vehicles, this is charging and so on. Can you just explain in more detail how that works. Is that infrastructure that you are getting as a service that will be installed in your depot? I'm assuming at the moment that would just be electric. If you also were to take hydrogen would that work in the same way? Can you say if you're talking to anybody about hydrogen as well, please. Thank you.

Chris Davies:

Yeah okay. Look, unfortunately Alex, the answer on the percentage of fleet is probably less than 1% right now. If I think about this, we have got less than 200 in the US. We will soon have a couple of 100 in the UK, but at the moment that is 30, whilst we wait for them to get commissioned. And there are 10s in Alsa . So you're probably at 1% of the fleet. On the infrastructure, I mean, I should hand over to Tom to talk about, two very specific depots. What he's done in Coventry and what might happen in Birmingham around hydrogen. But you know, it is, if you think of something like a School Bus depot, and that's where we've had to be very creative here. You know, if you think about something where a, the contract length may only be three to five years and nobody really is going to, and we typically back to back depot leases with those contract lengths.

So neither we nor potentially any kind of availability partner is going to want to build structural infrastructure. You know, there some very, really quite innovative ideas at the moment out there, so Zenobe, the company that we are partnering with in the UK, has an offer for a US school bus, which is effectively a giant battery pack in a sea container. So they can just drive the container up, drop that down, and you've got DC to DC charging, and they can take that away again. So effectively making that infrastructure quite variable, but I mean, Tom's the guy who's actually got the spade and the high vis and the working boots out.

Tom Stables:

So the electric depot at Coventry, which is going to be the UK's first all electric city deployment. Yes, there is a lot of electrical infrastructure going in, everything from the power coming into site, the upgrades, the transformation grid, and then the onsite stuff. The partnership with Zenobe is about doing this as infrastructure as a service. So we've worked hand in glove with them to put that in. Then in terms of hydrogen, there's a small pilot with Birmingham City Council at the moment, which is 20 vehicles, which will soon be deployed. There is central refueling for those in the city, but then longer term for our bids for new hydrogen vehicles, we have designed and developed new depot layouts, new schemes with leading experts in this field. Again, looking to do these through similar availability arrangements.

Alex Paterson:

Thank you. Sorry. Could you just say if there's anybody you're working with on the hydrogen side, apart from Birmingham Council?

Tom Stables:

So Birmingham Council are the client there, or through the drive to funding have provided the money for that pilot. We're working with a number of vehicle and fuel suppliers for the vehicles and for the Zebra Grant deployment.

Alex Paterson:

Great, thank you.

Operator:

It appears, there are no further questions at this time. I will pass the call back over to Ignacio Garat for any additional or closing remarks.

Ignacio Garat:

Well, thank you. Thank you very much for your time. As you can see, we're making good progress. You saw it is an exciting time for public transport. We are uniquely positioned as the only truly diversified public transport company. We have great management, great employees, great business, great opportunities in front of us, a very clear strategy, and now we're going to execute. And what I can assure you is that we have the collective sense of urgency coupled with a very structural approach and determination to make it happen. So thank you very much, and we'll be in touch.