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FirstGroup shares slide on margins warning

By Rose Jacobs

Shares in FirstGroup sank 14 per cent on Thursday after a warning by the transport company that margins in its UK bus business would fall by more than a third this year.

The country's biggest bus operator blamed "further deterioration of economic conditions, particularly in Scotland and the north of England" for its inability to counteract higher fuel prices and lower government subsidies with price rises. But it also admitted that rivals had managed their businesses better, retaining customers where FirstGroup had lost them.

"Every time in the past, as FirstGroup faced these kinds of pressures, it tickled up the rates across the network and pretty much was able to cover it over," Tim O'Toole, chief executive, told the Financial Times. "But because of the product we were putting out, the prices didn't hold and an old way of doing business simply wasn't able to respond and that was an unpleasant surprise for us."

Operating margins in the bus division are set to decline from almost 13 per cent in the year to March 31 to 8 per cent this year, reducing earnings by a fifth.

Management are accelerating a restructuring of the business as a result, aiming to unload £100m worth of assets this year.

The market's reaction echoed a similar sell-off a year ago after FirstGroup warned of sharp margin deterioration in another part of the business, its US school bus operations. But Mr O'Toole called any parallels simply "a painful coincidence" that did not point to fundamental communications or reporting problems within the group.

Analysts were more sceptical. "A 28 per cent cut in earnings before interest and tax in a bus business seems very extreme and should bring to the fore issues with budgeting and planning," said Liberum Capital's Peter Hyde.

The profits warning came as FirstGroup issued a trading statement ahead of 2011/2012 full-year results in May. Mr O'Toole expects to hit earnings and cash targets, and reiterated the board's commitment to 7 per cent dividend growth.

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FirstGroup showed last year it could put the brakes on falling margins when it stabilised its US school bus division. Mr O'Toole believes he can reverse the UK bus business even faster. But that depends on being able to sell some of the worst-performing parts in a difficult market. The £100m he reckons he can raise would go a good way to covering this year's planned dividend of approximately £117m; conversely, if the target isn't achieved, there is a chance the dividend would not be fully covered by cash flow. The fork in the road for FirstGroup may be approaching – with one path leading towards payouts funded by debt – significantly diminishing the appeal of the stock's 9.5 per cent dividend yield.