NATIONAL EXPRESS GROUP PLC

ANNUAL REPORT & ACCOUNTS 2006

MAKING TRAVEL SIMPLER

HIGHLIGHTS

CONTENTS

*Normalised results are the statutory results excluding the profit or loss on the sale of businesses, exceptional profit or loss on sale of non-current assets and charges for goodwill impairment, intangible asset amortisation, exceptional items and tax relief on qualifying exceptional items.

OPERATING HIGHLIGHTS

→ PASSENGER GROWTH OF OVER 4% IN COACHES AND 6% IN TRAINS

→ RAIL BUSINESSES LEADING THE INDUSTRY PERFORMANCE TABLES

→ INVESTMENT IN NEW TECHNOLOGY INCLUDING YIELD MANAGEMENT AND CUSTOMER RELATIONSHIP MARKETING

→ EXCELLENT NORTH AMERICAN BIDDING SEASON WITH $30.0M NEW BUSINESS WON WITH CONTRACT EXPANSION INTO FLORIDA, NEW JERSEY, LOUISIANA AND ARKANSAS

→ SUCCESSFUL INTEGRATION OF ALSA WITH GROWTH IN ALL AREAS OF THE BUSINESS IN FIRST FULL YEAR OF OPERATION AND THE AWARD OF NEW CONTRACTS

→ SALE OF STEWART AIRPORT LEASE FOR $78.5M AGREED, SUBJECT TO REGULATORY APPROVALS, WITH COMPLETION ANTICIPATED LATER THIS YEAR

FINANCIAL HIGHLIGHTS

REVENUE

£2.5bn

(2005: £2.2bn)

NORMALISED OPERATING PROFIT*

+19%

TO £184.8m (2005: £155.5m)

NORMALISED DILUTED EARNINGS PER SHARE*

76.5p

(2005: 76.3p)

NORMALISED PROFIT BEFORE TAX*

+15%

TO £156.1m (2005: £135.3m)

TOTAL DIVIDEND FOR THE YEAR PER SHARE

+8%

TO 34.75p (2005: 32.25p)

NATIONAL EXPRESS GROUP IS A LEADING TRANSPORT PROVIDER DELIVERING SERVICES IN THE UK, NORTH AMERICA AND SPAIN. OUR AIM IS TO MAKE TRAVEL SIMPLER

OUR VISION

TO BE A LEADING PROVIDER AND RETAILER OF TRANSPORT PRODUCTS AND SERVICES IN EVERY SECTOR AND COUNTRY IN WHICH WE OPERATE

WE WILL ACHIEVE THIS BY:

- → DELIVERING ORGANIC GROWTH IN OUR OPERATIONS THROUGH THE DEVELOPMENT OF OUR COMMERCIAL OFFER AND THE INNOVATION OF NEW PRODUCTS
- → BIDDING FOR NEW CONTRACTS WHICH PLAY TO OUR EXISTING STRENGTHS
- → ACQUIRING COMPLEMENTARY BUSINESSES TO DELIVER IMPROVED EFFICIENCY AND GROWTH

WE ARE COMMITTED TO:

- → OPERATING THE COMPANY ON A SOUND FINANCIAL BASIS CREATING VALUE FOR OUR SHAREHOLDERS AND OUR STAKEHOLDERS
- → RECOGNISING OUR WIDER RESPONSIBILITIES TO SOCIETY BY ENSURING WE DO EVERYTHING SAFELY AND RESPONSIBLY

CHAIRMAN'S STATEMENT

DAVID ROSS
CHAIRMAN

EXCELLENT RESULTS AND A PLATFORM FOR GROWTH

RESULTS AND DIVIDEND

Revenue was up 14% to £2.5bn (2005: £2.2bn) and normalised Group operating profit increased by 19% to £184.8m (2005: £155.5m). After interest and the Group's share of losses from associated undertakings, normalised profit before tax was up 15% to £156.1m (2005: £135.3m). Normalised diluted earnings per share from continuing operations were 76.5 pence (2005: 76.3 pence).

We are recommending a final dividend of 24.0 pence per ordinary share (2005: 22.25 pence), an increase of 7.9%, to be paid on 4 May 2007 to shareholders on the register at 27 April 2007. Including the interim dividend, the proposed total dividend for the year is 34.75 pence (2005: 32.25 pence).

I am pleased to report that 2006 was another excellent year for the Group with a strong finish to the year delivering results ahead of our expectations. This was achieved through sustained topline growth driven by our continued focus on operational excellence, as well as innovation and development of our broad range of products and services.

We are particularly pleased with the performance of Alsa, making its first full year contribution to the Group. We achieved excellent growth in our long distance operations in Spain and won a number of new contracts. We also experienced yet another best ever bid season in North America.

In the UK, Midland Mainline retained its position as the best performing Inter City rail operator as well as being awarded the prestigious "Operator of the Year" Award for 2006 at the National Rail Awards. c2c was once again named Britain's best performing train company. Our coach business, Britain's No 1 coach operator, goes from strength to strength with strong volume growth and innovative fare promotions. Our award winning Levante coaches are fully accessible to all our customers including those with wheelchairs. We have committed to making our entire fleet similarly accessible by 2012. Despite increased fuel costs, our Bus division produced another strong contribution.

The publication of the Stern Review highlighted the pivotal role that transport can play in tackling climate change. During 2007, National Express Group will be launching and participating in a number of initiatives aimed at maximising the role bus, coach and rail can play in reducing the impact of climate change.

GROUP STRATEGY

2006 was also a year of change for the Group. We welcomed Richard Bowker as Chief Executive in September. Richard has reviewed our businesses and with the Board concluded that:

→ We have a strong and diversified portfolio of businesses. The Group will grow them through acquisitions and new developments, both in the UK and overseas. We are now actively seeking opportunities to do this and have a number of potential opportunities under consideration;

→ We are a leading provider of integrated transport solutions both in the UK and other geographies. Our long term commitment to rail is demonstrated in our submissions for the East Midlands and New Cross Country franchise bids and, later this year, the Inter City East Coast franchise;

→ We will invest in the necessary products and systems to maximise the value of our customer base. Through greater customer relationship management and marketing we believe we can develop this relationship further and, by providing a level of service and innovation that customers want, stimulate repeat business;

→ We will maintain the efficiency of our balance sheet to give us greater flexibility and greater capacity for acquisitions whilst ensuring our investment strategy is driven by long term value creation.

Above all, National Express Group has the objective of "Making Travel Simpler", by listening to our customers and wider stakeholders and then delivering what they want. To do that, we recognise our people are our most important asset. We ask great things of them day after day and the Board would like to thank all our employees for their efforts in 2006 and looks forward to their support in the future.

In early January 2007 a National Express coach accident occurred on the M25/M4. The safety and security of our customers and employees is of paramount importance to us and we were deeply saddened by the events of that night. Our condolences go to those involved in this incident and particularly those who lost loved ones.

This year will be a period of change and growth at National Express. We will continue utilising the skills and values such as operational excellence that have made this Group so successful but we will build on them. We will apply an entrepreneurial approach to our product and business development and most of all we will listen to our customers, our stakeholders and our people.

OUTLOOK AND CURRENT TRADING

I am very pleased to report that we have started the year well. We have prequalified for the Inter City East Coast franchise and have recently submitted our bids for the East Midlands and New Cross Country franchises.

All of our businesses are performing well. We believe we can do more in 2007 and beyond by offering new services, putting our customers and stakeholders at the forefront of everything we do and bringing an even greater focus to sales and marketing. Our plans are designed to stimulate repeat business and attract new customers to our services thereby maximising the growth of our revenue.

Alongside this organic growth we will continue to seek attractive acquisitions in those core markets in which we operate. We have a strong balance sheet and look forward to utilising this to maximise our opportunities. We look to the future with confidence.

CHIEF EXECUTIVE'S REVIEW

RICHARD BOWKER
CHIEF EXECUTIVE

ACHIEVEMENTS IN 2006

- → Success in new contract awards
- → Greater numbers of customers travelling on our services
- → League-topping operational performance
- → Brand recognition in national Superbrand survey
- → Continuing improvement in employee satisfaction

PRIORITIES FOR 2007

- → Make Travel Simpler for our customers
- → Put "delighting the customer" at the heart of all our decision making
- → Communicate new vision and priorities, to inspire and empower our people
- → Pursue new business opportunities building on our core strengths

The world has changed. At National Express we not only recognise that but we are transforming the way we do business so that we are at the leading edge of delivering what customers want. Our customers take the fact that we can deliver operational excellence as a given. They want to enjoy the same quality of experience when they travel as they do when they buy anything else. At National Express we recognise that and we have a very straightforward vision – Making Travel Simpler.

National Express is a Group made up of complementary businesses with a single common theme; a passion for travel and transport. An attention to detail means we have high rankings in performance league tables. We're innovative too. We value our partnership and customer relationships and we have a brand in our Coach division which is trusted and liked. Overall we're a business in great shape but we have the potential to be better.

CUSTOMER EXPERIENCE

Transport has always been about delivery and getting things right, every time. But in 2007 it is also about providing an experience that our customers actually want to repeat. Customers want choice and they want value. And where their choices are limited such as when commuting, they want to feel valued and feel as if they are getting good value. At the very least, all our customers have options to consider when spending their money on leisure. We have to make sure we give them good reason and repeated reasons to spend it with us.

THE ENVIRONMENTAL DEBATE

We need to take a leadership role in our sector because the environment in which transport is delivered is changing. Congestion and climate change are big factors that need to be considered. At National Express, we believe in being part of the solution especially as coach, bus and train are three of the most environmentally friendly ways to travel. We will be launching a number of groundbreaking ideas in 2007 aimed at showing the environmental benefits of coach, bus and rail services over car and air and we will be practically incentivising customers to use transport modes that reduce carbon emissions. We are working with key organisations such as the Department for Transport, Transport for London, Centro, the Scottish Executive, Regional Development Agencies, School Boards and many more in order to be part of the debate that is creating solutions. We don't expect things to be handed to us on a plate. We understand the need, as well as our responsibility, to be part of the answer.

FUTURE CHANGE

To transform what we offer customers and stakeholders, we'll need to change ourselves. We need to build an awareness of how a modern consumer-facing business should behave into the way we behave. We are already developing a greater entrepreneurial approach and a greater willingness to push the boundaries. And the best bit is that our people, wherever they are in National Express, are eager to rise to this challenge. The reality is that our success or failure will be determined by the performance of our people who interact with our customers every minute of every day.

MAKING IT SIMPLE

Delivering great customer service every minute of every day, is easy to promise but much harder to do. In the transport arena it isn't hard to see why. Transport services are complex businesses with a great number of things outside of our immediate control.

We believe that our customers understand this. What they don't understand is when other things that are in our control don't work as well as they should. Making Travel Simpler means focusing on improving things in every way, no matter how big or small. We will make timetables easier to understand. We will make understanding ticket prices, indeed the different types of tickets available, simpler. We will make the interchange between different modes and services simpler. And we will make the whole experience of travelling simpler as well as more enjoyable. To do all of that means treating our customers as we would want to be treated ourselves.

This makes good business sense as well as ensuring we deliver good customer service. We will demonstrate that this approach is commercially sensible. We want all our stakeholders whoever they are to trust in our integrity. This year, I will be sharing a vision of where we're heading, and the kind of organisation we want to become as we grow in the UK and overseas. We will create the tools, training and environment that inspire and enable people to take us where we want to go.

Our brand is already widely respected and we will build on that in the future. We have some great opportunities ahead of us, and I believe our stakeholders will benefit from our journey as we deliver improved products and attract more customers to our services. As you'll see on the following pages, it's a journey that's already begun.

PUTTING OUR CUSTOMERS AT THE HEART OF WHAT WE DO

Great service comes from the heart. Like many companies, we strive to "delight our customers". In our business, that is not something we can achieve with systems and processes alone. Great customer service is essentially personal. It is delivered to people, by people who recognise their individual needs and concerns and act on them, there and then. We opened our third Customer Service Academy in 2006. And this year we are putting even more emphasis on training and empowering our people, particularly those on the front line, to enable them to make a difference.

Some of our services are the best in the business – Midland Mainline won the 2006 National Rail Award for "Passenger Operator of the Year" and Gatwick Express continues to top the National Passenger Survey tables for customer satisfaction. We want to achieve that kind of performance right across the Group. So we have been listening to customers more systematically, using increasingly detailed research to identify and fix the things that dissatisfy them, and make improvements across the board.

In North America, the customers for our school bus operations are school boards. Our regular customer questionnaires have always showed high levels of satisfaction, confirmed by a contract renewal rate of greater than 95%. Last year we held 150 in-depth interviews with all our customers in the US and Canada, which identified some important opportunities. For example, local management's responsiveness to customers is strongly linked to customer retention. Armed with this insight, we are taking appropriate action to provide tools for our management teams.

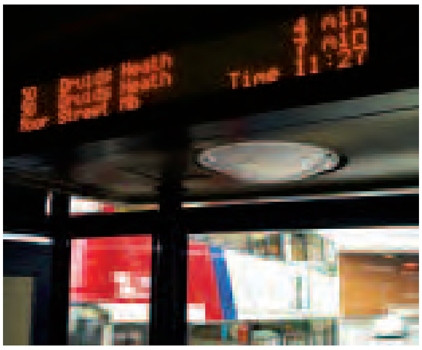
In our Trains division, our customer satisfaction programme focuses on one aspect at a time, until we get that aspect right. First we tackled performance and punctuality, and achieved significant improvements. In 2006 we worked to get the cleanliness and presentation of our trains to a consistently high standard. This year we are focusing on customer communication – especially to keep people better informed about service disruptions.

In Buses we have run a back to basics programme focused on vehicle cleaning and presentation. This included making cleaning more frequent, setting higher standards of presentation, appointing supervisors to make sure we meet our targets whilst also trialling material to make window glass etching easier to remove.

In Coaches we have gone a stage further by engaging with customers directly – piloting a mobile phone based service that enables them to report faults on the move by text message. For example, when one customer reported that a toilet wasn't working, we were able to text back to say that our teams were standing by at the next stop to fix it. And they did. We are extending this service across the whole network in 2007.

In 2006 we also looked at the response times in our customer contact centres. We piloted a number of improvements, and in 2007 we are putting in further significant investment. We are enthusiastic adopters of technology to give customers more information and more control over their travel.

SATISFACTION IS THE FIRST STEP – NOW HOW DO WE DELIGHT THEM?



↑ **WHEN'S YOUR BUS DUE?**
IN BIRMINGHAM, YOU CAN NOW FIND THE LATEST INFORMATION AT THE BUS STOP, YOUR PC OR YOUR MOBILE

TAKING THE INITIATIVE

In our Coach division we are installing touch-screen kiosks that help customers plan their journeys, print personalised timetables and buy their tickets. These have proved extremely popular with both customers and the Customer Experience Advisers who answer queries at coach stations: now they can hand customers an instant timetable for any journey, however complex. The first nine machines at our busiest coach stations sold £1.7m of tickets in their first year. In response to customers demand we are now introducing a new design that accepts cash as well as payment cards.

In Travel West Midlands we are using Automatic Vehicle Location (AVL) technology to improve bus services. So far, over 400 buses – about a quarter of the fleet – are fitted with a satellite tracking system, which enables our control centre to ensure buses arrive at the correct intervals. The system also sends timetables or estimated wait times to bus stops equipped with information displays. And now passengers need not even go to the bus stop to see when their bus is due. By texting their stop's unique code number, they can receive timetable information to their mobile. The system, which will be available for all 12,000 of our West Midlands stops by mid-2007, is being delivered by a partnership between us, the WMPTA–Centro transport authority, and local councils.

We have invested some £2m in our West Midlands AVL and text messaging technology. But delighting the customer need not always mean huge expenditure. It comes from thoughtful little touches – like the conspicuously uniformed roving support staff that Alsa employ in a number of major Spanish coach stations to provide help and advice at peak travel times.

Or the unexpected. On the last working day before Christmas, our Midland Mainline teams decided to make things a bit special for their customers. There were magicians doing tricks up and down the aisles on trains, and games of pass the parcel. One station had a jazz band, another handed out sweets, and Derby had a cathedral choir. Simple. But it made a lot of people's day.

We have to look beyond the status quo. We need to be leaders – in performance, quality and fresh ideas. To lead the way in public transport, we are learning to think and act differently. We called our new leadership development strategy DNA because it reflects the individuality of our businesses and our leaders. It also recognises the unique leadership skills that we share across the National Express Group and that we're developing to continuously improve and grow the business.

Unlike many businesses, we see all our managers as leaders, from the front line to the board room because we believe that leaders at every level in the business have a role to play in delighting our customers. DNA isn't just about attending training programmes. It's about creating ways of working that deliver continued success for the business whilst enabling people to achieve their potential.

In consultation across the business, we asked: what are the leadership skills that we need to become one of the world's leading transport businesses? The response: leaders who inspire people, think customer, look ahead, generate value, collaborate for success, drive improvement, and who 'get it right' day-in day-out. DNA is focused on developing these skills by taking an integrated approach to how we recruit, develop, support and motivate both existing and new leaders.

CHIEF EXECUTIVE'S REVIEW
CONTINUED

↑ **WE COULDN'T FIND AN IDEAL EXISTING SOLUTION FOR WHEELCHAIR TRAVELLERS. SO WE DEVELOPED AN AWARD WINNING ONE OURSELVES**

Some of the best service innovations come from seeing things from the customer's point of view. At Gatwick Express, we have applied the same principle to customer service training. Our Leading Lights training programme helps our people to tailor their service to the customer they're dealing with. It is a process of discovery, rather than teaching. The purpose-built classroom has a replica platform, ticket window and train interior. Working with an interactive CDROM and live actors on a variety of journey scenarios, participants debate the needs of individual customers and play out different responses to improve each customer's journey.

To get the knowledge and skills we need, it often makes sense to work with expert partners. For example, we teamed-up with NCP, the leading car parking provider, to see how we can enhance station car parks. As a result, we are the first train business to offer customers the opportunity to pay for their parking – or extend it – by text message, from wherever they happen to be.

In Spain we worked in partnership with VDO Siemens to develop Ociobus, an automated video information and entertainment system that needs minimal intervention from the driver. As Ociobus equipped vehicles pass through depots, or coach stations, they automatically use Wi-Fi to pick up tailored programmes including route information, films, news broadcasts and information about destination towns. Ociobus will be installed in 300 Alsa coaches this year.

When we wanted a better way to get wheelchair users on and off coaches, we worked in partnership with coachmaker Plaxton to develop a new easy access vehicle. At the 2006 UK Coach Rally it scooped two awards including 'best access for disabled people'. The large door and shallow entrance steps are particularly welcoming to elderly customers and people with impaired mobility. And the floor lift gives wheelchair users real freedom to travel independently by coach. Last year we introduced 44 easy access coaches, and we plan to invest some £100m in making our whole network fully accessible in time for the 2012 Olympics.

As part of our drive to make our buses cleaner and more presentable, we formed a partnership with Matthew Boulton College in Birmingham to launch customised training courses for our cleaners.

And in North America we worked closely with the country's leading bus manufacturer, Thomas Built Bus, to share ideas and experience during the development of its brand new model – a radical rethink of the traditional yellow school bus. As the company's largest direct customer, we have a common goal of providing the safest student transportation in North America.

A basic concern all travellers share is personal safety. We took a lead on this in 1999, when we launched the Safer Travel programme on our West Midlands bus services. This has grown into an award winning package of initiatives to reduce crime and anti-social behaviour. We have rolled this out across the country in partnership with the British Transport Police and local police forces, councils, transport authorities and schools.

Intelligence about criminal activity on bus services from the public is increasingly valuable to us, and new developments in 2006 included the launch of the Safer Travel SMS Textline, which enables passengers to report details of incidents or intelligence by text. Safer Travel has attracted nationwide interest from other transport operators and police forces. In 2006 we extended it to our Surrey Bus operation, and we are currently introducing it into our Trains division.

UNDERSTANDING OUR CONTRIBUTION

↑ PARTNERSHIP IS KEY: WITH COVENTRY COUNCIL WE'VE MADE BUSES A FAST, COMFORTABLE OPTION

We have a major impact in the political, social, economic, safety, and environmental arenas. So there are a great many stakeholders that we need to know, understand and work with. They include customers, rail and bus passenger groups, local, regional and state transport bodies, non government organisations, employees, suppliers, shareholders and Trades Unions, organisations like BAA and, of course, our own people.

We are getting to know them better, and are putting in place better processes to improve the way we communicate with individuals and organisations. Last year all our businesses formally identified the stakeholders they need to work with, and planned how to build more positive, active relationships with them to achieve our business goals.

The next step is to carry out detailed research, to understand better how they see us and how they want to relate to us. We need a realistic and up to date vision of the stakeholder landscape so that we can identify gaps, set priorities and move more quickly – as we have done, for example, in engaging with the Olympic Delivery Authority on plans for Stratford, the primary location for the London 2012 Olympics.

When we get to know stakeholders better, new possibilities emerge. We discover needs that we ought to be considering. And we find new opportunities to work in partnership to achieve things we could never manage on our own.

Over the past couple of years we have intensified our customer research, using mystery shoppers to monitor customer service and probing customer attitudes more deeply. One thing we have learned is that customer satisfaction is significantly higher in areas like Dundee, where we have the closest partnership with local councils and transport authorities. This is no coincidence: good partnership results in joint initiatives such as the Birmingham passenger information system described on page 5. So we are now sharing our customer research data with other stakeholders to help build stronger partnerships with them.

Our partnership with Coventry City Council and the WMPTA-Centro transport authority has resulted in improved bus services branded as PrimeLines. These aim to attract more bus customers by offering comfortable, quick, reliable and safe travel. The £42m project, backed by government funding, has been developing selected routes with new buses, shelters, information systems and CCTV security for buses and stops. Partnership is key to its success: for example, while we have invested in new quality buses, the council has introduced bus lanes and bus-priority traffic lights to allow faster journeys.

Another factor that correlates closely with customer satisfaction is employee satisfaction. We now run annual employee surveys across all our businesses, share the findings with our people and set action plans to deal with the points raised. We then follow-up with focus groups to monitor progress and to get direct feedback on what this research is telling us about our people and their satisfaction at work.

A clear lesson has emerged from this work: people who are well trained and motivated deliver not only higher customer satisfaction but consequently we see greater passenger growth. So getting these issues right delivers value for other stakeholders too – including investors. This is one reason for the DNA programme described on page 5. It is also why our managers have employee satisfaction targets which are measured through performance appraisals. These are then fed into reward and recognition arrangements.

CHIEF EXECUTIVE'S REVIEW
CONTINUED

↑ CREATING OPTIONS FOR OUR CUSTOMERS CAN MAKE LIFE JUST A LITTLE MORE FUN

GETTING THE DETAIL RIGHT

New challenges create the need for new partnerships – for example, as energy and environmental issues move up the political agenda. In Spain, our Alsa coach business is engaged in a major study of transport system energy consumption, in partnership with leading educational and university organisations. The project is part of a Ministry of Public Works Research and Innovation Programme linked to its Strategic Plan for Infrastructure and Transport. The Ministry is a key stakeholder for Alsa because of its role in regulating the industry.

Safety is a common concern for many stakeholder groups. In North America we join forces with the National Association of State Directors of Pupil Transportation Services to promote National School Bus Safety Week. This government-recognised event enables us to work with students, parents, school administrators – and our own drivers – to raise safety awareness.

The key to productive stakeholder partnerships is mutual benefit. Rather than leave unused station buildings boarded up and forgotten, Central Trains is making them available to local community organisations. Working with Network Rail it has created an innovative three-way lease that gives non-commercial groups tenancies of up to 25 years at peppercorn rents of as little as £1 a year. Tenants so far include a sustainable development project, a music teaching and practice facility, a local enterprise agency and an art gallery in a converted urinal.

The expected benefits include revitalised stations for Central Trains, better maintained assets and less vandalism for Network Rail. In addition, there is greater security and an improved environment for customers, extra amenities for the community, and greater engagement for all the stakeholders involved. Everyone wins.

A rail or bus timetable is a picture of order and predictability. Real life, unfortunately, is not. Beneath the surface of smooth-running operations there is a huge amount of activity by people with a passion for detail. They have a deep sense of their responsibility for delivering safe, reliable and excellent services. The more successfully they do their jobs, the less our customers should notice.

Our goal is to Make Travel Simpler. To do that, we first have to achieve operational excellence.

There is no operational issue more important than safety. Trains, coaches and buses are rightly recognised as three of the safest forms of transport, and we guard that reputation jealously. Safety is our first responsibility to our customers and our people, and essential to our business success.

We constantly review ways to improve our performance. All our UK coaches are fitted with seat belts by law, and since 2006 it has been mandatory for passengers over 14 to wear them. In Spain, the law will require seat belts to be fitted to coaches registered from October 2007. On that basis, it could have been 2011 before our whole Alsa fleet was seat belt

TABLE 1 TRAINS PUBLIC PERFORMANCE MEASURE
NATIONAL RAIL TRENDS, OFFICE FOR RAIL REGULATION, 19 DEC 2006
PERCENTAGE OF TRAINS ARRIVING ON TIME – MOVING ANNUAL AVERAGE TO SEPT 2006

SECTOR	OPERATOR	RANKING	SCORE	SECTOR AVERAGE
ALL UK FRANCHISES	C2C	1/20	94.0	87.5
LONDON & SOUTH EAST UK FRANCHISES (PEAK)	C2C	1/9	94.0	86.2
	SILVERLINK	2/9	92.9	86.2
LONG DISTANCE FRANCHISES	MIDLAND MAINLINE	1/6	92.5	84.3
REGIONAL UK FRANCHISES	GATWICK EXPRESS	1/5	91.8	86.4

NATIONALLY, C2C, SILVERLINK, MIDLAND MAINLINE AND GATWICK EXPRESS OCCUPIED THE TOP 4 POSITIONS

AIMING FOR CONSTANT IMPROVEMENT

equipped. But in fact, Alsa has been fitting this vital safety equipment to new coaches since 2003. And last year, with belts fitted to just under half the seats in its long distance scheduled fleet, Alsa decided to retro-fit belts to the rest of its long distance fleet. The work will be completed this year.

We maintain the same drive for constant improvement in our Trains division, where the key measure of safety performance is SPADs – signals passed at danger. Each of our rail businesses has its own SPAD reduction strategy involving driver training, driver assessment and competence management. Our SPAD rate has been improving for several years and the 2006 figure was our lowest ever. To maintain further improvement we are working in partnership with the drivers' union, ASLEF, on a development programme that will further enhance the way we support safety awareness and competence in our driver workforce.

After safety, customers' greatest concern is reliable, punctual services. In the most recent National Rail Trends reliability and punctuality table, National Express companies topped all three categories (see Table 1). But we still have work to do. In 2006 Central Trains achieved its highest ever scores for punctuality. In the National Passenger Survey's twice-yearly customer satisfaction figures, the weighted average of our train companies has been consistently ahead of the national average in both our focus areas of punctuality and cleanliness (see Table 2).

As we achieve the standards customers expect in basic criteria such as punctuality, we can now address more of the other details that affect customer satisfaction.

We are defining and formalising the levels of service customers can expect – for example, Midland Mainline now has written standards for every train setting out details such as when the buffet must be open. Customers are frustrated by complex fare structures and timetables, so we have been working with the Association of Train Operating Companies on fare simplification and the results will be seen in 2007. In Birmingham we have worked in partnership with Centro to simplify fares and use distinctive branding on certain routes to make identification simpler.

In Spain, we have just launched the Bus Plus card for regular customers. Cardholders get priority booking and fare discounts, and can change or cancel reservations with less hassle – which makes life simpler. They also get access to premium waiting rooms, special offers, discounted theatre tickets and a prize draw. Which makes life a bit more fun. Each of these little extras is just a detail. But taken together, we believe details like these make a real difference.

TABLE 2 PASSENGER SATISFACTION AUTUMN 2006

	ALL OPERATORS	NATIONAL EXPRESS COMPANIES (WEIGHTED AVERAGE)
PUNCTUALITY/RELIABILITY	79	82
CLEANLINESS OF TRAIN	72	74
CLEANLINESS INSIDE	71	74
CLEANLINESS OUTSIDE	67	69

SOURCE: NATIONAL PASSENGER SURVEY, SEPT-NOV 2006
PASSENGER FOCUS, 29 JANUARY 2007

CARING ABOUT WHAT WE DO

Our devolved structure means all our businesses can engage with their local communities in their own way. For example, in the US our Durham school bus business originally specialised in carrying pupils with special needs. Today, its commitment to them extends beyond the school run, for the past 10 years it has been supporting Special Olympics, an organisation that helps people with intellectual disabilities to participate in sports training and competitions. Durham is the charity's official transport sponsor for Texas, Northern California and Southern California, and last year over 500 of our people volunteered to help with Special Olympic events.

In the UK, Midland Mainline developed its wide-ranging momentum programme to help secondary school teachers engage pupils in debate on topics ranging from waste management to disability awareness. Since its launch in September 2005, it has involved 20 schools in Derby, Leicester, Sheffield and Nottingham. Pupils are encouraged to put their ideas into action: one school created a fully accessible organic community garden; another sold fruit smoothies at Derby station to raise money for Children in Need. Our employee involvement in the programme is led by 24 voluntary champions.

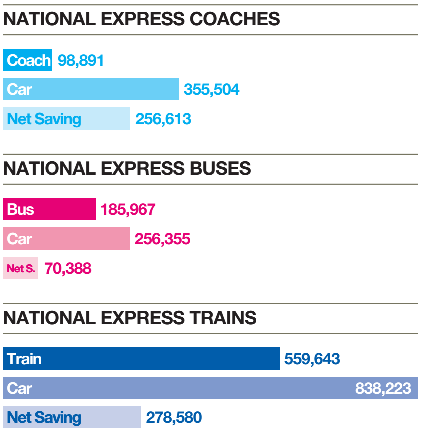
We continue to support and encourage community-centred projects like these throughout the business, and to tackle our environmental impacts in areas such as waste reduction and recycling. But for us, the hottest issue by far is climate change.

We're actively combating climate change in three ways: making our own operations more carbon-efficient, working with government and other bodies such as the WWF and the Climate Group to help shape lower-carbon transport policies; and directly encouraging people to switch to public transport.

We are reducing our own energy consumption and carbon emissions where we can. With vehicles, the options are limited – while newer buses and coaches produce lower exhaust emissions there is a trade-off with fuel efficiency. New safety, comfort and accessibility equipment can add to weight or energy demand. However, by raising our load factors we have been able to maintain or improve the emissions on a per passenger kilometre basis. Although the energy used by our sites is only a small percentage of our total greenhouse gas emissions we have worked at improving efficiency and last year we reduced energy use in our train depots by 17%.

Our Trains division has activated regenerative braking technology, which recovers energy during braking to generate electricity and can reduce train power consumption and CO_2 emissions by about 16% in the relevant electric trains at Silverlink, Central Trains and 'one'. By May 2007, c2c's fleet will also have been included in this process, meaning all trains capable of regenerative braking will have been activated.

RELATIVE GREENHOUSE GAS EMISSIONS AGAINST JOURNEYS BY CAR (tCO_2e)



The Coach/Bus/Train bar shows the emissions arising from our fleet operations. The car bar represents the estimated emissions if 80% of our passengers had travelled by car instead. Net Saving represents the emissions saved as a result of people travelling with our services rather than by car.
Data provided by the Edinburgh Centre for Carbon Management.

↑ **IN SPAIN'S PICOS DE EUROPA NATIONAL PARK, WE'VE HELPED CLEAR THE AIR BY REMOVING THREE HOUR TRAFFIC JAMS**

Our Spanish business, Alsa, has been trialling the use of biodiesel which reduces CO_2 emissions. Initially, the trial began in 2005 with buses on Premium inter city services. It has now been extended to 40 urban buses in Oviedo. Experience to date has been encouraging, and when the trials are complete Alsa will consider running its whole fleet on biodiesel.

Meanwhile, we are planning to begin trials of biodiesel on buses in the UK. And we are having positive discussions with Transport for London to trial five diesel-electric hybrid buses which should lead to a significant reduction in both CO_2 emissions and exhaust pollutants.

But the most important thing we can do to combat global warming is achieve large-scale shifts to public transport. As well as making public transport more attractive by improving our services, we are also promoting the environmental benefits: this year, for example, we are launching a new facility on our websites that enables people to calculate how much CO_2 they can save by changing their transport habits. The figures can be startling, for example, swapping from car to coach on a London to Birmingham return trip, travellers could cut their CO_2 emissions by up to 91%. Overall our services result in a massive net saving in emissions than had the journeys been undertaken by a car.

As well as saving energy, public transport eases congestion. In crowded town centres – and in some of Europe's finest mountain wilderness. In Northern Spain's Picos de Europa National Park in Asturias, holiday traffic on the road to Covadonga Lakes meant the 11km journey could take three hours in summer.

But not any more. In partnership with Alsa, the local authorities have established a flexible park and ride scheme involving three car parks and 40 coaches on a 25km route. During peak seasons the road is closed to cars and visitors travel quickly and comfortably by coach, watching an onboard video about the area and related environmental issues. The project has greatly improved the local environment, makes access quicker and easier, and saves an estimated 64,000 litres of fuel and almost 800 tonnes of CO_2 a year.

We will continue to explore ideas like these, and every avenue for reducing climate change. Not least because we also have to ensure that our operations are able to cope with the more extreme weather conditions that have been forecast.

DIVISIONAL OVERVIEW

RAY O'TOOLE
CHIEF OPERATING OFFICER

OPERATIONAL RESILIENCE IS THE KEY TO ACHIEVING OUR STRATEGIC OBJECTIVES

COACHES (UK)

NATIONAL EXPRESS
EUROLINES
AIRLINKS

National Express is the largest scheduled coach service provider in Europe. The Company operates a network of scheduled coach services to almost 1,000 destinations within the UK, including all of the major UK airports. It carries over 19 million passengers each year and operates 500 distinctive white coaches in the UK. Eurolines offers scheduled services to 500 destinations in Europe.

REVENUE (£m)	
04	195.6
05	200.5
06	207.3

NORMALISED OPERATING PROFIT (£m)	
04	19.3
05	21.5
06	23.7

TOTAL NUMBER OF EMPLOYEES	
04	1,867
05	1,803
06	1,694

BUSES (UK)

TRAVEL WEST MIDLANDS
TRAVEL COVENTRY
TRAVEL DUNDEE
TRAVEL LONDON
TRAVEL MIDLAND METRO

The UK Bus division operates high frequency urban bus services in the West Midlands, London and Dundee. In the West Midlands the Company operates commercial high-frequency urban bus services in Birmingham, Coventry and the Black Country. In Scotland it operates a similarly focused business in Dundee. In London its services are operated under contracts awarded by Transport for London.

REVENUE (£m)	
04	239.8
05	268.6
06	300.8

NORMALISED OPERATING PROFIT (£m)	
04	41.6
05	41.5
06	40.7

TOTAL NUMBER OF EMPLOYEES	
04	6,263
05	7,089
06	7,165

TRAINS (UK)

C2C
CENTRAL TRAINS
GATWICK EXPRESS
MIDLAND MAINLINE
'ONE'
SILVERLINK

The Trains division operates a range of inter city, commuter and rural passenger train services under franchise agreements with DfT Rail. The franchises generally last for a period of seven years with the possibility of short-term extensions.

REVENUE (£m)

04	1,712.1
05	1,497.2
06	1,497.6

NORMALISED OPERATING PROFIT (£m)

04	61.3
05	64.2
06	49.1

TOTAL NUMBER OF EMPLOYEES

04	11,536
05	11,565
06	9,477

NORTH AMERICA

DURHAM SCHOOL SERVICES
STOCK TRANSPORTATION
STEWART INT AIRPORT

The North American division is the second largest operator of school bus services in North America, spanning two provinces and 25 states. The division operates over 14,000 school buses, delivering one million students to school each day, serving more than 300 school districts.

REVENUE (£m)

04	213.2
05	241.8
06	283.7

NORMALISED OPERATING PROFIT (£m)

04	29.6
05	35.0
06	39.1

TOTAL NUMBER OF EMPLOYEES

04	13,776
05	15,880
06	18,376

ALSA (SPAIN)

ALSA

Alsa is Spain's leading coach and bus operator with long distance coaching services as well as regional urban bus operations. In addition Alsa operates urban contracts in Porto and Marrakesh and international coach routes across Europe.

REVENUE (£m)

06	249.3

NORMALISED OPERATING PROFIT (£m)

06	44.3

TOTAL NUMBER OF EMPLOYEES

06	3,720

Alsa was acquired by the Group in December 2005.

OPERATING AND FINANCIAL REVIEW

INTRODUCTION

The Directors are pleased to present the Operating and Financial Review ("OFR") of National Express Group PLC for the year ended 31 December 2006. This OFR describes the main trends and factors underlying our performance and position during the year, as well as the main trends and factors likely to affect our future development, performance and position.

Throughout this Annual Report and Accounts, National Express Group PLC is referred to as "the Company" and the Group, of which it is the ultimate parent company, is referred to as "the Group".

GROUP STRATEGY

The Group's objective is to deliver safe, reliable and innovative integrated transport products and services and in doing so to generate shareholder value over the longer term. Since joining the Group as Chief Executive in September, Richard Bowker has reviewed the Group businesses and with the Board set out the Group's strategy as follows:

→ We have a strong and diversified portfolio of businesses where the Group's strengths can be utilised through acquisitions and new developments in our core markets, both in the UK and overseas. We are now actively seeking opportunities to do this and have a number of potential opportunities under consideration;

→ We are a leading provider of integrated transport solutions both in the UK and other geographies. Our long-term commitment to rail is demonstrated in our submissions for the East Midlands and New Cross Country franchise bids and, later this year, the Inter City East Coast;

→ We will invest in the necessary products and systems to maximise the value of the customer base. We believe through greater customer relationship management and marketing we can develop this relationship further and, by providing a level of service and innovation that customers want, stimulate repeat business; and

→ We will maintain the efficiency of our balance sheet to give us greater flexibility and greater capacity for acquisitions whilst ensuring our investment strategy is driven by long term value creation.

STAKEHOLDER RELATIONSHIPS

The Group has a broad range of stakeholders who are key to the achievement of our business objectives.

Our stakeholders range from those who award us contracts such as the Department for Transport, local authorities, transport bodies and school boards to our passengers who use our services each day. In addition there are numerous other stakeholders such as non government organisations, Trades Unions, suppliers and user groups with whom we have a constant dialogue. Our stakeholders are also internal with over 40,000 employees enabling us to deliver our products and services day in day out.

We engage with our stakeholders at a Group, divisional and local business level. In 2005 we commenced a formal stakeholder mapping process across many of our businesses. During 2006 all of our UK businesses participated in this process mapping out accurately those stakeholders with whom we need to work to deliver our objectives. This process involved identifying stakeholders, understanding who is responsible for working with them and developing a programme of activity to engage with them on a regular basis. This process has enabled us to prioritise stakeholder contacts, particularly when key issues arise. We believe this is fundamental to our long-term development. We are currently implementing stakeholder mapping action plans to further strengthen these relationships and to establish key new contacts that we may need for the future.

We communicate with our stakeholders through a number of channels; open forums such as Meet the Manager sessions, customer magazines, websites and one to one meetings where appropriate. In addition we undertake surveys amongst our stakeholders, primarily customers and employees to gauge their satisfaction with our products and the degree of their engagement with the business.

RESOURCES

The Group has a range of resources that it uses to deliver its strategies and service its stakeholders.

Our Employees – The Group's most importance resource is its employees. We believe there is a strong correlation between employee satisfaction and customer satisfaction, which means that our employees are vital to achieving the Group's objectives.

Our Brand – Market surveys consistently demonstrate that the National Express brand is the most recognised brand amongst the UK transport groups. This gives us an advantage that, going forward, we are looking to utilise through a wider range of sales channels than previously.

Our Customers – Every year, passengers make almost 900 million journeys with us. This gives the Group a significant opportunity to market itself, open new sales channels and achieve incremental sales.

Our Reputation – The Group has a strong reputation as a reliable operator across all its divisions. This reputation enables us to bid for contracts safe in the knowledge that our customers know we can deliver.

Our Contracts – Our existing portfolio of contracts, including London Bus contracts, UK Train franchises, North American school bus contracts, Alsa long distance concessions and regional and urban contracts, provides assurance in those Divisions over the delivery of shareholder value in the short and medium term.

DESCRIPTION OF THE BUSINESS

National Express Group is a leading transport group with operations in Europe and North America. These operations are reported in five divisions: Alsa, UK Coach, UK Trains, UK Bus, and North America, reflecting the management responsibilities, operations and geographic characteristics of each activity. Narrative describing how the Group manages its operations is contained in the Corporate Governance report.

EUROPEAN COACH AND BUS (ALSA)

Alsa is Spain's leading private operator of coach and bus services, employing over 3,500 people.

The coach business operates long distance coach concessions in Spain and international coach routes across Europe. The long distance concessions are granted on an exclusive basis by the national government for each route with an average duration of 15 years. In addition, the business operates regional coach routes in Spain awarded by regional government. In the coach businesses, revenue is principally generated by the sale of tickets to passengers, some of which are subject to regulated price increases.

In addition to its coach businesses, Alsa operates urban networks in 19 cities in Spain, Portugal and Morocco. Urban contracts are awarded by city councils and revenue is principally generated by the operation of these contracted services. We do not retain any of the revenue from ticket sales, all revenue passes to the councils.

UK COACH

The UK Coach division operates a national integrated network of scheduled coach services under the National Express brand. This network operates to more than 1,000 destinations within the UK including all of the major UK airports.

Revenue is primarily generated through ticket sales to passengers with the development of yield management revenue systems used to maximise revenue in off peak periods. Fare increases are unregulated. The majority of vehicles used by the business are contracted from third parties who employ the drivers. Two businesses in the division, Eurolines and Airlinks, operate coach services to Europe and coach services at Gatwick Airport respectively. In total the division employs over 1,500 people.

UK TRAINS

The UK Trains division operates a range of inter-city, commuter, rural and airport passenger train services under franchise agreements with DfT Rail. The franchises we currently operate are: c2c, Central Trains, Gatwick Express, Midland Mainline, 'one' and Silverlink. The division employs 9,500 people.

Franchises are awarded following a tender process managed by the Department for Transport, in which applicants are required to prequalify for the main franchise bid process. Following a successful bid, the franchises generally last for a period of seven years, with the possibility of short-term extensions. Our Central Trains, Midland Mainline and Silverlink franchises finish in November 2007; Gatwick Express and c2c finish in 2010 and 'one' in 2011.

OPERATING AND FINANCIAL REVIEW
CONTINUED

We have recently submitted our bids for the East Midlands and New Cross Country franchises. We have prequalified for the Inter City East Coast franchise. The outcome of these bid processes is expected to be known in 2007.

Revenue is generated from the sale of tickets to passengers and through other income such as catering services and car park income. Increases in certain ticket prices are regulated. In addition, government funding is received in certain franchises in the form of franchise support.

UK BUS

The UK Bus division operates high frequency urban bus services in the West Midlands, London and Dundee. In the West Midlands and Dundee revenue is generated by the sale of tickets to our passengers. Fare increases are unregulated and we work in partnership with local authorities to grow the business.

In London our services are operated under contracts with TfL, that normally last for five years, with two year extensions. We are constantly bidding for new contracts and no one contract is material to the business. We do not retain any of the revenue from ticket sales in London with all revenue passing to TfL.

The division also operates Midland Metro, the light rail service in Birmingham, which generates revenue by the sale of tickets to passengers.

The division employs 7,000 people.

NORTH AMERICA

Our North American division is the second largest operator of private school bus services in both the United States and Canada, employing over 18,300 people and operating over 14,000 buses. With locations in 25 US states and 2 Canadian provinces, this division primarily earns revenue by operating contracts on behalf of school boards to transport children from home to school with additional revenue earned from ad hoc field trip and vehicle charter activity.

The North American student market is highly fragmented. Local school boards operate around 300,000 to 350,000 vehicles in house, with the balance being operated by private companies.

The disposal of Stewart Airport planned for later in 2007 means the North American division can now focus solely on student transportation.

OPERATIONAL REVIEW

GROUP RESULTS

We have achieved another strong set of results, increasing profit before tax by 17% to £104.1m (2005: £89.3m), driven by a 29% increase in operating profit to £141.6m (2005: £109.5m). Diluted earnings per share from continuing operations improved 18% to 52.5p (2005: 44.5p).

Our financial key performance indicators are based on normalised results, which we feel reflect the performance of the business more appropriately. Normalised results are defined as the statutory result before the following, as appropriate: profit or loss on the sale of businesses, exceptional profit or loss on the disposal of non-current assets and charges for goodwill impairment, intangible asset amortisation, exceptional items and tax relief thereon as appropriate.

The Group's Key Performance Indicators ("KPIs") for profitability are normalised operating profit, normalised profit before tax and normalised diluted earnings per share, which are calculated as per the notes to the accounts.

Normalised Group operating profit was up by 19% to £184.8m (2005: £155.5m), on revenue of £2,525.5m (2005: £2,216.0m) resulting in an increased operating margin of 7.3% (2005: 7.0%). Normalised profit before tax increased by 15% to £156.1m (2005: £135.3m). With an increase in the effective tax rate from 21.8% to 25.1% and the loss of rail profits, normalised diluted earnings per share from continuing operations marginally increased to 76.5p (2005: 76.3p). Net debt decreased by £125.0m to £438.4m. The proposed full year dividend per share will be increased by 8% to 34.75p (2005: 32.25p).

COACHES (UK)

PAUL BUNTING
CHIEF EXECUTIVE, COACH DIVISION

THE COACH DIVISION PROVIDES BRITAIN'S ONLY SCHEDULED NATIONAL COACH NETWORK AND SERVES MORE THAN 1,000 DESTINATIONS, PROVIDING APPROXIMATELY 19 MILLION CUSTOMER JOURNEYS EACH YEAR. THE AIRPORT SERVICES PROVIDE PREMIER, HIGH FREQUENCY SCHEDULED COACH SERVICES TO ALL THE UK'S MAJOR AIRPORTS. EUROLINES OFFERS VALUE FOR MONEY EUROPEAN TRAVEL BY COACH. THE DIVISION EMPLOYS OVER 1,500 PEOPLE.

REVENUE

£207.3m

(2005: £200.5m)

NORMALISED OPERATING PROFIT

£23.7m

(2005: £21.5m)

Revenue for the year was £207.3m (2005: £200.5m) with a normalised operating profit of £23.7m (2005: £21.5m). Passenger growth of 5.5% in the second half resulted in overall passenger growth of over 4%. Our key corridors have performed well and on some routes such as Bristol and Stansted to London we have seen double digit passenger growth. Our margins have increased above 11%.

Within our core schedule coaching business, the success of yield managed fares which ensure greater efficiency and utilisation of the fleet, helped drive growth. Such products enable us to provide customers with improved value for money fares. Funfares, from just £1, are now offered on 32 popular routes.

Direct sales accounted for 65% of total sales and internet sales continued to improve with over a quarter of all bookings now made on-line, of which over 90% of all tickets booked on-line are distributed either as e- or m-tickets or SMS messages.

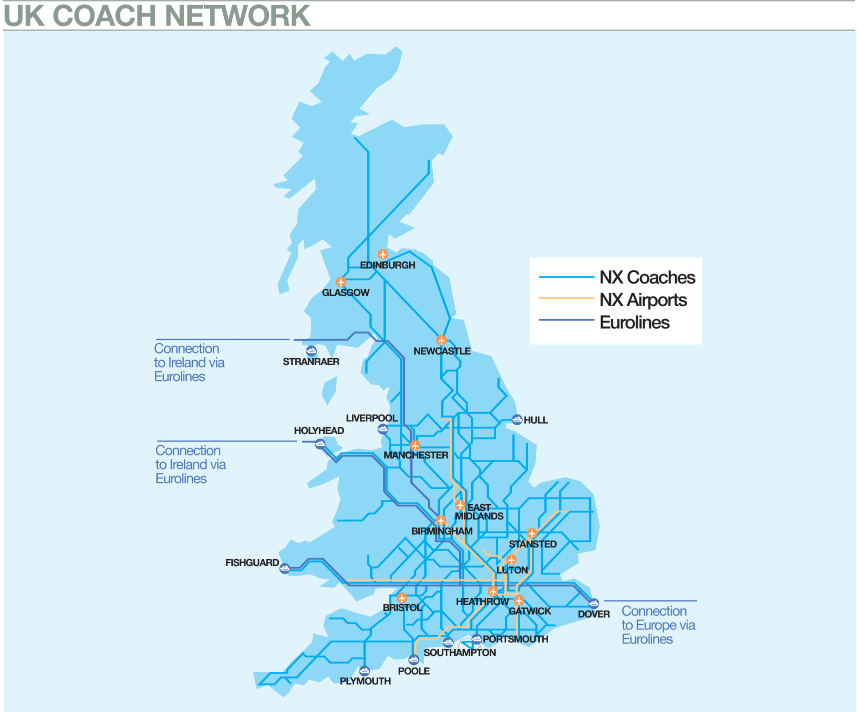
New self service touch screen fast issue ticket and journey planning kiosks have been installed at Heathrow, Gatwick, Birmingham and Manchester coach stations. In September the division scooped the top prize at the National Customer Service Awards winning "Best Use of Technology in Customer Service".

In November, the National Express coach brand was awarded Superbrand status in a poll conducted amongst more than 1,000 business professionals and a select panel of marketing, advertising and branding experts by YouGov. In this prestigious survey National Express was placed in the top 300 brands as well as in the top 10 UK travel brands. We are using this strong position to develop our services to a broader customer base.

We introduced easy access coaches onto a number of routes across the network during 2006. Forty-four of these new style coaches are now operating on some of our busiest routes including East Midlands to Stansted Airport, Brighton to London and Yorkshire to Heathrow and Gatwick. Our new wheelchair accessible Levante coach won two awards this year, "Clarkes Trophy" and the "Top Dual-Purpose vehicle" for a coach offering the best access for the disabled. We are committed to making the whole network fully accessible by the 2012 Olympics representing a £100m investment.

During the year we worked closely with BAA at Heathrow to redevelop the new £2.5m Central Bus Station terminal. This includes investment in the infrastructure and taking on the responsibility of operating the facility on behalf of BAA. We are working closely with BAA on the provision of coach services for Heathrow Terminal 5 which opens in 2008. Discussions regarding the redevelopment of Digbeth coach station are ongoing and we expect work to commence later this year.

UK COACH NETWORK



BUSES (UK)

NEIL BARKER
ACTING CHIEF EXECUTIVE, BUS DIVISION

THE BUS DIVISION OPERATES OVER 2,000 BUSES, PROVIDES APPROXIMATELY 380 MILLION PASSENGER JOURNEYS AND EMPLOYS 7,000 PEOPLE IN THE WEST MIDLANDS, DUNDEE AND LONDON. IT ALSO OPERATES THE MIDLAND METRO, THE LIGHT RAIL SERVICE IN THE WEST MIDLANDS.

REVENUE
£300.8m
(2005: £268.6m)

NORMALISED OPERATING PROFIT
£40.7m
(2005: £41.5m)

Revenue for the year was £300.8m (2005: £268.6m) and normalised operating profit was £40.7m (2005: £41.5m). We are particularly pleased with this result given the £9m year-on-year increase in fuel costs.

In Dundee we have relaunched a number of radial routes around the city as part of our partnership agreement with Dundee City Council. This included the provision of new bus shelters and customer information as well as investment in new liveries to promote the services. A national concessionary fares scheme was introduced in Dundee in April 2006 and we have seen increases in both concessionary and commercial patronage.

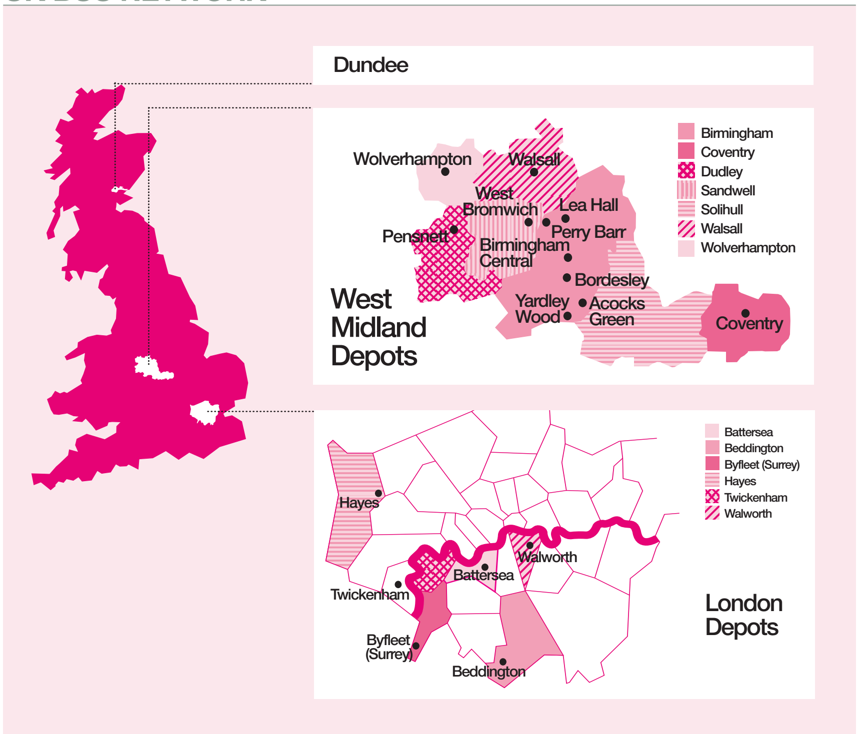
In the West Midlands we are starting to see the benefits of the launch of the national concessionary fare scheme. In partnership with Coventry City Council, an improved network was introduced following the findings of a joint network study.

We continue to invest in our fleet. 80% of the West Midlands fleet is low-floor, easy-access, the highest percentage of any major fleet outside London. Automatic vehicle technology has been fitted to over 20% of the TWM fleet and real time journey information is available across half of the network. In addition SMS timetable and real-time information is available via SMS codes published at over 1,200 bus stops. This service regularly receives over 3,000 hits a month. We believe the provision of accurate, timely information is key to making our services attractive and accessible to customers.

Travel London continued to extend its operations with new contract awards and extensions to existing contracts. The redevelopment of the Battersea depot is planned which will give an additional capacity for 100 buses. In partnership with Surrey County Council and BAA, we are providing key services to support the construction of Heathrow Terminal 5.

A Group priority for 2007 is to re-energise our relationships with our key stakeholders in our heartland bus operation in the West Midlands. This will ensure that we develop new quality partnerships in the coming year, which will enable us to deliver marketing, customer care, investment in new buses and innovation. Looking to the future we are working with Centro and Birmingham City Council to put in place an overarching partnership agreement to deliver improvements on selected key routes in the region.

UK BUS NETWORK



TRAINS (UK)

DAVID FRANKS
CHIEF EXECUTIVE, TRAINS DIVISION

WE OPERATE C2C, CENTRAL TRAINS, GATWICK EXPRESS, MIDLAND MAINLINE, 'ONE' INCLUDING THE STANSTED EXPRESS, AND SILVERLINK. WE PROVIDE 230 MILLION PASSENGER JOURNEYS PER YEAR AND EMPLOY 9,500 PEOPLE.

Revenue for the year was £1,497.6m (2005: £1,497.2m) with normalised operating profit of £49.1m (2005: £64.2m). The reduction in the operating profit primarily related to the transfer of the Great Northern and Wessex franchises in April 2006.

The division experienced a good year with a 6.1% increase in passenger numbers driven by investment in services, good operational performance and strong airport growth.

In the industry's operational performance tables Gatwick Express topped the regional category and c2c retained its position as Britain's best performing rail franchise. Midland Mainline retained its position as the UK's best performing inter city train company as well as Passenger Operator of the Year award winner for 2006.

We have been working to deliver greater value for money to our customers. Off peak discounted fares promotions have been introduced using yield management systems in Midland Mainline ("MML") and these have delivered growth of 20%. MML became the first train operator to launch a new Print@Home facility, allowing customers to purchase and print their train tickets at home. In December the £50m Sheffield Station Gateway Masterplan, a key hub for MML, was completed and in the last quarter of the year, MML moved into the new St Pancras International station.

In December we made our latest submission on the Brighton Main Line Route Utilisation Strategy, the outcome of which will affect Gatwick Express. Our other London franchises performed well in the period.

At 'one' a £25m modernisation and refurbishment of the mainline inter city fleet was completed. In April a new customer service academy was opened in London. In addition the Stansted Express has seen an enhanced frequency to every 15 minutes and seating capacity to cater for the increased demands of this growing airport. To assist with the increased energy costs that the train industry is facing, a project to introduce regenerative braking onto the 'one' fleet of Class 360 trains is underway.

We have recently submitted our bids for the East Midlands and New Cross Country franchises. We believe we have submitted excellent bids which reflect the aspirations and expectations of customers as well as the financial considerations of the Department for Transport. We have also prequalified for the Inter City East Coast franchise, one of the most prestigious in the UK and look forward to submitting a similarly excellent bid later in the year. Whilst the market for rail franchises remains intense, we are committed to bidding for franchises where we believe long term growth and shareholder returns can be achieved.

UK TRAINS NETWORK

REVENUE

£1,497.6m

(2005: £1,497.2m)

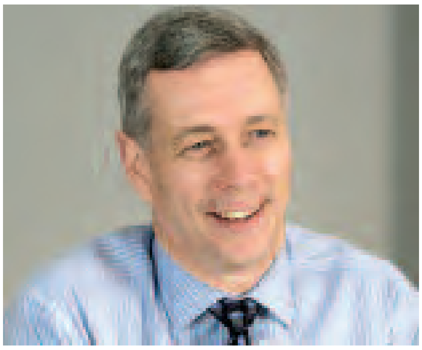
NORMALISED OPERATING PROFIT

£49.1m

(2005: £64.2m)

OPERATING AND FINANCIAL REVIEW
CONTINUED

NORTH AMERICA



BRIAN STOCK
CHIEF EXECUTIVE,
NORTH AMERICA

THE NORTH AMERICAN DIVISION CONSISTS OF STUDENT TRANSPORTATION. IT OPERATES OVER 14,000 BUSES AND PROVIDES APPROXIMATELY 200 MILLION PASSENGER JOURNEYS PER ANNUM. THE DIVISION EMPLOYS OVER 18,300 PEOPLE.

Our North American division goes from strength to strength. Revenue in the division for the year was £283.7m (2005: £241.8m) and normalised operating profit was £39.1m (2005: £35.0m). In local currency, revenue was US$524.0m (2005: US$440.5m) and normalised operating profit was US$72.3m (2005: US$63.7m).

In 2006 we experienced our best bidding season ever. We won $30 million of new business and achieved a retention rate of greater than 95%. We now operate in twenty five US states and two Canadian provinces. We expanded into Florida, New Jersey, Louisiana and Arkansas and completed six tuck-in acquisitions.

Our focus during the latter part of the year has been to integrate our North American companies under one management team. Further progress continues in 2007 with the amalgamation of key office functions such as finance and information technology. The focus on one company and standardisation of processes and systems now provide us with the foundation to execute our Transformation Project.

Our Transformation Project, which commenced in the fourth quarter of 2006, is well underway and supporting further growth in North America. Our focus is to differentiate our offering in the market and deliver even higher standards of customer service and satisfaction. The project will bring new standard, streamlined systems and processes to our operations, will enhance significantly the quality of our information, allow our local management to focus on the key roles of customer and employee relationship management and also develop our leadership team. In addition to the change in management focus, investment in technology is a key enabler to deliver these improvements and to achieve benefits of scale in such a geographically diverse business. Ultimately the project will enable us to improve our product offering and therefore achieve greater success.

As announced on 26 January the Port Authority of New York and New Jersey Board Commissioners have approved the purchase of the operating lease at Stewart International Airport, New York State for $78.5m. Completion of the sale is anticipated in the second half of the year.

REVENUE

£283.7m

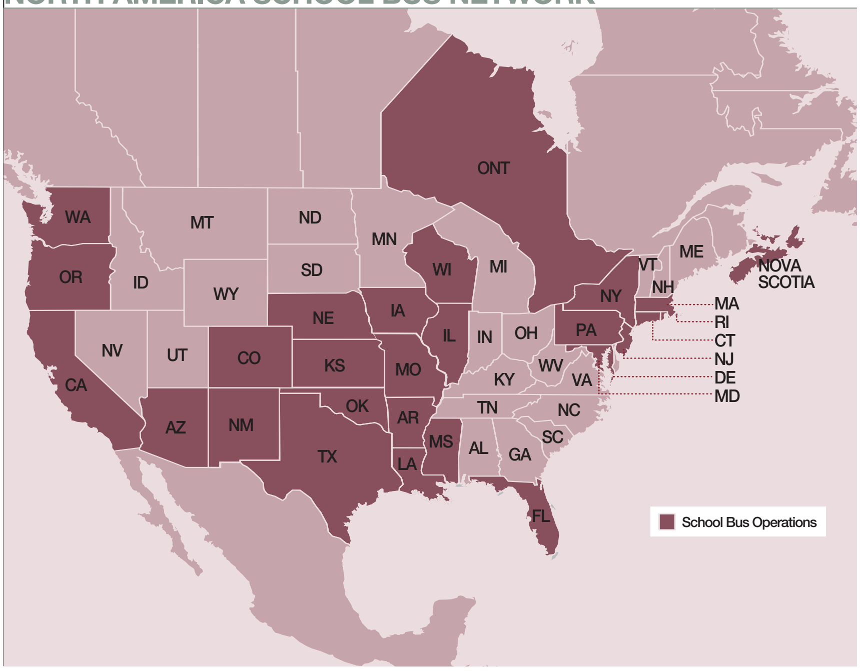
(2005: £241.8m)

NORMALISED OPERATING PROFIT

£39.1m

(2005: £35.0m)

NORTH AMERICA SCHOOL BUS NETWORK



ALSA (SPAIN)

JAVIER CARBAJO
CHIEF EXECUTIVE,
ALSA GROUP

ALSA IS SPAIN'S LEADING PRIVATE OPERATOR OF COACH AND BUS SERVICES OPERATING 64 COACH AND 19 BUS CONCESSIONS WITHIN THE SPANISH MARKET. THE DIVISION PROVIDES NEARLY 62 MILLION PASSENGER JOURNEYS PER ANNUM AND EMPLOYS OVER 3,500 PEOPLE.

Revenue in the year was £249.3m (2005: £18.2m) and normalised operating profit was £44.3m (2005: £2.6m). We are delighted with the progress of Alsa in its first full year as part of the Group. Our experienced local management team delivered an excellent performance and the financial integration project has been successfully completed.

We have continued to improve our fares and product offering. Our long distance coaching division saw passenger growth of 2%. Drawing on our experience in the UK for the first time, we introduced promotional fares and special offers. There has also been a greater focus on sales through the internet which now account for around 14% of total sales. We believe we can further reduce our cost of sales through increased promotion of the internet.

During the year, our urban bus division secured new business, retained contracts and moved into new geographic areas in Spain. We were awarded a contract to transfer customers to and from the new terminal at Madrid Airport and we won two new franchises in Catalonia to operate coach services from the AVE Station of Tarragona.

In December 2006, a 15 year contract to operate the urban network in the city of Leon was renewed and new school bus contracts were won in Levante. Bus station management contracts were awarded in Zaragoza and Seville. The regional franchises in Cantabria, have been renewed until 2012 and 2013 respectively. We also acquired a 25% shareholding in Bilbobus, the largest private operator in Bilbao which operates a fleet of over 270 buses. Our Moroccan bus operation continues to flourish and we are currently shortlisted on a tender for 400 buses in the capital city of Rabat.

We were also pleased to be awarded, with partners Madrid Metro and Caja Madrid bank, the concession to operate and maintain Madrid's newly constructed light rail system which is expected to commence in May 2007.

REVENUE

£249.3m

(2005: £18.2m)

NORMALISED OPERATING PROFIT

£44.3m

(2005: £2.6m)

Alsa was acquired by the Group in December 2005.

ALSA'S SPANISH COACH NETWORK

OPERATING AND FINANCIAL REVIEW
CONTINUED

ADAM WALKER
FINANCE DIRECTOR

FINANCIAL REVIEW

DIVISIONAL REVIEW

Commentary on the divisional results is included in the Operational Review on pages 16-21. Other financial points to note are included below.

ALSA

In local currency, Alsa's results are revenue of €365.6m (2005: €26.7m) and a normalised operating profit of €65.0m (2005: €3.8m).

This year has seen a great deal of work on the financial integration of Alsa, which is now complete. The integration has involved the development of Alsa reporting processes to deliver financial results prepared under IFRS in line with the Group's month end timetable. In addition, the valuation work on intangibles and key assets has been completed and the 31 December 2005 balance sheet updated in accordance with IFRS 3, 'Business Combinations'.

TRAINS

Increased fuel costs have added £5.3m to the cost base this year. We expect electricity charges to increase in 2007, although efficiency benefits such as regenerative braking would offset this increase.

Bid costs remain a significant investment for this Division with a total cost of £9.8m (2005: £6.1m) included in normalised operating profit.

As part of the DfT current re-mapping exercise, Central Trains, Silverlink and Midland Mainline will run until November 2007.

BUSES

On 2 March 2006, we received clearance from the Office of Fair Trading regarding our acquisition of the outstanding 67% share holding in Altram LRT Limited ("Altram"). Completion occurred on 14 March 2006 and the results of Altram have been fully consolidated from this date. A normalised operating loss of £0.4m is included in the divisional result.

NORTH AMERICA

In local currency, North America increased normalised operating profit to US$72.3m (2005: US$63.7m). Revenue has increased by US$83.5m to US$524.0m (2005: US$440.5m). Additional legal costs and a new pay award in Canada contributed to a lower margin of 13.8% (2005: 14.5%). The historic fuel hedges that were in place have ended in 2006, which will lead to a US$13m increase in the cost base in 2007.

Following the Group's announcement of the planned sale of the operating lease on Stewart International Airport to the Port Authority of New York in 2007, the assets and related liabilities of the disposal group have been separately identified on the balance sheet, in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations'. The business does not meet the definition of a discontinued operation, therefore the results, which do not make a significant contribution, are included within continuing operations.

JOINT VENTURES AND ASSOCIATES

We hold a 40% investment in Inter-Capital and Regional Rail Limited ("ICRRL") and account for a number of associates and joint ventures within Alsa. The total charge for associates and joint ventures was £29.5m (2005: £8.8m), which comprises our share of the post tax results from associates and joint ventures of £3.8m (2005: £8.8m) and a £25.7m exceptional charge for the designation of the Group's Eurostar contract with ICRRL as an onerous contract. As noted at the half year we have provided for the Eurostar losses to the end of the contract in 2010.

Our share of the operating profit for Altram for the period to 14 March 2006 was £0.1m (2005: loss of £0.2m). The results of the joint ventures and associates within Alsa were a loss of £0.2m (2005: £nil) and a profit of £0.2m (2005: £nil) respectively.

FINANCE COST

Net interest payable increased to £24.9m (2005: £11.4m), principally reflecting a higher level of net debt as a result of the Alsa acquisition in December 2005. This was offset by the weakening of the US dollar which decreased the cost of servicing our foreign currency denominated financing.

After excluding £nil (2005: £5.1m) for discontinued operations, continuing normalised operating profit before depreciation and other non-cash items ("EBITDA") was £264.0m (2005: £212.5m) and continuing EBITDA finance cover was 11.6 times (2005: 20.2 times).

GOODWILL AND INTANGIBLE ASSETS

The goodwill and intangible assets arising on the Alsa acquisition in 2005 were provisionally classified as goodwill at 31 December 2005. They have now been reallocated within the balance sheet. This has resulted in £174.2m reclassified as intangible assets representing the contracts acquired with the business. The balance of £294.1m, after further fair value adjustments, remains within goodwill.

Amortisation of £27.8m (2005: £4.9m) was charged on the intangible asset that arises from the Group's right to operate its rail franchises (£1.6m) and on contracts acquired in Alsa (£20.1m), UK Bus (£1.6m) and North America (£4.5m). The impairment charge for the year on the goodwill arising from the acquisition of Prism Rail PLC in December 2000 was £19.2m (2005: £33.3m); this goodwill is now fully amortised. Although IFRS 3, "Business Combinations" prohibits the amortisation of goodwill, the train franchises acquired with Prism have finite lives, and therefore the goodwill has been impaired over the remaining cash flows.

A goodwill impairment charge of £1.0m has been charged on goodwill acquired with the remaining share capital of Altram.

EXCEPTIONAL ITEMS

Exceptional items totalled a net income of £4.8m (2005: cost of £7.8m), comprising a credit of £6.7m in relation to defined benefit pension liabilities and charges of £1.9m in relation to the integration of Alsa. The pension credit reflects a negative past service cost that arises as a result of the "A-day" changes to pension legislation which increased the maximum limit on the lump-sum benefits that can be withdrawn tax free on retirement. We believe that to disclose this credit within normalised profit would present a misleading picture of the results.The profit on disposal of non-current assets of £16.9m comprises £7.5m of profit on the disposal of a car park in Sheffield and £9.4m of profit on disposal of our 14% shareholding in Trainline. Both profits relate to the UK Trains division.

DISCONTINUED OPERATIONS

An additional provision of £3.2m was booked in relation to the Group's Public Transit business which was disposed of in 2005. This provision reflects the Directors' best estimate of the Group's liability regarding an industry wide employment issue in California, over which the Group provided an indemnity to the purchaser at the time of the disposal.

TAXATION

The total tax charge of £23.6m (2005: £27.5m) on profit before tax of £104.1m (2005: £89.3m) represents an effective rate of 22.7% (2005: 30.8%). The tax charge on normalised profit of £156.1m (2005: £135.3m) was £39.2m (2005: £29.5m), which represents an effective rate of 25.1% (2005: 21.8%). The normalised effective tax rate has increased due to the higher proportion of overseas earnings in the Group.

The total tax charge includes a tax credit on exceptional items of £15.6m (2005: £2.0m) which includes the deferred tax impact of the Group's non-deductible intangible asset amortisation.

CASH FLOW

The Group continues to generate strong cash flow with a cash inflow from operations of £182.0m (2005: £79.9m), which includes an outflow of £27.7m in relation to the franchise exits in March. The Group's operating cash flow by Division and reconciliation of net debt are set out in tables 1 and 2.

The increase reflects the full year contribution from Alsa of £40.1m (2005: outflow of £1.2m) and the benefit of various working capital timing benefits in UK Trains and Central functions. This cash flow was used to maintain high levels of investment across the Group, particularly in North America where most of the capital expenditure relates to contract wins.

The working capital outflow in UK Bus comprises payments to the defined benefit pension schemes in excess of the income statement charge and the losses associated with the onerous contracts in our London business. The working capital movement in UK Trains relates to amounts received in the year in relation to 2005. In North America, a timing difference has contributed to the working capital outflow. The cash flow benefit in Central Functions arises through the restructure of our insurance arrangements.

Net capital expenditure was £87.4m (2005: £110.6m) including £20.7m (2005: £57.0m) of additions purchased under finance leases and £6.8m (2005: £8.1m) of proceeds from disposals.

Net interest paid of £20.6m (comprising the cash outflow of £19.7m adjusted for loan fee amortisation of £0.9m) is in line with last year as the 2005 cash flow included the termination of a US$200m interest rate swap during the year.

The receipt of tax rebates in respect of prior years resulted in reduced tax payments this year.

Acquisitions and disposals includes the acquisitions in the year of £19.8m, deferred consideration of £3.0m, acquisition of associates and investments of £8.7m and proceeds from the disposal of investments and intangible assets of £14.7m. The 2005 outflow includes the acquisition of Alsa for £367.4m.

TABLE 1: OPERATING CASH FLOW

	UK Bus £m	UK Coaches £m	UK Trains £m	North American Bus £m	Alsa £m	Central functions £m	Total £m
Normalised operating profit	40.7	23.7	49.1	39.1	44.3	(12.1)	184.8
Depreciation	15.7	5.7	21.6	25.3	12.9	0.5	81.7
Amortisation of leasehold property prepayment	0.1	–	–	0.5	–	–	0.6
Amortisation of fixed asset grants	–	–	(1.9)	–	(0.1)	–	(2.0)
Profit on disposal	0.2	(0.1)	(2.2)	(0.6)	(0.4)	–	(3.1)
Share-based payment	0.4	0.1	0.3	0.2	–	1.0	2.0
EBITDA	**57.1**	**29.4**	**66.9**	**64.5**	**56.7**	**(10.6)**	**264.0**
Working capital movement	(15.7)	0.2	34.3	(12.2)	0.3	26.2	33.1
Net cash inflow from operations	**41.4**	**29.6**	**101.2**	**52.3**	**57.0**	**15.6**	**297.1**
Net capital expenditure	(16.1)	(3.8)	(12.3)	(38.0)	(16.9)	(0.3)	(87.4)
Operating cash flow before one-offs	**25.3**	**25.8**	**88.9**	**14.3**	**40.1**	**15.3**	**209.7**
Other – Franchise exits							(27.7)
Operating cash flow							**182.0**

Operating cash flow is intended to be the cash flow equivalent to normalised operating profit. To reconcile the operating cash flow to the statutory cash flow the following items are included: "Cash generated from operations" plus "Proceeds from disposal of property, plant and equipment" less "Finance lease additions" and "Purchase of property, plant and equipment" as set out in note 38 and the cash flow statement. The non-operating items are then excluded which comprise £13.0m exceptional property proceeds, £8.4m payment to associates and £2.0m payments in relation to other exceptional items.

TABLE 2: RECONCILIATON OF NET DEBT

	2006 £m	2005 £m
Operating cash flow	**182.0**	79.9
Exceptional cash flow	**(2.0)**	(7.7)
Exceptional property proceeds	**13.0**	–
Payments to associates	**(8.4)**	(1.7)
Net interest	**(20.6)**	(22.0)
Taxation	**(9.0)**	(26.7)
Share buy back	**(11.6)**	(29.3)
Financial investments and shares	**15.8**	8.4
Acquisitions and disposals	**(16.8)**	(359.1)
Dividends	**(49.7)**	(41.6)
Net funds flow	**92.7**	(399.8)
Foreign exchange	**32.3**	(27.0)
Funds flow post exchange	**125.0**	(426.8)
Opening net debt	**(563.4)**	(136.6)
Closing net debt	**(438.4)**	(563.4)

TABLE 3: BALANCE SHEET

	2006 £m	2005 £m
Intangible assets	**697.6**	766.3
Property plant and equipment	**501.9**	514.4
Other non-current assets	**37.2**	66.0
Current assets excluding cash and debt receivable	**322.3**	337.5
Net debt	**(438.4)**	(563.4)
Non-current liabilities excluding borrowings	**(209.7)**	(226.4)
Current liabilities excluding borrowings	**(583.1)**	(582.1)
Disposal group net assets	**17.7**	–
Net assets	**345.5**	312.3

DIVIDEND

An interim dividend of 10.75p per share was paid in October 2006 and a final dividend of 24.0p per share will be paid in May 2007, bringing the total dividend for the year to 34.75p. This is an 8% increase in total dividends declared compared to 2005. This dividend is covered 2.2 times (2005: 2.3 times) by normalised profits after tax.

FINANCIAL POSITION

The Group looks to adopt efficient financing structures that enable it to use its balance sheet strength to achieve the Group's objectives without weakening the balance sheet in a way that would put shareholder value at risk. The Group's balance sheet is set out in table 3.

Movements in the Group's net debt are explained above. Gearing at 31 December 2006 was 127% (2005: 180%).

During the first half of the year, we refinanced our two existing bank debt facilities into one new £800m five year revolving credit facility maturing in June 2011. As at 31 December 2006, the headroom under the facility was £247.8m.

In the year, the Group repurchased 1,425,000 shares for consideration of £11.6m. All the shares repurchased have been retained as treasury shares within equity for future issue under the Group's share schemes or for cancellation or resale.

The Group's treasury objective is to manage the risk for potential loss of shareholder value from certain financial risks. The Group's financial risk management objectives and policies are described in more detail in note 30 to the Annual Report and Accounts.

PENSIONS

The Group's principal defined benefit pension schemes are all in the UK. The most recent triennial actuarial valuations were carried out at 31 March 2004 and 31 March 2005 for the two Bus schemes, 5 April 2004 for Coaches and 31 December 2004 for the Train schemes. These valuations showed funding levels of 88% to 89% on the Bus schemes, 65% on the Coach scheme and 86% to 95% on the Train schemes. Approximately 1,300 (18%) Bus division employees are members of the two schemes, which have been closed for some years, and some 420 members of staff are members of the Coach division scheme which was closed in June 2002. New employees in the Bus and Coach divisions are offered membership of defined contribution pension schemes. In the Trains division approximately 8,700 employees are members of the Train schemes.

The balance sheet includes provision for the deficits of the defined benefit schemes in the group which includes the Railways Pension Scheme ("RPS"), where our main obligation is to pay the contributions agreed with the scheme actuary over the life of our franchise.

Overall, the IAS 19 deficits have decreased as a result of the past service credit recognised in exceptional items combined with an improvement in the return on assets and discount rate. In the coach scheme the deficit decreased to £12.7m (2005: £14.9m). In the Bus schemes the deficit has decreased significantly to £17.3m (2005: £37.8m) and the RPS deficit decreased by £13.1m to £21.1m.

PRINCIPAL RISKS AND UNCERTAINTIES

In addition to the opportunities we have to grow and develop our business, the Group faces a range of risks and uncertainties as part of both its day to day operations and its corporate activities. The processes that the Board has established to safeguard both shareholder value and the assets of the Group are described in the Corporate Governance Report.

The narrative which follows describes those specific risks and uncertainties that the Directors believe could have the most significant impact on the Group's long term value generation. The risks and uncertainties described below are not intended to be an exhaustive list.

RISKS INHERENT IN BIDDING FOR CONTRACTS

One of the principal methods of increasing shareholder value is bidding for new contracts. Inherent in bidding for new contracts is a risk that assumptions are made in the bid model that turn out to be undeliverable for any number of reasons. To take UK Train bids as an example, if underlying economic growth falls short of the growth assumed in the bid, the passenger revenue target may not be achievable.

Additionally, when a business is based on winning contracts, there is a requirement for the business to win a minimum number of contracts to retain its existing scale of operations. If that minimum number is not achieved, that division's revenue and profits would be affected.

The division most exposed to this risk is UK Trains, where a robust process is followed to ensure that all bids are subject to sufficient challenge. In addition, UK Bus, North America and Alsa bid for contracts on a regular basis, but no one contract is material to those businesses.

COMPETITION

With the exception of North America, our businesses are competing with alternative modes of transportation. Our UK Coach, UK Trains and Alsa businesses face competition from a mix of long distance coaches, trains, low-cost airlines and the car. The principal alternative to our UK Bus business is the car, and with the cost of owning it remains imperative to create a more positive operating environment for the bus. In addition to modal competition, the competitive environment between transport companies remains intense. This is seen both in competition for passengers and when bidding for contracts.

We compete using the key themes explained in the Chief Executive's review: customer service, leading the way, knowing our stakeholders, operational excellence and showing we care.

ENERGY COSTS

All of our businesses incur energy costs with UK Bus, UK Coach, Alsa and North America predominantly using diesel, and UK Trains using either gasoil or electricity. All energy prices are subject to significant changes driven by international economic and political factors. In recent years, weather patterns such as mild or cold winters and hurricanes have also had an effect on energy prices.

We seek to limit the effect diesel and gasoil costs have on our year on year profitability through a risk management programme using fuel price swaps. In our UK Trains division we are currently negotiating with Network Rail to reach a new agreement on electricity pricing.

POLITICAL AND REGULATORY CHANGES

Our businesses are subject to varying degrees of regulation and as such, there is a risk that political and regulatory changes could impact their future prospects. At the current time, the highest profile political and regulatory uncertainty is around the UK Bus business where the debate around quality partnerships and quality contracts continues.

To mitigate the risk from political and regulatory changes, the Group looks to service the needs of its stakeholders and lobbies national, regional and local government in addition to passenger, employee and environmental bodies.

LABOUR COSTS

Our aim to offer high quality services is dependent on recruiting and retaining the right calibre of employees. For each of our businesses, local economic prosperity, employment levels and our image as an employer affect our ability to deliver this aim. Additionally, we incur significant other staff costs such as recruitment and training.

Employee costs are the largest single component of the Group's operating costs. We seek to mitigate this risk by securing competitive multi-year wage agreements where possible,which contain an element of productivity enhancement to ensure that cost increases above inflation are mitigated as far as possible.

MAJOR INCIDENTS

As our business is based on the transportation of passengers, there is a risk that any incidents that the Group is involved in, directly or indirectly, could result in injury to our passengers or staff. The potential impact on the Group is wide ranging and includes possible damage to our reputation with passengers, financial loss following insurance claims and our ability to win future contracts.

To mitigate this risk, the Board operates a Safety and Environment Committee which reviews the Group's safety practices, procedures and record as described in the Corporate Governance Report. For our employees, this translates itself into our culture of operational excellence that seeks to ensure the safety of all our passengers.

The impact of insurance claims costs is managed through the Group's risk management processes. The current policy is to self-insure high frequency claims with the businesses and then provide protection above these types of losses by purchasing insurance cover from a selection of proven and financially strong insurers. A risk remains that the number or size of the self-insured claims could be significantly higher than expected.

ECONOMIC CONDITIONS

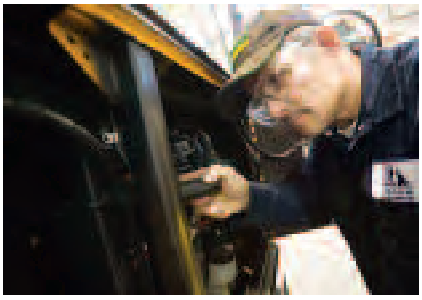
Changes in economic conditions have an effect on the ability of our customers to pay for our services or an impact on the number of journeys that they make. In particular the Trains division's historic growth has been closely correlated to the growth in the overall UK economy.

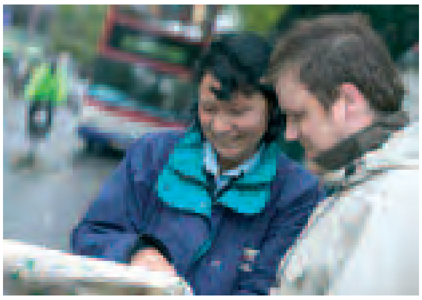
We look to mitigate this risk by closely monitoring the affordability of our services and varying the price where appropriate and possible.

IT'S ABOUT WHAT WE DO AND HOW WE DO IT

↓ ENGINEERS PROVIDE COMPREHENSIVE AND REGULAR VEHICLE MAINTENANCE TO ENSURE THE HIGHEST EFFICIENCY AND SAFETY STANDARDS

↓↓ LISTENING AND RESPONDING TO OUR CUSTOMERS' NEEDS





CORPORATE RESPONSIBILITY

National Express Group's commitment to corporate responsibility goes far beyond a passing acknowledgement. We believe that corporate responsibility is about what we do and how we do it.

Corporate responsibility is at the heart of what we do. We report more fully on our initiatives through our dedicated Corporate Responsibility ("CR") Report which is published each year at the time of our Annual General Meeting. Our profile in the CR area has also been evidenced through our involvement with key organisations in the field and our inclusion in a number of key CR indices; the Dow Jones Sustainability and the FTSE4Good.

With the forecasted increase in leisure travel and greater wealth enabling more time spent travelling, public transport has a key role to play in improving our quality of life. Our 2006 CR report will focus specifically on highlighting to policymakers the contribution that public transport can make to the economic, social and environmental landscape and the overall quality of life.

CLIMATE CHANGE

This year has seen the increased profile of climate change. The environmental benefits of public transport have been very much at the forefront following the publication of the Department for Transport's Eddington Transport Study and the Stern Review on the Economics of Climate Change. As operators we are already providing additional capacity through growth in our coach services, longer trains, rail platform extensions, and greater usage of buses for journeys where cars have historically been used. The Stern Review highlighted the important role that transport can play in tackling climate change and this is supported by Transport 2000, a leading non government transport organisation, which has highlighted that there are large net savings to be made when customers use public transport services instead of a car. It is the role of public transport operators to make their services attractive to encourage car users to use public transport services.

We know from our own research that there are net savings from customers using our services instead of the car with coach travel being the most efficient of all modes. This is highlighted on page 11. With the coach being the most environmentally friendly mode, during 2007, we will be promoting the environmental benefits of travelling by coach.

At National Express we have been leading the industry in driving forward the national environmental agenda by heading up forums in the sectors where we operate. We chair and guide much of the debate amongst rail operators at the Rail Sustainability Development Group and participation in this forum has led to the rail industry's commitment to reduce carbon emissions by 5% over the next ten years.

In 2007 we have shown our commitment to reducing emissions by joining the Climate Group, an independent, non profit organisation dedicated to advancing business and government leadership on climate change. We are one of the founding members and will be developing practical promotions and initiatives as part of the "We're In This Together" campaign to encourage changes in individual behaviour which reduce carbon emissions. As part of this Group we believe that by making it easier for individuals to change their behaviour through our products, services and communications we can, step-by-step, change public attitudes from concern to focus on positive action. By signing up to this initiative we have committed to the development of a consumer proposition which will make a difference. In addition we are participating in the WWF "One Planet Business" discussion forum where companies with an interest in sustainability will develop longer term initiatives to reduce CO_2 emissions.

Within our operation we have trialled alternative fuels such as biodiesel in a fleet of 40 buses within the Alsa fleet. Within our Trains division we undertook a detailed review of energy consumption. This identified a number of engineering and operational measures we can take to improve energy efficiency and we are now focused on delivering these. We have also implemented regenerative braking across the division's electric-powered fleet. Most significantly we have reduced site energy usage at our train depots by 17% during the year.

In addition, safety and development of our people are key to the success of our business as well as our contribution and reputation in those communities where we operate. The Group's overall vision is for continuous improvement in health, safety and environmental management and practice and, where appropriate, continuous improvement in health, safety and environmental performance. In 2006 we continued to reduce the risk of customer and employee injuries across our operations and are pleased to report that our signals passed at danger level is at its lowest ever at 0.76 signals passed at danger per million miles compared to 0.79 in 2005. We look forward to continuing this improvement.

FUTURE LEADERS

During 2006 the Group has developed a comprehensive leadership development strategy on the back of the Group Employee Survey which highlighted that a leader's performance has a big impact, both good and bad, on those around them. This strategy ensures that as we grow our business, we develop those who will lead the business in the future. The three year leadership development plan has projects including personal and skills development, talent and succession planning, performance management, reward and recognition, in addition to graduate and non graduate recruitment. Through focus groups we have identified seven leadership capabilities to drive our business success. Over the coming year all our leaders, about 4,000 of them, will be involved from the frontline to the boardroom.

STAKEHOLDER RECOGNITION

We are also focused on the requirements of our external stakeholders, many of whom are key for the development of our operations. Our stakeholders range from those who award us contracts such as the Department for Transport, local authorities, transport bodies and school boards to our customers who use our services each day. In addition there are numerous other stakeholders such as non government organisations, Trades Unions, suppliers and user groups with whom we have a constant dialogue.

Working with our stakeholders we believe the biggest challenge for public transport in the future is to make its use easy and simple whether it be planning journeys or the actual experience. To make this a reality during 2007, our commitment to our customers will be focused on "Making Travel Simpler".

UNDERSTANDING THE OFR

STATEMENT OF COMPLIANCE

This OFR is intended to develop the Group's narrative reporting to meet many of the requirements of the statutory OFR as laid out in the Accounting Standards Board's 'Reporting Statement of Best Practice on the OFR'. This OFR ensures compliance with the legal requirement under the Companies Act to provide a Business Review and is referenced from the Director's Report.

We note that this is the first year that UK companies have been required to produce a Business Review and therefore best practice is still emerging. We will continue to review the narrative disclosure we provide in the Annual Report and Accounts to ensure that the disclosures provided meet the requirements of our stakeholders.

CAUTIONARY STATEMENT

The OFR focuses on matters that are relevant to the interests of the shareholders of the Company. The purpose of the OFR is to assist the shareholders of the Company in assessing the strategies adopted by the Company and the potential for those strategies to succeed. It should not be relied on by any other party or for any other purpose.

Where this OFR contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. Shareholders will understand that these statements should be treated with caution due to the inherent uncertainties underlying any such forward-looking information.

BOARD OF DIRECTORS AND COMPANY SECRETARY

DIRECTORS

1 **DAVID ROSS**
CHAIRMAN
2 **RICHARD BOWKER CBE**
CHIEF EXECUTIVE
3 **ADAM WALKER**
FINANCE DIRECTOR
4 **RAY O'TOOLE**
CHIEF OPERATING OFFICER
5 **SIR ANDREW FOSTER**
NON EXECUTIVE DIRECTOR
6 **BARRY GIBSON**
NON EXECUTIVE DIRECTOR
7 **SUE LYONS OBE**
NON EXECUTIVE DIRECTOR
8 **JORGE COSMEN**
NON EXECUTIVE DIRECTOR
9 **TIM SCORE**
NON EXECUTIVE DIRECTOR
10 **TONY MCDONALD**
COMPANY SECRETARY

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BOARD OF DIRECTORS AND COMPANY SECRETARY

1 DAVID ROSS
CHAIRMAN *ƒ

David Ross joined the Board in February 2001 as a Non Executive Director and became Chairman in May 2004. He is Non Executive Deputy Chairman of The Carphone Warehouse Group PLC, a Non Executive Director of Trinity Mirror PLC, Big Yellow Group PLC and Cosalt PLC. David is a chartered accountant. Aged 41.

2 RICHARD BOWKER CBE
CHIEF EXECUTIVE

Richard Bowker was appointed to the Board as Chief Executive on 12 September 2006. He was formerly Chief Executive of Partnerships for Schools ("PfS"), a government body responsible for delivering the Building Schools for the Future Investment Programme. Between December 2001 and September 2004 he was Chairman and Chief Executive of the Strategic Rail Authority. Prior to that he was Group Commercial Director of Virgin Group and Co-chairman of Virgin Rail. Richard is a chartered management accountant and a Non Executive Director of British Waterways. Aged 41.

3 ADAM WALKER
FINANCE DIRECTOR

Adam Walker joined the Board in March 2003, as Finance Director. He joined the Group in October 2001 as Corporate Development Director working closely with the Group's operational subsidiaries on developing their financial strategies. Prior to joining the Group he was Director of Corporate Finance at Arthur Andersen and an Associate Director at NatWest Markets. He is a chartered accountant. Aged 39.

4 RAY O'TOOLE
CHIEF OPERATING OFFICER

Ray O'Toole joined the Board in November 1999 as Chief Operating Officer. He has 30 years' operational experience in transport. He spent the early part of his career in various engineering management positions at Greater Manchester Passenger Transport Executive. He joined National Express from FirstGroup plc, where he was responsible for its operations in Yorkshire and the North West as both Divisional Director and Group Engineering Director. He is a Member of the British Transport Police Authority. Aged 51.

5 SIR ANDREW FOSTER
NON EXECUTIVE DIRECTOR +*ƒ

Sir Andrew was appointed to the Board in August 2004. He has had an extensive career in the public sector having served as Chief Executive of the Audit Commission for England and Wales between 1992 and 2003. Before this he was Deputy Chief Executive of the NHS and is currently Deputy Chairman of the Royal Bank of Canada Europe Limited and a Non Executive Director of the Sports Council, Nestor Health Care and PruHealth. Sir Andrew has also recently completed reviews of Further Education and Athletics for the Government. Aged 62.

6 BARRY GIBSON
NON EXECUTIVE DIRECTOR +#ƒ

Barry Gibson joined the Board in November 1999 and became the Senior Independent Director in September 2005. He served on the Board at BAA plc as Group Retailing Director. Until October 2001 he was the Group Chief Executive of Littlewoods Organisation plc. He is also a Non Executive Director of William Hill PLC and Homeserve plc. Aged 55.

7 SUE LYONS OBE
NON EXECUTIVE DIRECTOR *#ƒ

Sue Lyons joined the Board in May 2001. Her career has been principally with Rolls Royce which she joined in 1975 and where she held the position of Managing Director, Defence (Europe). In 1998 she received an OBE for services to the engineering industry and in 1999 she was awarded the European Woman of Achievement Award – Business Category. Sue is also a Non Executive Director of Wagon plc. Aged 54.

8 JORGE COSMEN
NON EXECUTIVE DIRECTOR *ƒ

Jorge Cosmen was appointed to the Board on 1 December 2005 at the time of the Alsa transaction. He was Corporate Manager for the Alsa Group from 1995, becoming Chairman in 1999. Between 1986 and 1995 he worked in sales, distribution and banking. He is a Business Administration graduate and has an International MBA from the Instituto de Empresa in Madrid. Aged 38.

9 TIM SCORE
NON EXECUTIVE DIRECTOR +#ƒ

Tim Score was appointed to the Board in February 2005. He is Chief Financial Officer at ARM Holdings plc. Before joining ARM he worked as Finance Director of Rebus Group Limited which he joined in 1999. Between 1997 and 1999, he was Group Finance Director of William Baird plc, which he joined from LucasVarity plc. He is a chartered accountant. Aged 46.

10 TONY MCDONALD
COMPANY SECRETARY

Tony McDonald was appointed Company Secretary in May 2000. Prior to joining the Group he held senior legal positions with the in-house legal teams at Guardian Royal Exchange and BP and in private practice with Slaughter and May. He is a qualified solicitor. Aged 46.

+ Member of the Audit Committee
* Member of the Nomination Committee
# Member of the Remuneration Committee
ƒ Member of the Safety and Environment Committee

DIVISIONAL HEADS

NEIL BARKER
ACTING CHIEF EXECUTIVE, BUS DIVISION

Neil Barker joined the Group as Operations Director of the Group's Bus Division in January 2005. In February 2007 he was appointed Acting Chief Executive of the Bus Division. Neil joined the company from Arriva plc where he held a number of senior management roles latterly as managing director of the Midlands Regional Bus business. Aged 43.

PAUL BUNTING
CHIEF EXECUTIVE, COACH DIVISION

Paul Bunting joined the Group in 2004 as Managing Director at Midland Mainline from Stagecoach, where he was Business Development Director for the UK Bus Division. Prior to that Paul has held a number of senior positions within the rail industry, principally in planning and marketing roles in both InterCity and Regional Railway businesses. Aged 47.

JAVIER CARBAJO
CHIEF EXECUTIVE, ALSA GROUP

Javier Carbajo joined the Group in December 2005 when National Express acquired Alsa. A graduate in economics and with an MBA, Javier has been with Alsa for 28 years during which time he has held management positions in most areas of the business. In 1999 he was appointed Chief Executive of Enatcar following its acquisition by Alsa. In 2003 he was appointed CEO of Alsa Group. Aged 54.

DAVID FRANKS
CHIEF EXECUTIVE, TRAINS DIVISION

David Franks joined the Group in January 2003 as Trains Divisional Director (North). He was appointed as Chief Executive of the Trains Division in February 2004. David has over 30 years' experience in the rail industry and immediately prior to joining National Express he was Managing Director of South Central at the GoAhead Group. Aged 49.

BRIAN STOCK
CHIEF EXECUTIVE, NORTH AMERICA

Brian joined the Group in 2002 through the acquisition of Stock Transportation. He has overseen the North American student bus operations since March 2004 and was appointed as Chief Executive of the Group's North American operations in October 2004. Brian has had over 25 years in the bus industry. Prior to joining the Group, Brian was President of Stock Transportation and responsible for guiding the business to become the fifth largest school bus company in North America. Aged 48.

DIRECTORS' REPORT

The Directors are pleased to present their annual report and the audited accounts for the year ended 31 December 2006.

PRINCIPAL ACTIVITIES
National Express Group PLC is the holding company of the National Express Group of companies. Its subsidiary companies provide mass passenger transport services in the UK and overseas.

BUSINESS REVIEW
The information that fulfils the requirements of Section 234ZZB of the Companies Act 1985 can be found in the Chairman's statement,Chief Executive's Review and the Operating and Financial Review on pages 2 to 27, which are incorporated into this report by reference.

RESULTS AND DIVIDENDS
The profit on ordinary activities before tax for the year ended 31 December 2006 was £104.1m. (2005: £89.3m) and a profit attributable to equity shareholders of £76.5m (2005: £2.8m (loss)) was transferred to reserves.

The Directors recommend a final net dividend of 24.0p per share which, together with the interim net dividend of 10.75p per share paid on 20 October 2006, gives a total net dividend for the year of 34.75p per share (2005: 32.25p). If approved by shareholders, the final dividend will be paid on 4 May 2007 to shareholders on the register at 27 April 2007.

DIRECTORS
The Directors of the Company who served during the year were:

David Ross
Richard Bowker (appointed 12 September 2006)
Jorge Cosmen
Sir Andrew Foster
Barry Gibson
Sue Lyons
Ray O'Toole
Tim Score
Adam Walker
Phil White (resigned 11 September 2006)

David Ross and Barry Gibson will retire by rotation at the Annual General Meeting and, being eligible, will offer themselves for re-election. Richard Bowker will stand for election at the Annual General Meeting following his appointment to the Board on 12 September 2006. Phil White resigned as Chief Executive and a Director of the Company on 11 September 2006.

The names and biographies of the current Directors appear on pages 28 and 29. Details of the remuneration of the Directors, their interests in shares of the Company and service contracts are contained in the Report on Directors' Remuneration on pages 38 to 44.

DIRECTORS' INTERESTS IN CONTRACTS
Except as stated in note 37 on page 93, no contract existed during the year in relation to the Company's business in which any Director was materially interested.

DIRECTORS' LIABILITY INSURANCE
The Company maintains Directors' and Officers' Liability Insurance in respect of legal action that might be brought against its Directors. Under the Company's Articles of Association the Company may indemnify its Directors and Officers in accordance with the provisions of Section 309A of the Companies Act 1985. In addition indemnities have been provided by the Company to Ray O'Toole and Phil White who have been joined as defendants in proceedings being brought before the Supreme Court of New South Wales. These proceedings relate to a period of time when Ray O'Toole and Phil White were Directors of Bosnjak Holdings Pty Ltd, which was a subsidiary of the Group. Copies of the Articles of Association and the indemnities for Ray O'Toole and Phil White are available for inspection at the Company's registered office.

EMPLOYMENT POLICIES
The Group strives to meet its business objectives by motivating and encouraging its employees to be responsive to the needs of its customers and continually improve operational performance. The Group is committed to providing equality of opportunity to employees and potential employees. This applies to appropriate training, career development and promotion for all employees, regardless of physical ability, gender, sexual orientation, religion, age or ethnic origin. All UK businesses report diversity data and are responsible for benchmarking against their local population.

Full and fair consideration is given to applications for employment received from disabled persons, according to their skills and capabilities. The services of any existing employee disabled during their period of employment are retained wherever possible.

EMPLOYEE INVOLVEMENT
The Group encourages employee involvement in its affairs. Subsidiary companies produce a range of internal newsletters and circulars which keep employees abreast of developments. In addition, the Group-wide *express* magazine is aimed at keeping employees in touch with the worldwide activities of the Group and regular reviews of the Group's financial performance appear in this publication. Senior management within the Group meets regularly to review strategic developments and a group senior leadership conference is planned for 2007. Dialogue takes place regularly with Trades Unions and other employee representatives on a wide range of issues. Employees are able to share in the Group's results through various employee share schemes.

Employee satisfaction is tracked through an annual employee survey. Results from the 2006 survey have been fed back to employees and action plans at local level rolled out. A number of Group initiatives launched in 2005 for frontline staff were continued in 2006. For example, the 'Express Awards' reward outstanding employee activities in and out of the workplace and the 'Express Benefits' package gives UK employees competitive discounts with leading retailers.

ENVIRONMENTAL POLICY

Details of the Group's environment policy and environmental initiatives are to be found in the Corporate Responsibility review on pages 26 to 27 and in the separate Corporate Responsibility Report issued to shareholders.

CHARITABLE AND POLITICAL CONTRIBUTIONS

Charitable donations made during the year totalled £296,000 (2005: £286,000). It is the Group's policy not to make political donations and accordingly none were made in the year. However the Company did attend and sponsor various political events during the year for which total expenditure was £19,500 (2005: nil).

CREDITORS' PAYMENT POLICY AND PRACTICE

It is the Company's policy to agree terms of payment prior to commencing trade with any supplier and to abide by those terms based on the timely submission of satisfactory invoices.

Trade creditor days of the Company for the year ended 31 December 2006 were 21 days (2005: 24 days) based on the ratio of Company trade creditors at the end of the year to the amounts invoiced during the year by trade creditors.

FINANCIAL INSTRUMENTS

Details of the use by the Company and its subsidiaries of financial instruments can be found in the Notes to the Consolidated Accounts on pages 81 to 83.

SUBSTANTIAL SHAREHOLDINGS

The Company has been notified of the following holders of 3% or more of its issued share capital (excluding treasury shares) for the purpose of Section 198 of the Companies Act 1985, as at 26 February 2007:

European Express Enterprises Ltd	19,976,298	13.08%*
Newton Investment Management Ltd	15,320,955	10.09%*
Standard Life Group	6,696,605	4.40%*
Aegon Asset Management UK plc	6,425,409	4.23%*
Barclays Bank PLC	5,116,365	3.37%*
Legal & General Group Plc	5,070,738	3.33%*

*Percentages as at date of notification.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 1 May 2007. Shareholders will be asked to approve five items of special business, details of which are given in the Notice of Meeting accompanying this report.

PURCHASE OF OWN SHARES

The Company was granted authority at the Annual General Meeting in 2006 to purchase its own shares up to an aggregate value of 10% of the issued nominal capital. This authority expires at this year's Annual General Meeting and a resolution will be proposed for its renewal.

The share buy back programme initiated by the Company in 2005, as part of its overall finance strategy, continued in 2006. During the period 10 May 2006 to 15 June 2006 the Company made the following purchases of its ordinary 5p shares:

	Number of shares	Percentage of issued share capital	Nominal value	Average purchase price
Shares purchased	1,425,000	0.93%	£71,250	£8.11
Shares cancelled	–	–	–	–
Shares put into treasury	1,425,000	0.93%	£71,250	–

As at 26 February 2007 the Company held a total of 1,825,000 ordinary 5p shares (nominal value £91,250) in treasury equal to 1.2% of the issued share capital.

DISCLOSURE OF INFORMATION TO AUDITORS

The Directors who held office at the date of approval of the Directors' Report confirm that:

- so far as each Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- each Director has taken all steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

GOING CONCERN

It should be recognised that any consideration of the foreseeable future involves making a judgement, at a particular point in time, about future events which are inherently uncertain. Nevertheless, at the time of preparation of these accounts and after making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue operating for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

By order of the Board

Tony McDonald
Secretary
1 March 2007

CORPORATE GOVERNANCE

THE BOARD AND ITS PRINCIPAL COMMITTEES

Details of the Board and its principal Committees are set out below. Attendance at meetings by individual Directors during 2006 is shown next to the Director's name. All of the Committees are authorised to obtain legal or other professional advice as necessary, to secure the attendance of external advisers at their meetings and to seek information required from any employee of the Company in order to perform their duties. The full terms of reference of the Committees are available on the Company's website at www.nationalexpressgroup.com.

The Board of Directors

Ten meetings were held during the year.

Richard Bowker *Chief Executive* (appointed to the Board 12 September 2006)	(4)
Jorge Cosmen *Non Executive Director*	(10)
Sir Andrew Foster *Non Executive Director*	(9)
Barry Gibson *Senior Independent Director*	(9)
Sue Lyons *Non Executive Director*	(10)
Ray O'Toole *Chief Operating Officer*	(10)
David Ross *Chairman*	(10)
Tim Score *Non Executive Director*	(10)
Phil White *Chief Executive* (resigned from the Board 11 September 2006)	(6)
Adam Walker *Finance Director*	(10)

Company Secretary: Tony McDonald (also acts as Secretary to the Board Committees).

There is a formal schedule of matters reserved for the Board's attention which includes the review and approval of Group strategy and policies, major business acquisitions or disposals, major capital projects, Group budgets, significant changes to accounting policies, capital structure and dividend policy.

Audit Committee

Four meetings were held during the year.

Tim Score *Chairman*	(4)
Sir Andrew Foster	(4)
Barry Gibson	(3)

The Committee oversees the process for selecting the external auditor, assesses the continuing independence of the external auditor and recommends approval of the audit fee to the Board. It is responsible for ensuring that provision of non audit services does not impair the external auditors' independence or objectivity. It discusses with the external auditor the nature and scope of the audit and any issues or concerns arising from the audit process. The Committee reviews the internal audit programme, considers major findings of the internal audit investigations and reviews management's financial reporting and risk management. The Committee reviews the half-year and annual financial statements and the effectiveness of the Company's internal control and risk management systems.

Remuneration Committee

Seven meetings were held during the year.

Barry Gibson *Chairman*	(6)
Sue Lyons	(7)
Tim Score	(7)

The Committee is responsible for determining broad policy for the remuneration of the Executive Directors (including the Chief Executive), the divisional Chief Executives, the Chairman of the Company and the Company Secretary. Within the terms of the agreed policy the Committee will determine the total individual remuneration package of each Executive Director including, where appropriate, bonuses, incentive payments, pension arrangements and share options. The Committee is responsible for selecting, appointing and setting the terms of reference for any remuneration consultants who advise the Committee. The Committee ensures that contractual terms on termination, and any payments made, are fair to the individual and the Company, that failure is not rewarded and the duty to mitigate loss is, where appropriate, fully recognised.

Nomination Committee
Three meetings were held during the year.

David Ross *Chairman*	(3)
Sir Andrew Foster	(3)
Sue Lyons	(3)
Jorge Cosmen	(3)

The Committee is responsible for identifying and nominating for the approval of the Board, candidates to fill Board vacancies as and when they arise. It will give full consideration to succession planning, and keep under review the leadership needs of the organisation, both executive and non executive. The Committee reviews annually the time required from a Non Executive Director and uses performance evaluation to assess whether the Non Executive is spending enough time to fulfil their duties.

Safety and Environment Committee

Four meetings were held during the year.

Sue Lyons *Chairman*	(4)
Jorge Cosmen	(4)
Sir Andrew Foster	(3)
Barry Gibson	(3)
David Ross	(4)
Tim Score	(4)

The Committee reviews the Group's safety and environment practices, procedures and record.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Annual Report and Accounts contain the accounts and reports of the Directors, including the Report on Directors' Remuneration, in accordance with applicable United Kingdom law and International Financial Reporting Standards as adopted by the European Union or, in the case of the Company's accounts, UK GAAP. The Directors are required to prepare accounts for each financial year that present fairly the financial position of the Company and of the Group and the financial performance and cash flows of the Group for that period. The financial statements of the Company are required by law to give a true and fair view of the state of affairs and of the profit or loss for that period. In preparing those accounts the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information and accounting policies in a manner that provides relevant, reliable and comparable information; and
- state that the Company and the Group have complied with applicable accounting standards, subject to any material departures disclosed and explained in the accounts.

The Directors confirm that these accounts comply with the above requirements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Board supports the highest standards of corporate governance and ethical practices within all its operations and continues to review its policies on an ongoing basis. The Board has endorsed a set of principles which establish the framework for how its businesses operate. Key to these is working in an open and honest manner.

STATEMENT OF COMPLIANCE WITH THE COMBINED CODE

In the opinion of the Directors the Company has complied with Section 1 of the Combined Code on Corporate Governance published in 2003 (the 'Combined Code') throughout the year apart from provision B.1.6.9 (notice periods) as follows:

- the notice period of Ray O'Toole, which previously had been 12 months, was increased to 24 months as at 1 September 2006. This period reduces on a daily basis such that on 1 September 2007 the notice period will be 12 months. This change was approved by the Remuneration Committee on the appointment of a new Chief Executive to the Group to try to ensure continuity of management.

APPLYING THE PRINCIPLES OF GOOD GOVERNANCE

The Board of Directors, Chairman and Chief Executive

The Directors believe it is essential for the Group to be led and controlled by an effective Board that provides entrepreneurial leadership within a framework of sound controls. The Board is responsible for setting the Group's strategic aims, its values and standards and ensuring the necessary financial and human resources are in place to achieve its goals.

The Board consists of the Chairman, three Executive and five Non Executive Directors. The offices of Chairman and Chief Executive are held separately and the division of responsibilities between the Chairman and Chief Executive is shown below.

Main responsibilities of the Chairman include:

- chairing and managing the business of the Board;
- together with the Chief Executive, leading the Board in developing the strategy of the business and ensuring this is effectively implemented by the executive management team;
- ensuring that there is effective dialogue with investors concerning mutual understanding of objectives;
- in conjunction with the Nomination Committee, taking responsibility for the composition and replenishment of the Board;
- periodically reviewing with the Board its working practices and performance; and
- ensuring there is effective contribution from the Non Executive Directors and a constructive relationship between the Executive and Non Executive Directors.

Main responsibilities of the Chief Executive include:

- the development and implementation of management strategy;
- the day-to-day management of the Group;
- managing the executive management team; and
- fostering relationships with key stakeholders.

Barry Gibson is the Senior Independent Director. The Board considers all of the Non Executive Directors to be independent other than Jorge Cosmen, and considered David Ross to be independent prior to his appointment as Chairman. Mr Cosmen is not considered to be independent by the Board due to his close links with the Alsa business and significant interests in the shares of the Company which are held through European Express Enterprises Limited. The Non Executives bring a variety of different experiences and considerable knowledge to assist with Board decisions. Non Executive Directors do not participate in any of the Company's share option or bonus schemes and their service is non pensionable. Short biographies of the Directors are to be found on page 29.

The Board meets at least eight times during the year. In 2006 the Board visited businesses in Spain and North America. There is a formal schedule of matters reserved for the Board's decision, the main terms of which are shown on page 32 together with the attendance record of the Directors. During the year the Chairman met on several occasions with the Non Executives without the Executive Directors present to allow informal discussions on a variety of issues.

The Executive Directors are responsible for the day-to-day management of the Group's businesses, implementation of its strategy, policies and budgets and its financial performance. Executive management meetings, involving the Executive Directors and senior management from the divisions are held regularly to discuss current issues.

The Company purchases liability insurance to cover the directors and officers of the Company and its subsidiaries.

COMMITTEES OF THE BOARD

The Board has established a number of Committees with defined terms of reference and receives reports of their proceedings. The principal Committees are the Remuneration Committee, the Nomination Committee, the Audit Committee and the Safety and Environment Committee. The members of each Committee, attendance and main duties are shown on pages 32 to 33. In addition there is an Executive Committee with authority to approve routine matters of business and a Tax and Treasury Committee which reviews the Group's tax planning, banking facilities and treasury reports.

APPOINTMENTS TO THE BOARD

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Committee will prepare a description of the role and requirements for any particular appointment based on its evaluation of the Board as a whole.

The terms and conditions of appointment of the Non Executive Directors are available for inspection at the Company's registered office during normal business hours and at the Annual General Meeting of the Company. The Non Executive Directors disclose to the Board their other significant commitments. External advisers are normally appointed when recruiting Board members; they use as a basis for their search a description of the role and capabilities required for a particular appointment proposed by the Nomination Committee.

THE WORK OF THE NOMINATION COMMITTEE

The members of the Nomination Committee are David Ross (Chairman), Sir Andrew Foster, Sue Lyons and Jorge Cosmen.

Before making a recommendation for an appointment to the Board the Nomination Committee:

- prepares a job specification and a description of the capabilities required for a particular post;
- considers the current composition of the Board and mix of skills and experience; and
- where appropriate, and in particular where a vacancy for a Non Executive Director arises, will use an external search consultancy and/or open advertising.

During the year the Committee:

- considered the appointment of a new Chief Executive in view of the forthcoming retirement of Phil White;
- appointed search consultants for the Chief Executive's position;
- interviewed candidates for this position following which Richard Bowker was appointed as the new Chief Executive in September 2006.

INFORMATION AND PROFESSIONAL DEVELOPMENT

Reports from the Executive Directors, which include in-depth financial information, are circulated to Board members prior to every Board meeting. Senior management and advisers give presentations to the Board on significant matters during the year.

Under the direction of the Chairman, the Company Secretary is responsible for ensuring Board procedures are followed and applicable rules and regulations are complied with and advises the Board on governance matters. All Directors have access to the advice and services of the Company Secretary and the appointment or removal of the Company Secretary is a matter for the Board as a whole. There is a procedure in place for any Director to take independent professional advice where considered necessary.

On appointment, Directors are offered an appropriate training course and are thereafter encouraged to keep abreast of matters affecting their duties as a Director and to attend training courses relevant to their role. An induction process is in place for new Directors the aims of which are to:

- build an understanding of the nature of the Company, its business and the markets in which it operates;
- establish a link with the Group's employees;
- build an understanding of the Group's main relationships including stakeholders and customers.

PERFORMANCE EVALUATION

During the year the annual performance evaluation, led by the Senior Independent Director, was undertaken by an external third party. The evaluation covered in scope the Board's performance, its Committees and the Chairman. The evaluation process involved a detailed questionnaire with input from all of the Directors followed by individual interviews. Feedback was given to individual Directors and to the Board as a whole and action plans were developed as appropriate. These will be reviewed as part of the 2007 evaluation.

RE-ELECTION

In accordance with the Company's Articles of Association all Directors submit themselves for election at the Annual General Meeting following their appointment and thereafter by rotation at least once every three years. Non Executive Directors are appointed for specific terms, subject to re-election. Non Executive Directors will only be put forward for re-election if, following performance evaluation, the Board believes the Director's performance continues to be effective and demonstrates commitment to the role.

REMUNERATION AND SERVICE CONTRACTS

The report on Directors' remuneration including details of remuneration policy and service contracts is set out on pages 38 to 44.

ACCOUNTABILITY AND AUDIT

Statements of the responsibilities of the Directors and Auditors are set out on pages 33 and 45 respectively.

Internal control

The Board's responsibilities

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The Board maintains full control and direction over appropriate strategic, financial, operational and compliance issues and has put in place an organisational structure with formally defined lines of responsibility, delegated authorities and clear operating processes. The systems that the Board has established are designed to safeguard both the shareholders' investment and the assets of the Group, and are described below.

Key elements of the control framework

Strategic and financial planning – an annual budgeting and strategic planning process has been established whereby each division and constituent operating company assesses its competitive position and goals, taking account of the strategic risks faced. This strategy is translated into a financial plan with clear milestones and performance indicators.

Performance management – the performance of each division and operating company against its plan is closely monitored by a formal monthly reporting process and by the attendance of the Executive Directors at monthly divisional board meetings.

Annual fitness check process – a self assessment review takes place at each operating company to assess the integrity of the balance sheet and to challenge the effective operation of key financial and information systems controls within each material accounting cycle. This process is led by divisional finance Directors and is closely monitored by group finance and validated by the internal audit function.

Capital investment – a clear process is in place for the approval of capital expenditure, which includes detailed appraisal of the benefits of the proposed investment and any associated key risks. Material capital expenditure requires Board approval.

Health and Safety – Health and safety standards and benchmarks have been established in all our businesses and the performance of operating companies in meeting these standards is closely monitored.

Risk management reporting process – each division and operating company evaluates its internal control environment and key risks, and the results are cascaded through management levels and the Audit Committee before being presented to the Board. This process is reviewed on a regular basis to ensure the validity and relevance of the key risks reported and presented to the Board on a quarterly basis, unless exceptional issues arise. The review covers strategic, financial, compliance and risk management controls. These procedures are mandated and designed to manage the risk in order to ensure that the operations achieve their business objectives.

Internal audit – the internal control system is independently monitored and supported by an outsourced internal audit function. The internal audit function reports to management and the Audit Committee on the Group's financial and operational controls, and reviews the extent to which its recommendations have been implemented.

Board-level reporting on internal control – during the year the Audit Committee has reviewed regular reports from the internal audit function, the external auditors, and executive management on matters relating to internal control, financial reporting and risk management. The Audit Committee provides the Board with an independent assessment of the Group's financial position, accounting affairs and control systems. In addition, the Board receives regular reports on how specific risks that are assessed as material to the Group are being managed.

Review of internal control effectiveness

The system of internal control and risk management, described above, has been in place for the year under review and up to the date of approval of this Annual Report and Accounts. Such a system is designed to manage, rather than to eliminate, the risks inherent in achieving the Group's business objectives, and can therefore provide only reasonable and not absolute assurance against material misstatement or loss. The effectiveness of this system has been regularly reviewed by the Directors in line with the Guidance for Directors in the Combined Code published by the Financial Reporting Council (Turnbull guidance).

Audit Committee and auditors

THE WORK OF THE AUDIT COMMITTEE

Members of the Committee are Tim Score (Chairman), Sir Andrew Foster and Barry Gibson. Attendance by the members is shown on page 32.

The Committee meets at least three times a year and met four times in 2006. The agenda reflects the duties delegated to it by its Terms of Reference details of which are summarised on page 32. There are a number of standing items considered during the year such as consideration of the internal and external audit reports, review of the annual report and accounts, review of the preliminary and interim announcements, and review of the Corporate Governance Report.

Other items that were considered and discussed during 2006 included a review of the 2006 internal and external audit plans, Alsa financial integration, annual fitness checks within the subsidiaries and the external auditors' performance and fees.

At the invitation of the Committee, and as appropriate to the matters under discussion, meetings may be attended by the Executive Directors and internal and external auditors. Full minutes are kept by the Secretary of the matters considered and decisions taken by the Committee. Outside of the meeting process the Committee Chairman has regular contact with the Executive Directors, other Committee members and the auditors on a variety of topics.

Review of external auditors

The Audit Committee assesses and reviews on a regular basis the independence of the external auditors. As part of their determination the Audit Committee considers a report by the external auditors on the firm's independence which is required in order to carry out their professional duties and responsibilities as auditors.

Policy on auditors providing non audit work
The Committee has an approved policy on the provision of non audit services. The policy sets the approvals policy for the following types of service:

- services that are considered to have 'general pre-approval' by the Audit Committee, by virtue of the approval of the policy;
- services that require 'specific pre-approval', on a case-by-case basis, before any work can commence; and
- services that cannot be supplied by the external auditors ('prohibited services').

The services that require specific pre-approval are tax, transaction, investigation and valuation, advisory and corporate finance services. The fees for these services are pre-approved up to a level of 25% of the total fees paid to the external auditors. For services exceeding this limit specific pre-approval is required.

In deciding whether or not to grant approval for the provision of specific services by the external auditors, the Audit Committee includes in its consideration the following factors:

i) whether the external auditing firm is best placed to provide an effective and efficient service, given its familiarity with the Company's processes, systems and people; and

ii) the level of non audit fees paid to the external auditors in the year as a proportion of the annual external audit.

The majority of non audit work undertaken by the external auditors during the year relates to two items. These were tax advisory and compliance services and financial due diligence work for North American acquisitions. These items the Committee believes would be impractical and costly to provide through another party.

WHISTLEBLOWING POLICY
A Group 'whistleblowing' policy has been issued to all group companies to ensure a consistent approach across the Group.

RELATIONS WITH SHAREHOLDERS
Dialogue with institutional shareholders
The Board maintains regular dialogue with its institutional shareholders and fund managers through a variety of meetings and presentations throughout the year. Presentations are given by the Executive Directors following the full year and half year results to institutional investors, analysts and brokers which the Non Executive Directors may attend. In addition, the Company's brokers provide confidential feedback to the Company on the views of the major institutions following the interim and final results. An informal review of the opinions of the Company's major investors was undertaken in 2006. In 2007 it is intended that a formal review is undertaken asking for feedback on financial performance and management.

During the year written responses are given to correspondence received from shareholders and all shareholders receive copies of the Annual Report and Accounts or the Annual Review and Summary Financial Statement and the Interim Report. The Company has introduced an electronic communications facility to enable shareholders to receive documentation such as the Annual Report and Accounts electronically and also to cast their votes by proxy electronically. The Company has also introduced an electronic proxy appointment service for CREST members.

The Company's website, www.nationalexpressgroup.com, houses wide-ranging information about the Group, including the final and interim announcements, Annual Report and Accounts, press releases, share price data and links to subsidiary company websites.

The Annual General Meeting
The Annual General Meeting provides an opportunity for all shareholders to question the Chairman and Directors on a variety of topics, and information is provided at the meeting on different aspects of the Group's activities. All of the Company's Directors are present at the meeting. Proxy votes, including the number of abstentions, are displayed on the resolutions following the result on a display of hands. Notice of the Annual General Meeting and related papers are sent to shareholders at least 20 working days before the meeting.

REPORT ON DIRECTORS' REMUNERATION

This report has been approved by the Board and the Remuneration Committee (the Committee). Shareholders will be invited to approve the report at the 2007 Annual General Meeting.

REMUNERATION COMMITTEE

Composition of the Committee

The members of the Committee during the year, all of whom were independent directors, were:

Barry Gibson *(Chairman)*
Sue Lyons
Tim Score

Role of the Committee

The key responsibilities of the Committee are to:

- determine the fees of the Chairman;
- determine the remuneration and conditions of employment (including any termination arrangements) of the Executive Directors;
- approve the remuneration and conditions of employment of the Divisional Chief Executives and Company Secretary;
- review the remuneration and conditions of employment of the senior management team; and
- select and appoint any remuneration consultants who advise the Committee.

The full terms of reference of the Committee are available on the Company's website at www.nationalexpressgroup.com.

Advisers to the Committee

The Committee has appointed independent remuneration consultants, New Bridge Street Consultants LLP (NBSC), to advise on all aspects of senior executive remuneration. NBSC has no other connection with the Group other than in the provision of advice on executive and employee remuneration. During the year Mercer Human Resource Consulting Limited (Mercer) provided advice on a new performance appraisal system. Mercer also provide advice and actuarial services to one of the Group's pension schemes.

The Chief Executive provides guidance to the Committee on remuneration packages for senior executives employed by the Group (but not in respect of his own remuneration).

The Committee's recommendations in 2006 were all accepted and implemented by the Board.

REMUNERATION OF NON EXECUTIVE DIRECTORS

The fees of the Non Executive Directors are set by the Board as a whole following an annual review. The review takes account of fees paid for similar positions in the market, the time commitment required from the Director (estimated to be 100 days per year for the Chairman and 20 days per year for the other Non Executive Directors) and any additional responsibilities undertaken, such as acting as Chairman to one of the Board committees or Senior Independent Director. Non Executive Directors are not eligible to receive pension entitlements or bonuses and may not participate in share option schemes. For 2006 the basic fee for acting as a Non Executive Director was £40,000 a year. An additional fee of £5,000 was paid for chairing one of the Board Committees. An extra fee of £5,000 is paid to the Senior Independent Director. The Chairman, David Ross, has elected to take all of his fees as National Express Group shares.

REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

Remuneration policy is based on the following broad principles set by the Committee:

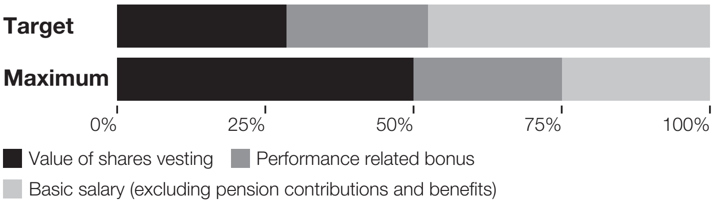
- to provide a competitive remuneration package to attract and retain quality individuals;
- to align remuneration to drive the overall objectives of the business;
- to align the interests of management with the interests of shareholders; and
- to provide the foundation for overall reward and remuneration beyond the specific roles governed by the Remuneration Committee.

The objective of this policy is aligned with the recommendation of the Combined Code on Directors' remuneration. That is to provide a level of remuneration 'to attract, retain and motivate Directors of the quality required to run the Company successfully, but avoid paying more than is necessary for this purpose. A significant proportion of Executive Directors' remuneration should be structured so as to link rewards to corporate and individual performance.'

In implementing its policy, the Committee gives full consideration to the principles set out in the Combined Code on Corporate Governance with regard to Directors' remuneration.

Remuneration policy is reviewed on an ongoing basis against the Committee's broad principles and in light of emerging best practice in corporate governance. During the year consideration was given to a new performance appraisal system. As a result of the review a new appraisal system was introduced for the Executive Directors. This has also been cascaded down to senior management throughout the Group.

Performance Related Versus Fixed Remuneration (%)



Fixed versus variable remuneration
A substantial proportion of the Executive Directors' pay is performance related. The table opposite shows the balance between fixed and performance related pay at target and maximum performance levels. Maximum performance assumes achievement of maximum bonus and full vesting of shares under the LTIP.

ELEMENTS OF REMUNERATION

Summary of the components of the Executive Directors' remuneration.

	Objective	Performance period	Policy
Basic salary	To position at a competitive level for similar roles within comparable markets	Annually	Individual pay levels (using comparable mid-market data for guidance) are determined by reference to the individual's performance, experience in post and potential.
Performance related bonus	To incentivise delivery of performance objectives	1 year	Bonus payments are based on the achievement of specified corporate objectives.
Pension	To provide competitive benefits in line with market practice and to act as a retention mechanism and reward long service	Ongoing	The policy is to provide market competitive retirement benefits. Only basic salary is pensionable.
Long Term Incentive Plan	To drive performance, aid retention and align the interests of Executive Directors with shareholders	3 years	Half of any award is subject to EPS growth. The remaining half is subject to the relative total shareholder return (TSR) of the Company compared against a bespoke peer group.
Other benefits	To provide competitive benefits in line with market practice	Ongoing	Executive Directors receive a fully expensed car, private health and long term sickness insurance. A cash alternative may be provided according to individual circumstances.

(i) Basic salary
The salary of individual Executive Directors is reviewed at 1 January each year. Account is taken of the performance of the individual concerned, together with any change in responsibilities that may have occurred and the rates for similar roles in a comparator group of companies. The comparator group for the 2006 financial year was made up of two groups of companies. These were a group of transport sector companies with a median market capitalisation of £1,280m and a group of companies from the FTSE Mid 250 drawn from all sectors with a median market capitalisation of £1,389m which reflects that of National Express following its merger with Alsa. For 2007 the comparator groups will be based on similar groups of transport/leisure and general sector companies drawn from the FTSE 250.

(ii) Performance-related bonus
The maximum potential bonus payable to Executive Directors was 100% of salary for 2006. 70% of the bonus payable was based on financial targets and 30% based on non-financial targets. The non-financial targets encompass customer, operational excellence and people objectives. No bonus is payable unless the Group's normalised profit budget is achieved. Normalised profit is profit before tax, goodwill impairment, intangible amortisation and exceptional items. Directors receive 50% of that part of the bonus referable to financial targets upon achieving budget and 100% of that part upon achieving a stretch target which, for 2006, was 107% of budget. The stretch financial targets for 2006 have been met in full. The balance of the 2006 bonus payable to individual Directors was, therefore, dependent on individual performance against the Director's personal objectives. For 2007 bonus payments will be based on a similar structure.

(iii) Pensions
Under the terms of their service agreements, Executive Directors are entitled to become members of one of the Group pension schemes or, if preferred, to receive payment of a fixed percentage of salary.

Adam Walker is a member of the National Express Group Staff Pension Plan ("the Plan") which is an HM Revenue & Customs (HMRC) approved defined benefit scheme. The benefits from this Plan are subject to HMRC limits. Spouses' pensions are provided in accordance with the terms of the Plan. Ray O'Toole was a member of this Plan until 7 April 2006 and he now receives a salary supplement of 44% in lieu of pension contributions. Richard Bowker is not a member of a company pension scheme and receives a 25% salary supplement in lieu of pension contributions.

Life assurance of four times' basic annual salary is provided for the Executive Directors.

(iv) Incentive scheme and share options

(a) Long term incentive arrangements

The National Express Group Long Term Incentive Plan (LTIP) was approved by shareholders at the 2005 Annual General Meeting and operates as the Company's sole type of executive long term incentive arrangement. The LTIP consists of annual awards of performance and matching shares. Details of the plan are provided below.

Performance shares
Executive Directors are eligible to receive a conditional award of shares up to an equivalent of 1x their annual basic salary. The vesting of the award is conditional on meeting the performance conditions set out below.

Matching shares
Executive Directors are also eligible to receive awards of matching shares that are based on a personal investment in National Express Group shares funded either through a personal investment (for example using an annual bonus award) or through pledging of shares already held but not already allocated to the LTIP. The maximum investment/pledge is 30% of gross salary per annum. Matching awards are based on the ratio of 100 shares for every 30 shares purchased. This is a two for one ratio on a grossed up for income tax basis. Matching share awards are also conditional on the performance conditions set out below.

If a participant ceases employment before vesting for a 'compassionate' reason (e.g. redundancy, retirement, death in service, sale of business out of the Company's group) his awards will ordinarily vest. The extent of vesting will be determined by the pro rata application of the performance conditions up to the date of cessation unless the Committee determines that it would be inappropriate to apply a pro rata reduction. Awards lapse on cessation of employment for any other reason.

Performance conditions
There are two distinct performance conditions applying to awards made. First, the performance condition attached to one-half of an award (Part 'A') is based on the Company's normalised diluted earnings per share ('EPS') growth performance in excess of inflation over a fixed three year period (three financial years commencing with the financial year in which the award is made). The performance condition attached to the other half of an award (Part 'B') is based on the Company's TSR performance over the same fixed three year period relative to the TSR of a comparator group of over 20 transport companies taken predominantly from the FTSE Industrial Transportation and FTSE Travel & Leisure sectors. The companies comprising the comparator group have been chosen on the basis of their comparability to National Express Group (based on their size and scope of business operations). There is no ability to retest either performance condition.

For awards made in 2005 and 2006 Parts A and B will vest in accordance with the tables below:

Average growth in the Company's normalised diluted EPS* in excess of inflation ('CPI'**)	Percentage of Part A that vests
Less than 3%	0%
3%	30%
6%	100%
Between 3% and 6%	30%–100% pro rata

*Normalised diluted earnings per share are before tax, goodwill impairment, intangible amortisation and exceptional items.
**CPI is a weighted measure of inflation calculated to reflect the scope of the Group's international operations and is currently based two-thirds on UK CPI and one-third on US CPI.

Rank of the Company's Total Shareholder Return against a comparator group	Percentage of Part B that vests
Below median	0%
Median	30%
20th percentile	100%
Between median and 20th percentile	30% and 100% – pro rata

EPS and TSR were chosen for the LTIP as the most appropriate measures of National Express's long term performance since EPS remains an important growth measure and driver and TSR improves shareholder alignment and is consistent with Company objectives of providing long term returns to shareholders.

(b) Savings Related Share Option Scheme (Sharesave Scheme)

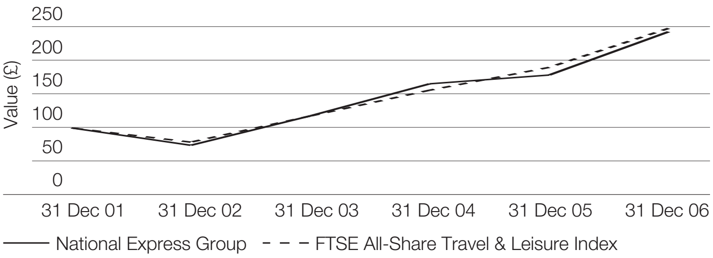
The Company operates an HMRC Revenue approved Sharesave Scheme which is open to all UK employees, including the Executive Directors, who have completed at least six months' service at the date of grant. The options are exercisable after three years at a discount of 10% of the market value of the shares at the time of grant.

Performance criteria
The Committee believes that budgeted profit and/or EPS growth as performance measures for the discretionary bonus scheme and long term incentives provide a transparent and accessible method of gauging the performance of the Company. The Company calculates performance against these performance measures by reference to the profit or earnings per share figures appearing in the Company's audited accounts, which the Company believes to be the most transparent and objective measure of the Company's profit or EPS. The Committee also monitors the Group's TSR against both the FTSE All Share Travel & Leisure Index as a measure against its peer group and the FTSE 250 Index, representing a broad equity market index of which the Company is a constituent member. TSR has been used by the Company as a second performance measure for awards made to Executive Directors under the LTIP as outlined above.

The following graphs show a comparison of National Express Group PLC total cumulative shareholder return against that achieved by the FTSE All Share Travel & Leisure Index and the FTSE 250 Index. These graphs have been selected because the Company is a constituent of each index and the Committee, therefore, feels that these are the most appropriate indices to represent the Company's relative performance.

Total shareholder return versus FTSE All-Share Travel & Leisure Index

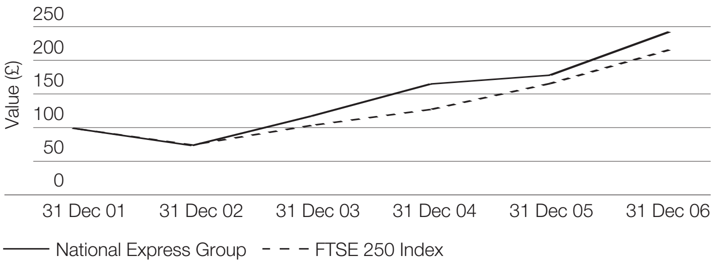
Source: Thomson Financial



Graph 1 looks at the value, by the end of 2006, of £100 invested in National Express Group on 31 December 2001 compared with £100 invested in the FTSE All-Share Travel & Leisure Index. The other points plotted are the values at intervening financial year-ends.

Total shareholder return versus FTSE 250 Index

Source: Thomson Financial



Graph 2 looks at the value, by the end of 2006, of £100 invested in National Express Group on 31 December 2001 compared with the value of £100 invested in the FTSE 250 Index. The other points plotted are the values at intervening financial year-ends.

DIRECTORS' SERVICE CONTRACTS, NOTICE PERIODS AND TERMINATION PAYMENTS

Executive Directors
The contract dates and notice periods for the Executive Directors are as follows:

Director	Contract date	Notice period from the Company	Notice period from the Director
Richard Bowker	22 May 2006	12 months	12 months
Ray O'Toole	11 September 2003	To 1 September 2006 – 12 months From 1 September 2006 – 24 months reducing on a daily basis to 12 months by 1 September 2007	6 months
Adam Walker	11 September 2003	12 months	6 months
Former Director Phil White	21 May 2003	12 months	6 months

It is the Committee's general policy for the notice periods of Executive Directors to be no longer than 12 months. However, the Committee approved a notice period of 24 months for Ray O'Toole on the appointment of a new Chief Executive to try to ensure continuity of management during this time of change. The notice period reduces on a daily basis between 1 September 2006 and 31 August 2007 such that on 1 September 2007 the notice period will be 12 months.

The service contracts of Richard Bowker and Adam Walker contain a provision, exercisable at the option of the Company, to pay an amount on early termination of employment equal to one year's salary. In the case of Ray O'Toole the early termination payment will fall from two years as at 1 September 2006 to one year's salary by 1 September 2007. The Company will use the payment in lieu of notice provisions when the speed, certainty and protection of restrictive covenants afforded by such clauses are thought to be in the best interests of the Company and the circumstances surrounding the departure of the relevant Director justify their use. The service contracts of Ray O'Toole and Adam Walker have a further provision that, where the Company initiates a termination, other than for cause, within six months of a change of control taking place the Company will exercise its option to make a payment in lieu of notice of an amount equal to the salary and benefits that the Director would have received during the notice period. In any event the Committee's policy is that payments to Directors on termination should reflect the circumstances that prevail at the time, also taking account of the Director's duty to mitigate if appropriate.

Under the terms of their service agreements, Board approval is required before any external appointment may be accepted by an Executive Director.

Non Executive Directors
The Non Executive Directors do not have service contracts with the Company but are appointed for fixed three-year terms. All Directors are required to stand at least once every three years for re-appointment by shareholders. The appointment dates of the Non Executive Directors are:

Jorge Cosmen –1 December 2005
Sir Andrew Foster – 1 August 2004
Barry Gibson – 17 November 1999
Sue Lyons – 23 May 2001
David Ross – 1 February 2001
Tim Score – 21 February 2005

Senior executive remuneration

The Remuneration Committee reviews and notes the salaries of senior executives within the Group. The salaries of this group of employees by band are as follows:

Salary band £000	Number of executives 2006
>200–270	3
>150–200	6
>100–150	25
70–100	59

INFORMATION SUBJECT TO AUDIT: DIRECTORS' REMUNERATION

Directors' emoluments

	Salary/fees £000	Performance related bonus £000	Benefits[1] £000	Benefits in lieu of pension £000	**Total 2006[2] £000**	Total 2005[2] £000
Executive Directors						
Richard Bowker (appointed 12 September 2006)	154	154	13	38	**359**	–
Ray O'Toole	360	360	25	119	**864**	528
Adam Walker	320	320	23	–	**663**	489
Non Executive Directors						
David Ross (Chairman)	160[3]	–	–	–	**160**	150
Jorge Cosmen	40	–	–	–	**40**	3
Sir Andrew Foster	40	–	–	–	**40**	35
Barry Gibson	50	–	–	–	**50**	41
Sue Lyons	45	–	–	–	**45**	40
Tim Score	45	–	–	–	**45**	34
Former Executive Director						
Phil White (resigned 11 September 2006)	349	349[4]	30	51	**778**	1,010

1 Benefits in kind include a company car, fuel and health insurance.
2 Total remuneration excludes Company pension contributions which are shown below.
3 David Ross has elected to take his Chairman's fees as National Express Group shares.
4 This represents Phil White's total 2006 bonus of £500,000 pro rated for his period as a Director.

FORMER DIRECTOR

Phil White stepped down as Chief Executive of the Company on 11 September 2006. He will remain in full time employment with the Group until 31 March 2007. He will continue to receive his usual salary and benefits in accordance with the terms of his contract until this date. On 31 March 2007 Phil White will receive, in accordance with his contractual entitlements, the title to his car (value £74,000) and any accrued but unused holiday entitlement. From 1 April 2007 to 30 September 2007 Phil White will act as a consultant for the Group for which he will receive a monthly fee of £25,000. During this period he will, in particular, be assisting the Company in connection with a piece of ongoing litigation in New South Wales, Australia. On retirement Phil White is entitled to exercise share options granted to him under the 2002 Executive Share Option Plan subject to the fulfilment of the applicable performance conditions. In addition unvested awards held by Phil White under the Long Term Incentive Plan (the Plan) shall vest subject to the fulfilment of the applicable performance conditions in accordance with the rules of the Plan.

PENSIONS

Pension benefits earned by Directors in the year to 31 December 2006 from both the approved and unapproved plans were:

	Age	NRA+	Accrued benefit at 1 Jan 2006 £000	Increase in period (net of indexation) £000	Transfer value of increase in period £000	**Accrued benefit at 31 Dec 2006 £000**	Transfer value at 1 Jan 2006 £000	**Transfer value at 31 Dec 2006 £000**	Movement in transfer value during period less Director's contributions £000	Employer contribution to defined contribution plan £000
Ray O'Toole*	51	60	28.5	4.5	61.6	**33.8**	351.8	**461.5**	105.6	–
Adam Walker	39	60	24.8	8.2	65.3	**33.7**	179.3	**266.8**	69.3	–
Former Executive Director Phil White (resigned 11 September 2006)	57	62	–	–	–	**–**	–	**–**	–	123.4**

+Normal Retirement Age.
*Ray O'Toole ceased to accrue pension benefits on 7 April 2006.
**Employer contribution shown is for the period 1 January 2006 to 11 September 2006 when Phil White resigned as a Director.

DIRECTORS' SHAREHOLDINGS

Directors' interests and transactions

(This table is not subject to audit)

The beneficial and non beneficial interests of the Directors in office as at 31 December 2006 are shown below:

	At 31 December 2006*	At 1 January 2006 or on appointment if later	Change from 31 December 2006 to 26 February 2007
Executive Directors			
Richard Bowker	**2,554**	–	–
Ray O'Toole	**24,364**	19,236	–
Adam Walker	**19,400**	9,700	–
Non Executive Directors			
Jorge Cosmen	**23,017,253**	18,506,130	–
Sir Andrew Foster	**–**	–	–
Barry Gibson	**3,000**	3,000	–
Sue Lyons	**2,072**	2,072	–
David Ross	**2,000,000**	634,926	2,001,555
Tim Score	**–**	–	–
Former Executive Director			
Phil White (resigned 11 September 2006)	**165,408**	165,408	

*For Phil White as at date of resignation.

In order to align the interests of the Directors more closely with the shareholders, the Remuneration Committee has also determined that the Executive Directors should build up a share fund equal to at least one year's salary over a period of five years.

Share Option Awards

	Note	At 1 Jan 2006	During year Granted	During year Exercised	During year Lapsed	**At 31 Dec 2006****	Option price	Market price at date of exercise	Date from which exercisable	Expiry date
Ray O'Toole										
	(i ,iv)	5,128	–	5,128	–	**–**	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	40,171	–	39,740		**431***	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	113,065		113,065	–	**–**	398.0p	915.0p	18.03.06	18.03.13
	(ii, v)	92,511	–	–	–	**92,511**	681.0p	–	12.05.07	12.05.14
Adam Walker										
	(i, iv)	5,128	–	5,128	–	**–**	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	14,530	–	14,343	–	**187***	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	75,377	–	75,377	–	**–**	398.0p	915.0p	18.03.06	18.03.13
	(ii, v)	76,358	–	–	–	**76,358**	681.0p	–	12.05.07	12.05.14
	(iii)	453	–	453	–	**–**	417.0p	956.0p	01.12.05	01.06.06
Former Executive Director										
Phil White (resigned 11 Sept 2006)										
	(i, iv)	5,128	–	5,128	–	**–**	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	63,248	–	62,598	–	**650***	585.0p	915.0p	05.07.05	05.07.12
	(ii, iv)	169,598	–	169,598	–	**–**	398.0p	915.0p	18.03.06	18.03.13
	(ii, v)	132,159	–	–	–	**132,159**	681.0p	–	12.05.07	12.05.14

*Performance hurdle not yet passed as at 31 December 2006.
**For Phil White as at date of resignation.

Notes

(i) Options granted under the 2002 National Express Group Executive Share Option Plan Part 1 Approved.
(ii) Options granted under the 2002 National Express Group Executive Share Option Plan Part 2 Unapproved.
(iii) Options granted under the National Express Group Savings Related Share Option Scheme.
(iv) The performance condition is as follows: (a) for awards up to 50% of salary; EPS growth of RPI +4% p.a., (b) for awards between 51% of salary and up to 100% of salary; EPS growth of RPI +6% p.a., (c) for awards between 101% of salary and up to 150% of salary; EPS growth of RPI +8% p.a., (d) for awards between 151% of salary and up to 200% of salary; EPS growth of RPI +10% p.a. Parts (a) and (b) are initially tested over years 0–3 with a facility to retest over years 0–4 and 0–5. Parts (c) and (d) are not subject to retesting. Straightline vesting occurs between EPS levels.
(v) The performance condition is as follows: (a) for awards up to 50% of salary; EPS growth of RPI +4% p.a., (b) for awards between 51% of salary and up to 100% of salary; EPS growth of RPI +5% p.a., (c) for awards between 101% of salary and up to 150% of salary; EPS growth of RPI +6% p.a., (d) for awards between 151% of salary and up to 200% of salary; EPS growth of RPI +10% p.a. Performance is tested over years 0-3. Straightline vesting occurs between EPS levels. Retesting is not permitted.

*

LONG TERM INCENTIVE PLAN (LTIP) AWARDS

Performance shares of 1 x salary are awarded to Executive Directors as nil cost options under the Long Term Incentive Plan (LTIP). In addition 100 matching shares are awarded for every 30 investment shares pledged or invested by the Director under the share matching element of the LTIP. Further details of the LTIP and the applicable performance conditions are shown on page 40.

	LTIP Share Awards	At 1 Jan 2006*	During year Awarded	During year Exercised	During year Lapsed	**At 31 Dec 2006****	Market price on date of award	Market price on date of exercise	Date from which exercisable	Expiry date
Richard Bowker										
	Performance shares	–	48,590	–	–	**48,590**	1032.5p	–	09.11.09	09.05.10
	Matching shares	–	8,513	–	–	**8,513**	1032.5p	–	09.11.09	09.05.10
Ray O'Toole										
	Performance shares	35,287	–	–	–	**35,287**	921.0p	–	27.06.08	27.12.08
	Matching shares	56,613		–	–	**56,613**	921.0p	–	27.06.08	27.12.08
	Performance shares	–	38,814	–	–	**38,814**	931.0p	–	06.04.09	06.10.09
	Matching shares	–	24,600	–	–	**24,600**	931.0p	–	06.04.09	06.10.09
Adam Walker										
	Performance shares	32,573	–	–	–	**32,573**	921.0p	–	27.06.08	27.12.08
	Matching shares	32,333	–	–	–	**32,333**	921.0p	–	27.06.08	27.12.08
	Performance shares	–	34,501	–	–	**34,501**	931.0p	–	06.04.09	06.10.09
	Matching shares	–	32,333	–	–	**32,333**	931.0p	–	06.04.09	06.10.09
Former Executive Director										
Phil White (resigned 11 Sept 2006)										
	Performance shares	48,859	–	–	–	**48,859**	921.0p	–	27.06.08	27.12.08
	Matching shares	116,580	–	–	–	**116,580**	921.0p	–	27.06.08	27.12.08
	Performance shares	–	53,908	–	–	**53,908**	931.0p	–	06.04.09	06.10.09
	Matching shares	–	51,666	–	–	**51,666**	931.0p	–	06.04.09	06.10.09

*Or date of appointment if later.
**Or date of resignation.

Note: for the purposes of the EPS performance conditions, CPI has been calculated to have increased by 3% during the year ended 31December 2006.

In addition to their individual interests in shares the Executive Directors were, for Companies Act purposes, regarded as interested in the 319,574 shares held at 26 February 2007 by the National Express Group Employee Benefit Trust in respect of the Long Term Incentive Plan.

The Register of Directors' Interests maintained by the Company contains full details of the Directors' holdings of shares and options over shares in the Company. The aggregate gain between the option price and market price on date of exercise of share options by the Directors during the year was £2,286,881.

The mid-market price of the Company's ordinary shares at 31 December 2006 was 1130p (2005: 866.25p) and the range during the year ended 31 December 2006 was 742.75p to 1130p.

By Order of the Board

J M B Gibson
Director and Chairman of the Remuneration Committee
1 March 2007

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NATIONAL EXPRESS GROUP PLC

We have audited the Group financial statements of National Express Group PLC for the year ended 31 December 2006 which comprise the Group Income Statement, the Group Balance Sheet, the Group Statement of Cash Flows, the Group Statement of Recognised Income and Expense and the related notes 1 to 38. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of National Express Group PLC for the year ended 31 December 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS
The Directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Statement, the Operating and Financial Review, the Corporate Governance Statement, the Statement of Directors' Responsibilities, the unaudited part of the Report on Directors' Remuneration and the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

OPINION
In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group financial statements.

Ernst & Young LLP
Registered auditor
London
1 March 2007

GROUP INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Total before goodwill impairment, intangible amortisation and exceptional items 2006 £m	Goodwill impairment, intangible amortisation and exceptional items 2006 £m	Total 2006 £m	Total before goodwill impairment, intangible amortisation and exceptional items 2005 £m	Goodwill impairment, intangible amortisation and exceptional items 2005 £m	Total 2005 £m
Continuing operations							
Revenue	4	**2,525.5**	**–**	**2,525.5**	2,216.0	–	2,216.0
Operating costs before goodwill impairment, intangible amortisation and exceptional items		**(2,340.7)**	**–**	**(2,340.7)**	(2,060.5)	–	(2,060.5)
Goodwill impairment	5	**–**	**(20.2)**	**(20.2)**	–	(33.3)	(33.3)
Intangible amortisation	5	**–**	**(27.8)**	**(27.8)**	–	(4.9)	(4.9)
Exceptional items	5	**–**	**4.8**	**4.8**	–	(7.8)	(7.8)
Total operating costs		**(2,340.7)**	**(43.2)**	**(2,383.9)**	(2,060.5)	(46.0)	(2,106.5)
Group operating profit		**184.8**	**(43.2)**	**141.6**	155.5	(46.0)	109.5
Profit on disposal of non-current assets	5	**–**	**16.9**	**16.9**	–	–	–
Profit from operations		**184.8**	**(26.3)**	**158.5**	155.5	(46.0)	109.5
Share of post tax results from associates and joint ventures accounted for using the equity method	18	**(3.8)**	**(25.7)**	**(29.5)**	(8.8)	–	(8.8)
Finance income	9	**12.4**	**–**	**12.4**	10.8	–	10.8
Finance costs	9	**(37.3)**	**–**	**(37.3)**	(22.2)	–	(22.2)
Profit before tax		**156.1**	**(52.0)**	**104.1**	135.3	(46.0)	89.3
Tax expense	10	**(39.2)**	**15.6**	**(23.6)**	(29.5)	2.0	(27.5)
Profit after tax for the year from continuing operations		**116.9**	**(36.4)**	**80.5**	105.8	(44.0)	61.8
(Loss)/profit for the year from discontinued operations	11	**–**	**(3.2)**	**(3.2)**	3.8	(68.3)	(64.5)
Profit/(loss) for the year		**116.9**	**(39.6)**	**77.3**	109.6	(112.3)	(2.7)
Profit/(loss) attributable to equity shareholders		**116.1**	**(39.6)**	**76.5**	109.5	(112.3)	(2.8)
Profit attributable to minority interests		**0.8**	**–**	**0.8**	0.1	–	0.1
		116.9	**(39.6)**	**77.3**	109.6	(112.3)	(2.7)
Earnings/(loss) per share:							
– basic earnings/(loss) per share	13			**50.7p**			(2.0p)
– diluted earnings/(loss) per share	13			**50.4p**			(2.0p)
Normalised earnings per share:							
– basic earnings per share	13	**77.0p**			77.4p		
– diluted earnings per share	13	**76.5p**			76.3p		
Earnings per share from continuing operations:							
– basic earnings per share	13			**52.8p**			45.2p
– diluted earnings per share	13			**52.5p**			44.5p
Dividends per ordinary share:							
– interim				**10.75p**			10.00p
– final				**24.00p**			22.25p
				34.75p			32.25p

Dividends of £50.1m were paid during the year (2005: £41.6m). Dividends of £52.5m were proposed for approval during the year (2005: £47.0m).

GROUP BALANCE SHEET

AT 31 DECEMBER 2006

	Note	2006 £m	2005* £m
Assets			
Non-current assets			
Intangible assets	14	**697.6**	766.3
Property, plant and equipment	15	**501.9**	514.4
Financial assets – Available for sale	17	**13.5**	11.4
– Derivative financial instruments	17	**0.3**	0.6
Investments accounted for using the equity method	18	**8.7**	4.8
Other receivables	20	**4.1**	26.2
Deferred tax asset	27	**10.6**	23.0
		1,236.7	1,346.7
Current assets			
Inventories	21	**15.5**	18.7
Trade and other receivables	22	**272.3**	301.8
Financial assets – Derivative financial instruments	17	**8.1**	6.7
Current tax assets		**26.4**	11.3
Cash and cash equivalents	23	**143.6**	145.5
		465.9	484.0
Disposal group assets classified as held for sale	11	**20.1**	–
Total assets		**1,722.7**	1,830.7
Non-current liabilities			
Financial liabilities – Borrowings	28	**(538.4)**	(495.5)
– Derivative financial instruments	28	**(8.3)**	(8.3)
Deferred tax liability	27	**(84.3)**	(81.9)
Other non-current liabilities	25	**(3.0)**	(6.1)
Defined benefit pension liability	35	**(52.8)**	(88.8)
Provisions	26	**(61.3)**	(41.3)
		(748.1)	(721.9)
Current liabilities			
Trade and other payables	24	**(518.4)**	(532.4)
Financial liabilities – Borrowings	28	**(43.6)**	(214.4)
– Derivative financial instruments	28	**(6.4)**	(13.4)
Current tax liabilities		**(40.9)**	(24.0)
Provisions	26	**(17.4)**	(12.3)
		(626.7)	(796.5)
Liabilities directly associated with disposal group assets classified as held for sale	11	**(2.4)**	–
Total liabilities		**(1,377.2)**	(1,518.4)
Net assets		**345.5**	312.3
Shareholders' equity			
Called up share capital	32	**7.7**	7.5
Share premium account	33	**189.8**	174.2
Capital redemption reserve	33	**0.2**	0.2
Own shares	33	**(16.7)**	(5.1)
Other reserves	34	**7.9**	24.5
Retained earnings	33	**153.3**	108.1
Total shareholders' equity		**342.2**	309.4
Minority interest in equity		**3.3**	2.9
Total equity		**345.5**	312.3

*Adjusted for Alsa fair value movements as required by IFRS 3.

S R Bowker CBE Chief Executive
A C Walker Finance Director
1 March 2007

GROUP STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £m	2005 £m
Cash generated from operations	38	**254.5**	181.1
Tax paid		**(9.0)**	(26.7)
Net cash from operating activities		**245.5**	154.4
Cash flows from investing activities			
Payments to acquire businesses, net of cash acquired		**(19.8)**	(218.8)
Deferred consideration for businesses acquired		**(3.0)**	(0.3)
Purchase of property, plant and equipment		**(73.5)**	(61.7)
Proceeds from disposal of property, plant and equipment		**24.3**	8.1
Payments to acquire investments		**(4.6)**	–
Payments to acquire associates		**(1.5)**	–
Receipts from disposal of investments		**13.2**	–
Receipts from disposal of businesses, net of cash disposed		**–**	71.3
Receipts from disposal of intangible assets		**1.5**	–
Interest received		**12.4**	10.8
Receipts from sale of shares for employee schemes		**–**	3.5
Net cash used in investing activities		**(51.0)**	(187.1)
Cash flows from financing activities			
Proceeds from issue of ordinary shares		**15.8**	4.9
Purchase of treasury shares		**(11.6)**	(3.5)
Share buy back		**–**	(25.8)
Interest paid		**(32.1)**	(32.6)
Finance lease principal payments		**(21.5)**	(20.0)
Repayment of loan notes		**–**	(6.7)
Net loans (repaid)/advanced		**(89.9)**	148.1
Loans receivable repaid		**1.0**	–
Dividends paid		**(49.7)**	(41.6)
Net cash (used in)/from financing activities		**(188.0)**	22.8
Increase/(decrease) in cash and cash equivalents		**6.5**	(9.9)
Opening cash and cash equivalents		**140.0**	147.2
Increase/(decrease) in cash and cash equivalents		**6.5**	(9.9)
Foreign exchange		**(2.9)**	2.7
Closing cash and cash equivalents	23	**143.6**	140.0

GROUP STATEMENT OF RECOGNISED INCOME AND EXPENSE

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £m	2005 £m
Income and expense recognised directly in equity			
Exchange differences on retranslation of foreign operations		**(55.3)**	50.3
Exchange differences on retranslation of foreign currency borrowings		**46.8**	(45.5)
Actuarial gains/(losses) on defined benefit pension plans	35	**20.6**	(32.0)
(Loss)/gain on cash flow hedges taken to equity		**(12.1)**	14.5
		–	(12.7)
Transfers to the income statement			
Exchange differences on disposal of foreign operations		**–**	1.5
On cash flow hedges		**1.6**	(9.4)
		1.6	(7.9)
Tax on exchange differences on retranslation of foreign operations		**(1.3)**	7.1
Tax on share-based payments		**2.4**	1.4
Deferred tax on actuarial (gains)/losses		**(6.2)**	9.0
Deferred tax on cash flow hedges		**3.7**	(1.4)
Tax on items taken directly to or transferred from equity		**(1.4)**	16.1
Net losses recognised directly in equity		**0.2**	(4.5)
Profit/(loss) for the financial year		**76.5**	(2.8)
Profit attributable to minority interests		**0.8**	0.1
Total recognised income/(expense) for the year		**77.5**	(7.2)
Income/(expense) attributable to equity shareholders		**76.7**	(7.3)
Income attributable to minority interests		**0.8**	0.1
		77.5	(7.2)
Effects of changes in accounting policy:			
Equity shareholders:			
Net loss on hedges on first-time adoption of IAS 39		–	(18.4)
Tax recognised on hedges on first-time adoption of IAS 39		–	5.6
		–	(12.8)

NOTES TO THE CONSOLIDATED ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2006

1 CORPORATE INFORMATION

The consolidated accounts of National Express Group PLC for the year ended 31 December 2006 were authorised for issue in accordance with a resolution of the Directors on 1 March 2007 and the balance sheets were signed on the Board's behalf by S R Bowker and A C Walker. National Express Group PLC is a limited company incorporated in England and Wales whose shares are publicly traded on the London Stock Exchange.

The principal activities of the Group are described in the Operating and Financial Review ("OFR") that accompanies these accounts.

2 ACCOUNTING POLICIES

Statement of compliance

These accounts have been prepared in accordance with International Financial Reporting Standards ("IFRS") and the International Financial Reporting Interpretations Committee's ("IFRIC") interpretations as adopted by the European Union ("EU"), and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The Group is required to comply with international accounting requirements under IAS 1 'Presentation of Financial Information' except in extremely rare circumstances where management concludes that compliance would be so misleading that it would conflict with the objective to 'present fairly' its accounts. On this basis, the Group has departed from the requirements of IAS 19 'Employee Benefits' and has accounted for its constructive but not legal obligations for the Railways Pension Scheme ("RPS") under the terms of its UK rail franchise agreements. Details of the background and rationale for this departure are provided in note 35, including the impact on the Group's reported financial performance and position of adopting this accounting treatment as required by IAS 1.

Basis of preparation

The financial statements have been prepared under the historical cost convention, except for the recognition of derivative financial instruments and available for sale investments detailed below.

As noted above, the Group has taken the extremely rare decision to depart from the requirement of IAS 19 'Retirement Benefits' so as to present fairly its financial performance, position and cash flows in respect of its obligation for the RPS. The details of this departure and impact on the Group's accounts are set out in note 35.

A summary of the Group's accounting policies applied in preparing the accounts for the year ended 31 December 2006 is set out below.

The preparation of accounts in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge, actual results ultimately may differ from those estimates.

The key sources of estimation uncertainty that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are the measurement and impairment of indefinite life intangible assets (including goodwill) and measurement of defined benefit pension obligations. The measurement of intangible assets other than goodwill on a business combination involves estimation of future cash flows and the selection of a suitable discount rate. The Group determines whether indefinite life intangible assets are impaired on an annual basis and this requires an estimation of the value in use of the cash generating units to which the intangible assets are allocated. This requires estimation of future cash flows and choosing a suitable discount rate (see note 14). Measurement of defined benefit pension obligations requires estimation of future changes in salaries and inflation, as well as mortality rates, the expected return on assets and the choice of a suitable discount rate (see note 35).

The consolidated accounts are presented in pounds sterling and all values are rounded to the nearest one hundred thousand (£0.1m) except where otherwise indicated.

Basis of consolidation

The consolidated accounts comprise the accounts of National Express Group PLC and all its subsidiaries drawn up to 31 December each year. Adjustments are made to bring any dissimilar accounting policies that may exist into line with the Group's accounting policies.

On acquisition of a business, the purchase method of accounting is adopted, and the Group income statement includes the results of subsidiaries and businesses purchased during the year from the date control is assumed. Purchase consideration is allocated to assets and liabilities on the basis of fair value at the date of acquisition. On the sale of a business, the Group income statement includes the results of that business to the date of disposal.

Minority interests represent the portion of profit or loss and net assets in subsidiaries that is not held by the Group and is presented separately from parent shareholders' equity in the consolidated balance sheet.

Interests in joint ventures

The Group has a number of contractual arrangements with other parties which represent joint ventures which take the form of agreements to share control of other entities.

The Group recognises its interest in the entity's assets and liabilities using the equity method of accounting. The Group balance sheet includes the appropriate share of these joint ventures' net assets and the income statement the appropriate share of their results after tax.

Accounts of jointly controlled entities are prepared for the same reporting period as the Group. Adjustments are made in the Group's accounts to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its jointly controlled entities. The Group ceases to use the equity method from the date it no longer has joint control over the entity.

Interests in associates

Companies, other than subsidiaries and joint ventures, in which the Group has an investment representing not less than 20% of the voting rights and over which it exerts significant influence are treated as associates. The Group accounts include the appropriate share of these associates' results and reserves based on their latest accounts under the equity method.

Income statement presentation

The income statement has been presented in a columnar format to highlight the impact of intangible assets amortisation and exceptional items. This is to enable users of the financial statements to view the normalised results of the Group. Normalised results are defined as the statutory results before the following as appropriate: profit or loss on the sale of businesses, exceptional profit or loss on the sale of non-current assets and charges for goodwill impairment, amortisation of intangible assets, exceptional items and tax relief on qualifying exceptional items.

2 ACCOUNTING POLICIES (CONTINUED)

Exceptional items

Exceptional items are material items of income or expenditure which due to their nature and infrequency require separate identification on the face of the income statement to allow a better understanding of the financial performance in the year, in comparison to prior years.

Revenue recognition

Rendering of services

Revenue comprises income from road passenger transport, train passenger services, airport operations and related activities in the UK, North America and Europe. Where appropriate, amounts are shown net of rebates and sales tax.

Revenue is recognised by reference to the stage of completion of the customer's travel or services provided under contractual arrangements as a proportion of total services to be provided.

UK Trains revenue includes amounts attributed to the train operating companies ("TOCs"), based principally on agreed models of route usage, by Railway Settlement Plan Limited (which administers the income allocation system within the UK rail industry), in respect of passenger receipts. In addition, franchise agreement receipts from the Department for Transport Rail Division ("DfT Rail") and local Passenger Transport Executives ("PTEs") are treated as revenue. Franchise agreement payments to DfT Rail are recognised in operating costs. UK Coach revenue comprises amounts receivable generated from ticket sales. UK Bus and European Coach & Bus (Alsa) revenue comprises amounts receivable generated from ticket sales and revenue generated from services provided on behalf of local transport authorities, which is recognised as the services are provided. For all the divisions noted above, the relevant share of season ticket or travelcard income is deferred within liabilities and released to the income statement over the life of the relevant season ticket or travelcard. North American Bus revenue from school boards and similar contracts is recognised as the services are provided.

Rental income

Rental income is accounted for on a straight-line basis over the lease term.

Interest income

Revenue is recognised using the effective interest method.

Government grants

Government grants relating to property, plant and equipment are included in liabilities as deferred income and are credited to the income statement over the expected useful economic life of the assets concerned. Other grants are credited to the income statement as the related expenditure is expensed.

Segmental reporting

Each of the Group's business and geographical segments provides services that are subject to risks and returns that are different from those of the other business segments. Due to the nature of the Group's operations the distinct business segments align directly with geographical segments which are operating in separate economic environments.

The Group's segments comprise: UK Buses; UK Coaches; UK Trains; North American Bus; European Coach & Bus (Alsa); and Central functions. These segments are described in more detail in the OFR accompanying these accounts.

Operations in our North America – Public Transit business was discontinued in 2005.

The net assets of Stewart International Airport are disclosed in 'disposal group assets classified as held for sale' and liabilities disclosed in 'liabilities directly associated with disposal group assets classified as held for sale' reflecting the expected sale of this business in 2007.

Leases

Leases of property, plant and equipment where substantially all the risks and rewards of ownership of the asset have passed to the Group, are capitalised in the balance sheet as property, plant and equipment. Finance leases are capitalised at the lower of the fair value of the leased property or the present value of the minimum lease payments. The capital element of future obligations under hire purchase contracts and finance leases is included as a liability in the balance sheet. The interest element of rental obligations is charged to the income statement over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases of property, plant and equipment where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rentals paid under operating leases are charged to the income statement on a straight-line basis over the term of the lease. Incentives received under operating leases and initial direct costs in negotiating the lease are amortised to the income statement on a straight-line basis over the term of lease.

Borrowing costs

Borrowing costs are recognised as an expense when incurred in accordance with the benchmark accounting treatment under IAS 23 'Borrowing Costs'.

2 ACCOUNTING POLICIES (CONTINUED)

Current tax and deferred tax

Current tax is provided on taxable profits earned according to the local tax rates applicable where the profits are earned. Income taxes are recognised in the income statement unless it relates to an item accounted for in equity, in which case the tax is recognised directly in equity.

Deferred tax is provided in full in respect of all material temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes (except on the initial recognition of goodwill, where the recognition of an asset or liability does not arise through a business combination or through the recognition of a profit or loss and in respect of investment in subsidiaries, associates and joint ventures where the Group is able to control the reversal of the temporary difference and it is probable the temporary difference will not reverse in the foreseeable future). Deferred tax is measured on a non-discounted basis at tax rates that are expected to apply in the periods in which the temporary differences reverse based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognised where their recovery is considered more likely than not in that there will be taxable profits from which the future reversal of underlying temporary differences can be deducted. Their carrying amount is reviewed at each balance sheet date on the same basis.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and when the Group intends to settle its current tax assets and liabilities on a net basis.

Intangible assets

Intangible assets acquired separately that meet the recognition criteria of IAS 38 'Intangible Assets', are capitalised at cost and when acquired in a business combination are capitalised at fair value at the date of acquisition. Following initial recognition, finite life assets are amortised on a straight-line basis and indefinite life assets are held at historic cost. The amortisation expense is taken to the income statement through operating expenses.

The existing finite life intangible assets have a residual value of nil and are amortised over their estimated useful lives as follows:

Customer contracts	– over the life of the contract (between 1 and 33 years)
Right to operate TOC franchises	– over the life of the franchise (between 1 and 7 years)

Intangible assets with indefinite lives are tested annually for impairment and the useful lives of finite assets are examined on an annual basis and adjustments, where applicable, made on a prospective basis. Finite life assets are reviewed for impairment where indicators of impairment exist.

The Group's indefinite life intangible assets include customer relationships and goodwill. Customer relationship intangible assets are recognised only on contracts where historical experience has shown that these contracts are consistently renewed.

Goodwill

IFRS 3 "Business Combinations", has been applied to the accounting for business combinations from 1 January 2004, as permitted by IFRS 1 "First-time Adoption of IFRS".

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is stated at historic cost less any accumulated impairment. If an acquisition gives rise to an excess of the acquirer's interest in the net fair value of the acquiree's indentifiable assets, liabilities and contingent liabilities over cost (previously referred to as negative goodwill), this is credited immediately to the income statement.

In accordance with IFRS 3 "Business combinations", goodwill is not amortised. All goodwill is subject to an annual test of impairment and an impairment charge recognised as required.

Fair value accounting adjustments are made in respect of acquisitions. Fair value adjustments based on provisional estimates are amended within one year of the acquisition if required, with a corresponding adjustment to goodwill, in order to refine adjustments to reflect further evidence gained post acquisition.

Where goodwill forms part of a cash-generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of the operation when determining the gain or loss on the disposal of the operation.

Property, plant and equipment

All property, plant and equipment is stated at historic cost less accumulated depreciation and any impairment. Under the transitional arrangements of IFRS 1 the Group has elected to deem the fair value of certain revalued assets to be equivalent to cost.

Land and buildings comprise mainly vehicle depots and garages, and offices. Freehold land is not depreciated. Other property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives as follows:

Freehold buildings	– 30 to 50 years
Long leasehold property improvements	– 15 to 40 years
Public service vehicles	– 8 to 15 years
Plant and equipment, fixtures and fittings	– 3 to 15 years

The carrying value of items of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the current carrying value may not be recoverable, and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and adjustments, where applicable, are made on a prospective basis. Repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

2 ACCOUNTING POLICIES (CONTINUED)

Impairment of non-current assets

All non-current assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, except for indefinite life intangible assets and goodwill which are reviewed annually. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount which is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognised in the income statement in expense categories consistent with the function of the impaired asset.

Except for goodwill impairments, a review is made at each reporting date of any previous impairment losses to assess whether they no longer exist or may have decreased. If such indication exists, the asset's recoverable amount is estimated and any previously recognised impairment loss is reversed only if there has been a change in the estimates used to assess the recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased, subject to a limit of the asset's net book value had no previous impairment loss been recognised. Such reversal is recognised in the income statement. Future depreciation or amortisation is then adjusted to allocate the asset's revised carrying amount over its remaining useful economic life. Impairments to goodwill cannot be reversed.

Financial instruments

The Group determines the classification of its financial instruments at initial recognition and re-evaluates the designation at each year end. When financial instruments are recognised initially, they are measured at fair value.

Financial assets held by the Group include certain derivative contracts and investments in entities that are not subsidiaries, associates or joint ventures.

Available for sale financial assets

The Group's investments in entities that are not subsidiaries, associates or joint ventures are classified as available for sale financial assets. After initial recognition these assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or the investment is determined to be impaired, at which time the previously reported cumulative gain or loss is included in the income statement. Where there is no active market for the Group's investments, fair value is determined using valuation techniques including recent commercial transactions and discounted cash flow analyses. In the absence of any other reliable external information, assets are carried at amortised cost.

Derivative financial instruments

The Group uses derivative financial instruments such as foreign currency forward exchange contracts, fuel price swaps and interest rate swaps to hedge its risks associated with foreign currency, fuel price and interest rate fluctuations. Such derivative financial instruments are initially recognised at fair value and subsequently remeasured to fair value for the reported balance sheet. The fair value of foreign currency forward exchange contracts, interest rate and fuel price swaps is calculated by reference to market exchange rates, interest rates and fuel prices at the period end.

The Group's fuel price swaps and interest rate swaps are designated as cash flow hedges. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the income statement. The gains or losses deferred in equity in this way are recycled through the income statement in the same period in which the hedged underlying transaction or firm commitment is recognised in the income statement.

Foreign currency forward exchange contracts are used to hedge the Group's net investment in foreign currency denominated operations and to the extent they are designated and effective as net investment hedges are matched in equity against foreign exchange exposure in the related assets.

For derivatives that do not qualify for hedge accounting, gains or losses are taken directly to the income statement in the period.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

Trade and other receivables

Trade and other receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. Doubtful debts are provided for when collection of the full amount is no longer probable, whilst bad debts are written off when identified.

Pre-contract costs

Pre-contract costs associated with securing new rail franchises are expensed as incurred except where it is virtually certain that a franchise will be awarded, in which case they are recognised as an asset and are expensed to the income statement over the life of the franchise. Costs associated with the commencement of all new contracts other than rail franchises are expensed as incurred.

Cash and cash equivalents

Cash and cash equivalents as defined for the cash flow statement comprise cash in hand, cash held at bank with immediate access, other short-term investments and bank deposits with maturities of three months or less from the date of inception and bank overdrafts. In the consolidated balance sheet cash includes cash and cash equivalents excluding bank overdrafts. Bank overdrafts that have no legal right of set-off against cash and cash equivalents are included within borrowings in current liabilities.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost being the net fair value of the consideration received plus transaction costs that are directly attributable to the issue of the financial asset or liability. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

Inventories

Inventories are valued at the lower of cost and net realisable value on a FIFO basis, after making due allowance for obsolete or slow moving items.

2 ACCOUNTING POLICIES (CONTINUED)

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material using a pre-tax discount rate. The amortisation of the discount is recognised as a finance cost.

Insurance

The Group's policy is to self-insure high frequency claims within the businesses. To provide protection above these types of losses the Group purchases insurance cover from a selection of proven and financially strong insurers. The insurance provision is based on estimated exposures at the year end principally for claims arising in the UK and North America prior to the year end date, subject to the overall stop loss within the Group's insurance arrangements. The majority of provisions will be utilised within six years, and the provision has been discounted to take account of the expected timing of future cash settlements.

Pensions and other post-employment benefits

The Group has a number of pension schemes, both of a defined benefit and defined contribution nature. Full details are provided in note 35 including the departure from IAS 19 required for the Group's RPS obligations as outlined in the Statement of Compliance.

The liability in respect of defined benefit schemes comprises the total for each scheme of the present value of the relevant defined benefit obligation at the balance sheet date less the fair value of plan assets. The trustees complete a full actuarial valuation triennially, separately for each plan, but the obligation is updated annually by independent actuaries for financial reporting purposes, using the projected unit credit method. The present value of the obligation is determined by the estimated future cash outflows using interest rates of high quality corporate bonds which have terms to maturity equivalent to the terms of the related liability.

The current service cost and gains and losses on settlements and curtailments are recognised in staff pension costs within operating costs in the income statement. Past service costs are included in operating costs where the benefits have vested, otherwise they are amortised on a straight-line basis over the vesting period. The finance elements of the pension cost, comprising the expected return on assets of funded defined benefit schemes and the interest on pension scheme liabilities, are also included in operating costs. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the statement of recognised income or expense in the period in which they arise.

Our TOCs participate in the RPS, a defined benefit scheme which covers the whole of the UK Rail industry. This is partitioned into sections and the Group is responsible for the funding of these sections whilst it operates the relevant franchise. In contrast to the pension schemes operated by most businesses, the RPS is a shared cost scheme, which means that costs are formally shared 60% by the employer and 40% by the employee. A liability is recognised in line with other defined benefit schemes in the Group, although this is offset by a franchise adjustment so that the net liability represents the deficit that the Group expects to fund during the franchise term. This represents a departure from IAS 19 so as to present fairly the Group's financial performance, position and cash flow in respect of its obligations for the RPS.

The charges in respect of defined contribution schemes are recognised when they are due. The Group has no legal or constructive obligation to pay further contributions into a defined contribution scheme if the fund has insufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

Share-based payment

In accordance with the transitional provisions of IFRS 1, IFRS 2 "Share-based payment", has been applied only to equity-settled awards granted after 7 November 2002 that were unvested as of 1 January 2005.

The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant by an external valuer using a stochastic model. Non-market-based performance-related vesting conditions are not taken into account when estimating the fair value; instead those non-market conditions are taken into account in calculating the current best estimate of the number of shares that will eventually vest and at each balance sheet date before vesting, the cumulative expense is calculated based on that estimate. Market-based performance conditions are taken into account when determining the fair value and at each balance sheet date before vesting. The cumulative expense is calculated irrespective of whether or not the market conditions are satisfied, provided that all other performance conditions are met.

Share capital, share premium and dividends

Ordinary shares are classified as equity. Where either the Company or employee share trusts purchase the Company's equity share capital, the consideration paid, including any transaction costs, is deducted from total shareholders' equity as own shares until they are cancelled or reissued. Any consideration subsequently received on sale or reissue is included in shareholders' equity.

Dividends are recorded as a liability in the period in which the liability to pay shareholders arises.

Foreign currencies

The trading results of foreign currency denominated subsidiaries, joint ventures and associates are translated into sterling, the presentation currency of the Group and functional currency of the parent, using average rates of exchange for the year as a reasonable approximation to actual exchange rates at the dates of transactions.

The balance sheets of foreign currency denominated subsidiaries, joint ventures and associates are translated into sterling at the rates of exchange ruling at the year end and exchange differences arising are taken directly to the translation reserve in equity. On disposal of a foreign currency denominated subsidiary, the deferred cumulative amount recognised in the translation reserve (since 1 January 2004 under the transitional rules of IFRS 1) relating to that entity is recognised in the income statement. All other translation differences are taken to the income statement, with the exception of differences on foreign currency borrowings and forward foreign currency contracts which are used to provide a hedge against the Group net investments in foreign enterprises. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the income statement.

2 ACCOUNTING POLICIES (CONTINUED)

New standards and interpretations not applied

The IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these accounts:

International Accounting Standards (IAS/IFRS)		
IFRS 7	Financial Instruments: Disclosures	1 January 2007
IAS 1	Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
International Financial Reporting Interpretations Committee (IFRIC)		
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1 March 2006
IFRIC 8	Scope of IFRS 2	1 May 2006
IFRIC 9	Reassessment of Embedded Derivatives	1 June 2006
IFRIC 10	Interim Financial Reporting and Impairment	1 November 2006
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions	1 March 2007
IFRIC 12	Service Concession Arrangements	1 January 2008

Upon adoption of IFRS 7 the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail although there will be no effect on reported income or net assets. The Directors are currently reviewing the requirements of IFRIC 12 to determine whether there will be a material impact on the Group's accounts. Apart from this the Directors do not anticipate the adoption of these standards and interpretations will have a material impact on the Group's accounts in the period of initial application.

3 EXCHANGE RATES

The most significant exchange rates to UK sterling for the Group are as follows:

	Closing rate 2006	**Average rate 2006**	Closing rate 2005	Average rate 2005
US dollar	**1.96**	**1.85**	1.72	1.82
Canadian dollar	**2.28**	**2.09**	2.00	2.20
Euro	**1.48**	**1.47**	1.45	1.47
Australian dollar	**2.48**	**2.44**	2.35	2.39

The 2005 average rate for euros reflects the average rate since the Alsa acquisition.

If the results for the year to 31 December 2005 had been retranslated at the average exchange rates for the year to 31 December 2006, North America would have achieved normalised operating profit of £35.0m on revenue of £241.7m, compared to normalised operating profit of £35.0m on revenue of £241.8m as reported, and Alsa would have remained the same with normalised operating profit of £2.6m on revenue of £18.2m (note 5).

4 REVENUE

	2006 £m	2005 £m
Rendering of services	**2,517.6**	2,208.8
Rental income	**7.9**	7.2
Revenue	**2,525.5**	2,216.0
Finance income	**12.4**	10.8
Total revenue from continuing operations	**2,537.9**	2,226.8

During the year, franchise agreement receipts from DfT Rail and PTEs amounted to £377.1m (2005: £337.0m) in UK Trains.

NOTES TO THE CONSOLIDATED ACCOUNTS
CONTINUED

5 SEGMENTAL ANALYSIS
The operating businesses are organised and managed separately according to the nature of the public transport services they provide and the geographical market they operate in. Due to the nature of the services the Group provides, the primary and secondary segments coincide. Commentary on the segments is included in the OFR.

Analysis by class and geography of business

	External revenue 2006 £m	**Inter-segment sales 2006 £m**	**Segment revenue 2006 £m**	External revenue 2005 £m	Inter-segment sales 2005 £m	Segment revenue 2005 £m
UK Bus	**297.7**	**3.1**	**300.8**	268.6	–	268.6
UK Trains	**1,497.6**	**–**	**1,497.6**	1,497.2	–	1,497.2
UK Coach	**197.2**	**10.1**	**207.3**	190.2	10.3	200.5
Inter-segment sales elimination	**–**	**(13.2)**	**(13.2)**	–	(10.3)	(10.3)
UK operations	**1,992.5**	**–**	**1,992.5**	1,956.0	–	1,956.0
North American Bus	**283.7**	**–**	**283.7**	241.8	–	241.8
European Coach & Bus (Alsa)	**249.3**	**–**	**249.3**	18.2	–	18.2
Revenue from continuing operations	**2,525.5**	**–**	**2,525.5**	2,216.0	–	2,216.0
Discontinued operations	**–**	**–**	**–**	100.8	–	100.8
Total	**2,525.5**	**–**	**2,525.5**	2,316.8	–	2,316.8

Inter-segment sales represent rail replacement services provided to UK Trains by UK Bus and UK Coach. Inter-segment trading is undertaken on standard arm's length commercial terms. Due to the nature of the Group's businesses, the origin and destination of revenue is the same.

	Continuing			**Discontinued**	Continuing			Discontinued
	Normalised operating profit 2006 £m	**Goodwill impairment, intangible amortisation and exceptional items 2006 £m**	**Segment result 2006 £m**	**Segment result 2006 £m**	Normalised operating profit 2005 £m	Goodwill impairment, intangible amortisation and exceptional items 2005 £m	Segment result 2005 £m	Segment result 2005 £m
UK Bus	**40.7**	**2.3**	**43.0**		41.5	(2.4)	39.1	
UK Trains	**49.1**	**(20.8)**	**28.3**		64.2	(39.2)	25.0	
UK Coach	**23.7**	**1.3**	**25.0**		21.5	–	21.5	
UK operations	**113.5**	**(17.2)**	**96.3**		127.2	(41.6)	85.6	
North American Bus	**39.1**	**(4.5)**	**34.6**		35.0	(4.4)	30.6	
European Coach & Bus (Alsa)	**44.3**	**(20.8)**	**23.5**		2.6	–	2.6	
Central functions	**(12.1)**	**(0.7)**	**(12.8)**		(9.3)	–	(9.3)	
Result from continuing operations	**184.8**	**(43.2)**	**141.6**		155.5	(46.0)	109.5	
Result from discontinued operations	**–**	**–**	**–**	**–**	–	–	–	(56.4)
Total result	**184.8**	**(43.2)**	**141.6**	**–**	155.5	(46.0)	109.5	(56.4)
Profit on disposal of non-current assets			**16.9**	**–**			–	–
Profit/(loss) from operations			**158.5**	**–**			109.5	(56.4)
Share of post tax results from associates and joint ventures			**(29.5)**	**–**			(8.8)	–
Loss on sale of discontinued operations			**–**	**(3.2)**			–	(6.6)
Cumulative exchange differences transferred from reserves			**–**	**–**			–	(1.5)
Net finance costs			**(24.9)**	**–**			(11.4)	(0.2)
Profit/(loss) before tax			**104.1**	**(3.2)**			89.3	(64.7)
Tax (expense)/credit			**(23.6)**	**–**			(27.5)	0.2
Profit/(loss) for the year			**80.5**	**(3.2)**			61.8	(64.5)

5 SEGMENTAL ANALYSIS (CONTINUED)

Goodwill impairment, intangible asset amortisation, property and exceptional items can be analysed by class and geography of business as follows:

	Goodwill impairment 2006 £m	**Intangible asset amortisation 2006 £m**	**Exceptional items 2006 £m**	**Total other items 2006 £m**
UK Bus	**1.0**	**1.6**	**(4.9)**	**(2.3)**
UK Trains	**19.2**	**1.6**	**–**	**20.8**
UK Coach	**–**	**–**	**(1.3)**	**(1.3)**
North American Bus	**–**	**4.5**	**–**	**4.5**
European Coach & Bus (Alsa)	**–**	**20.1**	**1.9**	**22.0**
Central functions	**–**	**–**	**(0.5)**	**(0.5)**
Total	**20.2**	**27.8**	**(4.8)**	**43.2**

	Goodwill impairment 2005 £m	Intangible asset amortisation 2005 £m	Exceptional items 2005 £m	Total 2005 £m
UK Bus	–	0.9	1.5	2.4
UK Trains	33.3	2.4	3.5	39.2
North American Bus	–	1.6	2.8	4.4
Total continuing operations	33.3	4.9	7.8	46.0
Discontinued operations	60.0	–	0.2	60.2
Total	93.3	4.9	8.0	106.2

In the year to 31 December 2006 exceptional income arose in UK Bus, UK Coach and Central Functions for the past service pension credit. Integration costs of £1.9m were incurred in Alsa.

In the year to 31 December 2005 exceptional items were incurred in UK Bus for business reorganisation costs, in UK Trains for staff redundancy programmes and business reorganisations and in North America in respect of the divisional head office relocation.

Non-operating exceptional items comprise £7.5m (2005: £nil) of profit on the disposal of property and £9.4m (2005: £nil) of profit on disposal of investments, both items relate to the UK Trains division.

Assets, liabilities and capital expenditure can be analysed by class and geography of business as follows:

	Assets 2006 £m	**Liabilities 2006 £m**	**Capital expenditure 2006 £m**	Assets 2005* £m	Liabilities 2005* £m	Capital expenditure 2005 £m
UK Bus	**197.4**	**(129.4)**	**16.6**	203.0	(174.8)	46.8
UK Trains	**236.7**	**(373.2)**	**12.5**	290.5	(411.6)	28.3
UK Coach	**47.0**	**(47.8)**	**6.0**	48.1	(45.1)	10.1
Intercompany elimination	**(1.4)**	**1.4**	**–**	(2.5)	2.5	–
UK operations	**479.7**	**(549.0)**	**35.4**	539.1	(629.0)	85.2
North American Bus	**444.7**	**(84.4)**	**39.6**	473.9	(77.0)	34.7
European Coach & Bus (Alsa)	**593.8**	**(63.9)**	**23.5**	613.1	(62.8)	0.6
Central functions	**(4.3)**	**(72.1)**	**0.3**	39.6	(55.7)	0.2
Unallocated	**202.5**	**(619.2)**	**–**	199.5	(728.4)	–
Intercompany elimination	**(13.8)**	**13.8**	**–**	(34.5)	34.5	–
Total continuing operations	**1,702.6**	**(1,374.8)**	**98.8**	1,830.7	(1,518.4)	120.7
Disposals group assets/(liabilities directly associated with disposal) classified as held for sale	**20.1**	**(2.4)**	**–**	–	–	1.4
Total	**1,722.7**	**(1,377.2)**	**98.5**	1,830.7	(1,518.4)	122.1

*Adjusted for Alsa fair value movements as required by IFRS 3.

Capital expenditure comprises property, plant and equipment additions as disclosed above and in note 15 and £0.3m of intangible asset additions in UK Trains as disclosed in note 14.

NOTES TO THE CONSOLIDATED ACCOUNTS
CONTINUED

5 SEGMENTAL ANALYSIS (CONTINUED)

Unallocated assets and liabilities comprise the following items:

	Unallocated assets 2006 £m	**Unallocated liabilities 2006 £m**	Unallocated assets 2005 £m	Unallocated liabilities 2005 £m
Cash	**143.6**	**–**	145.5	–
Other debt receivables	**–**	**–**	1.0	–
Current tax	**26.4**	**(40.9)**	11.3	(24.0)
Available for sale investments	**13.5**	**–**	11.4	–
Derivative financial assets/(liabilities)	**8.4**	**(14.7)**	7.3	(21.7)
Borrowings, excluding finance leases	**–**	**(478.9)**	–	(600.8)
Dividend payable	**–**	**(0.4)**	–	–
Deferred tax	**10.6**	**(84.3)**	23.0	(81.9)
Total	**202.5**	**(619.2)**	199.5	(728.4)

An operating cash flow and significant non-cash expenditure items by segment are included in the OFR.

6 OPERATING COSTS

		2006 £m	2005 £m
Materials and consumables		**108.2**	83.1
Staff costs (including exceptional income of £6.7m (2005: expense of £3.0m))		**775.1**	711.7
Depreciation – Owned assets		**70.3**	46.8
– Leased assets		**11.4**	8.7
Amortisation of leasehold property prepayment		**0.6**	0.8
Amortisation of fixed asset grants		**(2.0)**	(0.9)
Operating lease charges	Rolling stock: capital element	**168.8**	175.9
	Rolling stock: non-capital element	**68.1**	76.7
	Public service vehicles	**4.6**	8.9
	Other	**5.8**	6.6
	– Plant and equipment	**247.3**	268.1
	Fixed track access	**309.0**	189.1
	Other	**74.3**	82.4
	– Land and buildings	**383.3**	271.5
Pre-contract bid costs: UK Trains		**9.8**	6.1
Other charges (including exceptional expense of £1.9m (2005: £4.8m))		**731.9**	672.4
Operating costs before amortisation and impairment		**2,335.9**	2,068.3
Goodwill impairment		**20.2**	33.3
Intangible asset amortisation		**27.8**	4.9
Total operating costs – continuing operations		**2,383.9**	2,106.5

The TOCs have fixed track access contracts with Network Rail Infrastructure Limited for access to the railway infrastructure (tracks, stations and depots). The TOCs also have contracts under which rolling stock is leased. The capital element of the rolling stock lease charge is based on the purchase price, capital funded refurbishments and modifications, and the non-capital element of the lease charge includes heavy maintenance charges, risk and charges based on mileage.

Total depreciation of £nil (2005: £1.3m) not included above was charged as part of discontinued operations.

An analysis of fees paid to the Group's auditors is provided below:

	2006 £m	2005 £m
Fees payable to the Company's auditors for the audit of the consolidated company's annual accounts	**0.3**	0.3
Fees payable to the Company's auditors and its associates for other services:		
The audit of the Company's subsidiaries	**0.9**	1.0
Other services pursuant to legislation	**0.1**	0.1
Tax services	**0.9**	0.2
Corporate finance services	**–**	1.2
Other services	**–**	0.1
	2.2	2.9

Included in the above fees paid to the Group's auditors are £11,000 (2005: £1,212,000) of fees capitalised with respect to acquisitions. Fees charged to the income statement for corporate finance services are £5,000 (2005: £12,800) and for other services £17,000 (2005: £63,000).

In addition to the above fees paid to the auditors for the Group's continuing operations which were included within profit before taxation, £nil (2005: £15,000) was incurred in relation to our disposed North American business comprising £nil (2005: £15,000) for statutory audit services which is included within loss for the year from discontinued operations.

7 EMPLOYEE BENEFIT COSTS

(a) Staff costs

	2006 £m	2005 £m
Wages and salaries	**676.6**	626.0
Social security costs	**72.6**	54.7
Pension costs (see note 35)	**23.9**	27.5
Share-based payment (see note 8)	**2.0**	3.5
	775.1	711.7

Included within wages and salaries are exceptional costs of £nil (2005: £3.0m), and included within pension costs is exceptional income of £6.7m (2005: £nil).

In the year to 31 December 2005, wages and salaries of £65.3m, social security costs of £4.8m, pension costs of £1.0m and share-based payments of £0.1m were incurred in discontinued operations.

The average number of employees, in continuing and discontinued operations and including Executive Directors, during the year was as follows:

	2006	2005
Managerial and administrative	**3,733**	3,701
Operational	**35,781**	35,807
	39,514	39,508

Included in the above costs are the following costs related to the Group's key management personnel who comprise the Directors of the parent company.

	2006 £m	2005 £m
Fees	**0.4**	0.3
Basic salaries	**1.2**	1.1
Benefits	**0.3**	0.3
Performance related bonuses	**1.2**	0.7
Post-employment benefits	**0.3**	0.2
Share-based payment	**0.6**	0.4
	4.0	3.0

Information concerning Directors' emoluments, shareholdings and options is disclosed in the Report on Directors' Remuneration.

(b) Share schemes

Details of options or awards outstanding as at 31 December 2006 under the Group's share schemes are as follows:

	Number of share options 2006	Number of share options 2005	Exercise price	Future exercise periods
Executive Share Option Plan	**1,060,076**	4,196,358	398p–1224p	2007–2014
Savings Related Share Option Scheme	**–**	120,323	417p	–
Long Term Incentive Plan	**1,102,793**	559,485	nil	2008–2010
Share Matching Plan	**155,596**	75,720	nil	2008–2010
Deferred Annual Share Bonus Scheme	**166,415**	81,094	nil	2007–2010
WMT Long Service Option Scheme	**325,922**	491,027	398p–1224p	2007–2016
	2,810,802	5,524,007		

(i) Executive Share Option Plan

The Company operates tax approved and unapproved executive share option schemes open to Group employees in senior management positions and Executive Directors. Options granted by this Plan have a maximum term of between seven and 10 years. The options vest after three years subject to the satisfaction of certain performance criteria, as disclosed in the Report on Directors' Remuneration, based on the achievement of a target growth in earnings per share. If the performance criteria are not met when initially tested, in some instances they may be reassessed during the term of the option. From 2005 executive share option grants have been replaced by awards made under the Long Term Incentive Plan, as described in (iii). There are no cash settlement alternatives.

(ii) Savings Related Share Option Scheme (Sharesave scheme)

The National Express Group approved Sharesave scheme enables eligible UK employees, including Executive Directors, to acquire shares in the Company through monthly savings over a three year period, at the end of which they also receive a tax free bonus. The savings and bonus may be used to purchase shares at the option price set at the beginning of the savings contract. The options mature three years after the grant date and may be exercised for a period of up to six months after this date. The latest scheme matured on 1 December 2005. There are no cash settlement alternatives.

(iii) Long Term Incentive Plan (LTIP)

The LTIP was introduced in 2005 on the recommendation of the Remuneration Committee to replace the annual award under the Executive Share Option Plan to Executive Directors and to certain senior employees. Under the LTIP a Performance Award to acquire a specified number of shares for free may be made to the employee or Director. In addition a Matching Award may be made, as described in (iv). Performance conditions are attached to the vesting of Performance and Matching Awards based on either the achievement of target growth in earnings per share or the relative total shareholder return (TSR) of the Company against a comparator group of companies. If the performance conditions are met Performance and Matching Awards vest on the third anniversary of the grant date and remain exercisable for a period of up to six months following the vesting date. There are no cash settlement alternatives at present.

7 EMPLOYEE BENEFIT COSTS (CONTINUED)
(b) Share schemes (continued)
(iv) Share Matching Plan (the Plan)
The Share Matching Plan was introduced in 2005 as part of the new Long Term Incentive Plan arrangements described in (iii). Under the Plan, a Matching Award to acquire a specified number of shares for free may be made if the employee pledges a number of shares as investment shares which are then matched by the Company on either a 1:1 or 2:1 basis with the number of shares that could have been purchased with the pre-tax equivalent of the amount invested. The Matching Awards vest on the third anniversary of the grant date and remain exercisable for a period of up to six months following the vesting date. There are no cash settlement alternatives at present.

(v) Deferred Annual Share Bonus Plan
The Deferred Annual Share Bonus Plan is a discretionary scheme which forms part of the bonus arrangements for certain senior employees. Under the scheme part of any bonus may be received in cash whilst the remainder is used to make an award of nil cost options which vest three years after the award date. The options must be exercised within three months of vesting. There are no cash settlement alternatives at present.

(vi) West Midlands Travel Ltd ("WMT") Long Service Option Scheme
The WMT Long Service Option Scheme utilises a fixed amount of shares set aside for this purpose following the acquisition of WMT in 1995 and is open to all WMT employees who have been in service for more than 25 years. The options are exercisable between three and 10 years following the grant date. There are no cash settlement alternatives.

(vii) TWM Share Incentive Plan (the "SIP")
The TWM SIP exists for the benefit of WMT employees. At the end of the year 40,686 National Express Group PLC shares held for the benefit of the Trustee are expected to be issued in 2007. Dividends on shares held in the SIP forfeited shares account are waived. There are no cash settlement alternatives.

8 SHARE-BASED PAYMENT
The charge in respect of share-based payment transactions included in the Group's income statement for the year is as follows:

	2006 £m	2005 £m
Expense arising from share and share option plans – continuing operations	2.0	3.5
– discontinued operations	–	0.1
	2.0	3.6

During the year ended 31 December 2006, the Group had seven share-based payment arrangements, which are described in note 7.

Included in the charge for share-based payment transactions is £nil (2005: £2.1m) which relates to share options granted in 2005 under the TWM SIP which vested immediately. The fair value of share options granted in 2005 under the TWM SIP was measured using the market price at the grant date.

For the following disclosure, share options with a nil exercise price have been disclosed separately to avoid distorting the weighted average exercise prices. The number of share options in existence during the year was as follows:

	2006		2005	
	Number of share options	Weighted average exercise price p	Number of share options	Weighted average exercise price p
Options without a nil exercise price:				
At 1 January	4,807,708	620	7,594,301	587
Granted during the year	36,406	932	49,534	883
Lapsed during the year	(378,604)	833	(979,569)	658
Exercised during the year	(3,079,512)	544	(1,856,558)	471
Outstanding at 31 December[1]	1,385,998	738	4,807,708	620
Exercisable at 31 December	492,299	813	1,632,374	786
Options with a nil exercise price:				
At 1 January	716,299	nil	11,002	nil
Granted during the year	791,645	nil	711,271	nil
Lapsed during the year	(61,845)	nil	(5,974)	nil
Exercised during the year	(21,295)	nil	–	nil
Outstanding at 31 December	1,424,804	nil	716,299	nil
Exercisable at 31 December	–	–	–	–
Total outstanding at 31 December	2,810,802		5,524,007	
Total exercisable at 31 December	492,299		1,632,374	

(1) Included within this balance are options over 412,896 (2005: 2,360,125) shares for which no expense has been recognised in accordance with the transitional provisions of IFRS 2 as the options were granted before 7 November 2002 and have not been subsequently modified.

8 SHARE-BASED PAYMENT (CONTINUED)

The options outstanding at 31 December 2006 had exercise prices that were between 398p and 1224p (2005: between 398p and 1224p) excluding options with a nil exercise price. The range of exercise prices for options was as follows:

Exercise price (p)	2006	2005
350–650	**157,453**	2,640,007
650–950	**1,110,455**	1,870,461
950–1250	**118,090**	297,240
	1,385,998	4,807,708

The options have a weighted average contractual life of four years (2005: six years). Options were exercised regularly throughout the year and the weighted average share price at exercise was 911p (2005: 863p).

The weighted average fair value of the share options granted during the year was calculated using a stochastic model, with the following assumptions and inputs:

	Share options without nil exercise price		Share options with nil exercise price	
	2006	2005	2006	2005
Risk free interest rate	**4.4%–4.7%**	4.3%–4.8%	**–**	–
Expected volatility	**27.0%–27.5%**	27.6%–28.0%	**19%**	25.0%–27.0%
Peer group volatility	**–**	–	**29.7%–31.2%**	34.0%
Expected option life in years	**6 years**	6 years	**3 years**	3 years
Expected dividend yield	**3.6%–3.8%**	3.4%	**3.4%–3.5%**	3.3%–3.7%
Weighted average share price	**937p–940p**	871p–888p	**931p–1033p**	838p–906p
Weighted average exercise price	**920p–940p**	875p–888p	**0p**	0p
Weighted average fair value of options granted	**181p–188p**	175p–183p	**369p–934p**	561p–821p

Experience to date has shown that approximately 15% (2005: 15%) of options are exercised early, principally due to redundancies. This has been incorporated into the calculation of the expected option life for the share options without nil exercise price.

Expected volatility in the table above was determined from historic volatility over the last eight years, adjusted for one-off events that were not considered to be reflective of the volatility of the share price going forward. The expected dividend yield represents the dividends declared in the 12 months preceding the date of the grant divided by the average share price in the month preceding the date of the grant.

For share options granted during the year under the LTIP, the TSR targets have been reflected in the calculation of the fair value of the options above.

9 NET FINANCE COSTS

	2006 £m	2005 £m
Bank interest payable	**(28.2)**	(16.3)
Finance lease interest payable	**(7.0)**	(4.7)
Other interest payable	**–**	(0.3)
Unwind of provision discounting	**(2.1)**	(0.9)
Finance costs	**(37.3)**	(22.2)
Finance income: Bank interest receivable	**12.4**	10.8
Net finance costs	**(24.9)**	(11.4)

10 TAXATION

a) Analysis of taxation charge/(credit) in the year

	2006 £m	2005 £m
Current taxation:		
UK corporation tax – continuing operations	**10.0**	19.5
Overseas taxation – continuing operations	**8.8**	(1.2)
Overseas taxation – discontinued operations	**–**	(0.2)
Current income tax charge	**18.8**	18.1
Amounts overprovided in prior years – UK	**(4.8)**	(9.5)
Amounts overprovided in prior years – Overseas	**(0.2)**	–
Total current income tax	**13.8**	8.6
Deferred taxation (see note 27):		
Origination and reversal of temporary differences – continuing operations	**9.8**	18.7
Total tax charge	**23.6**	27.3
The tax charge in the income statement is disclosed as follows:		
Income tax expense on continuing operations	**23.6**	27.5
Income tax credit on discontinued operations	**–**	(0.2)
	23.6	27.3
The tax expense on continuing operations is disclosed as follows:		
Tax charge on profit before goodwill impairment, intangible asset amortisation and exceptional items	**39.2**	29.5
Tax credit on intangible asset amortisation and exceptional items	**(15.6)**	(2.0)
	23.6	27.5

b) Tax on items charged to equity

	2006 £m	2005 £m
Current taxation:		
(Charge)/credit on exchange movements offset in reserves	**(0.8)**	7.1
Credit on share-based payment	**2.7**	–
	1.9	7.1
Deferred taxation:		
Deferred tax (charge)/credit on share-based payments	**(0.3)**	1.4
Deferred tax (charge)/credit on actuarial gains/(losses)	**(6.2)**	9.0
Deferred tax charge on exchange movements on cash flow hedges	**(0.5)**	–
Deferred tax credit/(charge) on cash flow hedges	**3.7**	(1.4)
	(3.3)	9.0

c) Reconciliation of the total tax charge

	2006 £m	2005 £m
Profit from continuing operations before income tax	**104.1**	89.3
(Loss)/profit from discontinued operations before income tax	**(3.2)**	(64.7)
Accounting profit before income tax	**100.9**	24.6
Notional charge at UK corporation tax rate of 30%	**30.3**	7.4
Non-deductible goodwill impairment and intangible amortisation	**7.2**	11.5
Utilisation of unrecognised tax losses	**(0.5)**	–
Prior year adjustments within current and deferred tax	**(8.9)**	(12.0)
Non-deductible losses from associates	**1.2**	–
Effect of overseas tax rates including effect of rate reductions	**0.4**	2.3
Reinvestment relief	**(2.3)**	(2.8)
Non taxable loss on sale of businesses	**–**	20.4
Non taxable profit on sale of non-current assets	**(3.2)**	–
Overseas financing deduction	**(2.1)**	(0.9)
Non deductible expenditure	**1.5**	1.4
Total tax charge reported in the income statement	**23.6**	27.3

10 TAXATION (CONTINUED)

d) Temporary differences associated with Group investments

No deferred tax (2005: £nil) is recognised on the unremitted earnings of subsidiaries, associates and joint ventures, as the Group has determined that these undistributed profits will not be distributed in the near future. The temporary differences associated with investments in subsidiaries, associates and joint ventures, for which deferred tax liability has not been recognised totals £33.8m (2005: £32.8m).

e) Unrecognised tax losses

There is no recognition of the deferred tax asset in relation to the excess overseas tax losses on the grounds that there is insufficient evidence to determine that they are recoverable. Overseas deferred tax assets that the Group has not recognised in the accounts amount to £34.8m (2005: £37.6m), of which £0.8m will expire between 2012 and 2020. In addition, there are capital losses of £26.4m (2005: £30.2m) which have not been recognised, recoverability of which is dependent on capital gains arising.

f) Deferred tax included in the income statement

	2006 £m	2005 £m
Accelerated capital allowances	**5.0**	14.3
Short-term temporary differences	**1.8**	5.2
Utilisation/(recognition) of losses	**3.0**	(0.8)
	9.8	18.7

Details on the balance sheet position of deferred tax are included in note 27.

11 DISCONTINUED OPERATIONS

The Group had no discontinued operations in the year to 31 December 2006. The charge in the year of £3.2m represents an increase to the disposal provision (see note 26) following the Group's disposal of its North American Public Transit operation (trading as ATC) on 1 September 2005.

In the year to 31 December 2005, in addition to the disposal of North American Public Transit, the Group also announced the voluntary administration of the Bosnjak Holdings Group (comprising the Group's remaining operations in Australia) on 31 January 2005.

The results of the Group's discontinued operations in 2005 are presented below. The results for the Bosnjak Group were immaterial in 2005 other than the proceeds from the administration as disclosed in note 19.

	2005 North American Public Transit £m
Revenue	100.8
Operating expenses	(97.0)
Normalised operating profit	3.8
Finance costs	(0.2)
Normalised profit before tax	3.6
Tax on normalised profit	0.2
Normalised profit	3.8
Goodwill impairment	(60.0)
Exceptional items	(0.2)
	(60.2)
Loss on sale of discontinued operations	(6.6)
Cumulative exchange differences transferred from reserves	(1.5)
	(68.3)
Tax on exceptional and other items	–
	(68.3)
Loss for the period from discontinued operations	(64.5)

11 DISCONTINUED OPERATIONS (CONTINUED)

	2005 £m
Cash flows from operations discontinued in 2005	
Net cash inflow from operating activities	3.6
Net cash inflow from investing activities	47.0
Loss per share	
Basic from discontinued operations	(47.2p)
Diluted from discontinued operations	(46.5p)

12 DIVIDENDS PAID AND PROPOSED

	2006 £m	2005 £m
Declared and paid during the year		
Ordinary final dividend for 2005 paid of 22.25p per share (2004: 20.65p per share)	**33.9**	28.1
Ordinary interim dividend for 2006 paid of 10.75p per share (2005: 10.0p per share)	**16.2**	13.5
	50.1	41.6
Proposed for approval (not recognised as a liability as at 31 December)		
Ordinary final dividend for 2006 of 24.00p per share (2005: 22.25p per share)	**36.3**	33.5

13 EARNINGS PER SHARE

	2006	2005
Basic earnings per share – continuing operations	**52.8p**	45.2p
Basic loss per share – discontinued operations	**(2.1p)**	(47.2p)
Basic earnings/(loss) per share – total	**50.7p**	(2.0p)
Normalised basic earnings per share – continuing operations	**77.0p**	77.4p
Diluted earnings per share – continuing operations	**52.5p**	44.5p
Diluted loss per share – discontinued operations	**(2.1p)**	(46.5p)
Diluted earnings/(loss) per share – total	**50.4p**	(2.0p)
Normalised diluted earnings per share – continuing operations	**76.5p**	76.3p

Basic earnings per share is calculated by dividing the earnings attributable to equity shareholders of £76.5m (2005: loss of £2.8m) by the weighted average number of ordinary shares in issue during the year, excluding those held by employee share ownership trusts and those held as treasury shares which are both treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue during the year is adjusted to include the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The reconciliation of basic and diluted weighted average number of ordinary shares is as follows:

	2006	2005
Basic weighted average shares	**150,847,303**	136,591,474
Adjustment for dilutive potential ordinary shares	**915,923**	2,017,744
Diluted weighted average shares	**151,763,226**	138,609,218

The normalised basic and normalised diluted earnings per share have been calculated in addition to the basic and diluted earnings per shares required by IAS 33 since, in the opinion of the Directors, they reflect the underlying performance of the business's operations more appropriately.

13 EARNINGS PER SHARE (CONTINUED)

The reconciliation of the earnings and earnings per share to their normalised equivalent is as follows:

	2006 £m	Basic EPS 2006 p	Diluted EPS 2006 p	2005 £m	Basic EPS 2005 p	Diluted EPS 2005 p
Profit/(loss) attributable to equity shareholders	**76.5**	**50.7**	**50.4**	(2.8)	(2.0)	(2.0)
Loss from discontinued operations	**3.2**	**2.1**	**2.1**	64.5	47.2	46.5
Profit from continuing operations attributable to equity shareholders	**79.7**	**52.8**	**52.5**	61.7	45.2	44.5
Goodwill impairment on continuing operations	**20.2**	**13.4**	**13.3**	33.3	24.4	24.1
Intangible asset amortisation	**27.8**	**18.5**	**18.3**	4.9	3.6	3.5
Exceptional charge for associate onerous contract provision	**25.7**	**17.0**	**16.9**	–	–	–
Exceptional items	**(4.8)**	**(3.2)**	**(3.1)**	7.8	5.7	5.6
Profit on disposal of non-current assets	**(16.9)**	**(11.2)**	**(11.1)**	–	–	–
Tax relief on goodwill and exceptional items	**(15.6)**	**(10.3)**	**(10.3)**	(2.0)	(1.5)	(1.4)
Normalised profit attributable to equity shareholders	**116.1**	**77.0**	**76.5**	105.7	77.4	76.3

14 INTANGIBLE ASSETS

	Customer contracts £m	Rail franchise £m	Finite life assets £m	Contractual relationships £m	Goodwill £m	Indefinite life assets £m	Total £m
Cost or valuation:							
At 1 January 2006	188.8	13.0	**201.8**	16.9	621.7	**638.6**	**840.4**
Additions through business combinations	7.3	–	**7.3**	3.2	9.7	**12.9**	**20.2**
Additions	–	0.3	**0.3**	–	–	**–**	**0.3**
Disposals	(1.5)	(1.6)	**(3.1)**	–	–	**–**	**(3.1)**
Foreign exchange	(3.8)	–	**(3.8)**	(2.1)	(34.7)	**(36.8)**	**(40.6)**
At 31 December 2006	**190.8**	**11.7**	**202.5**	**18.0**	**596.7**	**614.7**	**817.2**
Amortisation:							
At 1 January 2006	3.2	4.3	**7.5**	–	66.6	**66.6**	**74.1**
Charge for year	26.2	1.6	**27.8**	–	–	**–**	**27.8**
Annual impairment charge for the year – UK Trains	–	–	**–**	–	19.2	**19.2**	**19.2**
Impairment charge for the year – Other	–	–	**–**	–	1.0	**1.0**	**1.0**
Disposals	–	(1.6)	**(1.6)**	–	–	**–**	**(1.6)**
Foreign exchange	(0.9)	–	**(0.9)**	–	–	**–**	**(0.9)**
At 31 December 2006	**28.5**	**4.3**	**32.8**	**–**	**86.8**	**86.8**	**119.6**
Net book value:							
At 31 December 2006	**162.3**	**7.4**	**169.7**	**18.0**	**509.9**	**527.9**	**697.6**
At 1 January 2006	185.6	8.7	194.3	16.9	555.1	572.0	766.3

14 INTANGIBLE ASSETS (CONTINUED)

	Customer contracts £m	Rail franchise £m	Finite life assets £m	Contractual relationships £m	Goodwill £m	Indefinite life assets £m	Total £m
Cost or valuation:							
At 1 January 2005	0.9	13.0	13.9	2.5	372.0	374.5	388.4
Additions through business combinations*	187.1	–	187.1	13.3	314.9	328.2	515.3
Attributable to discontinued operations	–	–	–	–	(96.6)	(96.6)	(96.6)
Foreign exchange	0.8	–	0.8	1.1	31.4	32.5	33.3
At 31 December 2005	188.8	13.0	201.8	16.9	621.7	638.6	840.4
Amortisation:							
At 1 January 2005	0.4	1.9	2.3	–	33.3	33.3	35.6
Charge for year	2.5	2.4	4.9	–	–	–	4.9
Annual impairment charge for the year – UK Trains	–	–	–	–	33.3	33.3	33.3
Impairment charge for the year – Other	–	–	–	–	60.0	60.0	60.0
Attributable to discontinued operations	–	–	–	–	(60.0)	(60.0)	(60.0)
Foreign exchange	0.3	–	0.3	–	–	–	0.3
At 31 December 2005	3.2	4.3	7.5	–	66.6	66.6	74.1
Net book value:							
At 31 December 2005	185.6	8.7	194.3	16.9	555.1	572.0	766.3
At 1 January 2005	0.5	11.1	11.6	2.5	338.7	341.2	352.8

*Adjusted for Alsa fair value movements as required by IFRS 3.

Indefinite life intangible assets including goodwill have been allocated to individual cash generating units for annual impairment testing on the basis of the Group's business operations. The carrying value of indefinite life intangible assets by cash generating unit is as follows:

	2006 Contractual relationships £m	**2006 Goodwill £m**	**2006 Total £m**	2005 Contractual relationships £m	2005 Goodwill £m	2005 Total £m
UK Bus	**–**	**13.2**	**13.2**	–	13.2	13.2
UK Trains	**–**	**–**	**–**	–	19.2	19.2
UK Coach	**–**	**5.6**	**5.6**	–	5.6	5.6
North American Bus	**18.0**	**200.3**	**218.3**	16.9	218.9	235.8
European Coach & Bus (Alsa)	**–**	**290.8**	**290.8**	–	298.2	298.2
	18.0	**509.9**	**527.9**	16.9	555.1	572.0

The project to allocate the consideration paid to acquire Alsa to the fair value of assets acquired was completed during the year (see note 19). The amortisation charge in 2005 on the Alsa intangible assets acquired was immaterial.

The useful economic lives of contractual relationships in North America are deemed to be indefinite where historical experience has shown that these contracts are consistently renewed. The customer contract and rail franchise intangible assets are amortised over the finite duration of the contract or franchise as appropriate. All amortisation charges in the year have been charged to operating costs.

The recoverable amount of indefinite life intangible assets has been determined based on a value in use calculation using cash flow projections based on financial budgets and forecasts approved by senior management covering a three year period. Growth has then been extrapolated forward from the end of the forecasts.

14 INTANGIBLE ASSETS (CONTINUED)

The assumptions used for the cash generating units, excluding UK Trains, are as follows:

	Discount rate applied to cash flow projections		Growth rate used to extrapolate cash flows beyond three year period of management plan	
	2006	2005	**2006**	2005
UK Bus	**10.7%**	10.7%	**2.0%**	5.0%
North America Bus	**11.7–12.1%**	10.8–12.1%	**2.0%**	2.0%
UK Coach	**10.7%**	10.7%	**2.0%**	2.0%
European Coach and Bus (Alsa)	**10.7%**	10.7%	**2.0%**	2.0%

The discount rates represent the risk adjusted weighted average cost of capital appropriate for the cash flow generated.

The calculation of value in use for each cash-generating unit is most sensitive to the assumptions over gross margin, discount rates, price inflation and growth rate.

The Directors consider the assumptions used to be consistent with the historical performance of each unit and to be realistically achievable in the light of economic and industry measures and forecasts.

Due to the nature of the fixed term franchise agreements, the Group believes the goodwill that arises in UK Trains on the acquisition of Prism Rail PLC has a finite life. This goodwill is subject to an annual impairment charge to reflect the finite nature of the cash flows related to this goodwill. The net book value of this goodwill is £nil (2005: £19.2m).

With respect to the recoverable amount of the UK Trains goodwill, the discount rate applied to cash flow projections is 10.7% (2005: 10.7%) and the growth rate applied to the cash flow projections is 7.8% (2005: 13.4%). Cash flows are sourced from management plans through to the end of the franchise.

The impairment charge in 2006 of £1.0m relates to the goodwill arising on the remaining share capital acquired of Altram LRT Limited due to ongoing operating losses.

The impairment charge in 2005 of £60.0m relates to our North American Public Transit operations that were sold on 1 September 2005 (see note 11).

15 PROPERTY, PLANT AND EQUIPMENT

	Freehold land and buildings £m	Long leasehold property improvements £m	Public service vehicles £m	Plant and equipment, fixtures and fittings £m	**Total £m**
Cost:					
At 1 January 2006	54.0	15.4	471.3	179.0	**719.7**
Additions	3.0	0.7	74.3	20.5	**98.5**
Acquisitions of businesses	–	–	11.8	–	**11.8**
Disposals	(0.9)	(8.5)	(17.1)	(30.2)	**(56.7)**
Attributable to assets held for sale	–	–	–	(3.5)	**(3.5)**
Reclassifications	0.6	(3.7)	0.8	2.3	**–**
Foreign exchange	(1.0)	(0.6)	(37.7)	(1.5)	**(40.8)**
At 31 December 2006	**55.7**	**3.3**	**503.4**	**166.6**	**729.0**
Depreciation:					
At 1 January 2006	4.8	2.9	107.1	90.5	**205.3**
Charge for the year	1.1	0.6	50.8	29.2	**81.7**
Disposals	(0.4)	(0.7)	(14.5)	(27.4)	**(43.0)**
Attributable to assets held for sale	–	–	–	(0.9)	**(0.9)**
Reclassifications	0.5	(1.5)	0.6	0.4	**–**
Foreign exchange	(0.1)	(0.4)	(15.1)	(0.4)	**(16.0)**
At 31 December 2006	**5.9**	**0.9**	**128.9**	**91.4**	**227.1**
Net book value:					
At 31 December 2006	**49.8**	**2.4**	**374.5**	**75.2**	**501.9**
At 1 January 2006	49.2	12.5	364.2	88.5	514.4

Property, plant and equipment held for sale relates to Stewart International Airport.

15 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	Freehold land and buildings £m	Long leasehold property improvements £m	Public service vehicles £m	Plant and equipment, fixtures and fittings £m	Total £m
Cost:					
At 1 January 2005	28.3	12.4	309.7	144.6	495.0
Additions	3.7	2.2	80.0	36.2	122.1
Acquisitions of businesses*	23.3	0.4	78.2	7.1	109.0
Disposals	(1.8)	(0.2)	(11.0)	(2.8)	(15.8)
Attributable to discontinued operations	–	–	(12.9)	(6.8)	(19.7)
Foreign exchange	0.5	0.6	27.3	0.7	29.1
At 31 December 2005	54.0	15.4	471.3	179.0	719.7
Depreciation:					
At 1 January 2005	4.6	1.8	78.3	76.8	161.5
Charge for the year	0.6	0.6	34.6	21.0	56.8
Disposals	(0.5)	(0.1)	(7.0)	(2.1)	(9.7)
Attributable to discontinued operations	–	–	(9.0)	(5.5)	(14.5)
Foreign exchange	0.1	0.6	10.2	0.3	11.2
At 31 December 2005	4.8	2.9	107.1	90.5	205.3
Net book value:					
At 31 December 2005	49.2	12.5	364.2	88.5	514.4
At 1 January 2005	23.7	10.6	231.4	67.8	333.5

*Adjusted for Alsa fair value movements as required by IFRS 3.

Property, plant and equipment held under finance lease agreements are analysed as follows:

	2006 £m	2005 £m
Public service vehicles		
– cost	**179.7**	178.5
– depreciation	**(63.7)**	(61.1)
	116.0	117.4
Plant and equipment		
– cost	**3.0**	3.5
– depreciation	**(0.3)**	(2.2)
	2.7	1.3
Net book value	**118.7**	118.7

Finance leased assets and assets under hire purchase contracts are pledged as security for the related finance lease and hire purchase liabilities.

16 SUBSIDIARIES

The companies listed below include all those which principally affect the result and net assets of the Group. A full list of subsidiaries, joint ventures and associates will be annexed to the next Annual Return to Companies House. The principal country of operation in respect of the companies below is the country in which they are incorporated.

National Express Group PLC is the beneficial owner of all the equity share capital, either itself or through subsidiaries, of the companies. The Group's train passenger services in the UK are operated through franchises awarded by DfT Rail, as delegated by the UK Government.

Incorporated in England and Wales	
National Express Limited	Administration and marketing of express coach services in Great Britain
Eurolines (UK) Limited	Administration and marketing of express coach services to Europe
Airlinks Airport Services Limited	Operation of coach services
National Express Rail Replacement Services Limited	Operation of coach services
West Midlands Travel Limited	Operation of bus services
Travel London Limited	Operation of bus services
Travel London (West) Limited	Operation of bus services
Travel London (Middlesex) Limited	Operation of bus services
c2c Rail Limited	Operation of train passenger services
Central Trains Limited	Operation of train passenger services
Gatwick Express Limited	Operation of train passenger services
London Eastern Railway Limited (trading as 'one')	Operation of train passenger services
Maintrain Limited	Provision of train maintenance services
Midland Main Line Limited	Operation of train passenger services
National Express Trains Limited*	Holding company for train operating companies
Silverlink Train Services Limited	Operation of train passenger services
Incorporated in Scotland	
Tayside Public Transport Co Limited (trading as Travel Dundee)	Operation of bus services
Incorporated in the USA	
Durham School Services LP	Operation of school bus services
SWF Airport Acquisition Inc	Provision and management of airport facilities
Incorporated in Canada	
Stock Transportation Limited	Operation of school bus services
Incorporated in Spain	
Dabliu Consulting SLU**	Holding company for operating companies
Tury Express SA**	Holding company for operating companies
General Tecnica Industrial SL**	Holding company for operating companies

*Shares held by the Company. All other shares held by subsidiaries.
**The main holding companies of the Alsa Group.

17 FINANCIAL ASSETS

	31 December 2006 £m	31 December 2005 £m
Available for sale investments (unlisted ordinary and preference shares)	**13.5**	11.4
Derivative financial instruments – interest rate swaps	**0.3**	–
Derivative financial instruments – fuel price swaps	**–**	0.6
Financial assets included in non-current assets	**13.8**	12.0
Derivative financial instruments – interest rate swaps	**1.5**	–
Derivative financial instruments – fuel price swaps	**–**	6.7
Derivative financial instruments – foreign exchange forward contracts	**6.6**	–
Financial assets included in current assets	**8.1**	6.7

Further information on the Group's use of fuel price swaps and foreign exchange forward contracts instruments is included in note 30.

Available for sale investments

	31 December 2006 £m	31 December 2005 £m
Cost or valuation:		
At 1 January	**17.2**	16.0
Arising on acquisition of subsidiaries	**–**	1.2
Additions	**5.3**	–
Disposals	**(3.2)**	–
At 31 December	**19.3**	17.2
Accumulated impairment:		
At 1 January and 31 December	**(5.8)**	(5.8)
Net carrying amount:		
At 31 December	**13.5**	11.4
At 1 January	**11.4**	10.2

The principal available for sale investments are as follows:

Name	County of registration	Class of share	Proportion held %
London & Continental Railways (LCR)	England and Wales	Ordinary shares	21
Prepayment Cards Limited (PCL)	England and Wales	Ordinary shares	23.5
Union Railways (South) Limited (URS)	England and Wales	Preference shares	21
Metros Ligeros de Madrid, S.A. (MLM)	Spain	Ordinary shares	15
Various investments within Alsa	Spain	Ordinary shares	4–16

The investment in Trainline Holdings Limited, which could not be reliably measured at 31 December 2005, was sold on 4 July 2006 for total proceeds of £13.8m. After disposal costs of £1.2m, a profit on disposal of £9.4m has been recognised. Disposal costs of £0.6m are unpaid at 31 December 2006.

Additions of £5.3m comprises an investment in Metros Ligeros de Madrid, S.A., of which £0.7m will be paid in 2007.

Although the Group holds more than 20% of the ordinary shares of LCR, it does not have a presence on the board and is not in a position to exert significant influence over this investment. Athough the Group holds more than 20% of the ordinary shares of PCL, the investment is held at nil value and the Group has no obligation to make further investments.

18 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

Investments accounted for using the equity method are as follows:

	2006 £m	2005 £m
Joint ventures	**2.2**	2.2
Associates	**6.5**	2.6
Total investments accounted for under the equity method	**8.7**	4.8

The Group's share of post tax results from associates and joint ventures accounted for using the equity method is as follows:

	2006 £m	2005 £m
Share of joint ventures' loss	**(0.2)**	–
Share of associates' loss	**(3.6)**	(8.8)
	(3.8)	(8.8)
Exceptional charge for associate onerous contract provision	**(25.7)**	–
Total share of results from associates and joint ventures	**(29.5)**	(8.8)

a) Investments in joint ventures

The Group's interests in joint ventures are as follows:

Name	County of registration	Activity	Total issued share capital £000	Proportion held %
Ibero – Eurosur S.L	Spain	Holding company of Deutsche Touring	7,885	20
Movelia Tecnologias S.L	Spain	Travel website	2,640	42

The financial information of these joint ventures is summarised below:

	Ibero		Movelia		Total	
Share of joint ventures' balance sheets	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Non-current assets	**3.0**	–	**0.5**	0.4	**3.5**	0.4
Current assets	**0.5**	3.7	**0.7**	0.6	**1.2**	4.3
Share of gross assets	**3.5**	3.7	**1.2**	1.0	**4.7**	4.7
Non-current liabilities	**(2.0)**	(2.1)	**(0.1)**	(0.3)	**(2.1)**	(2.4)
Current liabilities	**–**	–	**(0.4)**	(0.1)	**(0.4)**	(0.1)
Share of gross liabilities	**(2.0)**	(2.1)	**(0.5)**	(0.4)	**(2.5)**	(2.5)
Share of net assets[1]	**1.5**	1.6	**0.7**	0.6	**2.2**	2.2

1 Movelia Tecnologias S.L.'s share of net assets incorporates a capital increase adjustment of £0.2m.

	Ibero		Movelia		Total	
Share of joint ventures' revenue and loss	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Revenue	**0.1**	–	**0.2**	–	**0.3**	–
Loss	**(0.1)**	–	**(0.1)**	–	**(0.2)**	–

The carrying amount of the investment in joint ventures matches the Group's share of the net assets.

18 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (CONTINUED)

b) Investments in associates

The Group's carrying amount of the investment in associates is disclosed as follows:

	Altram	ICRRL		Alsa		Total	
	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Carrying amount of investment	–	**–**	–	**6.5**	2.6	**6.5**	2.6

As described in note 19b, Altram became a subsidiary on 14 March 2006.

The Group's interests in associates are as follows:

Name	County of registration	Total issued share capital £000	Proportion held %
Inter-Capital and Regional Rail Limited	England and Wales	1	40
Alsa associates	Spain	4,591	20–50

Inter-Capital and Regional Rail Limited ("ICRRL") is contracted to manage the operations of Eurostar UK until 2010. The associates of Alsa are generally involved in the operation of coach and bus services, management of bus stations and similar operations.

The associates' financial information is summarised below:

	Altram		ICRRL		Alsa		Total	
Share of associates' balance sheets:	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Non-current assets	**–**	–	**–**	–	**6.2**	3.8	**6.2**	3.8
Current assets	**–**	2.1	**6.6**	4.0	**10.1**	3.9	**16.7**	10.0
Share of gross assets	**–**	2.1	**6.6**	4.0	**16.3**	7.7	**22.9**	13.8
Non-current liabilities	**–**	–	**–**	–	**(2.8)**	(1.5)	**(2.8)**	(1.5)
Current liabilities	**–**	(3.0)	**(30.6)**	(20.9)	**(7.0)**	(3.6)	**(37.6)**	(27.5)
Share of gross liabilities	**–**	(3.0)	**(30.6)**	(20.9)	**(9.8)**	(5.1)	**(40.4)**	(29.0)
Share of net assets/(liabilities)	**–**	(0.9)	**(24.0)**	(16.9)	**6.5**	2.6	**(17.5)**	(15.2)

The Group's net investment in associates is £6.5m (2005: £2.6m) which comprises the Alsa associates only. The increase in the year represents the Group's acquisition of a 25% share in Bilbobus, the largest private operator in Bilbao.

The Group's obligation in respect of ICRRL is included in provisions.

	Revenue		Profit/(loss)	
Share of associates' revenue and results:	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Alsa associates	**7.6**	–	**0.2**	–
Altram	**0.4**	2.0	**0.1**	(0.2)
Total associate results excluding ICRRL	**8.0**	2.0	**0.3**	(0.2)
Normalised ICRRL	**1.9**	1.8	**(3.9)**	(8.6)
Total normalised associates' results	**9.9**	3.8	**(3.6)**	(8.8)
Exceptional ICRRL charge	**–**	–	**(25.7)**	–
Total associates' results	**9.9**	3.8	**(29.3)**	(8.8)

An onerous contract provision has been recognised in the year in relation to the Group's obligation to fund the losses of ICRRL. This has resulted in a total income statement charge of £29.6m of which £25.7m is included in exceptional items.

19 BUSINESS COMBINATIONS AND DISPOSALS
a) Acquisitions
2006 acquisitions
In Canada, the Group acquired the net assets of school bus operators Vine (Vine Bus Lines Ltd) on 7 July 2006, M&O (M&O Bus Lines (Handicab) Ltd) on 11 April 2006, and the entire share capital of Deluxe (Palangio Enterprises (1982) Ltd) on 29 September 2006. In the United States, the Group acquired the entire share capital of school bus operators Reliance (Reliance Motor Coach Company Inc.) on 1 June 2006, and Double A (Double A Transportation Inc.) on 15 December 2006. The Group also acquired the net assets of J&R (J&R Bus Co., LLC) on 20 October 2006, a school bus operator in the United States.

North America Net assets at date of acquisition:	Reliance £m	J&R £m	Double A £m	Deluxe £m	M&O/Vine £m	Book value Total £m	Fair value adjustments £m	**Fair value Total £m**
Intangible assets	–	–	–	–	–	–	10.5	**10.5**
Property, plant and equipment	4.4	1.1	4.0	1.4	0.5	11.4	0.4	**11.8**
Trade and other receivables	0.7	–	0.2	–	–	0.9	0.5	**1.4**
Cash and cash equivalents	0.2	–	0.3	–	–	0.5	–	**0.5**
Trade and other payables	(1.5)	–	(0.8)	(0.1)	–	(2.4)	0.1	**(2.3)**
Deferred tax liability	(1.0)	–	–	–	–	(1.0)	(3.1)	**(4.1)**
Net assets acquired	2.8	1.1	3.7	1.3	0.5	9.4	8.4	**17.8**
Goodwill on acquisition								**8.7**
Total consideration								**26.5**
Net consideration								**25.4**
Acquisition costs								**1.1**
Total consideration								**26.5**
Less: deferred consideration								**(0.9)**
Less: acquisition costs accrued								**(0.3)**
Less: net cash acquired								**(0.5)**
Net cash outflow								**24.8**

The acquisition balance sheets have been adjusted to reflect provisional fair value adjustments The adjustments represent:

a) the recognition of finite life intangible assets of customer contracts acquired with the Reliance business (£4.4m), J&R (£0.4m), Double A (£1.9m) and Deluxe (£0.6m), and of indefinite life intangible assets of customer relationships acquired with J&R (£2.3m) and Deluxe (£0.9m) which reflects the expected indefinite renewal of these school bus contracts in North America. The customer contracts will be amortised over the life of the contracts, whilst customer relationships will not be amortised, but will be tested for impairment on an annual basis;

b) an adjustment to the value of property, plant and equipment at J&R and Double A following a review of the vehicle fleet;

c) an increase in working capital of £0.6m to reflect the liabilities excluded from the opening balance sheet at Double A (£0.5m) and Reliance (£0.3m), offset by an increase in insurance provisions of £0.2m at Double A; and

d) the deferred tax liability recognised on the customer contracts, customer relationships and property, plant and equipment.

Consideration was £10.8m for Reliance (including £0.1m acquisition costs), £4.6m for J&R (including £0.2m acquisition costs and £0.8m deferred consideration), £7.2m for Double A (including £0.4m acquisition costs), £3.0m for Deluxe (including £0.1m deferred consideration and £0.4m acquisition costs), and £0.9m for M&O and Vine.

From their respective dates of acquisition Reliance, J&R, Double A and the Canadian acquisitions have contributed £0.6m, £0.1m, £0.1m and £0.2m respectively to operating profit of the Group. If these combinations had taken place at the beginning of the year the Group operating profit would have been £142.6m, and revenue from continuing operations would have been £2,541.7m.

Included in the goodwill recognised above are certain intangible assets that cannot be separately identified and measured due to their nature. This includes control over the acquired businesses and increased scale in our North American school bus operations. Management believes that goodwill represents value to the Group for which the recognition of a discrete intangible asset is not permitted. The majority of the value was assessed to comprise of synergy benefits expected to be achieved by merging the businesses acquired into the Group's North American operations.

19 BUSINESS COMBINATIONS AND DISPOSALS (CONTINUED)

a) Acquisitions (continued)

On 14 March 2006 the Group acquired the remaining 67% of the share capital of Altram LRT Limited (Altram), a provider of light transport systems, for £0.2m, giving rise to goodwill of a further £1.0m which has been impaired.

Altram

	Final fair value Total £m
Current assets	**5.9**
Current liabilities	**(7.4)**
Net liabilities acquired	**(1.5)**
Share of associate's liabilities	**0.7**
Goodwill on acquisition	**1.0**
Total consideration	**0.2**
Net consideration	**–**
Acquisition costs	**0.2**
Total consideration	**0.2**
Less: net cash acquired	**(5.2)**
Net cash inflow	**(5.0)**

Altram has contributed a £0.4m loss to operating profit of the Group. If the remaining 67% of share capital had been acquired at the beginning of the year, the operating profit of the Group would have been £141.7m and revenue from continuing operations would have been £2,526.3m.

2005 acquisitions

The project to allocate the consideration paid in 2005 to acquire Alsa to the fair value of the assets acquired was completed in the first half of the year. The fair values of the assets acquired have now been updated.

Alsa	Original fair value £m	2005 Fair value adjustments £m	2006 Fair value adjustments £m	Final fair value total £m
Intangible assets	178.2	(178.2)	174.2	**174.2**
Property, plant and equipment	59.2	14.4	7.2	**80.8**
Available for sale investments	1.2	-	-	**1.2**
Investments accounted for under the equity method	6.0	(1.2)	-	**4.8**
Inventories	3.1	-	-	**3.1**
Trade and other receivables	52.8	(3.8)	-	**49.0**
Current tax	0.8	-	-	**0.8**
Cash and cash equivalents	10.0	-	-	**10.0**
Trade and other payables	(55.4)	-	0.3	**(55.1)**
Retirement benefit obligations	(0.2)	(0.9)	-	**(1.1)**
Provisions	(1.0)	-	-	**(1.0)**
Financial liabilities – Borrowings	(211.8)	-	-	**(211.8)**
Deferred tax liability	0.4	(6.5)	(54.8)	**(60.9)**
Net assets	43.3	(176.2)	126.9	**(6.0)**
Less: minority interest	(11.4)	(4.1)	-	**(15.5)**
Group's share of net assets	31.9	(180.3)	126.9	**(21.5)**
Goodwill on acquisition				**294.1**
Total consideration				**272.6**
Net consideration				**268.2**
Acquisition costs				**4.4**
Total consideration				**272.6**
Less: shares issued				**(122.5)**
Add: provisional completion adjustment receivable				**3.0**
Less: accrued acquisition costs				**(0.2)**
Less: net cash acquired				**(10.0)**
Net cash outflow				**142.9**

During the year ended 31 December 2005, provisional fair value adjustments were made to the assets and liabilities acquired. Due to the proximity of the combination to the 2005 year end, the Group completed the detailed valuation of the intangible and tangible assets acquired with the business during the year ended 31 December 2006. In accordance with IFRS 3 the 2005 comparative balance sheet has been restated to reflect the final fair value adjustments made during the year ended 31 December 2006.

19 BUSINESS COMBINATIONS AND DISPOSALS (CONTINUED)
a) Acquisitions (continued)
The final fair value adjustments represent:

a) the recognition of finite life customer contracts of £174.2m;

b) an upward revaluation of property acquired;

c) a change in the value of working capital acquired; and

d) the deferred tax liability associated with the revaluation of property of £2.5m, and on the customer contracts recognised on acquisition of £52.3m

On 15 December 2005 the Group paid £12.7m of cash consideration to acquire the 10.2% minority interest of Enatcar, a subsidiary of Alsa. This payment represented fair value and consequently had no impact on the goodwill recognised above. Due to the date of acquisition, the profit accrued in 2005 was not material to the Group.

In addition, during the year ended 31 December 2005, the Group acquired the entire share capital of TGM Buses Limited and TGM Middlesex Limited, representing the London bus operations of Tellings Golden Miller PLC (TGM), Aboutown School Transit Inc and Northstar Passenger Services LP, both school bus operators in Canada and Jones School Bus Service Inc, a school bus operator in the United States.

UK Bus and North America Net assets at date of acquisition:	Book value TGM £m	Aboutown £m	Northstar £m	Jones £m	Total £m	Fair value adjustments £m	Fair value Total £m
Intangible assets	–	–	–	–	–	26.2	26.2
Property, plant and equipment	6.3	0.5	13.9	5.9	26.6	1.6	28.2
Inventories	0.2	–	0.2	–	0.4	–	0.4
Trade and other receivables	2.2	–	0.6	2.7	5.5	–	5.5
Cash and cash equivalents	1.8	–	–	0.2	2.0	–	2.0
Trade and other payables	(2.0)	–	(1.2)	(3.2)	(6.4)	(2.1)	(8.5)
Current tax payable	–	–	(0.3)	–	(0.3)	–	(0.3)
Financial liabilities – borrowings	(2.1)	–	(0.2)	–	(2.3)	–	(2.3)
Deferred tax liability	(1.0)	–	(2.2)	(1.7)	(4.9)	–	(4.9)
Net assets acquired	5.4	0.5	10.8	3.9	20.6	25.7	46.3
Goodwill on acquisition							20.8
Total consideration							67.1
Net consideration							65.9
Acquisition costs							1.2
Total consideration							67.1
Less: deferred consideration							(1.9)
Less: net cash acquired							(2.0)
Net cash outflow							63.2

The acquisition balance sheets were adjusted to reflect provisional fair value adjustments.

The adjustments represented:

a) the recognition of customer contracts acquired with the TGM business (£4.5m), Aboutown (£0.6m), Northstar (£1.5m) and Jones (£6.3m), and customer relationships acquired with Aboutown (£2.8m) and Northstar (£10.5m) which reflects the expected indefinite renewal of these school bus contracts in Canada. The customer contracts are amortised over the life of the contracts, whilst customer relationships are not amortised, but are tested for impairment on an annual basis;

b) an increase in the value of property, plant and equipment at Jones following a review of the vehicle fleet; and

c) an increase in payables of £1.6m at TGM, £0.3m at Jones and £0.2m at Northstar.

b) Disposals
Certain assets of Stewart International Airport meet the definition of non-current assets held for resale following the Group's announcement of the sale of the operating lease to the Port Authority of New York in 2007. The sale is expected to complete in the second half of the year. The assets and related liabilities of the disposal group have been separately identified on the balance sheet.

Stewart International Airport

	Assets held for resale £m
Property, plant and equipment	2.6
Leasehold prepayment	17.5
Current liabilities	(2.4)
Net assets held for resale	17.7

19 BUSINESS COMBINATIONS AND DISPOSALS (CONTINUED)

b) Disposals (continued)

During the year ended 31 December 2005, the Group sold its North American Public Transit operations on 1 September 2005 for gross proceeds of £50.0m. The Group announced the voluntary administration of the Bosnjak Holdings Group (comprising the Group's remaining operations in Australia) on 31 January 2005, and received proceeds of £25.4m (A$60m) when the administrator sold the business on 30 September 2005. The Group also sold its airside coach business at Heathrow Airport on 21 February 2005.

2005 Net assets disposed of:	North American Public Transit £m	Bosnjak Group £m	Heathrow airside £m	Total £m
Property, plant and equipment	5.5	26.0	1.1	32.6
Inventories	1.9	0.2	–	2.1
Trade and other receivables	28.1	2.6	–	30.7
Cash and cash equivalents	2.5	2.1	–	4.6
Trade and other payables	(11.9)	(2.7)	–	(14.6)
Provisions	(10.0)	–	–	(10.0)
Deferred tax	(1.8)	(0.1)	–	(1.9)
Minority interest	–	(0.9)	–	(0.9)
Interest bearing liabilities	–	(2.8)	–	(2.8)
Net assets disposed	14.3	24.4	1.1	39.8
Goodwill realised	36.0	–	0.1	36.1
Disposal provision created	2.7	–	–	2.7
Deferred tax liability on disposal	3.2	–	–	3.2
Loss on sale of businesses	(6.6)	–	–	(6.6)
Net consideration	49.6	24.4	1.2	75.2
Total consideration	50.0	25.9	1.2	77.1
Less: disposal costs	(0.4)	(1.5)	–	(1.9)
Net consideration	49.6	24.4	1.2	75.2
Less: net cash disposed	(2.5)	(2.1)	–	(4.6)
Add: completion adjustment to pay purchaser	1.2	–	–	1.2
Deferred consideration	–	(0.5)	–	(0.5)
Net cash inflow	48.3	21.8	1.2	71.3

20 NON-CURRENT ASSETS – OTHER RECEIVABLES

	2006 £m	2005 £m
Other receivables	**1.8**	2.9
Prepayments and accrued income	**2.3**	23.3
	4.1	26.2

21 INVENTORIES

	2006 £m	2005 £m
Raw materials and consumables	**15.5**	18.7

The movement on the provision for slow moving and obsolete inventory is immaterial.

22 CURRENT ASSETS – TRADE AND OTHER RECEIVABLES

	2006 £m	2005 £m
Trade receivables	**172.9**	160.6
Less: provision for impairment of receivables	**(5.6)**	(2.6)
Trade receivables – net	**167.3**	158.0
Amounts due from associates and joint ventures	**3.3**	7.9
Amounts owed by related parties	**0.6**	2.9
Other receivables	**51.2**	62.3
Prepayments and accrued income	**49.9**	70.7
	272.3	301.8

The charge to the income statement in respect of trade receivables not recovered was £3.0m (2005: £0.2m). Credit risk with respect to trade receivables is low as a large proportion of the Group's trading is with public or quasi-public organisations.

23 CASH AND CASH EQUIVALENTS

	2006 £m	2005 £m
Cash at bank and in hand	**43.7**	53.2
Overnight deposits	**21.6**	24.5
Other short-term deposits	**78.3**	67.8
Cash and cash equivalents as stated in Group balance sheet	**143.6**	145.5
Bank overdrafts (note 28)	**–**	(5.5)
Cash and cash equivalents included in Group statement of cash flows	**143.6**	140.0

Included in cash and cash equivalents are restricted balances of £33.5m (2005: £79.5m) held by the TOCs due to restrictions included in the franchise agreements and £nil (2005: £25.6m (A$60.1m)) held by NBC Pty Ltd in Australia.

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. The fair value of cash and cash equivalents matches the carrying value.

24 CURRENT LIABILITIES – TRADE AND OTHER PAYABLES

	2006 £m	2005* £m
Trade payables	**187.3**	174.8
Amounts owed to associates and joint ventures	**1.0**	8.8
Amounts owed to related parties	**1.9**	1.7
Other tax and social security payable	**22.4**	25.0
Accruals and deferred income	**206.0**	201.0
Other payables	**99.8**	121.1
	518.4	532.4

*Adjusted for Alsa fair value movements as required by IFRS 3.

Trade payables are non-interest bearing and are normally settled on 30 day terms and other payables are non-interest bearing and have an average term of two months. Included within other payables are deferred fixed asset grants from government or other public bodies of £1.5m (2005: £2.0m).

25 OTHER NON-CURRENT LIABILITIES

	2006 £m	2005 £m
Other liabilities	**3.0**	6.1

Other non-current liabilities comprise deferred consideration of £nil (2005: £3.5m), deferred fixed asset grants of £2.5m (2005: £1.7m) and other liabilities of £0.5m (2005: £0.9m).

26 PROVISIONS

	Insurance claims[a] £m	Eurostar onerous contract provision[b] £m	Other[c] £m	Total £m
At 1 January 2006	41.1	–	12.5	53.6
Charged to income statement	13.8	29.6	3.7	47.1
Utilised in the year	(15.8)	–	(5.9)	(21.7)
Amortisation of discount	1.1	1.0	–	2.1
Exchange difference	(1.7)	–	(0.7)	(2.4)
At 31 December 2006	**38.5**	**30.6**	**9.6**	**78.7**
Current 31 December 2006	8.1	9.3	–	17.4
Non-current 31 December 2006	30.4	21.3	9.6	61.3
	38.5	**30.6**	**9.6**	**78.7**
Current 31 December 2005	8.3	–	4.0	12.3
Non-current 31 December 2005	32.8	–	8.5	41.3
	41.1	–	12.5	53.6

a) The insurance claims provision arises from estimated exposures at the year end, the majority of which will be utilised in the next six years, and principally comprises provisions for existing claims arising in the UK and North America.

b) A provision of £29.6m was recognised for the Group's onerous contract for Eurostar with ICRRL.

c) A provision of £3.2m was recognised for an increase in the expected liabilities in relation to the North American Public Transit business that was disposed of in 2005. These liabilities arise as the Group is a party to an industry-wide litigation in respect of working time regulations. A provision has been recognised for the expected value of the settlement, but the total amount of the provisions recognised by the Group is not disclosed as this may prejudice the Group's position in this matter. £5.3m has been utilised in the year for the onerous contract on the acquisition of Travel London.

When the effect is material, the provisions are discontinued to their net present value.

27 DEFERRED TAX

	2006 £m	2005* £m
Net deferred tax (liability)/asset brought forward	**(58.9)**	13.8
Deferred tax recognised on financial instruments on adoption of IAS 39	**–**	5.6
Net deferred tax (liability)/asset at 1 January	**(58.9)**	19.4
Acquisition of subsidiaries	**(4.1)**	(65.8)
Charge to income statement	**(9.8)**	(18.7)
(Charge)/credit to reserves	**(3.3)**	9.0
Attributable to discontinued operations	**–**	1.9
Charged in loss on disposal	**–**	(3.2)
Exchange differences	**2.4**	(1.5)
Net deferred tax liability at 31 December	**(73.7)**	(58.9)

*Adjusted for Alsa fair value movements as required by IFRS 3.

Based on current capital investment plans, the Group expects to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

The movements in deferred tax assets and liabilities during the period are shown below. Deferred tax liabilities and assets within the same jurisdiction have been offset.

Deferred tax assets	Accelerated tax depreciation £m	Losses carried forward £m	Short-term temporary differences £m	Total £m
At 1 January 2005	(4.5)	–	28.4	23.9
Charged to income statement	(3.9)	–	(5.0)	(8.9)
Credited directly to equity	–	–	9.0	9.0
Acquisition of subsidiaries	–	–	(1.0)	(1.0)
At 31 December 2005	(8.4)	–	31.4	23.0
(Charged)/credited to income statement	(1.6)	0.1	(7.6)	(9.1)
Charged directly to equity	–	–	(3.3)	(3.3)
At 31 December 2006	**(10.0)**	**0.1**	**20.5**	**10.6**

27 DEFERRED TAX (CONTINUED)

Deferred tax liabilities:	Accelerated tax depreciation £m	Losses carried forward £m	Short-term temporary differences £m	Total £m
At 1 January 2005	(26.6)	11.1	11.0	(4.5)
(Charged)/credited to income statement	(10.4)	0.8	(0.2)	(9.8)
Acquisition of subsidiaries*	(10.1)	–	(54.7)	(64.8)
Attributable to discontinued operations	9.8	(2.8)	(5.1)	1.9
Included in loss on disposal	(3.2)	–	–	(3.2)
Exchange difference	(1.9)	0.4	–	(1.5)
At 31 December 2005	(42.4)	9.5	(49.0)	(81.9)
(Charged)/credited to income statement	(3.4)	(3.1)	5.8	(0.7)
Acquisition of subsidiaries	–	–	(4.1)	(4.1)
Exchange difference	1.6	(0.6)	1.4	2.4
At 31 December 2006	**(44.2)**	**5.8**	**(45.9)**	**(84.3)**

*Adjusted for Alsa fair value movements as required by IFRS 3.

28 FINANCIAL LIABILITIES

	31 December 2006 £m	31 December 2005 £m
Non-current		
Bank loans	**458.0**	410.0
Finance lease obligations	**80.4**	85.5
Financial liabilities – interest bearing loans and borrowings	**538.4**	495.5
Fuel price swaps	**2.6**	–
Interest rate swaps	**5.7**	8.3
Financial liabilities – derivative financial instruments	**8.3**	8.3
Non-current financial liabilities	**546.7**	503.8
Current		
Loan notes	**0.8**	0.8
Bank loans	**20.1**	184.5
Bank overdrafts	**–**	5.5
Finance lease obligations	**22.7**	23.6
Financial liabilities – interest bearing loans and borrowings	**43.6**	214.4
Foreign exchange forward contracts	**–**	9.3
Fuel price swaps	**4.3**	–
Interest rate swaps	**2.1**	4.1
Financial liabilities – derivative financial instruments	**6.4**	13.4
Current financial liabilities	**50.0**	227.8

An analysis of interest bearing loans and borrowings is provided in note 29. Further information on derivative financial instruments is provided in note 31.

29 INTEREST BEARING LOANS AND BORROWINGS

The effective interest rates on loans and borrowings at the balance sheet date were as follows:

	Maturity	2006 £m	Effective interest rate	2005 £m	Effective interest rate
Current					
Bank overdraft		**–**	–	5.5	EURIBOR +0.5%
Sterling loan notes	On demand	**0.8**	LIBOR +1.0%	0.8	LIBOR +1.0%
Bank overdrafts and loan notes		**0.8**		6.3	
Short-term sterling bank loans		**–**	–	12.2	5.2%
Short-term US dollar bank loans	January 2007	**5.1**	LIBOR +1.0%	0.3	4.8%
Short-term euro bank loans	January 2007	**15.0**	EURIBOR +0.5%	0.2	2.9%
Euro bank loans unhedged		**–**	–	34.4	EURIBOR +0.4%
Euro bank loans subject to interest hedge		**–**	–	137.4	2.8%
Bank loans		**20.1**		184.5	
Canadian dollar finance leases		**–**	–	0.2	7.7%
US dollar finance leases	2007	**2.9**	3.6%	5.4	3.6%
US dollar finance leases at floating rate	2007	**2.6**	LIBOR –0.3%	–	–
Euro finance leases at floating rate	2007	**3.0**	EURIBOR +0.5%	2.0	EURIBOR +0.5%
Sterling finance leases	2007	**5.9**	5.4%	8.2	5.4%
Sterling finance leases at floating rate	2007	**8.3**	LIBOR +3.0%	7.8	LIBOR +3.0%
Finance leases		**22.7**		23.6	
Total current		**43.6**		214.4	
Non-current					
Sterling bank loans		**–**	–	9.4	LIBOR +0.4%
US dollar bank loans subject to interest rate hedge	June 2011	**51.0**	7.3%	58.1	7.3%
US dollar bank loans unhedged	June 2011	**45.9**	LIBOR +0.4%	104.6	LIBOR +0.4%
Euro bank loans subject to interest rate hedge	June 2011	**235.8**	3.6%	–	–
Euro bank loans at floating rate	June 2011	**84.2**	EURIBOR +0.4%	202.9	EURIBOR +0.4%
Canadian dollar bank loans	June 2011	**41.1**	LIBOR +0.4%	35.0	LIBOR +0.4%
Bank loans		**458.0**		410.0	
Canadian dollar finance leases		**–**	–	0.2	7.7%
US dollar finance leases	2009–2012	**18.5**	3.6%	28.3	3.6%
US dollar finance leases at floating rate	2009–2012	**22.4**	LIBOR –0.3%	–	–
Euro finance leases at floating rate	2008–2013	**3.0**	EURIBOR +0.5%	5.9	3.8%
Sterling finance leases	2008–2018	**31.5**	5.6%	37.5	5.4%
Sterling finance leases at floating rate	2008–2009	**5.0**	LIBOR +3.0%	13.6	LIBOR +3.0%
Finance leases		**80.4**		85.5	
Total non-current		**538.4**		495.5	

Details of the Group's interest rate management strategy and interest rate swaps are included in notes 30 and 31.

The Group is subject to a number of covenants in relation to its borrowing facilities which, if contravened, would result in its loans becoming immediately repayable. These covenants specify maximum net debt to EBITDA and minimum EBITDA to interest ratios.

30 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Financial risk factors and management

The Group's multi-national operations and significant debt financing expose it to a variety of financial risks, the most material of which are the effects of changes in foreign currency exchange rates, interest rates and changes in fuel prices. The Group has in place a risk management programme that seeks to limit the adverse effects of these risks on the financial performance of the Group by using financial instruments including borrowings, forward exchange contracts, fuel price and interest rate swaps.

The Board of Directors have delegated to a sub-committee, the Treasury committee, the responsibility for implementing the risk management policies laid down by the Board. The policies are implemented by the central treasury department that receives regular reports from all the operating companies to enable prompt identification of financial risks so that appropriate actions may be taken. The treasury department has a policy and procedures manual that sets out specific guidelines to manage foreign currency exchange risk, interest rate risk, credit risk including the use of financial instruments. The Group does not hold any financial instruments that would be classified as held for trading under IAS 39.

30 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

Foreign currency

The Group has major operations in the US, Canada, Spain and residual assets in Australia and as a result is exposed to foreign exchange risks on translation of net assets and on earnings denominated in foreign currency. The Group finances overseas investments mainly through the use of foreign currency borrowings to hedge the net asset investment. The Group has also entered into forward exchange contracts to hedge the foreign currency exposure of its overseas subsidiaries. These have the effect of increasing foreign currency denominated debt and reducing sterling debt. The forward exchange contract terms run for periods up to one year. The Group has a policy of hedging between 50% and 100% foreign currency denominated net assets. At 31 December 2006 78% of the Group's exposure to US dollar assets were hedged, 92% of the exposure to Canadian dollar assets, 89% of the exposure to Australian dollar assets and 94% of the exposure to euro assets.

The Group also has transactional currency exposures, and with the exception of fuel purchases the Group believes these exposures are immaterial.

Interest rate risk

The Group is exposed to interest rate risk on both interest bearing assets and interest bearing liabilities. It is the Group's policy to maintain an appropriate balance between fixed and floating interest rates on borrowings in order to provide certainty as to the level of our interest expense in the short-term and to reduce the year on year impact of interest rate fluctuations over the medium term. Interest on the Group's floating interest rate debt is based on LIBOR or EURIBOR and, to achieve the above objectives, the Group has entered into a series of interest rate swaps that have the effect of converting floating debt to fixed debt. The net effect of these transactions was that as at 31 December 2006 the Group was hedged against interest rate movements on £345.6m of gross debt for an average of 2.8 years. Based on the year end debt, each 1% increase in interest rates would cost the Group approximately £0.9m.

Commodity prices

The Group is exposed to commodity price risk as a result of fuel usage. It is our policy to hedge this exposure in order to provide certainty as to the level of costs in the short-term and to reduce the year on year impact of price fluctuations over the medium term. This is achieved by entering into fuel swaps and purchase contracts which are expected to be highly effective. As at 31 December 2006 the Group had hedged approximately 97% of its 2007 expected usage, 63% of its 2008 expected usage and 35% of its 2009 expected usage.

Credit risk

The maximum credit risk exposure of the Group is the gross carrying value of each of its financial assets. This risk is mitigated by a number of factors. The majority of the Group's receivables are public (or quasi-public) bodies, both national (DfT Rail and Network Rail in the UK) and local (school boards in North America, municipal authorities in Spain, Portugal and Morocco, Transport for London and Centro in the UK). The Group does not consider these counterparties to be a significant credit risk. Outside of this the Group does not consider it has significant concentrations of credit risk. The Group has implemented policies that require appropriate credit checks on potential customers before sales commence.

Financial instrument counterparties are subject to pre-approval by the Treasury Committee and such approval is limited to financial institutions with an A rating or better. The amount of exposure to any individual counterparty is subject to a limit, which is reassessed annually by the Treasury Committee.

Liquidity risk

The Group actively maintains a mixture of long term and short-term committed facilities that are designed to ensure the Group has sufficient available funds to meet current and forecast financial requirements as cost effectively as possible. As at 31 December 2006 the Group had committed borrowing facilities of £903.1m of which £247.8m were undrawn. The Group's primary loan facilities expire in June 2011 and the lease facilities at various times in line with their terms.

31 FINANCIAL INSTRUMENTS

Fair values

The fair value of foreign exchange forward contracts, fuel price and interest rate swaps has been determined by the third party financial institution with whom the Group holds the instrument, in line with the market value of similar financial instruments.

The fair value of the Group's financial assets and liabilities is equal to the carrying value.

Other receivables and other payables are to be settled in cash in the currency they are held in.

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement', the Group has reviewed all contracts for embedded derivatives that are required to be separately accounted for.

The following table sets out the carrying amount, by maturity of the Group's financial instruments that are exposed to interest rate risk.

As at 31 December 2006	<1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	>5 years £m	**Total £m**
Fixed rate							
Bank loans	–	–	–	–	(286.8)	–	**(286.8)**
Finance leases	(8.8)	(9.3)	(6.0)	(7.0)	(4.1)	(23.6)	**(58.8)**
Net interest rate swaps	(0.6)	–	–	(5.4)	–	–	**(6.0)**
Floating rate							
Cash assets	143.6	–	–	–	–	–	**143.6**
Loan notes	(0.8)	–	–	–	–	–	**(0.8)**
Bank loans	(20.1)	–	–	–	(171.2)	–	**(191.3)**
Finance leases	(13.9)	(9.6)	(4.4)	(3.5)	(1.7)	(11.2)	**(44.3)**

31 FINANCIAL INSTRUMENTS (CONTINUED)

As at 31 December 2005	<1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	>5 years £m	Total £m
Fixed rate							
Other debt receivable	1.0	–	–	–	–	–	1.0
Bank loans	(150.1)	–	–	(58.1)	–	–	(208.2)
Finance leases	(13.6)	(10.2)	(8.3)	(8.5)	(8.9)	(29.9)	(79.4)
Interest rate swaps	(4.1)	–	–	(8.3)	–	–	(12.4)
Floating rate							
Cash assets	145.5	–	–	–	–	–	145.5
Bank overdrafts	(5.5)	–	–	–	–	–	(5.5)
Loan notes	(0.8)	–	–	–	–	–	(0.8)
Bank loans	(34.4)	–	–	(351.9)	–	–	(386.3)
Finance leases	(10.0)	(12.7)	(2.5)	(2.0)	(1.0)	(1.5)	(29.7)

Hedging activities
The movement on derivative financial instruments is detailed below:

	Interest rate swaps £m	Foreign currency forward contracts £m	Fuel swaps £m	**Total £m**
Net (liability)/asset at 1 January 2006	(12.4)	(9.3)	7.3	**(14.4)**
Fair value taken to income statement	2.4	–	(0.8)	**1.6**
Revaluation	1.4	(0.4)	(13.1)	**(12.1)**
Exchange differences	2.6	16.3	(0.3)	**18.6**
Net (liability)/asset at 31 December 2006	**(6.0)**	**6.6**	**(6.9)**	**(6.3)**

	Interest rate swaps £m	Foreign currency forward contracts £m	Fuel swaps £m	Total £m
Net (liability)/asset at 1 January 2005	(27.5)	14.9	6.3	(6.3)
Closed out during year	11.9	–	–	11.9
Fair value taken to income statement	3.5	–	(12.9)	(9.4)
Revaluation	1.3	(0.1)	13.3	14.5
Exchange differences	(1.6)	(24.1)	0.6	(25.1)
Net (liability)/asset at 31 December 2005	(12.4)	(9.3)	7.3	(14.4)

Interest hedges
The Group has a number of interest rate swaps in place to hedge both the cash flow and fair value risk in relation to interest rates. These instruments are summarised below:

a) A cash flow hedge with a total principal of US$100m that was entered into in September 2000 fixed at 6.8545% until September 2010.

b) A cash flow hedge with a principal of €200m that was entered into in December 2005 fixed at 2.84% until December 2007.

c) A cash flow hedge with a principal of €150m that was entered into in December 2006 fixed at 3.77% until December 2008

d) An interest rate swap of US$100m that was entered into in September 2000 fixed at 6.9% and a separate US$100m interest rate swap that has the effect of fixing the accrued loss on the first swap. These instruments do not qualify for hedge accounting, the net effect on the income statement is immaterial.

The conditions of all swaps remaining in place at 31 December 2006 coincide with the material conditions of the underlying loans.

The benchmark rate for floating rate financial liabilities is the relevant interbank borrowing rate.

During the year £2.4m has been transferred from the hedging reserve to the income statement in respect of interest rate swaps.

31 FINANCIAL INSTRUMENTS (CONTINUED)

Hedging activities (continued)

Hedge of net investments in foreign entities

Included in bank loans are borrowings of US$190m (£96.9m) (2005: US$280m (£162.7m)), CAN$96m (£41.1m) (2005: CAN$70m (£35.0m)) and €475m (£320.0m) (2005: €545m (£374.9m)) which have been designated as a hedge of net investments in the foreign currency denominated net assets of the Group and are being used to reduce the exposure to foreign exchange risk. In addition the Group has synthetic debt in the form of foreign currency forward contracts in place split between US$185.0m (£94.4m) (2005: US$nil), CAN$150.0m (£65.7m) (2005: CAN$156.7m (£78.3m)), AUD$72.0m (£29.0m) (2005: AUD$80m (£34.1m)) and €200.5m (£135.1m) (2005: €160m (£110.1m)) to complete the post-tax hedge of the net investment in foreign entities. The portion of the gain or loss on the foreign currency forward contracts that is determined to be an effective hedge is recognised directly in equity and, to this extent, offsets any gains or losses on translation of the net investments in the subsidiaries.

Fuel price hedges

The Group has a number of fuel price swaps in place to hedge the different types of fuel used in each division. Ultra low sulphur diesel and gasoil as used in the UK Bus, UK Coach, UK Trains and European Coach & Bus (Alsa) divisions are hedged by swaps in the same type of fuel. Diesel used in the North American division is hedged by heating oil swaps which have been determined to be effective hedges of the fuel used with a strong correlation in price movements between the two products.

During the year £0.8m (2005: £12.9m) has been transferred from the hedging reserve, of which £6.7m (2005: £4.9m) was recognised in the hedging reserve at 1 January 2006 and the remainder was generated during the year due to the movement in market fuel prices.

Fuel price swaps can be analysed as follows:

	31 December 2006 £m	31 December 2005 £m	**31 December 2006 Volume Million litres**	31 December 2005 Volume Million litres
Sterling denominated fuel swaps – UK Bus, UK Coach and UK Trains	**(1.6)**	0.6	**131.5**	118.5
US dollar denominated fuel swaps – North American Bus	**(1.5)**	5.7	**45.4**	42.2
Euro denominated fuel swaps – European Coach & Bus (Alsa)	**(1.2)**	0.4	**44.4**	42.0
Fuel price swaps included in current (liabilities)/assets	**(4.3)**	6.7	**221.3**	202.7
Sterling denominated fuel swaps – UK Bus, UK Coach and UK Trains	**(0.7)**	0.6	**72.0**	59.0
US dollar denominated fuel swaps – North American Bus	**(0.9)**	–	**34.6**	–
Euro denominated fuel swaps – European Coach & Bus (Alsa)	**(1.0)**	–	**58.8**	–
Fuel price swaps included in non-current (liabilities)/assets	**(2.6)**	0.6	**165.4**	59.0
Total fuel price swaps	**(6.9)**	7.3	**386.7**	261.7

32 CALLED-UP SHARE CAPITAL

	2006 £m	2005 £m
At 31 December:		
Authorised:		
200,000,000 (2005: 200,000,000) ordinary shares of 5p each	**10.0**	10.0
Issued called-up and fully paid:		
153,835,012 (2005: 150,920,310) ordinary shares of 5p each	**7.7**	7.5

Movement in ordinary shares during the year:	£m	Number of shares
At 1 January 2005	7.0	139,153,158
Issue of shares in consideration for acquisition of Alsa (note 19)	0.7	13,503,600
Exercise of share options	–	957,141
TWM SIP appropriation	–	206,411
Shares purchased and cancelled	(0.2)	(2,900,000)
At 1 January 2006	7.5	150,920,310
Exercise of share options	0.2	2,914,702
At 31 December 2006	**7.7**	**153,835,012**

The total number of share options exercised in the year was 3,100,807 (2005: 1,856,558) of which 2,914,702 (2005: 957,141) exercises were satisfied by newly issued shares and 186,105 (2005: 899,417) exercises were satisfied by transferring shares from the National Express Employee Benefit Trust.

33 SHARE CAPITAL AND RESERVES

	Share capital £m	Share premium £m	Capital redemption reserve £m	Own shares £m	Other reserves (note 34) £m	Retained earnings £m	Total £m	Minority interests £m	Total equity £m
At 1 January 2006	7.5	174.2	0.2	(5.1)	24.5	108.1	309.4	2.9	312.3
Shares issued	0.2	15.6	–	–	–	–	15.8	–	15.8
Shares purchased	–	–	–	(11.6)	–	–	(11.6)	–	(11.6)
Total recognised expense/income	–	–	–	–	(16.6)	93.3	76.7	0.8	77.5
Share-based payments	–	–	–	–	–	2.0	2.0	–	2.0
Dividends	–	–	–	–	–	(50.1)	(50.1)	–	(50.1)
Payments to minority interest	–	–	–	–	–	–	–	(0.4)	(0.4)
At 31 December 2006	**7.7**	**189.8**	**0.2**	**(16.7)**	**7.9**	**153.3**	**342.2**	**3.3**	**345.5**

	Share capital £m	Share premium £m	Capital redemption reserve £m	Own shares £m	Other reserves (note 34) £m	Retained earnings £m	Total £m	Minority interests £m	Total equity £m
At 31 December 2004	7.0	47.5	–	(5.1)	13.3	203.2	265.9	0.9	266.8
Adoption of IAS 39	–	–	–	–	(5.9)	(6.9)	(12.8)	–	(12.8)
At 1 January 2005	7.0	47.5	–	(5.1)	7.4	196.3	253.1	0.9	254.0
Shares issued	0.7	126.7	–	–	–	–	127.4	–	127.4
Shares purchased	(0.2)	–	0.2	(3.5)	–	(25.8)	(29.3)	–	(29.3)
Acquisition of minority interest	–	–	–	–	–	–	–	2.8	2.8
Total recognised expense/income	–	–	–	–	17.1	(24.4)	(7.3)	0.1	(7.2)
Own shares released to satisfy employee share schemes	–	–	–	3.5	–	–	3.5	–	3.5
Disposal of subsidiaries	–	–	–	–	–	–	–	(0.9)	(0.9)
Share-based payments	–	–	–	–	–	3.6	3.6	–	3.6
Dividends	–	–	–	–	–	(41.6)	(41.6)	–	(41.6)
At 31 December 2005	7.5	174.2	0.2	(5.1)	24.5	108.1	309.4	2.9	312.3

Own shares comprise treasury shares and shares held in the Employee Benefit Trust.

Treasury shares include 1,825,000 (2005: 400,000) ordinary shares in the Company. During the year, the Group repurchased 1,425,000 (2005: 3,300,000) shares for consideration of £11.6m (2005: £29.3m). 1,425,000 (2005: 400,000) shares have been retained as treasury shares within equity for future issue under the Group's share schemes or cancellation. No shares were cancelled during the year (2005: 2,900,000).

Own shares include 663,351 (2005: 849,456) ordinary shares in the Company that have been purchased by the Trustees of the National Express Employee Benefit Trust (the "Trust"). During the year, the Trust purchased no (2005: 5,329) shares and 186,105 (2005: 899,417) shares were used to satisfy options granted under a number of the Company's share schemes. The value of shares within the Trust has been recognised as an investment in treasury shares. The market value of these shares at 31 December 2006 was £7.5m (2005: £7.3m). The dividends payable on these shares have been waived.

34 OTHER RESERVES

	Merger reserve £m	Hedging reserve £m	Translation reserve £m	Total £m
At 1 January 2006	15.4	(2.2)	11.3	24.5
Hedge movements net of tax	–	(6.8)	–	(6.8)
Exchange differences, net of tax	–	–	(9.8)	(9.8)
At 31 December 2006	**15.4**	**(9.0)**	**1.5**	**7.9**

	Merger reserve £m	Hedging reserve £m	Translation reserve £m	Total £m
At 31 December 2004	15.4	–	(2.1)	13.3
Adoption of IAS 39	–	(5.9)	–	(5.9)
At 1 January 2005	15.4	(5.9)	(2.1)	7.4
Hedge movements net of tax	–	3.7	–	3.7
Exchange differences, net of tax	–	–	11.9	11.9
Cumulative exchange differences of disposed operations	–	–	1.5	1.5
At 31 December 2005	**15.4**	**(2.2)**	**11.3**	**24.5**

The nature and purpose of the other reserves are as follows:

- the merger reserve includes the premium on shares issued to satisfy the purchase of Prism Rail PLC in 2000. The reserve is not distributable;
- the hedging reserve records the movements on designated hedging items, offset by any movements recognised directly in equity on underlying hedged items;
- the translation reserve records exchange differences arising from the translation of the accounts of foreign currency denominated subsidiaries offset by the movements on loans and derivatives used to hedge the net investment in foreign subsidiaries.

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS

a) Summary of pension benefits and assumptions

The UK Bus and UK Coach divisions operate both funded defined benefit schemes and a defined contribution scheme. The majority of employees of the UK Train companies are members of the appropriate shared-cost section of the Railways Pension Scheme (“RPS”), a funded defined benefit scheme. The assets of all schemes are held separately from those of the Group. Contributions to the schemes are determined by independent professionally qualified actuaries.

Subsidiaries in North America contribute to a number of defined contribution plans. The Group also provides certain additional unfunded post-employment benefits to employees in North America and Spain, which are disclosed in section c) in the Other category.

The total pension cost for the year was £23.9m (2005: £27.5m), of which £3.4m (2005: £2.5m) relates to the defined contribution schemes.

The defined benefit pension liability included in the balance sheet is as follows:

	2006 £m	2005 £m
UK Bus	**(17.3)**	(37.8)
UK Coach	**(12.7)**	(14.9)
UK Train	**(21.1)**	(34.2)
Other	**(1.7)**	(1.9)
Total	**(52.8)**	(88.8)

The valuations conducted for financial reporting purposes are based on the triennial actuarial valuations. A summary of the latest triennial actuarial valuations, and assumptions made, is as follows:

	UK Bus		UK Coach	UK Train
Date of actuarial valuation	Tayside 31 March 2005	Travel West Midlands 31 March 2004	5 April 2004	31 December 2004
Actuarial method used	Projected unit	Attained age*	Projected unit	Projected unit
Rate of investment returns per annum	6.0%	5.6%–6.6%	5.2%–6.0%	4.8%–6.8%
Increase in earnings per annum	4.3%	4.3%	4.7%	4.3%
Scheme assets taken at market value	£34.9m	£300.7m	£25.3m	£638.9m
Funding level	89%	88%	65%	86%–95%

*Amounts included in the income statement, statement of recognised income and expense and the balance sheet are calculated using the projected unit method.

The range of funding levels for UK Trains reflects the range of funding levels in the various sections of the RPS. The plans do not provide medical benefits.

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

a) Summary of pension benefits and assumptions (continued)

The most recent triennial valuations are then updated by independent professionally qualified actuaries for financial reporting purposes, in accordance with IAS 19. The main actuarial assumptions underlying the IAS 19 valuations are:

			2006			2005
	UK Bus	UK Coach	UK Trains	UK Bus	UK Coach	UK Trains
Rate of increase in salaries	**4.0%**	**4.0%**	**4.5%**	3.7%	3.7%	4.2%
Rate of increase of pensions	**3.0%**	**3.0%**	**3.0%**	2.7%	2.7%	2.7%
Discount rate	**5.1%**	**5.1%**	**5.1%**	4.8%	4.8%	4.8%
Inflation assumption	**3.0%**	**3.0%**	**3.0%**	2.7%	2.7%	2.7%
Expected rates of return on scheme assets:						
Equities	**7.9%**	**7.9%**	**7.9%**	8.0%	8.0%	8.0%
Bonds	**5.1%**	**5.1%**	**5.1%**	4.8%	4.8%	4.8%
Properties	**6.2%**	**6.2%**	**6.2%**	6.2%	6.2%	6.2%
Other	**4.3%**	**4.3%**	**4.3%**	3.8%	3.8%	3.8%
Post retirement mortality in years:						
Current pensioners at 65 – male	**17.8**	**21.3**	**17.8**	17.8	21.3	17.8
Current pensioners at 65 – female	**20.7**	**24.2**	**20.1**	20.7	24.2	20.1
Future pensioners at 65 – male	**19.4**	**23.1**	**18.8**	19.4	23.1	18.8
Future pensioners at 65 – female	**22.4**	**25.9**	**21.3**	22.4	25.9	21.3

The demographic assumptions reflect those included in the most recent triennial valuation. For the RPS, mortality assumptions are based on the recent experience of the Scheme with an allowance for future improvements in mortality.

Scheme assets are stated at their market values at the respective balance sheet dates. The expected rate of return on scheme assets is determined based on the market returns prevailing on that date.

b) Accounting for the Railways Pension Scheme

The majority of employees of the UK Train companies are members of the appropriate section of the RPS, a funded defined benefit scheme. The RPS is a shared cost scheme, which means that costs are formally shared 60% employer and 40% employee. To date, the Group has experienced five changes of UK Train franchise ownership where the current owner has funded the scheme during the franchise term and the pension deficit at franchise exit has transferred to the new owner, without cash settlement. However, although the Group's past experience has proven otherwise, our legal advisers have opined that in certain situations, the liability for the deficit on the relevant sections of the RPS could theoretically crystallise for funding by an individual TOC at the end of the franchise. By entering into the franchise contract, the TOC becomes the designated employer for the term of the contract and under the rules of the RPS must fund its share of the pension liability in accordance with the schedule of contributions agreed with the Scheme trustees and actuaries and for which there is no funding cap set out in the franchise contract. We understand that franchise contracts entered into in the future will clarify that RPS pension deficits and surpluses will not be the responsibility of the outgoing franchisee following exit.

To comply with IAS 19, the Group is required to account for its legal obligation under the formal terms of the RPS and its constructive obligation that arises under the terms of each franchise agreement.

In determining the appropriate accounting policy for the RPS to ensure that the Group's accounts present fairly its financial position, financial performance and cash flows, management has consulted with TOC industry peers and has concluded that the Group's constructive but not its legal RPS defined benefit obligations should be accounted for in accordance with IAS 19. This accounting policy, which in all other respects is consistent with that set out in this note for the Group's other defined benefit schemes, means that the Group's accounts reflect that element of the deficits anticipated to be settled by the Group during the franchise term and will prevent gains arising on transfer of the existing RPS deficits to a new owner at franchise exit.

In calculating the Group's constructive obligations in respect of the RPS, the Group has calculated the total pension deficits in each of the RPS sections in accordance with IAS 19 and the assumptions set out above. These deficits are reduced by a 'franchise adjustment' which is that portion of the deficit projected to exist at the end of the franchise and for which the Group will not be required to fund. The franchise adjustment, which has been calculated by the Group's actuaries, is offset against the present value of the RPS liabilities so as to fairly present the financial performance, position and cash flows of the Group's obligations.

The franchise adjustment decreased from £71.0m at 31 December 2005 to £44.4m at 31 December 2006. The decrease is caused by interest on the franchise adjustment of £2.5m offset by net actuarial movements in scheme liabilities of £6.7m and by £22.4m relating to the franchise exits. In the prior year, the franchise adjustment increased by £3.4m from £67.6m at 1 January 2005 to £71.0m at 31 December 2005. The increase was caused by interest on the franchise adjustment of £3.6m offset by net actuarial movements in scheme liabilities of £0.2m.

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

b) Accounting for the Railways Pension Scheme (continued)

If the Group had accounted for its legal obligation in respect of the RPS instead of the constructive obligation, the following adjustments would have been made to the financial information:

	2006 £m	2005 £m
Balance sheet		
Defined benefit pension deficit	**(44.4)**	(71.0)
Deferred tax asset	**13.6**	20.1
Intangible asset	**3.3**	3.4
Net reduction in net assets	**(27.5)**	(47.5)
Statement of recognised income and expense		
Actuarial gains/(losses)	**6.7**	0.2
Tax on actuarial gains and losses	**(0.3)**	0.3
Net increase in actuarial gains	**6.4**	0.5
Income statement		
Interest on franchise adjustment	**(2.5)**	(3.6)
Curtailment gain on franchise exit	**22.4**	–
Intangible asset amortisation	**0.2**	1.1
Deferred tax credit/(charge)	**(6.2)**	0.3
Net increase in income	**13.9**	(2.2)

c) Financial results for pension benefits

The amounts charged to the Group income statement and Group statement of recognised income and expense for the years ended 31 December 2006 and 2005 are set out in the following tables.

Year ended 31 December 2006

Group income statement	UK Bus 2006 £m	UK Coach 2006 £m	UK Trains 2006 £m	Other 2006 £m	**Total 2006 £m**
Amounts charged to normalised operating profit:					
Current service cost	(6.1)	(1.7)	(32.6)	(0.2)	**(40.6)**
Expected return on pension scheme assets	24.4	2.3	30.8	–	**57.5**
Interest on pension liabilities	(20.0)	(2.5)	(24.1)	–	**(46.6)**
Interest on franchise adjustment	–	–	2.5	–	**2.5**
Charge to normalised operating profit	(1.7)	(1.9)	(23.4)	(0.2)	**(27.2)**
Past service credit (within exceptional items)	4.9	1.8	–	–	**6.7**
Total charge to income statement	3.2	(0.1)	(23.4)	(0.2)	**(20.5)**
Actual return on plan assets	31.9	2.3	63.4	–	**97.6**

Group statement of recognised income and expense	UK Bus 2006 £m	UK Coach 2006 £m	UK Trains 2006 £m	Other 2006 £m	**Total 2006 £m**
Actual return less expected return on pension scheme assets	7.5	–	32.6	–	**40.1**
Other actuarial gains and losses	1.5	(0.5)	(20.5)	–	**(19.5)**
Actuarial gain/(loss)	9.0	(0.5)	12.1	–	**20.6**

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)
c) Financial results for pension benefits (continued)

Year ended 31 December 2005

Group income statement	UK Bus 2005 £m	UK Coach 2005 £m	UK Trains 2005 £m	Other 2005 £m	Total 2005 £m
Amounts charged to normalised operating profit:					
Current service cost	(5.3)	(1.6)	(31.2)	(0.2)	(38.3)
Expected return on pension scheme assets	23.9	2.1	30.1	–	56.1
Interest on pension liabilities	(20.2)	(2.2)	(24.0)	–	(46.4)
Interest on franchise adjustment	–	–	3.6	–	3.6
Charge to normalised operating profit	(1.6)	(1.7)	(21.5)	(0.2)	(25.0)
Total charge to income statement	(1.6)	(1.7)	(21.5)	(0.2)	(25.0)
Actual return on plan assets	59.2	4.6	84.5	–	148.3

Group statement of recognised income and expense	UK Bus 2005 £m	UK Coach 2005 £m	UK Trains 2005 £m	Other 2005 £m	Total 2005 £m
Actual return less expected return on pension scheme assets	35.3	2.5	54.4	–	92.2
Other actuarial gains and losses	(41.6)	(7.3)	(75.3)	–	(124.2)
Actuarial loss	(6.3)	(4.8)	(20.9)	–	(32.0)

The amounts recognised in the balance sheet at 31 December are:

As at 31 December 2006

	UK Bus 2006 £m	UK Coach 2006 £m	UK Trains 2006 £m	Other 2006 £m	**Total 2006 £m**
Equities	228.9	19.6	593.3	–	**841.8**
Bonds	169.1	20.0	78.4	–	**267.5**
Property	4.0	–	70.9	–	**74.9**
Other	4.0	0.3	0.8	–	**5.1**
Fair value of scheme assets	406.0	39.9	743.4	–	**1,189.3**
Present fair value of scheme liabilities	(423.3)	(52.6)	(808.9)	(1.7)	**(1,286.5)**
Franchise adjustment	–	–	44.4	–	**44.4**
Group's defined benefit obligation	(423.3)	(52.6)	(764.5)	(1.7)	**(1,242.1)**
Defined benefit pension deficit	(17.3)	(12.7)	(21.1)	(1.7)	**(52.8)**

As at 31 December 2005

	UK Bus 2005 £m	UK Coach 2005 £m	UK Trains 2005 £m	Other 2005 £m	Total 2005 £m
Equities	218.5	17.2	638.1	–	873.8
Bonds	159.7	18.5	88.2	–	266.4
Property	3.6	–	67.3	–	70.9
Other	4.0	–	2.8	–	6.8
Fair value of scheme assets	385.8	35.7	796.4	–	1,217.9
Present fair value of scheme liabilities	(423.6)	(50.6)	(901.6)	(1.9)	(1,377.7)
Franchise adjustment	–	–	71.0	–	71.0
Group's defined benefit obligation	(423.6)	(50.6)	(830.6)	(1.9)	(1,306.7)
Defined benefit pension deficit	(37.8)	(14.9)	(34.2)	(1.9)	(88.8)

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)

c) Financial results for pension benefits (continued)

The movement in the present value of the defined benefit obligation in the year is as stated below. For UK Trains, the RPS is a shared cost scheme, which means that costs are formally shared 60% employer and 40% employee. The defined benefit obligation disclosed below represents only the Group's share of the liability.

The Group's defined benefit obligation comprises £1,240.4m (2005: £1,304.8m) arising from plans that are wholly or partly funded and £1.7m (2005: £1.9m) from unfunded plans.

	UK Bus £m	UK Coach £m	UK Trains £m	Other £m	**Total £m**
Group's defined benefit obligation at 1 January 2006	(423.6)	(50.6)	(830.6)	(1.9)	**(1,306.7)**
Current service cost	(6.1)	(1.7)	(32.6)	(0.2)	**(40.6)**
Past service credit	4.9	1.8	–	–	**6.7**
Franchise extension	–	–	(0.3)	–	**(0.3)**
Franchise exit	–	–	176.2	–	**176.2**
Benefits paid	21.4	1.4	22.4	0.2	**45.4**
Contributions by employees	(1.4)	(0.5)	(14.9)	–	**(16.8)**
Finance charge	(20.0)	(2.5)	(24.1)	–	**(46.6)**
Interest on franchise adjustment	–	–	2.5	–	**2.5**
Liability movement for members' share of assets	–	–	(42.6)	–	**(42.6)**
Exchange difference	–	–	–	0.2	**0.2**
Actuarial loss recognised in statement of recognised income and expense	1.5	(0.5)	(20.5)	–	**(19.5)**
Group's defined benefit obligation at 31 December 2006	(423.3)	(52.6)	(764.5)	(1.7)	**(1,242.1)**

	UK Bus £m	UK Coach £m	UK Trains £m	Other £m	Total £m
Group's defined benefit obligation at 1 January 2005	(374.2)	(39.7)	(652.3)	(0.6)	(1,066.8)
Current service cost	(5.3)	(1.6)	(31.2)	(0.2)	(38.3)
Benefits paid	19.2	0.7	19.6	0.1	39.6
Contributions by employees	(1.5)	(0.5)	(14.5)	–	(16.5)
Finance charge	(20.2)	(2.2)	(24.0)	–	(46.4)
Interest on franchise adjustment	–	–	3.6	–	3.6
Liability movement for members' share of assets	–	–	(56.5)	–	(56.5)
Acquisition of subsidiary	–	–	–	(1.1)	(1.1)
Exchange difference	–	–	–	(0.1)	(0.1)
Actuarial loss recognised in statement of recognised income and expense	(41.6)	(7.3)	(75.3)	–	(124.2)
Group's defined benefit obligation at 31 December 2005	(423.6)	(50.6)	(830.6)	(1.9)	(1,306.7)

The movement in the fair value of scheme assets is as follows:

	UK Bus £m	UK Coach £m	UK Trains £m	**Total £m**
Fair value of scheme assets at 1 January 2006	385.8	35.7	796.4	**1,217.9**
Expected return	24.4	2.3	30.8	**57.5**
Franchise exit	–	–	(176.2)	**(176.2)**
Cash contributions – Employer	8.3	2.8	24.7	**35.8**
Cash contributions – Employee	1.4	0.5	14.9	**16.8**
Benefits paid	(21.4)	(1.4)	(22.4)	**(45.2)**
Members' share of return on assets	–	–	42.6	**42.6**
Actuarial gain recognised in statement of recognised income and expense	7.5	–	32.6	**40.1**
Fair value of scheme assets at 31 December 2006	406.0	39.9	743.4	**1,189.3**

35 PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (CONTINUED)
c) Financial results for pension benefits (continued)

	UK Bus £m	UK Coach £m	UK Trains £m	Total £m
Fair value of scheme assets at 1 January 2005	338.0	28.7	634.4	1,001.1
Expected return	23.9	2.1	30.1	56.1
Cash contributions – Employer	6.3	2.6	26.1	35.0
Cash contributions – Employee	1.5	0.5	14.5	16.5
Benefits paid	(19.2)	(0.7)	(19.6)	(39.5)
Members' share of return on assets	–	–	56.5	56.5
Actuarial gain recognised in statement of recognised income and expense	35.3	2.5	54.4	92.2
Fair value of scheme assets at 31 December 2005	385.8	35.7	796.4	1,217.9

The Group expects to contribute £33.8m to its defined benefit pension plans in 2007.

History of experience gains and losses:	**2006 £m**	2005 £m	2004 £m
UK Bus			
Fair value of scheme assets	**406.0**	385.8	338.0
Present value of Group's defined benefit obligation	**(423.3)**	(423.6)	(374.2)
Deficit in the scheme	**(17.3)**	(37.8)	(36.2)
Experience adjustments arising on liabilities	**(3.0)**	(3.3)	24.9
Experience adjustments arising on assets	**7.5**	35.3	9.8
UK Coach			
Fair value of scheme assets	**39.9**	35.7	28.7
Present value of Group's defined benefit obligation	**(52.6)**	(50.6)	(39.7)
Deficit in the scheme	**(12.7)**	(14.9)	(11.0)
Experience adjustments arising on liabilities	**(1.6)**	–	(0.4)
Experience adjustments arising on assets	**–**	2.5	1.7
UK Train			
Fair value of scheme assets	**743.4**	796.4	634.4
Present value of Group's defined benefit obligation	**(764.5)**	(830.6)	(652.3)
Deficit in the scheme	**(21.1)**	(34.2)	(17.9)
Experience adjustments arising on liabilities	**(25.5)**	(53.8)	(13.0)
Experience adjustments arising on assets	**32.6**	54.4	10.9
Other			
Fair value of scheme assets	**–**	–	–
Present value of Group's defined benefit obligation	**(1.7)**	(1.9)	(0.6)

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expense since 1 January 2004 is £13.7m loss (2005: £34.3m loss). The Directors are unable to determine how much of the pension scheme deficit recognised on transition to IFRSs and taken directly to equity of £51.9m is attributable to actuarial gains and losses since inception of those pension schemes. Consequently the Directors are unable to determine the amount of actuarial gains and losses that would have been recognised in the statement of recognised income and expense before 1 January 2004.

36 COMMITMENTS AND CONTINGENCIES

Operating lease commitments

The Group's total operating lease commitments are as follows:

		2006 £m	2005 £m
Future minimum rentals payable under non-cancellable operating leases:			
Within one year:	Land and Buildings	**394.1**	301.4
	Plant and Equipment	**215.8**	253.5
		609.9	554.9
After one year but not more than five years:	Land and Buildings	**609.8**	614.6
	Plant and Equipment	**433.1**	601.0
		1,042.9	1,215.6
More than five years:	Land and Buildings	**15.7**	43.7
	Plant and Equipment	**1.2**	37.7
		16.9	81.4
		1,669.7	1,851.9

The majority of the Group's commitments arise in the UK Trains division. Trains division companies have contracts with Network Rail Infrastructure Limited for access to the railway infrastructure (tracks, stations and depots). They also have contracts under which rolling stock is leased. The TOCs obligations to fulfil these commitments exist only as part of their franchise agreement. The table below reflects the commitments up to the current franchise end dates unless an extension or new franchise agreement has been signed. The commitments are based on charges advised by the Rail Regulator for the period starting on 1 April 2004. Commitments for future minimum rental payments under these contracts are shown below:

		Land and buildings		Plant and equipment	
UK Trains division commitments:		2006 £m	2005 £m	2006 £m	2005 £m
Future minimum rentals payable under non-cancellable operating leases:					
Within one year:	Fixed track access	**329.2**	226.4	**–**	–
	Rolling stock	**–**	–	**209.0**	241.0
	Other	**55.4**	66.0	**2.2**	2.2
		384.6	292.4	**211.2**	243.2
After one year but not more than five years:	Fixed track access	**479.4**	437.8	**–**	–
	Rolling stock	**–**	–	**419.7**	573.0
	Other	**105.7**	147.5	**5.5**	7.4
		585.1	585.3	**425.2**	580.4
More than five years:	Fixed track access	**–**	25.4	**–**	–
	Rolling stock	**–**	–	**–**	34.8
	Other	**0.1**	9.9	**1.2**	2.5
		0.1	35.3	**1.2**	37.3
		969.8	913.0	**637.6**	860.9

Fixed track access agreements have an average remaining life of 3.6 years (2005: 4.0 years), other land and buildings have an average duration of 3.9 years (2005: 4.9 years). Rolling stock agreements have an average life of 4.0 years (2005: 4.4 years) and other plant and equipment 5.1 years (2005: 6.2 years).

Outside of the UK Trains division the Group has entered into operating leases on certain properties, public service vehicles and various items of plant and equipment. Commitments for future minimum rental payments under cancellable operating leases are shown below:

	Land and buildings		Public service vehicles		Other	
Other divisions' commitments:	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Within one year:	**9.5**	9.0	**3.7**	7.7	**0.9**	2.6
After one year but not more than five years:	**24.7**	29.3	**5.7**	15.9	**2.2**	4.7
More than five years:	**15.6**	8.4	**–**	0.4	**–**	–
	49.8	46.7	**9.4**	24.0	**3.1**	7.3

The average remaining life of operating lease commitments in the 'Other divisions' is 8.8 years (2005: 6.7 years) for land and buildings, 2.7 years (2005: 3.2 years) for public service vehicles and 2.5 years (2005: 2.9 years) for other plant and equipment.

NOTES TO THE CONSOLIDATED ACCOUNTS
CONTINUED

36 COMMITMENTS AND CONTINGENCIES (CONTINUED)
Operating lease agreements where the Group is the lessor

The Group receives rent on properties as follows:

	2006 £m	2005 £m
Future minimum rentals receivable under non-cancellable operating leases:		
Within one year:	**4.9**	6.3
After one year but not more than five years:	**9.9**	16.7
More than five years:	**–**	5.0
	14.8	28.0

The leases have an average unexpired duration of 3.8 years (2005: 3.9 years).

Finance lease commitments

The Group has finance leases for public service vehicles and various items of plant and equipment. These leases have terms of renewal but no purchase options and escalation clauses. Renewals are at the option of the specific entity that holds the lease.

	2006		2005	
	Minimum payments £m	Present value of payments £m	Minimum payments £m	Present value of payments £m
Within one year	**27.3**	**22.7**	28.4	23.6
After one year but not more than five years	**57.0**	**45.6**	65.0	54.1
More than five years	**39.7**	**34.8**	38.8	31.4
Total minimum lease payments	**124.0**		132.2	
Less future financing charges	**(20.9)**		(23.1)	
Present value of minimum lease payments	**103.1**	**103.1**	109.1	109.1

Capital commitments

	2006 £m	2005 £m
Contracted	**25.4**	19.3

The Group is committed to vehicle purchases and various land and buildings improvements.

Contingent liabilities

Bonds and letters of credit

In the ordinary course of business, the Group is required to issue counter-indemnities in support of its operations. As at 31 December 2006, there were UK Train performance bonds of £46.9m (2005: £44.6m) and UK Train season ticket bonds of £85.3m (2005: £100.0m). The Group has other performance bonds which include the £15.0m (2005: £14.6m) performance bond in respect of ICRRL, performance bonds in respect of businesses in the US of £49.2m (2005: £34.5m) and the rest of Europe of £31.8m (2005: £9.6m). Letters of credit have been issued to support insurance retentions of £82.1m (2005: £84.7m).

Claims

The Directors' Report discloses that Ray O'Toole and Phil White have been joined as defendants in proceedings being brought before the Supreme Court of New South Wales. These proceedings relate to a period of time when Ray O'Toole and Phil White were directors of Bosnjak Holding Pty Ltd, which was a subsidiary of the Group. The Company is also a defendant to these proceedings. The Directors believe no liabilities will arise from these proceedings and therefore no provision has been made at 31 December 2006.

37 RELATED PARTY TRANSACTIONS

	Amount of transactions		Amounts due from related parties		Amounts due to related parties	
	2006 £m	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Associates						
Altram	**–**	7.0	**–**	5.3	**–**	–
ICRRL	**8.4**	1.7	**–**	–	**–**	(8.4)
Alsa associates	**0.3**	–	**2.4**	2.0	**(0.9)**	(0.3)
Joint ventures						
Alsa joint ventures	**0.2**	–	**0.9**	0.6	**(0.1)**	(0.1)
Trade investments						
Trainline Holdings Limited	**–**	–	**–**	2.5	**–**	–
Alsa trade investments	**0.8**	–	**0.1**	0.2	**(0.9)**	(1.7)
Property transactions						
Stock	**0.3**	0.3	**–**	–	**–**	–
Alsa	**3.5**	0.2	**0.5**	0.2	**(0.7)**	–
Durham	**–**	–	**–**	–	**(0.3)**	–
Total associates and joint ventures	**8.9**	8.7	**3.3**	7.9	**(1.0)**	(8.8)
Total other related parties	**4.6**	0.5	**0.6**	2.9	**(1.9)**	(1.7)
Total	**13.5**	9.2	**3.9**	10.8	**(2.9)**	(10.5)

Amounts due to ICRRL of £9.3m are included in provisions as disclosed in note 26.

As disclosed in note 19b, Altram became a subsidiary on 14 March 2006. As disclosed in note 17, the Group's investment in Trainline Holdings Limited was sold on 4 July 2006.

Property transactions
Brian Stock was appointed as Chief Executive of the Group's North American operations in October 2004. Stock Transportation Limited, a school bus operator in North America, was acquired in July 2002. As part of the Sale and Purchase Agreement, the Group entered into leases for eight properties at market rents and on standard terms and conditions. The rental payments of £0.3m (2005: £0.3m) are made to Stock Properties Limited and Stock Realty Limited, of which Brian Stock is a related party.

A number of Alsa companies have leased properties from companies related to the Cosmen family. Jorge Cosmen is a Non Executive Director of the Group. These leases were in place before the Group's acquisition of Alsa and are for appropriate market rates.

Compensation of key management personnel of the Group

	2006 £m	2005 £m
Total compensation paid to key management personnel (as disclosed in note 7)	**4.0**	3.0

Directors' interests in employee share plans are disclosed in the Report on Directors' Remuneration.

38 CASH FLOW STATEMENT

The net cash inflows from operating activities include outflows of £2.0m (2005: £7.7m) from continuing operations which related to exceptional costs.

a) Reconciliation of Group operating profit to cash generated from operations

Total Operations	2006 £m	2005 £m
Net cash inflow from operating activities		
Group operating profit	**141.6**	109.5
Operating loss of discontinued operations	**–**	(56.4)
Depreciation of property, plant and equipment	**81.7**	56.8
Amortisation of leasehold property prepayment	**0.6**	0.8
Goodwill impairment	**20.2**	93.3
Intangible asset amortisation	**27.8**	4.9
Amortisation of fixed asset grants	**(2.0)**	(0.9)
Profit on disposal of fixed assets (in operating profit)	**(3.1)**	(2.0)
Share-based payments	**2.0**	3.6
Decrease/(increase) in inventories	**2.9**	(0.7)
Decrease in receivables	**27.3**	22.4
Decrease in payables	**(21.1)**	(37.2)
Decrease in provisions	**(23.4)**	(13.0)
Cash generated from operations	**254.5**	181.1

Discontinued operations	2006 £m	2005 £m
Net cash inflow from operating activities		
Operating profit	**–**	(56.4)
Depreciation of property, plant and equipment	**–**	1.3
Goodwill impairment	**–**	60.0
Profit on disposal of fixed assets (in operating profit)	**–**	(0.1)
Share-based payments	**–**	0.1
Increase in inventories	**–**	(0.1)
Increase in receivables	**–**	(1.1)
Increase in payables	**–**	1.2
Decrease in provisions	**–**	(1.3)
Cash generated from operations	**–**	3.6

b) Analysis of changes in net debt

Net debt at 31 December 2006 comprises cash and cash equivalents of £143.6m (2005: £145.5m) as disclosed in note 23, current interest bearing loans and borrowings of £43.6m (2005: £214.4m) and non-current interest bearing loans and borrowings of £538.4m (2005: £495.5m) as disclosed in note 28 and other debt receivable of £nil (2005: £1.0m).

	At 1 January 2006 £m	Cash flow £m	Acquisitions/ Disposals £m	Exchange differences £m	Other movements £m	**At 31 December 2006 £m**
Cash	53.2	(8.1)	–	(1.4)	–	**43.7**
Overnight deposits	24.5	(2.9)	–	–	–	**21.6**
Other short-term deposits	67.8	12.0	–	(1.5)	–	**78.3**
Bank overdrafts	(5.5)	5.5	–	–	–	**–**
Cash and cash equivalents	140.0	6.5	–	(2.9)	–	**143.6**
Other debt receivable	1.0	(1.0)	–	–	–	**–**
Borrowings:						
Loan notes	(0.8)	–	–	–	–	**(0.8)**
Bank loans	(594.5)	89.9	(2.6)	30.0	(0.9)	**(478.1)**
Finance lease obligations	(109.1)	21.5	–	5.2	(20.7)	**(103.1)**
	(704.4)	111.4	(2.6)	35.2	(21.6)	**(582.0)**
Net debt	(563.4)	116.9	(2.6)	32.3	(21.6)	**(438.4)**

Short-term deposits included within liquid resources relate to term deposits repayable within three months. Changes in cash and cash equivalents arising from acquisitions and disposals in the year are disclosed separately on the face of the cash flow statement.

38 CASH FLOW STATEMENT (CONTINUED)

b) Analysis of changes in net debt (continued)

Other non cash movements in net debt represent finance lease additions of £20.7m (2005: £57.0m) and £0.9m (2005: £0.2m) amortisation of loan arrangement fees.

	At 1 January 2005 £m	Cash flow £m	Acquisitions/ Disposals £m	Exchange Differences £m	Other movements £m	At 31 December 2005 £m
Cash	26.8	25.0	–	1.4	–	53.2
Overnight deposits	24.1	0.4	–	–	–	24.5
Other short-term deposits	96.3	(29.8)	–	1.3	–	67.8
Bank overdrafts	–	(5.5)	–	–	–	(5.5)
Cash and cash equivalents	147.2	(9.9)	–	2.7	–	140.0
Other debt receivable	1.0	–	–	–	–	1.0
Borrowings:						
Loan notes	(7.5)	6.7	–	–	–	(0.8)
Bank loans	(215.5)	(148.1)	(204.0)	(26.7)	(0.2)	(594.5)
Finance lease obligations	(61.8)	20.0	(7.3)	(3.0)	(57.0)	(109.1)
	(284.8)	(121.4)	(211.3)	(29.7)	(57.2)	(704.4)
Net debt	(136.6)	(131.3)	(211.3)	(27.0)	(57.2)	(563.4)

c) Reconciliation of net cash flow to movement in net debt

	2006 £m	2005 £m
Increase/(decrease) in cash and cash equivalents in the year	**6.5**	(9.9)
Cash outflow/(inflow) from movement in debt and lease financing	**110.4**	(121.4)
Change in net debt resulting from cash flows	**116.9**	(131.3)
Change in net debt resulting from acquisitions and disposals	**(2.6)**	(211.3)
Change in net debt resulting from non cash flows	**10.7**	(84.2)
Movement in net debt in the year	**125.0**	(426.8)
Opening net debt	**(563.4)**	(136.6)
Net debt	**(438.4)**	(563.4)

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NATIONAL EXPRESS GROUP PLC

We have audited the parent company financial statements of National Express Group PLC for the year ended 31 December 2006 which comprise the Company Balance Sheet and the related notes 1 to 19. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of National Express Group PLC for the year ended 31 December 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS
The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the parent company Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Statement, the Operating and Financial Review, the Corporate Governance Statement, the Statement of Directors' Responsibilities, the unaudited part of the Report on Directors' Remuneration and the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the Directors' Remuneration Report to be audited.

OPINION
In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2006;
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

Ernst & Young LLP
Registered auditor
London
1 March 2007

COMPANY BALANCE SHEET
AT 31 DECEMBER 2006

	Note	2006 £m	2005 £m
Fixed assets			
Tangible assets	4	**1.0**	1.2
Financial assets – Other investments	5	**880.0**	1,151.4
		881.0	1,152.6
Current assets			
Debtors	7	**903.1**	715.3
Financial assets – Derivative financial instruments	6	**8.4**	–
Cash at bank and in hand	8	**20.7**	–
		932.2	715.3
Creditors: amounts falling due within one year	9	**(799.7)**	(943.2)
Financial liabilities – Derivative financial instruments	6	**(2.1)**	(13.4)
Net current assets/(liabilities)		**130.4**	(241.3)
Total assets less current liabilities		**1,011.4**	911.3
Creditors: amounts falling due after more than one year	10	**(458.0)**	(410.0)
Financial liabilities – Derivative financial instruments	6	**(5.7)**	(8.3)
Provisions for liabilities and charges	11	**(31.5)**	(0.7)
Net assets		**516.2**	492.3
Shareholders' equity			
Called up share capital	14	**7.7**	7.5
Share premium account	15	**189.8**	174.2
Capital redemption reserve	15	**0.2**	0.2
Own shares	15	**(16.7)**	(5.1)
Hedging reserve	15	**(4.1)**	(7.1)
Profit and loss account	15	**339.3**	322.6
Shareholders' funds		**516.2**	492.3

S R Bowker CBE Chief Executive
A C Walker Finance Director
1 March 2007

NOTES TO THE COMPANY ACCOUNTS

1 ACCOUNTING POLICIES

Basis of preparation

The separate accounts of the parent Company are presented as required by the Companies Act 1985.The accounts have been prepared under the historic cost convention and in accordance with applicable accounting standards in the United Kingdom.

In applying these policies management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the accounts and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

No profit and loss account is presented by the Company as permitted by Section 230 of the Companies Act 1985.

Leases

Leases of tangible fixed assets where substantially all the risks and rewards of ownership of the asset have passed to the Company, are classified as finance leases and are capitalised in the balance sheet as plant and equipment. Finance leases are capitalised at the fair value of the present value of the minimum lease payments. The capital element of future obligations under hire purchase contracts and finance leases is included as a liability in the balance sheet. The interest element of rental obligations is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Assets acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases of assets where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rentals paid under operating leases are charged to the profit and loss account on a straight-line basis over the term of the lease. Incentives received under operating leases and initial direct costs in negotiating the lease are amortised to the profit and loss account on a straight-line basis over the term of lease, or to the first review if shorter.

Tangible fixed assets

Tangible fixed assets are stated at historic cost less accumulated depreciation and any impairment. Tangible fixed assets are depreciated on a straight-line basis over their estimated useful lives as follows:

Plant and equipment – 3 to 10 years

The carrying value of fixed assets are reviewed for impairment if events or changes in circumstances indicate that the current carrying value may not be recoverable, and are written down immediately to their recoverable amount. Repairs and maintenance are charged to the profit and loss account during the financial period in which they are incurred.

Investments in subsidiaries

Investments are held at historic cost less any provision for impairment.

Available for sale investments

Available for sale financial assets are non-derivative financial assets that are designated as such, or that are not classified in any of the other categories. After initial recognition these assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or the investment is determined to be impaired, at which time the previously reported cumulative gain or loss is included in the income statement. Where there is no active market for the Group's investments, fair value is determined using valuation techniques including recent commercial transactions and discounted cash flow analyses. In the absence of any other reliable external information, assets are carried at amortised cost.

Interest bearing loans and borrowings

Loans and borrowings are initially recognised at the fair value of the consideration received, net of issue costs. Issue costs are amortised over the expected life of the instrument. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Hedge accounting is adopted where derivatives such as fixed to floating interest rate swaps are held as fair value hedges against fixed interest rate borrowings. Under fair value hedge accounting, fixed interest rate borrowings are revalued at each balance sheet date by the change in fair value attributable to the interest rate being hedged.

Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed the reimbursement is recognised as a separate asset but only when reimbursement is virtually certain.

1 ACCOUNTING POLICIES (CONTINUED)
Pensions
The Company participates in both the National Express Group multi-employer funded defined benefit scheme and a defined contribution scheme. The Company is unable to identify its share of the underlying assets and liabilities of the multi-employer scheme on a consistent and reasonable basis, and therefore has accounted for the scheme as if it were a defined contribution scheme under the requirements of FRS 17, "Retirement Benefits".

Share-based payment
In accordance with the transition provisions, FRS 20 "Share-based payment" has been applied to all grants after 7 November 2002 that were unvested as of 1 January 2005.

The Company issues equity-settled share-based payment to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant by an external valuer using a stochastic model. Non-market-based performance-related vesting conditions are not taken into account when estimating the fair value; instead those non-market conditions are taken into account in calculating the current best estimate of the number of shares that will eventually vest and at each balance sheet date before vesting. The cumulative expense is calculated based on that estimate. Market-based performance conditions are taken into account when determining the fair value and at each balance sheet date before vesting, the cumulative expense is calculated irrespective of whether or not the market conditions are satisfied, provided that all other performance conditions are met.

Deferred tax
Deferred tax is recognised in respect of all material timing differences that have originated, but not reversed, by the balance sheet date. Deferred tax is measured on a non-discounted basis at tax rates that are expected to apply in the periods in which the timing differences reverse based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised where their recovery is considered more likely than not in that there will be suitable taxable profits from which the future reversal of underlying timing differences can be deducted.

Foreign currencies
Foreign currency assets and liabilities are translated into sterling at the rates of exchange ruling at the year end. Foreign currency transactions arising during the year are translated into sterling at the rate of exchange ruling on the date of the transaction. Any exchange differences so arising are dealt with through the profit or loss account.

Derivative financial instruments
The Company uses derivative financial instruments such as foreign currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative financial instruments are initially recognised at fair value and subsequently remeasured to fair value for the reported balance sheet. The fair value of forward exchange contracts and interest rate swaps is calculated by reference to market exchange rates and interest rates at the period end.

In relation to cash flow hedges which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity, and the ineffective portion in the profit and loss account. The gains or losses deferred in equity in this way are recycled through the profit and loss account in the same period in which the hedged underlying transaction or firm commitment is recognised in the profit and loss account.

For derivatives that do not qualify for hedge accounting, including the foreign currency contracts gains or losses are taken directly to the profit and loss account in the period.

Hedge accounting is discontinued when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

2 EXCHANGE RATES
The most significant exchange rates to the pound for the Company are as follows:

	Closing rate 2006	**Average rate 2006**	Closing rate 2005	Average rate 2005
US dollar	**1.96**	**1.85**	1.72	1.82
Canadian dollar	**2.28**	**2.09**	2.00	2.20
Euro	**1.48**	**1.47**	1.45	1.47
Australian dollar	**2.48**	**2.44**	2.35	2.39

The 2005 average rate for euros reflects the average rate since the Alsa acquisition.

3 DIRECTORS' EMOLUMENTS
Detailed information concerning Directors' emoluments, shareholdings and options is shown in the Report on Directors' Remuneration.

NOTES TO THE COMPANY ACCOUNTS
CONTINUED

4 TANGIBLE FIXED ASSETS

	Plant and equipment £m
Cost:	
At 1 January 2006	4.5
Additions	0.3
Disposals	(1.4)
At 31 December 2006	**3.4**
Depreciation:	
At 1 January 2006	3.3
Charge for the year	0.5
Disposals	(1.4)
At 31 December 2006	**2.4**
Net book value:	
At 31 December 2006	**1.0**
At 31 December 2005	1.2

Tangible fixed assets held under finance lease agreements are analysed as follows:

	2006 £m	2005 £m
Plant and equipment		
– cost	**0.2**	0.2
– depreciation	**(0.1)**	(0.1)
	0.1	0.1

Leased assets and assets under hire purchase contracts are pledged as security for the related finance lease and hire purchase liabilities.

5 FINANCIAL ASSETS: OTHER INVESTMENTS

	Investments in subsidiaries £m	Available for sale investments £m	Total £m
Cost or valuation:			
At 1 January 2006	1,557.8	12.8	1,570.6
Additions	1.5	–	1.5
Disposals	(272.9)	–	(272.9)
At 31 December 2006	**1,286.4**	**12.8**	**1,299.2**
Provisions			
At 1 January 2006	(413.4)	(5.8)	(419.2)
At 31 December 2006	**(413.4)**	**(5.8)**	**(419.2)**
Net carrying amount:			
At 31 December 2006	**873.0**	**7.0**	**880.0**
At 31 December 2005	1,144.4	7.0	1,151.4

The information provided below is given for the Company's principal subsidiaries. A full list of subsidiaries and investments will be annexed to the next Annual Return to Companies House. The principal country of operation in respect of the companies below is the country in which they are incorporated.

National Express Group PLC is the beneficial owner of all the equity share capital, either itself or through subsidiary undertakings, of the companies. The Group's train passenger services in the UK are operated through franchises awarded by DfT Rail, as delegated by the UK Government.

5 FINANCIAL ASSETS: OTHER INVESTMENTS (CONTINUED)

The following holdings are 100% held directly by the Company:

Incorporated in England and Wales	
National Express Holdings Limited	Holding company for UK Coach operating companies
National Express Guernsey Limited	Insurance captive
National Express Group Holdings Limited	Holding company for US operating companies
National Express Overseas Limited	Holding company for discontinued Australian business
National Express Trains Limited	Holding company for UK Train operating companies
National Express Transport Holdings Limited	Holding company for UK Bus and Canadian operating companies
National Express European Holdings Limited	Holding company for Spanish operating companies

Other investments include:

Name	County of registration	Class of share	Proportion held %
Inter-Capital and Regional Rail Limited	England and Wales	Ordinary shares	40
London & Continental Railways	England and Wales	Ordinary shares	21
Prepayment Cards Limited	England and Wales	Ordinary shares	23.5
Union Railways (South) Limited	England and Wales	Preference shares	21

6 DERIVATIVES

	2006 £m	2005 £m
Interest rate swaps	**0.3**	–
Financial assets due over one year	**0.3**	–
Interest rate swaps	**1.5**	–
Foreign exchange forward contracts	**6.6**	–
Financial assets due under one year	**8.1**	–
Interest rate swaps	**(5.7)**	(8.3)
Financial liabilities due over one year	**(5.7)**	(8.3)
Interest rate swaps	**(2.1)**	(4.1)
Foreign exchange forward contracts	**–**	(9.3)
Financial liabilities due under one year	**(2.1)**	(13.4)

Full details of the Group's financial risk management objectives and policies can be found in note 30 of the Group accounts. As the holding company for the Group, the Company faces similar risks over foreign currency and interest rate movements.

7 DEBTORS

	2006 £m	2005 £m
Trade debtors	**0.3**	0.3
Amounts owed by subsidiary undertakings	**874.9**	694.5
Corporation tax recoverable	**18.6**	4.6
Deferred tax asset	**3.0**	6.3
Other debtors	**5.5**	3.4
Prepayments and accrued income	**0.8**	6.2
	903.1	715.3

Credit risk with respect to debtors is low due to the fact that a large amount of the Company's balances are with subsidiary undertakings that it controls.

Included within prepayments is £0.6m (2005: £0.7m) which is recoverable after more than one year.

NOTES TO THE COMPANY ACCOUNTS
CONTINUED

8 CASH AT BANK AND IN HAND

	2006 £m	2005 £m
Other short-term deposits	**19.0**	–
Cash at bank	**1.7**	–
	20.7	–

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates. The fair value of cash matches the carrying value.

9 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006 £m	2005 £m
Bank loans	**–**	184.5
Bank overdrafts	**9.2**	49.1
Trade creditors	**2.3**	2.8
Amounts owed to subsidiary undertakings	**777.5**	698.1
Finance lease obligations	**–**	0.1
Accruals and deferred income	**4.7**	7.8
Other creditors	**6.0**	0.8
	799.7	943.2

Trade creditors are non-interest bearing and are normally settled on 30 day terms and other creditors are non-interest bearing and have an average term of six months.

10 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2006 £m	2005 £m
Bank loans	**458.0**	410.0

11 PROVISIONS FOR LIABILITIES AND CHARGES

	Insurance claims[(a)] £m	Deferred tax[(b)] £m	Eurostar onerous contract[(c)] £m	Total £m
At 1 January 2006	0.7	–	–	0.7
Provided in the year	0.6	–	29.6	30.2
Amortisation of discount	–	–	1.0	1.0
Utilised in the year	(0.4)	–	–	(0.4)
At 31 December 2006	**0.9**	**–**	**30.6**	**31.5**

(a) The insurance claims provision arises from estimated exposures at the year end, the majority of which will be utilised in the next six years and comprise provisions for existing claims arising in the UK.

(b) See note 12 for further details on deferred tax.

(c) The Company has recognised an onerous contract provision to reflect its obligations to meet its share of the operating losses of Inter-Capital and Regional Rail Ltd.

12 DEFERRED TAX

The major components of the provision for deferred taxation are as follows:

	2006 £m	2005 £m
Accelerated capital allowances	**0.1**	–
Other timing differences	**2.9**	6.3
Net deferred tax asset at 31 December	**3.0**	6.3

The reconciliation of deferred tax balances is as follows:

	£m
Deferred tax asset at 1 January 2006	6.3
Charged to profit and loss	(2.1)
Credited to equity in relation to cash flow hedges and share-based payments	(1.2)
Deferred tax asset at 31 December 2006	**3.0**

Timing differences associated with group investments

No deferred tax (2005: £nil) is recognised on the unremitted earnings of subsidiaries and associates. The Group has determined that undistributed profits of its overseas subsidiaries will not be distributed in the near future.

Unrecognised tax losses

There is no recognition of the deferred tax asset in relation to the capital losses since there is insufficient evidence to determine that they are recoverable. Deferred tax assets that the Company has not recognised in the accounts amount to £nil (2005: £0.4m).

13 INTEREST BEARING LOANS AND BORROWINGS

The effective interest rates at the balance sheet date were as follows:

	Maturity	**2006 £m**	Effective interest rate	2005 £m	Effective interest rate
Current					
Bank overdraft	On demand	**9.2**	BASE +1.0%	49.1	BASE +1.0%
Short-term sterling bank loans		**–**	–	12.2	5.2%
Short-term US dollar bank loans		**–**	–	0.3	4.8%
Short-term euro bank loans		**–**	–	0.2	2.9%
Euro bank unhedged		**–**	–	34.4	EURIBOR +0.4%
Euro bank loans subject to interest hedge		**–**	–	137.4	2.8%
Bank loans		**–**		184.5	
Sterling finance leases		**–**	–	0.1	5.4%
Total current		**9.2**		233.7	
Non-current					
Sterling bank loans		**–**	–	9.4	LIBOR +0.4%
US dollar bank loans subject to interest rate hedge	June 2011	**51.0**	7.3%	58.1	7.3%
US dollar bank loans unhedged	June 2011	**45.9**	LIBOR +0.4%	104.6	LIBOR +0.4%
Euro bank loans subject to interest rate hedge	June 2011	**235.8**	3.6%	–	–
Euro bank loans at floating rates	June 2011	**84.2**	EURIBOR +0.4%	202.9	EURIBOR +0.4%
Canadian dollar bank loans	June 2011	**41.1**	LIBOR +0.4%	35.0	LIBOR +0.4%
Bank loans		**458.0**		410.0	
Total non-current		**458.0**		410.0	

Details of the Company's interest rate management strategy and interest rate swaps are included in note 30 of the Group accounts.

NOTES TO THE COMPANY ACCOUNTS
CONTINUED

14 CALLED-UP SHARE CAPITAL

	2006 £m	2005 £m
At 31 December:		
Authorised:		
200,000,000 (2005: 200,000,000) ordinary shares of 5p each	**10.0**	10.0
Issued called-up and fully paid:		
153,835,012 (2005: 150,920,310) ordinary shares of 5p each	**7.7**	7.5

Movement in ordinary shares during the year	£m	Number of shares
At 1 January 2005	7.0	139,153,158
Issue of shares in consideration for acquisition of Alsa	0.7	13,503,600
Exercise of share options	–	957,141
TWM SIP appropriation	–	206,411
Shares purchased and cancelled	(0.2)	(2,900,000)
At 1 January 2006	7.5	150,920,310
Exercise of share options	0.2	2,914,702
At 31 December 2006	**7.7**	**153,835,012**

The total number of share options exercised in the year by employees of the Group was 3,100,807 (2005: 1,856,558) of which 2,914,702 (2005: 957,141) exercises were satisfied by newly issued shares and 186,105 (2005: 899,417) exercises were satisfied by transferring shares from the National Express Employee Benefit Trust.

15 SHAREHOLDERS' FUNDS AND STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Share capital £m	Share premium £m	Capital redemption reserve £m	Own shares £m	Hedging reserve £m	Profit and loss account £m	Total £m
At 1 January 2006	7.5	174.2	0.2	(5.1)	(7.1)	322.6	492.3
Shares issued	0.2	15.6	–	–	–	–	15.8
Shares purchased	–	–	–	(11.6)	–	–	(11.6)
Share-based payments	–	–	–	–	–	1.0	1.0
Tax on share-based payments credited to reserves	–	–	–	–	–	2.4	2.4
Hedge movements	–	–	–	–	3.0	–	3.0
Profit for the year	–	–	–	–	–	13.3	13.3
At 31 December 2006	**7.7**	**189.8**	**0.2**	**(16.7)**	**(4.1)**	**339.3**	**516.2**

Own shares comprise treasury shares and shares held in the Employee Benefit Trust.

Treasury shares include 1,825,000 (2005: 400,000) ordinary shares in the Company. During the year the Group repurchased 1,425,000 (2005: 3,300,000) shares for consideration of £11.6m (2005: £29.3m). 1,425,000 (2005: 400,000) shares have been retained as treasury shares within equity for future issue under the Group's share schemes or cancellation. No shares were cancelled during the year (2005: 2,900,000).

Own shares include 663,351 (2005: 849,456) ordinary shares in the Company that have been purchased by the Trustees of the National Express Employee Benefit Trust (the 'Trust'). During the year, the Trust purchased no (2005: 5,329) shares and 186,105 (2005: 899,417) shares were uesd to satisfy options granted under a number of the Company's share schemes. The value of shares within the Trust has been recognised as an investment in treasury shares. The market value of these shares at 31 December 2006 was £7.5m (2005: £7.3m). The dividends payable on these shares have been waived.

The profit and loss reserve for the Company includes £20.8m (2005: £12.2m) that is non-distributable on account of own shares held and the hedging reserve.

16 RETIREMENT BENEFITS

The Company participates in both the National Express Group multi-employer funded defined benefit scheme and a defined contribution scheme. The Company is unable to identify its share of the underlying assets and liabilities of the multi-employer scheme on a consistent and reasonable basis, and therefore has accounted for the scheme as if it were a defined contribution scheme under the requirements of FRS 17, 'Retirement Benefits'. Contributions to this scheme are determined by independent professionally qualified actuaries. The details of the latest actuarial valuation are detailed in note 35 to the Group accounts.

The pension charge for the year amounted to £1.1m (2005: £1.1m).

17 SHARE-BASED PAYMENT

During the year ended 31 December 2006, the Company had the following share-based payment arrangements, which are described in note 7 to the Group accounts:

- Executive Share Option Plan
- Savings Related Share Option Scheme (Sharesave Scheme)
- Long Term Incentive Plan (LTIP)
- Share Matching Plan (SMP)
- Deferred Annual Share Bonus Plan

For the following disclosure, share options with a nil exercise price have been disclosed separately to avoid distorting the weighted average exercise prices. The number of share options in existence during the year was as follows:

	2006		2005	
	Number of share options	**Weighted average exercise price (p)**	Number of share options	Weighted average exercise price (p)
Options without a nil exercise price:				
At 1 January	**1,759,870**	**574**	1,879,335	573
Granted during the year	**–**	**–**	–	–
Lapsed during the year	**(24,304)**	**985**	(75,352)	583
Exercised during the year	**(1,242,443)**	**511**	(44,113)	520
Outstanding at 31 December[1]	**493,123**	**689**	1,759,870	574
Exercisable at 31 December	**38,679**	**782**	295,632	790
Options with a nil exercise price:				
At 1 January	**462,337**	**nil**	9,352	nil
Granted during the year	**472,790**	**nil**	455,009	nil
Lapsed during the year	**(2,243)**	**nil**	(2,024)	nil
Exercised during the year	**(2,093)**	**nil**	–	–
Outstanding at 31 December	**930,791**	**nil**	462,337	nil
Exercisable at 31 December	**–**	**–**	–	–
Total outstanding at 31 December	**1,423,914**		2,222,207	
Total exercisable at 31 December	**38,679**		295,632	

1 Included within this balance are options over 35,487 (2005: 629,339) shares for which no expense has been recognised in accordance with the transitional provisions of FRS 20, as the options were granted before 7 November 2002 and have not been subsequently modified.

The options outstanding at 31 December 2006 had exercise prices that were between 398p and 862.5p (2005: between 398p and 1224p) excluding options with a nil exercise price. The range of exercise prices for options was as follows:

Exercise price (p)	**2006**	2005
350 – 650	**8,679**	1,072,093
650 – 950	**484,444**	642,777
950 – 1250	**–**	45,000
	493,123	1,759,870

The options have a weighted average contractual life of four years (2005: seven years). Options were exercised throughout the year and the weighted average share price at exercise was 919p (2005: 875p).

NOTES TO THE COMPANY ACCOUNTS
CONTINUED

17 SHARE-BASED PAYMENT (CONTINUED)
The weighted average fair value of the remaining share options granted during the year was calculated using a stochastic model, with the following assumptions and inputs:

	Share options with nil exercise price	
	2006	2005
Risk free interest rate	**–**	–
Expected volatility	**19.0%**	25.0%–27.0%
Peer group volatility	**29.7%–31.2%**	34.0%
Expected option life in years	**3 years**	3 years
Expected dividend yield	**3.4%–3.5%**	3.3%–3.4%
Weighted average share price	**931p–1033p**	888p–906p
Weighted average exercise price	**0p**	0p
Weighted average fair value of options granted	**369p–934p**	561p–821p

Experience to date has shown that approximately 15% (2005: 15%) of options are exercised early, principally due to redundancies. This has been incorporated into the calculation of the expected option life for the share options without nil exercise price.

Expected volatility in the table above was determined from historic volatility over the last eight years, adjusted for one-off events that were not considered to be reflective of the volatility of the share price going forward. The expected dividend yield represents the dividends declared in the 12 months preceding the date of the grant divided by the average share price in the month preceding the date of the grant.

For share options granted during the year under the LTIP, the TSR targets have been reflected in the calculation of the fair value of the options above.

18 COMMITMENTS AND CONTINGENCIES
Operating lease commitments
The Company has entered into operating leases on certain properties. Commitments for future minimum rental payments are shown below:

	Land and buildings	
	2006 £m	2005 £m
Operating leases which expire:		
Within two to five years	**0.6**	0.6

Contingent liabilities

a) Guarantees
The Company has guaranteed credit facilities totalling £101.6m (2005: £99.8m) of certain subsidiaries.

b) Bonds and letters of credit
In the ordinary course of business, the Company is required to issue counter-indemnities in support of its subsidiaries' operations. As at 31 December 2006, there were UK Train performance bonds of £46.9m (2005: £44.6m) and UK Train season ticket bonds of £86.3m (2005: £100.0m). The Company has other performance bonds which include the £15.0m (2005: £14.6m) performance bond in respect of Inter-Capital and Regional Rail Limited and performance bonds in respect of businesses in the United States of £49.2m (2005: £34.5m) and the rest of Europe of £31.8m (2005: £9.6m). Letters of credit have been issued to support insurance retentions of £82.1m (2005: £84.7m).

c) Claims
The Directors' Report discloses that Ray O'Toole and Phil White have been joined as defendants in proceedings being brought before the Supreme Court of New South Wales. These proceedings relate to a period of time when Ray O'Toole and Phil White were directors of Bosnjak Holdings Pty Ltd, which was a subsidiary of the Group. The Company is also a defendant to these proceedings. The Directors believe no liabilities will arise from these proceedings and therefore no provision has been made at 31 December 2006.

19 RELATED PARTY TRANSACTIONS
The Company has taken advantage of the exemption in paragraph 3c of FRS 8, 'Related party disclosures' from disclosing transactions with related parties that are part of the National Express Group or investees of the Group.

FIVE YEAR SUMMARY

Year ended 31 December	**IFRS 2006 £m**	IFRS 2005 £m	IFRS 2004 £m	UK GAAP 2003 £m	UK GAAP 2002 £m
Revenue	**2,525.5**	2,216.0	2,354.5	2,565.7	2,572.3
Normalised* operating profit	**184.8**	155.5	143.3	128.9	125.9
Group operating profit	**141.6**	109.5	99.9	83.2	67.2
Profit before tax	**104.1**	89.3	77.9	54.1	(85.6)
Statistics					
Basic earnings/(loss) per share	**50.7p**	(2.0)p	45.7p	31.9p	(80.0)p
Normalised* diluted earnings per share	**76.5p**	76.3p	69.3p	50.1p	52.3p
Dividends per share	**34.75p**	32.25p	30.0p	26.0p	24.5p
Net assets	**345.5**	312.3	266.8	264.2	262.6
Net (debt)/funds					
Cash in bank and in hand	**143.6**	145.5	147.2	97.0	93.7
Other debt receivable	**–**	1.0	1.0	–	–
Loan notes	**(0.8)**	(0.8)	(7.5)	(8.4)	(9.1)
Bank and other loans	**(478.1)**	(594.5)	(215.5)	(324.4)	(361.2)
Bank overdrafts	**–**	(5.5)	–	(0.2)	–
Finance lease obligations	**(103.1)**	(109.1)	(61.8)	(53.1)	(58.0)
	(438.4)	(563.4)	(136.6)	(289.1)	(334.6)
Net gearing	**127%**	180%	51%	109%	127%

*Normalised results are defined as the statutory results before the following as appropriate: profit or loss on sale of businesses, exceptional profit or loss on sale of non-current assets and charges for goodwill impairment, intangible asset amortisation, property, plant and equipment impairments, exceptional items and tax relief on qualifying exceptional items.

SHAREHOLDER INFORMATION

SHAREHOLDER ELECTRONIC COMMUNICATIONS

By registering for electronic communications you can help us to conserve environmental resources by reducing print, paper and postage costs. Log on to www.shareview.co.uk if you would like to:

- register your e-mail so that future shareholder information, including the annual report and accounts, are sent to you electronically;
- check the balance of your shareholding;
- set up a dividend mandate online;
- change your registered postal address or your dividend mandate details; or
- submit your vote on-line prior to a general meeting.

To sign up for the first time you should click on “Register” and follow the simple instructions – you will need your shareholder reference number from your share certificate or dividend voucher or any other correspondence sent to you by Lloyds TSB Registrars.

DIVIDENDS PAID DIRECT TO YOUR BANK ACCOUNT

Having dividends paid direct to your bank account has the following advantages:

- avoids the risk of cheques being lost in the post;
- saves you time in presenting the cheque for payment;
- the dividend is credited to your account on the payment date.

The tax voucher is sent to your registered address at the same time as the dividend is credited to your account. To set up a new dividend mandate please log on to www.shareview.co.uk or contact the Registrar at: Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Shareholder helpline number: 0870 601 5366

COMPANY WEBSITE

The Company website at www.nationalexpressgroup.com has information about the Group, press releases, share price data and copies of the interim and annual report and accounts.

SHARE DEALING SERVICE

A telephone and internet share dealing service, which provides a simple way to buy and sell shares, has been arranged through Lloyds TSB Registrars. For further information log on to www.shareview.co.uk/dealing or telephone 0870 850 0852.

SHAREGIFT

ShareGift is an independent charity share donation scheme administered by the Orr Mackintosh Foundation (registered charity number 1052686). Those shareholders who hold only a small number of shares, the value of which make it uneconomic to sell them, can donate the shares to ShareGift who will sell them and donate the proceeds to a wide range of charities. Further information about ShareGift can be obtained from its website at www.sharegift.org and a ShareGift transfer form can be downloaded from www.nationalexpressgroup.com.

UNCLAIMED ASSETS REGISTER

The Company participates in the Unclaimed Assets Register (“UAR”) which provides a search facility for shareholdings and other financial assets that may have been forgotten. For further information contact UAR, Bain House 16 Connaught Place, London W1J 5JA Tel: 0870 241 1713 or visit www.uar.co.uk.

ANALYSIS OF ORDINARY SHAREHOLDINGS AT 26 FEBRUARY 2007

	Number of accounts	Per cent of total number of accounts	Number of shares '000	Per cent of ordinary capital
By size of holding				
1 – 500	7,883	56	1,413	1
501 – 1,000	2,017	14	1,531	1
1,001 – 5,000	2,995	21	6,739	4
5,001 – 50,000	1,162	8	12,779	8
50,001 – 1,000,000	193	1	46,994	31
Over 1,000,000	31	–	84,385	55
	14,281	100	153,841	100
By investor type				
Individuals	12,950	11	16,823	11
Institutional Investors	1,206	78	119,433	78
Other Corporate Investors	125	11	17,585	11
	14,281	100	153,841	100

DIVIDENDS AND FINANCIAL CALENDAR

Final dividend ex dividend date	25 April 2007
Final dividend record date	27 April 2007
Annual General Meeting	1 May 2007
Final dividend payment date	4 May 2007
Interim results announced	July 2007
Interim dividend ex dividend date	September 2007
Interim dividend record date	September 2007
Interim dividend payment date	September 2007

CORPORATE INFORMATION

SECRETARY AND REGISTERED OFFICE
A J McDonald
National Express Group PLC
75 Davies Street
London W1K 5HT
Tel: +44 (0)20 7529 2000
Fax: +44 (0)20 7529 2100
e-mail: info@natex.co.uk
www.nationalexpressgroup.com

REGISTERED NUMBER
2590560

REGISTRAR
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
Shareholder helpline: 0870 601 5366

FINANCIAL ADVISORS
Merrill Lynch International Limited
Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

STOCKBROKERS
Merrill Lynch International Limited
Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

Morgan Stanley
20 and 25 Cabot Square
Canary Wharf
London E14 4QW

CORPORATE SOLICITORS
Ashurst
Broadwalk House
5 Appold Street
London EC2A 2HA

AUDITORS
Ernst & Young LLP
1 More London Place
London SE1 2AF

PRINCIPAL BANKERS
HSBC Bank plc
8 Canada Square
London E14 5HQ

Royal Bank of Scotland
135 Bishopsgate
London EC2M 3UR

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Thank you.

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www.nationalexpressgroup.com/nx/ic/reports

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Printed by CTD

National Express Group PLC
75 Davies Street
London W1K 5HT
Tel: +44 (0)20 7529 2000
Fax: +44 (0)20 7529 2100
e-mail: info@natex.co.uk
www.nationalexpressgroup.com