



**SANDELL**  
**CASTLERIGG INVESTMENTS**

30 June 2014

Mr. John McFarlane  
Chairman, The Board of Directors  
FirstGroup plc.  
50 Eastbourne Terrace  
London W2 6LG

By Email and By Hand

Dear John,

Thank you for taking the time to speak with us on Tuesday 24<sup>th</sup> June. We are writing to follow up on certain corporate governance matters discussed on our call and to highlight other concerns that we have.

As discussed during our call, we welcome the steps you have taken to reshuffle the Company's Board and believe Ms. Imelda Walsh, Mr. Warwick Brady and Mr. Drummond Hall are all accomplished individuals who should improve the Board's effectiveness. However, we remain concerned that the Board still lacks sector expertise, specifically relating to First Student and First Transit (FirstGroup US). We believe the addition of this sector expertise is vital to improve management oversight and manage the latest turnaround plan. If sector expertise had been available on the Board, we believe a number of poor strategic decisions taken over the past few years could have been avoided.

During our conversation, we discussed Sandell's previous proposal to complement the existing Board through the addition of a new independent non-executive director. The independent candidate that we suggested a month ago for the Board's consideration is highly qualified and has considerable experience relevant to the FirstGroup US businesses, experience which you acknowledged would be useful and appeared to make him a qualified candidate. Since then, we have also informed you that we have other highly qualified independent candidates with similar experience ready to join the Board should you find good reason for the candidate to be unsuitable.

While we appreciate the Board has a structure and process in place for evaluating the composition of the Board and considering any new appointments to the Board, we note that the Nomination Committee's duties (set out in its terms of reference) include (i) evaluating the composition of the Board, (ii) leading the process for any appointments to the Board and (iii) recommending candidates for the Board's approval. Therefore, your statement during our most recent call that you wish for Mr. O'Toole, the Chief Executive, to meet with and to evaluate the director candidate prior to him being put forward to the Nomination Committee process has caused us significant concern. The explicit involvement of an executive director in the appointment process of a potential Board member prior to the commencement of the Nomination Committee process appears to disregard the Company's own published corporate governance policies, and this letter should be treated as Sandell's formal registration of a complaint in this regard.

We expect the Nomination Committee to give due and proper consideration of the director candidate without further involvement from Mr. O'Toole and we look forward to hearing the outcome of this process within a reasonable timeframe. If the candidates we have identified are not regarded as suitable, we hope you will explain to shareholders why these candidates were not qualified or why adding sector expertise would not improve the Board's effectiveness.

Given that the incumbent management team has presided over both operational and share price decline at FirstGroup, we were also surprised and disappointed to find that its members have been so well rewarded for failure. FirstGroup's CEO remuneration package has risen 209% over the past five years and Mr. O'Toole is the

highest paid CEO amongst his peers. However, during this five year period FirstGroup shares are the worst performing shares in its peer group, having returned -8% compared to +231% for its peers, an underperformance of 239%. We strongly believe that management's and shareholders' interests should be aligned and that properly structured rewards can incentivise management teams. We simply do not believe that a 94% rise in remuneration package is deserved for Mr. O'Toole's 2013/14 performance. In fact, the Executive Annual Bonus Plan appears to have been subverted by deficient targets, and has allowed the executive directors to earn a bonus every year despite significant underperformance. The fact that these targets are not fully disclosed to shareholders only increases our concern regarding the lack of transparency. **Accordingly, we intend to vote against the remuneration report at the Annual General Meeting and will encourage other shareholders to do likewise.**

Fiscal Year	CEO	£ '000s		Share Returns
		Salary	Total (1)	vs. Peer Group (%) (2)
2010	Moir Lockheed	609	643	-46.5%
2011	Moir Lockheed	364	503	
	Tim O'Toole	357	357	
	2011 Total	721	860	-21.7%
2012	Tim O'Toole	846	1,055	-30.1%
2013	Tim O'Toole	846	1,068	-13.8%
2014	Tim O'Toole	846	1,986	-57.4%
<b>FY2010-2014 Growth %</b>		<b>38.9%</b>	<b>208.9%</b>	<b>-238.9%</b>

	CEO Total Comp (3)	Year	Total Share Returns
<b>FirstGroup</b>	<b>£1,986</b>	<b>FY2014</b>	<b>-11.0%</b>
Stagecoach	£1,203	FY2013	+27.8%
National Express	£1,553	FY2013	+41.8%
Go-Ahead	£942	FY2013	+31.4%
Student Transportation	£957	FY2013	+5.5%

As an active owner of the Company, we believe in open and transparent dialogue with other shareholders. Consistent with best practices, we intend to publish this letter to enable a broad discussion with other shareholders and stakeholders in the Company. We remain eager to continue a direct dialogue with the Company and the Board and we look forward to hearing from you.

Yours sincerely,



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 Sandell Asset Management Corp.  
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Notes:

(1) 2014 total compensation includes vesting of a retention award that was granted in 2011 worth £324k. Even excluding this, Mr. O'Toole remains the highest paid CEO in his peer group. 2013 total compensation includes a pension component of £176k per the 2014 annual report; in the 2013 annual report, this was disclosed as £133k. 2011 data for Mr. O'Toole shown only for his role as Chief Executive (excludes £225k remuneration for role as Chief Operating Officer and £9k fee as a Non-Executive Director); salary assumed to equal total compensation since breakdown of compensation by role not given for 2011. Salary obtained from FirstGroup annual reports between 2010 and 2014.

(2) FirstGroup total share returns less average of peer group total share returns. Peers include National Express, Stagecoach, Go-Ahead and Student Transportation of America.

(3) Compensation for Student Transportation of America converted into £ at the average exchange rate over FY2013.