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Student Transportation Inc. | STB

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COMPANY: Student Transportation Inc. / STB

We believe Student Transportation (STB or "the Company") has a flawed business and financial strategy. It has undertaken a leveraged and dilutive acquisition spree that is not accretive to shareholders, but that benefits its bankers and management team. STB's financing scheme appears dependent on continually raising fresh capital from new investors in order to pay its fixed dividend to existing investors, or "Borrowing from Peter to Pay Paul." Conclusion: In the absence of new capital, we believe STB's dividend would be cut, and its stock price would fall closer to our fair value estimate of $2.00 per share.

July 26, 2012

Recommendation:
Strong Sell

Ticker:	STB/STB.TO
Exchange:	Nasdaq/TSX
Price:	$7.10
52wk High:	$7.50
52wk Low:	$4.80
Price Target:	$2.00
Downside:	70%
Shares Out:	78.2
Market Cap ($mm):	$555
Cash:	$8
Total Adj. Debt:	$229
Enterprise Value:	$776

Fiscal Yr Ended June 30th

Financials	LTM	2012E
Sales	$355	$372
Adj. EBITDAR	$68	$67
EPS	($0.07)	($0.01)

Valuation	LTM	2012E
EV/Sales	2.2x	2.1x
EV/EBITDAR	11.4x	11.5x
P/ LTM EPS	NM	NM
P/ Tangible Book	NM	NM

Research Summary

STB Cannot Support its Dividend w/out Continuous Dilution

- From 2007-2011, STB generated free cash flow of just $21m, while paying $120m of dividends and repurchasing $15m of 100% mgmt owned Series B stock
- Significantly dilutive equity and convertible debt financings have been used to fund the dividend gap; $180m of equity has been raised, causing the share count to balloon by 33% per annum, which further exacerbates the dividend burden
- Based on our analysis, STB's free cash flow will not cover its dividend again in FY 2013, placing the dividend at severe risk of being cut and potentially pushing the stock price toward our fair value estimate, ~70% below current levels

Debt-Fueled M&A Benefiting Management, Not Shareholders

- School bus industry has largely been consolidated by competitors in the past 10 yrs leaving many small, independent operators of lower quality as targets
- STB's acquisition strategy provides no synergies, is driving top-line revenue growth, with no improvement in EPS and limited free cash flow improvement without sacrificing critical capital expenditures
- Management bonuses tied primarily to revenue growth vs. EPS growth metrics used by peers, resulting in misaligned incentive structure to grow revenues at any cost; significant goodwill accumulation indicates possible overpayments

STB's Capacity to Raise New Capital Appears to Be Hitting a Wall

- STB listed its shares on the Nasdaq in 2011 after trading for years in Canada. Based on its business model, we believe the company needed a new venue to issue more stock; STB quickly issued C$75m of stock to pay down debt, as it had no excess cash flow to reduce debt, pay the dividend, and support its high capex needs
- STB has almost no institutional investor support; ~66% of the stock is held by retail investors. STB's capacity for finding new retail investors may be limited

Significant Overvaluation to Peers and Underlying Asset Value

- STB's valuation at 11.5x EV/EBITDAR is a significant premium to transportation deal values of 5.0x – 7.0x; the company's EV/Vehicle for its 9,000 vehicles is $87,000 vs. ~ $75,000 for the cost of a brand new school bus
- Conclusion: We believe STB's shares are worth no more than $2.00 and that they are at risk of a precipitous decline in the absence of the continued dilution that appears necessary to support its dividend

Legal Disclaimer:

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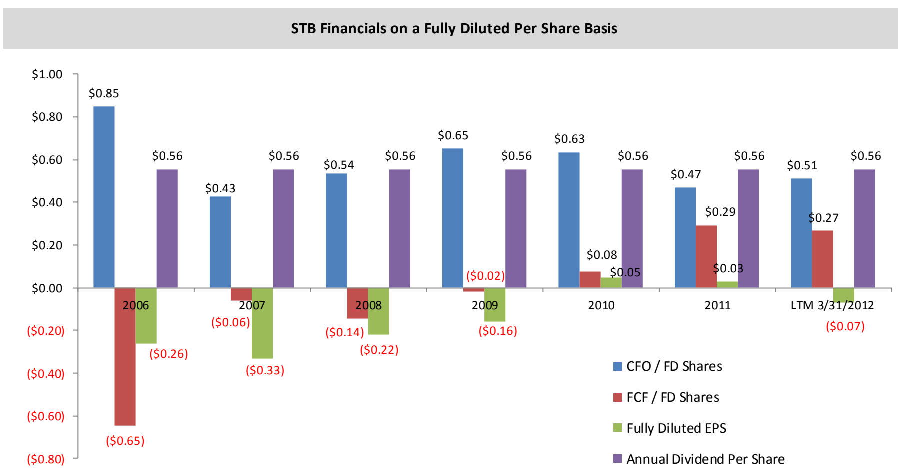
Table of Contents

Executive Summary 6
Business Overview 8
History and Path to the Capital Markets 9
Constrained Fundamentals in the Student Transportation Market 12
STBs Flawed Acquisition Strategy 14
Is STBs Financial Strategy Sensible in the Long-Run? 17
Valuation and Price Target 21
Appendix 1 − Capital Structure 27
Appendix 2 − Company Financials 28
Appendix 2 − Company Financials (Continued) 29
Appendix 3 − Revenue Focused Deals 30
Appendix 4 − Promotion and Hype or Real News? 32
Appendix 5 − Executive Compensation Benchmarks 33
Appendix 6 − Is STB Under-Spending For Capex? 34

Executive Summary

Shares of Student Transportation (Nasdaq/TSX: STB) are trading near an all-time high from retail investors who are attracted to the feel good story of investing in a company that provides school bus services to children. As a return on their investment, the company is providing a monthly dividend with an optically attractive dividend yield of 8%. In reality, STB's business and financial strategy benefits bankers and management, and is not accretive to shareholders. STB's financing scheme relies on raising increasing capital from new shareholders and creditors to maintain its irrationally high dividend, which is akin to taking money from Peter to pay Paul. As a result, in the absence of new capital, we believe STB's dividend would ultimately be cut, and its stock price would fall closer to our fair value target of $2.00 per share, or 70% below the current stock price. As shown below, STB has never been able to cover its dividend from its operating free cash flow and is projected to fall short again in FY 2013 (Appendix 3).



Source: STB

Instead, STB has repeatedly raised money through dilutive security issuances from new investors to pay a dividend to an ever expanding group of existing and new investors. For example, STB recently listed their shares on the Nasdaq in September 2011, and wasted no time tapping new investors for C$75m in February 2012 with a dilutive stock offering. We believe the company's listing on the Nasdaq is a strong signal that they have largely exhausted their financing options from the Canadian market. The dividend is really the only thing attracting retail investors to their stock, meaning that any strain in financial markets going forward could have severe consequences for the stability of the dividend.

Growth Story Fantasy

The school transportation industry is fragmented, but dominated by two large foreign competitors that have already consolidated a majority of the industry. STB has been selling investors on their acquisition growth strategy given the anemic organic growth in the industry. STB has acquired 47 independent school bus companies over the years in smaller markets where they believe there are lower levels of competition and operating costs. While on the surface this makes intuitive sense, the company's own financial results do not support the conclusion that the strategy is yielding benefits. There are no revenue synergies and few cost synergies to justify STB's levered acquisition spree. Overall, the economics of the student transportation industry are highly competitive, capital intensive, increasingly regulated, and result in low margins and returns to shareholders.

Misaligned Incentives: Management and Bankers Win, Shareholders Lose

STB is a banker's dream client because of all the debt and equity capital they require, M&A deals they complete, and fuel hedges they execute. In return for the millions of fees that STB pays banks, the company receives glowing "strong buy" recommendations and unjustified price targets backing their levered acquisition spree. Of course, STB's bankers have no accountability or alignment with the shareholders, but what about STB's management and their alignment and incentive structure? STB's management owns less than 1% of the common stock, but instead gets rewarded with a preferential Series B stock that allows them to regularly sell shares back to the company. STB's management has liberally sold millions of dollars of stock back to the company, while virtually no common shares have been repurchased under the common stock buyback program. Worse yet, the management is rewarding themselves with bonuses tied primarily to revenue growth, instead of measures that are directly measurable to shareholders such as EPS or cash flow growth. This allows the management to reward themselves richly for growing revenues at any price. Investors need look no farther for evidence of overpayment than the massive goodwill and intangible accumulation on the company's balance sheet, which now totals 44% of total assets. As another measure of STB's outrageous management compensation plan, the founder and CEO reaped $1.8 million of total compensation in 2011, which is greater than STB's total 2011 EPS. The amount is also larger than almost any CEO of a publicly traded North American transportation company, even those with enterprise values 4x larger (Appendix 5).

Retail Driven Ownership Leading to Massive Stock Overvaluation

Looking at STB's shareholder base, it is entirely clear that institutional investors have refused to own shares of the company. As of March 31, 2012, 66% of shares were in the hands of retail investors, leaving only 33% of the shares in the hands of institutions. However, even this number is misleading due to the fact that just two institutions own approximately 21%. Management owns less than 1% of the common stock of the company.

Based on the points described above, it is clear that institutional investors and management are completely unwilling to hold the stock at any price. Yet, retail investors have driven the valuation up to a level which is nearly double that of comparable companies. STB currently trades at 11.5x EV/ 2012E EBITDAR and 62x Price / FY 2013E EPS vs. peers which trade at only 5-8x and 7-12x, respectively. No transportation company has ever been sold in a private transaction at a multiple that even comes close to STB's current value. It seems clear that retail investors have simply ignored the valuation of STB, its flawed strategy, and misaligned incentive structure. The absurdity of the company's valuation is also seen from the perspective that investors are ascribing a value of $87,000 per school bus, which on average is 6 years old; brand new buses can be purchased for much less.

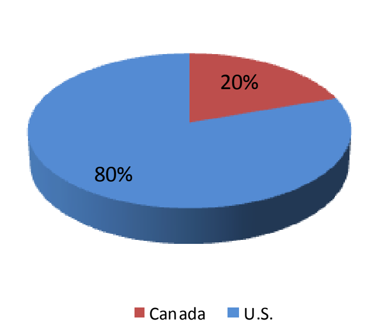
Conclusion: Buyer Beware

As with any financing scheme, the game ends when the company can no longer raise money from new investors to continue paying out existing ones. STB's recent listing on the Nasdaq, rapid stock offering, and weak insider and institutional ownership are clear signals that the company is having difficulty finding greater support for their misguided acquisition strategy. Meanwhile, global tightness and instability in financial markets does not bode well for capital intensive business such as STB's going forward. Investors are strongly cautioned to consider the misalignment of incentives with this company, and the future security of the dividend.

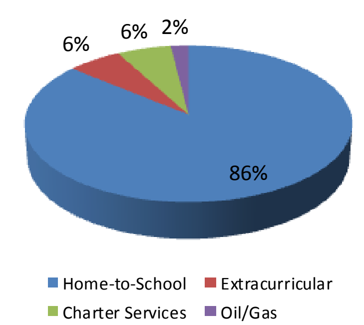
Business Overview

Student Transportation Inc. was founded in 1997 and today is reportedly the third largest provider of school bus transportation services in North America with 9,000 vehicles and revenues of $355 million as of LTM 3/31/12. The company's operations are located in Ontario, Canada and 15 states across America. The company's primary service of transporting students to and from school ("home-to-school" busing) comprises approximately 86% of revenue. Charter services for athletic events, field trips, summer camp routes and other non-school related charter services and extracurricular activities account for 12% of revenues. The remaining 2% of revenue comes from a non-operating interest in oil and gas properties the company acquired through its acquisition of Canadex in 2008.

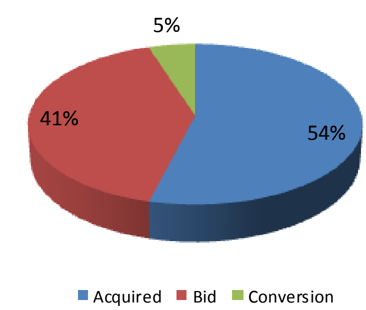
FY 2011 Revenue By Geography



FY 2011 Revenue By Activity



FY 2011 Revenue By Activity



Source: Company filings

The company has grown its business primarily by executing on its A-B-C strategy. Acquisitions have formed the basis for the majority of the company's growth over the years. STB has completed 47 companies since its inception. As we'll explore in greater detail in this report, many of these acquisitions are privately owned, independent regional operators. Bidding activities are directed toward school districts that have chosen to solicit bids from private operators for their school bus transportation contracts. These contracts are primarily awarded by school districts based on a competitive public bidding process or Request for Proposal, on the basis of the "lowest responsible bid." Lowest responsible bids enable school districts to consider factors other than price in awarding a bid, such as safety records and initiatives, driver training programs, community involvement and quality of service. Conversions are focused on privatizing school districts in regions contiguous to the company's existing operations. Approximately 68% of the school bus market is operated by school districts, which allows companies like STB to claim there is a large opportunity to grow by converting school districts to outsourced operation at substantial cost savings. To date, STB has completed only 10 conversions.

History and Path to the Capital Markets

The company was initially founded in 1997 by Dennis Gallagher upon his departure from Laidlaw Inc. Prior to joining Laidlaw, Mr. Gallagher sold his school bus transportation company to Laidlaw in 1987 and held a senior position with the company. The formation of Student Transportation nearly faltered from the start, when Laidlaw filed an injunctive motion claiming its executives breached their non-compete contracts, although the courts ultimately denied Laidlaw's motion for preliminary and supplemental injunctive relief.[1] Initial seed capital was provided by Golder, Thoma, Cressey, Rauner (GTCR), a private equity firm in Chicago. The company came public in Canada in 2004 on the Toronto Stock Exchange through an Income Participating Securities ("IPS") offering of C$ 116 million which included IPS units and Senior Subordinated Notes paying 14%. Over time, the company has eliminated the IPS structure and Subordinated Notes through exchange offers, convertible bond and stock offerings.

Student Transportation Financing History

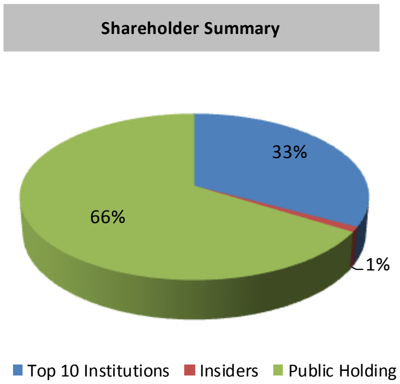
$ in millions except per share amounts

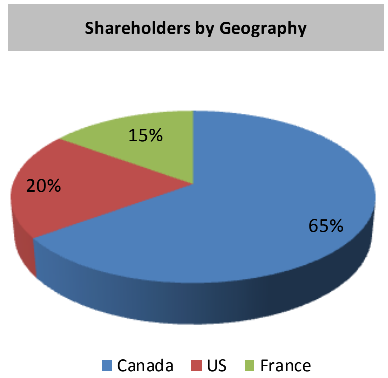
Date	Capital Raise	Market	Shares	Price	Conv Price	Amount	Note
May 2007	Seed Capital	Private	--	N.A.	--	N.A.	GTCR sponsors company
10/31/2001	Debt/Equity	Private	--	N.A.	--	C$ 87.0	Senior Sub Notes (RSTW); Equity (Wynnchurch/RSTW)
12/21/2004	IPO - IPS	Public	11.6	C$ 10.00	--	C$ 116.0	--
12/21/2004	IPO - Sub Note	Public	--	14.0%	--	C$ 3.8	Sub Notes Offered with IPS
12/21/2004	Sub Notes	Private	--	14.0%	--	C$ 10.0	Separate Sub Notes Offering
1/7/2005	IPS Overallotment	Private	1.2	C$ 10.00	--	C$ 11.6	--
10/25/2005	IPS -Follow-on	Private	3.1	C$ 12.00	--	C$ 37.2	Debt Reduction, GCP
12/22/2006	Senior Secured Notes	Private		5.941%	--	$35.0	Sun Life/Canada Life
6/14/2006	IPS- Follow-on	Private	4.9	C$ 12.25	--	C$ 60.0	Acq Positive Connections, Liftlock
9/4/2007	Exchange Offer	Public	8.0	C$ 3.847	--	C$ 45.8	Common Stock for Sub Notes 0.67 for C$ 3.846 Sub Note
3/29/2007	Common Shares	Private	3.0	C$ 6.65	--	C$ 20.0	Debt Reduction, Series B repurchase
4/17/2008	Common Shares	Private	1.7	C$ 5.85	--	C$ 10.0	Debt Reduction; GCP
4/15/2008	Common Shares	Private	8.3	C$6.15/C$ 5.85	--	C$ 50.0	Caisse / SNCF, Debt Reduction
9/4/2008	Exchange Offer	Public	1.0	C$ 3.847	--	C$ 4.9	Common Stock for Sub Notes 0.767 for C$ 3.846 Sub Notes
6/4/2009	Common Shares	Public	12.0	C$ 3.50	--	C$ 42.0	Debt Reduction
7/6/2009	--	--	--	--	--	--	IPS delisting / Sub Note listing
11/10/2009	Convertible Offering	Private	10.0	7.50%	C$ 5.15	C$ 51.8	Sub Note Repurchase / GCP
6/1/2010	Convertible Offering	Private	6.9	6.75%	C$ 7.25	C$ 50.0	Debt Reduction / GCP
12/15/2010	Conv of Converts		0.3	7.50%	--	C$ 1.8	--
2/7/2011	New Credit Facility	Private				$140.00	$100m Accordian
6/7/2011	Convertible Offering	Private	6.3	6.25%	$9.50	$60.0	Debt Reduction / GCP
11/10/2011	Snr Sec. Notes Refi	Private	--	4.24%	--	C$ 35.0	Sun Life/Canada Life
2/28/2012	Common Shares	Public	10.95	C$ 6.85	--	C$ 75.0	Debt Reduction

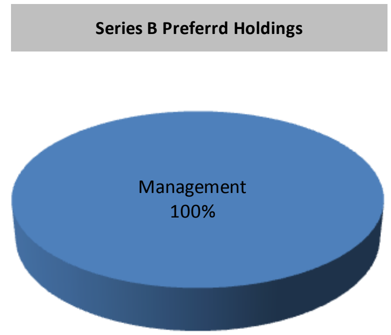
Source: Public Information

Given that the origins of the company's management and business operations are primarily in the U.S., the choice of listing in Canada through the IPS structure appears motivated by the ability to access retail investor demand for income yielding securities. To this day, the company has maintained a generous dividend policy, and pays a monthly dividend payment of $0.046 cents per share which provides a current dividend yield of 8.0%. The company's initial equity sponsors no longer own shares; today's shareholders are predominately Canadian and US retail investors who own 66% of the shares. The two largest institutional shareholders are Societe Nationale de Chemins de fer France ("SNCF" 12%) and Caisse de Depot (9%).

[1] Source: http://nj.findacase.com/research/wfrmDocViewer.aspx/xq/fac.19980911_0000138.DNJ.htm/qx

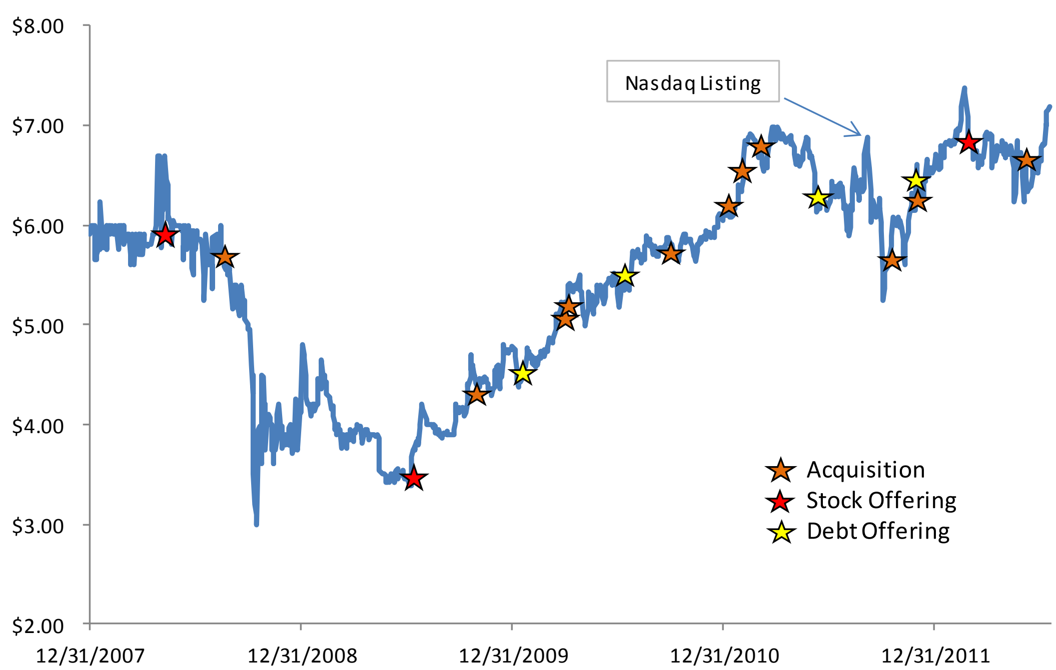






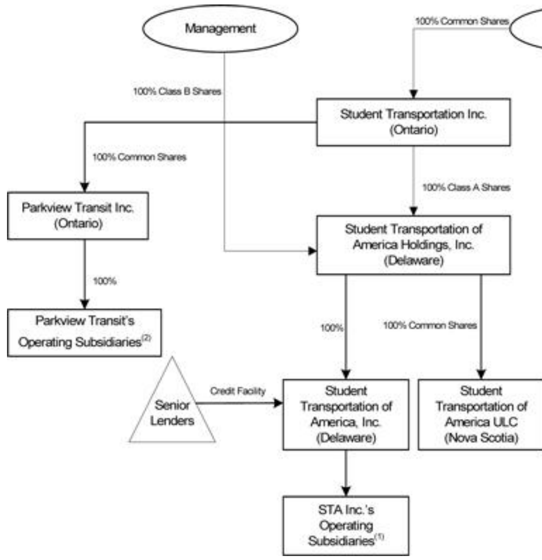
Source: Public Filings, Company Information

In July 2011, STB made its trading debut for its Class A common shares in the U.S. on the Nasdaq. According to the company, the listing "Creates access to a larger shareholder base and allows U.S. institutional and retail investors to trade shares more easily and with greater liquidity." Since the listing event, we don't believe STB has garnered serious investment from any major U.S. financial institution.[2] However, we believe the company has used the listing to attract additional retail investors who are gravitating towards the dividend. As we will explore later in this report, we believe the dividend is a fundamentally flawed financial policy, which the company is highly dependent on paying to sustain its investment appeal, and attract new equity capital for its levered growth trajectory.



[2] WealthTrust Axicom reported ownership of 0.8 million shares as of 3/31/12

Ownership and Corporate Structure



As indicated in the corporate diagram above, the company's management owns 100% of the Series B shares. The table below provides additional detail on the Series B share classes. The management owns ~1% of the common shares and is currently receiving Series B-3 shares as part of their annual Equity Incentive Plan ("EIP"). The Series B is entitled to dividends and receives certain preferences to common shareholders that are noteworthy, particularly a put option which allows management to force the company to repurchase their shares in annual amounts. This put option is accounted for as a liability on the company's balance sheet, and we will evaluate the impact of management's exercising these options on cash flow later in the report.

Student Transportation Share Structure - March 31, 2012

$ in millions

	Mgmt. Ownership	Shares	Fair Value	Puttable (2)	Dividend Rights (3)	Issuing Plan (4)	Voting	Liquidation Preference (5)
Class A Common	1%	778,966	$5.45	No	Yes		1 Vote	
Series B-1 (1)	100%	**Repurchased and Cancelled**						
Series B-2	100%	186,591	$2.00	Yes	Yes	EIP (Pre-IPS)	1 Vote	Yes
Series B-3	100%	924,183	$6.40	Yes	Yes	EIP (Post-IPS)	1 Vote	
Total		1,889,740	$13.85					

(1) Repurchased 12/22/06 with borrowings under credit facility and Senior Notes.

(2) One third puttable each year following issuance at fair value.

(3) For B-2: Fixed cumulative preferential cash dividends at a rate of 14% of the Liquidation Amount (C$0.5386/sh, per yr), to be paid before any dividend on the Class A Shares and the Class B-3 Shares.
For B-3: Dividends approximately equivalent to Class A Shares.

(4) EIP = Equity Incentive Plan.

(5) Sum of C$3.847 (the "Liquidation Amount") together with all accrued and unpaid (whether or not declared) cummulative dividends upon dissolution of STA Holdings.

Constrained Fundamentals in the Student Transportation Market

The fundamentals in the student transportation market are characterized by limited barriers to entry and few proprietary points of differentiation to customers, capital and labor intensity, thin and pressured margins, increasing regulatory requirements, and constrained growth opportunities.

Limited Barriers to Entry; Few Proprietary Aspects of the Business

There are limited barriers to entering the student bus transportation market. Anyone that can purchase or lease a bus, obtain the proper licenses and insurance, can operate and compete in this market. Contracts with school districts are announced publicly and bid specifications are provided to any interested party. In advance of bidding, any prospective bidder can obtain information regarding that school district's prior or existing school bus contracts. Prospective bidders may also obtain information on bids that were submitted to the school board in the past in connection with existing or prior contracts from competitors. The awarding of business contracts typically applies the “lowest responsible bidder” principle to determining which carrier is selected. While price is the predominant factor to evaluating this principle, other factors such as safety, quality of service, community involvement, etc. may be taken into consideration.

The industry is largely fragmented with some 500,000 buses in operation across the U.S. However, among the privatized, outsourced segment, the market has been largely consolidated in the past 10 years by UK publicly owned FirstGroup and National Express whom control approximately 52% of the privatized market. The top 10 providers account for 67% of the privatized market. The current industry concentration presents challenges to the acquisition strategy of companies such as Student Transportation, and will be more formally analyzed later in this report.

Student Bus Transportation Providers - 2011

$ in millions

Rank	Company	Fleet Size (1)	Student Revenues	Headquartered	Acquisitive	Ownership
1	First Student Inc. (FirstGroup plc)	57,400	$2,480	Cincinnati, OH	x	Public
2	National Express Group plc	17,408	$772	Chicago, IL	x	Public
3	**Student Transportation**	**9,000**	**$305**	**Wall, NJ**	**x**	**Public**
4	Atlantic Express Transportation	5,477	>$400	NY		Wyzata Inv.
5	Illinois Central School Bus Co.	3,400	N.A.	Channahon, IL		Carlyle Infra.
6	Petermann Ltd.	3,351	$150	Cincinnati, OH		Nat'l Express
7	Cook-Illinois Corp.	2,275	N.A.	Oak Forest, IL		Private
8	George Krapf Jr. & Sons Inc.	1,323	N.A.	PA	x	Private
9	WE Transport	1,200	N.A.	Plainview, NY		Private
10	Lamers Bus Lines Inc.	1,124	N.A.	Green Bay, WI		Private
	Total Top 10	101,958				
11-50	Total of Next 40 Operators	18,312				
	Total Private Industry	150,000 (2)				

(1) School Bus Fleet Magazine

(2) Based on an industry total of 500,000 school buses and a 30% market share of the estimated 4,000 private operators, as per 2011 School Transportation New Buyers' Guide

Overall, significant competition, limited barriers to entry, and few proprietary aspects of the business that limit the ability for one bus company to differentiate itself, constrain the upside potential of the student bus transportation market.

Capital and Labor Intensive

The school bus transportation market is characterized as capital intensive. New school buses can cost $75,000, have a useful life of 12 years, and require significant maintenance capital expenditure costs. In practical terms, this means bus operators need to replace 8 %– 10% of their fleet each year. Keeping a younger bus fleet is advantageous as it helps minimize maintenance expense. Buses typically have low fuel mileage economy and require a large labor force to operate. Key components of operating capital costs include fuel, wages and salaries and benefits, insurance, regulatory compliance, and maintenance expenses. Wages and salaries are the largest cost of operations, with labor unions playing a large role in the industry. Approximately 15% of Student Transportation's workforce is unionized.

Revenue and Cost Mismatch Pressuring Margins

As illustrated earlier, revenue contracts are awarded by school districts, which typically last from three to eight years. These contracts are primarily fixed price contracts and may include inflation escalators tied to the Consumer Price Index ("CPI"). Currently, the non-seasonally adjusted all U.S. CPI is 2.7% as reported by the Bureau of Labor Statistics. However, on the operating cost side of the industry, expenses are primarily variable and rising substantially. Take for example diesel prices: U.S. No. 2 Diesel Prices have risen 11% in the past year and 86% in the past two years according to the U.S. Energy Information Administration ("EIA").[3] Likewise, significant unionization of labor forces in the industry has resulted in increases in salaries in wages, while healthcare costs have also risen significantly. Furthermore, insurance policies must be renewed annually, and these costs have also been rising in recent years. A recent study by the U.S. Department of Transportation ("DOT") in June 2009 indicated school bus fatal crashes represented the highest proportion of all bus crashes analyzed between 1999 and 2005.[4] The overall mismatch between headline CPI inflation, and real inflation costs of the underlying business pose serious risks to levered school bus operators. For example, the industry's fourth largest operator, Atlantic Express Transportation, filed for bankruptcy protection in 2002, and upon emergence from Chapter 11 in 2003, later went through another financial restructuring in 2009.[5]

Increasing Regulatory Environment

Student bus transportation companies are required to comply with laws and regulations relating to safety, driver qualifications, insurance, worker overtime and other matters promulgated by various federal and state regulatory agencies including, among others, state motor vehicle agencies, state departments of education, the Federal Highway and Safety Administration, the National Highway Traffic Safety Administration and the Occupational Safety and Health Administration. Regulatory considerations are increasingly being factored into decisions by operators to remain in the industry. For example, Stagecoach recently cited regulatory considerations as a factor for selling its Dairyland business to Student Transportation in November 2011, even though it had a favorable financial profile.[6] The Dairyland business and its financial impact on Student Transportation is analyzed more formally later in this report.

[3] http://www.eia.gov/petroleum/gasdiesel/
[4] http://www.fmcsa.dot.gov/facts-research/research-technology/report/FMCSA-RRA-09-041_BIFA.pdf
[5] http://www.nytimes.com/2002/08/17/business/company-news-atlantic-express-transportation-files-for-chapter-11.html
[6] http://otp.investis.com/clients/uk/stagecoach/rns/regulatory-story.aspx?cid=273&newsid=226991

Outsourcing Market Share Shift Slow to Materialize

The growth of the industry through "conversions," or outsourcing of bus operations to private contracts, has been slow to evolve. Currently, approximately 68% of the market is still operated by school districts, which in theory leaves a large market opportunity for private contracts to gain market share. Commentary provided by industry participants such as First Student (FirstGroup) and National Express also indicates that the market share shift to conversions has only been ~2% in the past few years. In practical terms, outsourcing has been slow to materialize due to municipal funding pressures, competing priorities for other issues faced by school districts, overall bureaucracy, labor union intervention, and limited changes in the total student population and like-for-like mileage growth. Take for example, the recently released report in May 2012 by the New York School Board Association. The results of the study indicate that 30.9% of NY school districts plan to reduce transportation in their 2012 – 2013 budgets.[7] On a national level, the effects of reducing student transportation needs are becoming more tangible. For the month of April, the U.S. Labor Department reported that school-bus related employment saw the biggest decline in jobs for the month among all industries.[8] These data points cast doubt on the industry growth story.

STBs Flawed Acquisition Strategy

Now that we've provided an overview of the industry's conditions, we can analyze whether Student Transportation's aggressive acquisition strategy makes sense. According to the company's recent February 2012 investor presentation, they have acquired 47 companies and target purchase price multiples of 3.5x – 5.5x EBITDA. Given the fragmentation of the industry beyond the largest providers, the company has focused on smaller operators in rural markets where they believe there are lower levels of competition and operating costs. While on the surface this makes intuitive sense, the company's own financial results and incentive structure do not support the conclusion that the strategy is yielding benefits.

Let's first look at the management incentive structure of the company. The company's Short-Term Incentive Plan ("STIP") provides that 40% of management's cash bonus is tied to annual revenue growth, with another 20% as discretionary. A comparison of small-cap North American transportation firms reveals that Student Transportation is the only company tying short-term management bonuses primarily to revenue. The most common compensation factors in the industry are EPS and return on capital targets. Therefore, we conclude that STB's managers have a strong incentive to maximize revenue, and not cash flow or capital efficiency.

[7] http://www.nyssba.org/clientuploads/nyssba_pdf/NYSSBA-NYSASBO-Budget-Report.pdf
[8] http://blogs.wsj.com/economics/2012/05/04/school-buses-drive-job-losses-in-transport-sector/?mod=google_news_blog

$ in millions

Company	Enterprise Value	Short-Term Cash Bonus Criteria: Revenue Growth	EBITDA Margin	EPS Target	ROIC Target	ROA Target	Cash Flow Improve	Operating Ratio	Discretionary / Qualitative
Heartland Express (1)	$1,031	--	--	--	--	--	--	--	--
Student Transport.	$760	40%	30%	--	--	10%	--	--	20%
Marten Transport.	$414	--	--	100%	--	--	--	--	--
Celadon Group	$548	--	--	35%	35%	--	--	--	30%
Arkansas Best	$287	--	--	--	50%	--	50%	--	--

(1) No current targets established; in the past they've been tied to fleet growth, revenue miles, and customer service objectives
Source: Company proxy filings

Acquisitions of bus companies appear to offer few synergies to justify aggressive empire building. There are no identifiable revenue synergies from adding target companies. In an acquisition, Student Transportation adds its acquired contracts with school districts, physical assets, and employees. There may be some very marginal economies of scale in negotiating price concessions in purchasing fuel, new vehicles, and other related services. However, adding companies and entering new territories and regions also has added integration costs and expenses, such as adding new terminals and dispatchers. Overall, it does not appear that there is a net synergy benefit from an acquisition strategy in the student bus transportation industry. Take for example the company's recently announced acquisition of Dairyland for $47 million. By analyzing the company's recently filed pro-forma financial statements, we can assess the potential free cash flow impact.[9] A cursory view of the deal indicates that STB's free cash flow margin would increase from 7.4% to 8.4% or 100 basis points from the deal. However, this ignores any incremental capital expenditures required from adding this new territory in Wisconsin to the company's geographic profile. A sensitivity analysis suggests that any additional expense above $3 million for this acquisition negates free cash flow margin expansion. A careful review of Student Transportation's acquisition announcements indicate a steady disclosure of the revenue accretion from transactions, but provide no information on synergies or incremental costs associated with integration (See Appendix 3).

[9] Source: http://www.sec.gov/Archives/edgar/data/1419465/000117184312000550/exh_991.htm

Pro Forma Analysis: Student Transportation and Dairyland

$ in millions

	Dairyland	STB	Adj.	Pro Forma Combined FY 2011	Margin Effect
Revenues	$34.5	$305.3	--	$339.8	
Cost of Ops.	$24.2	$222.4	($1.0)	$245.6	
% margin	*70.1%*	*72.9%*		*72.3%*	-0.6%
G&A	$1.2	$31.4	$0.1	$32.7	
% margin	*3.4%*	*10.3%*		*9.6%*	-0.7%
Stock Comp	$0.0	$2.5	--	$2.5	
Dep. & Amort.	$2.8	$36.5	$2.8	$42.1	
EBIT	$6.4	$12.4	($1.9)	$16.9	
% margin	*18.6%*	*4.1%*		*5.0%*	0.9%
EBITDA	**$9.2**	**$51.5**	**$0.9**	**$61.6**	
% margin	***26.7%***	***16.9%***		***18.1%***	1.3%
Net Income	$2.8	$1.6	($0.9)	$3.4	
% margin	*8.0%*	*0.5%*		*1.0%*	0.5%
Cash from Ops.	$6.2	$36.3	$1.9	$44.4	
Capex	($2.2)	($13.6)	?	($15.8)	
Free Cash Flow	**$4.0**	**$22.7**	**$0.9**	**$28.6**	
% margin	***11.5%***	***7.4%***		***8.4%***	1.0%

Incremental Capex Requirements for Acquisitions

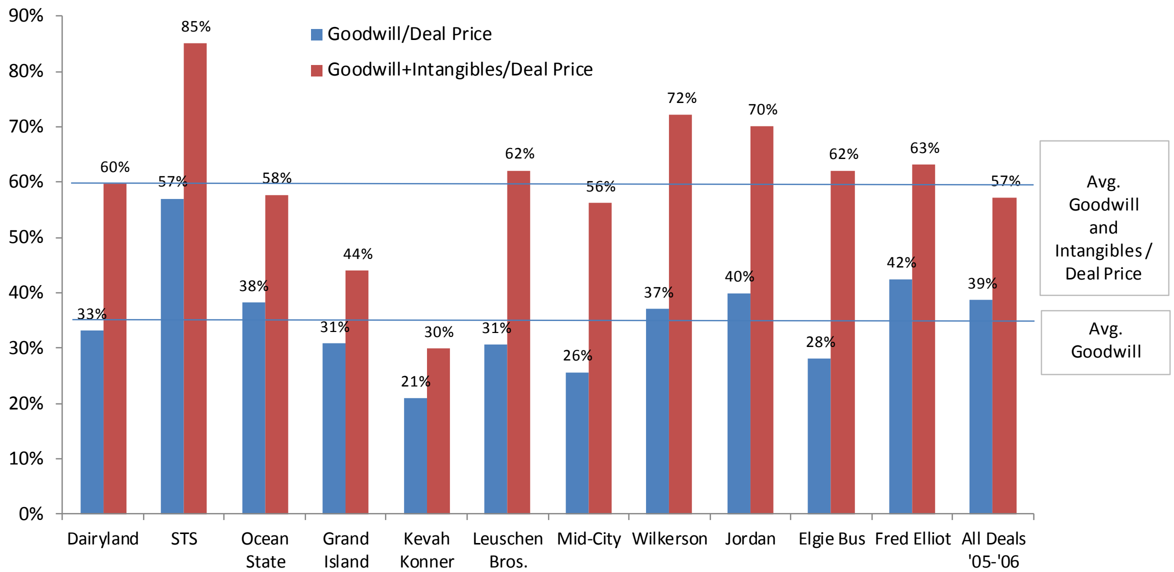
$2.00	**$2.50**	**$3.00**	**$3.50**	**$4.00**	**$4.50**
7.82%	7.67%	7.52%	7.37%	7.23%	7.08%

Free Cash Flow Breakeven

Other challenges faced by Student Transportation of maintaining its acquisition strategy include the expense of identifying and sourcing a pipeline of actionable investment targets. With over 4,000 private contractors in the market, many local family businesses, the company is dependent on acquiring small operators who want to sell to Student Transportation versus retain control, or sell to a competitor who might have greater financial resources to pay for the business. Many of the company's competitors have all been active in the M&A market in recent years, and have shown the willingness to pay for the right target, not just any target at all. See the section on Valuation for a complete list of M&A deals in the sector and how these deals compare with Student Transportation's overall company valuation.

One way to assess the relative aggressiveness of the Company's acquisition spree is to look at the goodwill accumulation that has been associated with these transactions. Intangibles primarily include contract values, non-compete agreements, and trade names. Goodwill is the excess of the deal price over working capital, PP&E, and intangibles less assumed liabilities. Goodwill and Intangible assets on the company's balance sheet currently total over $221 million or 44% of the company's reported assets. On average, 35% of the recent purchase price from acquisitions is attributable to goodwill.

Goodwill and Intangibles as a % of Deal Price for STB's Acquisitions



Source: Company filings

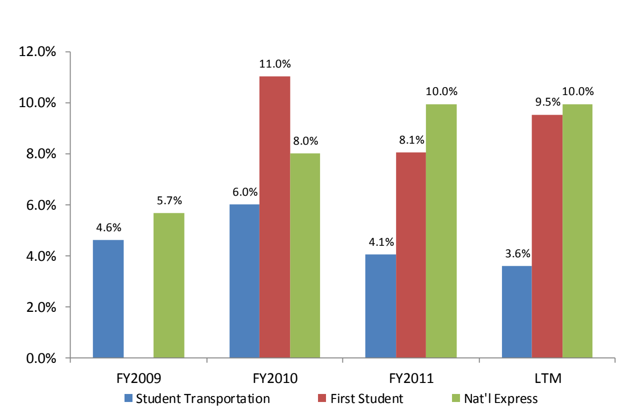
Is STBs Financial Strategy Sensible in the Long-Run?

With our foregoing discussion on the challenging industry dynamics and Student Transportation's aggressive acquisition strategy, we are now in a position to assess if the company has an attractive and sustainable financial business model. The charts below show a remarkable result about the company's capital allocation and margin profile. First, using publicly reported information in segment disclosures, we can compare Student Transportation's adjusted operating margin (EBIT) with its two largest competitors, First Student and National Express. The chart shows very clearly that the company's margins trail its competitors by 500 – 600 basis points, and their margins have been under pressure in the past few fiscal years. Meanwhile, both competitors have recently undertaken restructuring efforts in their North American student bus operations to improve and stabilize margins.

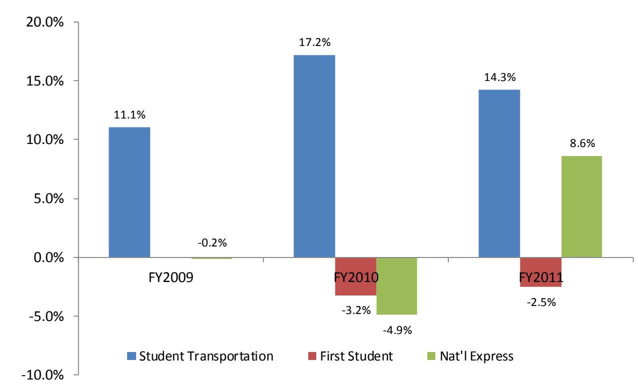
However, the two most striking observations from the charts are related to the company's capital allocation strategy in the past five and a half years. From these charts we can see clearly the sources and uses of their cash flow, and can reach some conclusions about the financial model. Looking at the sources of cash, we see the company has generated $166 million from operations, but has raised more money from selling equity in the amount of $180 million in the same period. Approximately $212 million has been used for acquisitions, $146 million for capital expenditures, and $120 million for the dividend have been used. Actual free cash flow, or cash from operations less capital expenditures, has amounted to only $21 million. Typically, it would be prudent to use free cash flow for discretionary measures such as debt reduction, dividends, or share repurchases. However, the company's free cash is significantly less than the amount used for dividends and Series B stock repurchased from management.

Looking more closely at the capital allocation chart, we can see that cash from operations has been largely stagnant in the past three years, while total debt funded for acquisitions has increased by $154 million.

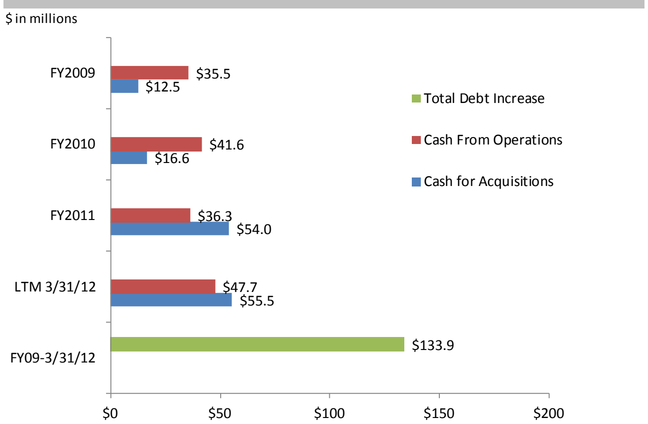
Adjusted EBIT Margins - North American Student Bus Operators



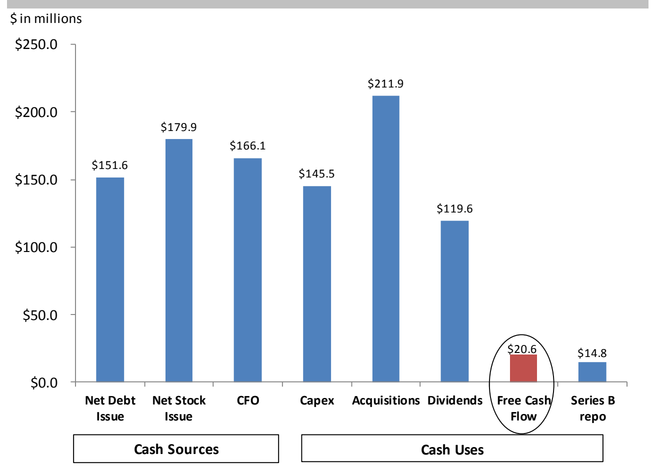
Reported Industry Annual Revenue Growth



Capital Allocation



Cumulative Cash Flow Summary FY 2007 - 3/31/12



Notes: First Student FY ended March; FirstGroup did not provide segment detail prior to FY2010
Nat'l Express FY ended Dec
Student Transportation FY ended June
Note: Free Cash Flow = Cash from Operations - Capex
Source: Public company filings

Leverage Levels are High and Will Increase with More Acquisitions

The escalation of the company's debt outstanding and margin pressure is concerning from the viewpoint that free cash flow has not increased commensurately. At the start of 2012, the company's liquidity was not adequate with less than $4 million of cash on the balance sheet, and under $30 million of borrowing capacity under its credit facility. The company's financial strategy has been to borrow short term for acquisitions, and then term out the debt with dilutive securities (straight equity issuance or convertible bonds). The company has the ability to exercise a $100 million accordion in its credit facility as well. According to our analysis, earlier this year the company was close to its covenant levels of 5.0x total leverage and 3.0x senior leverage. The covenants reference the company's EBITDA metric and allow for pro forma adjustments based on the acquisitions being made. Accordingly, the company recently announced a C$75 million new equity raise at $6.85 per share on February 28, 2012. We also consider the company's use of off-balance sheet operating leases amounting to over $70 million a form of debt. For a complete overview of the company's capital structure see Appendix 1. With the new financial cushion, the company has stated that they are currently evaluating additional acquisitions.

STB's Bank Covenants	From	To	Ratio
Total Leverage	3/31/2011	9/30/2012	< 5.00x
Ratio	12/31/2012	onward	< 4.75x
Senior Leverage	3/31/2011	9/30/2012	< 3.00x
Ratio	12/31/2012	onward	< 2.75x
Int Coverage	All quarters		>2.00x
Capex	12 month Period		< 25% of Sales

Total Liquidity	
Cash	$8.6
Borrowing Capacity (1)	$117.9
Total Liquidity	**$126.4**

(1) $100m accordion feature available

Estimated Covenant Calculations		
Interest Coverage	**Post Equity(2)**	**Pre-Equity**
LTM Adj. EBITDA	$57.2	$51.5
LTM Cash Interest Expense	$15.8	$14.5
Coverage Ratio	**3.62x**	**3.55x**
Total Leverage Ratio		
Total Funded Debt	$190.8	$278.8
LTM Adj. EBITDA	$57.2	$51.5
Total Leverage Ratio	**3.34x**	**5.41x**
Total Senior Leverage Ratio		
Total Funded Debt	$190.8	$278.8
Less: Convertible Debentures	($132.5)	($132.5)
Total Senior Funded Debt	$58.4	$146.3
LTM Adj. EBITDA	$57.2	$57.2
Senior Leverage Ratio	**1.02x**	**2.56x**

(2) Equity raised concluded 3/21/12

Transportation companies do not typically support such high levels of leverage due to many risk factors. The company has made use of the fact that it has contracted revenues of 3 – 8 years, and over 184 contracts which provide revenue diversity. However, 26% and 29% of its contracts mature in fiscal years 2012 and 2013 and there is no guarantee that contracts will be renewed; however, the company tends to have success in renewing contracts in the 90% range. With school districts under pressure to cut costs, re-opening contracts are expected to be fiercely competed. The company also has fuel protection measures in 60% of its contracts, with an additional 20% of exposures hedged through annual fixed-price fuel contracts with suppliers. However, pricing under these fuel contracts has annual rollover risk. To illustrate, pricing under new contracts has increased 30% year-over-year as of the current quarter.

How Shareholder Friendly is the Dividend and Series B Stock Repurchases

In the context of a management team that is highly incentivized to grow revenues, levering up to acquire companies, and not growing free cash flow, how wise is the dividend and management owned Series B stock repurchases? As we've illustrated earlier and in the chart below, the company's free cash flow is not sufficient enough to cover either the dividend or Series B repurchases. The company also recently announced a common stock repurchase program up to $5 million, but has only purchased $100,000 of common stock. Where is the money coming from to fund these payments? The answer is that the money is coming from both creditors and new investors through share issuance. Put in this perspective, the dividend is not so friendly after all, but rather akin to taking money from Peter to pay Paul. The company will have to continue attracting new sources of capital to grow and maintain its current financial practices; otherwise, the dividend will be in jeopardy. As more shares get issued, the total annual cash dividend payment increases. Given that leverage is already at elevated levels and will increase with more acquisitions, the most likely outcome for the company is continued stock issuance in the foreseeable future. The common stock repurchase announcement also does not look friendly from the perspective that the company has repurchased $15 million of management's Series B stock since 2007.

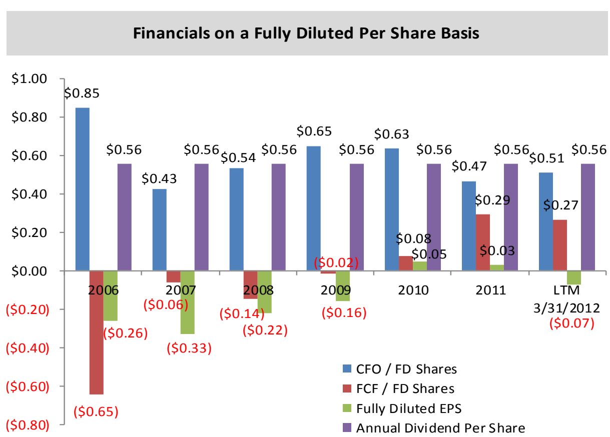
The Series B has also been collecting dividend payments too, which further incentivizes management to maintain the dividend.

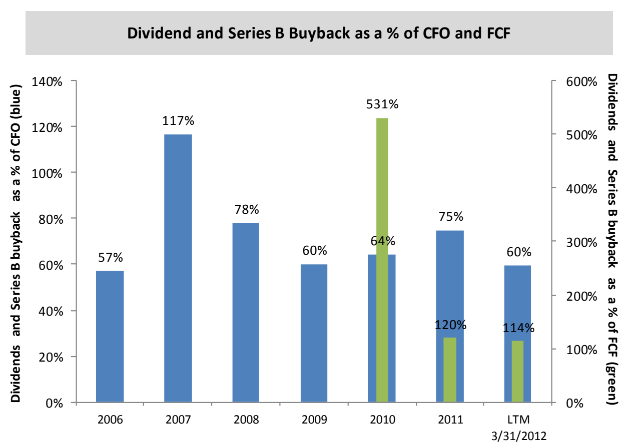
STB Stock Repurchases

	Number of Shares Repurchased			Repurchase Amount Value		
	Common Stock	**Series B-2**	**Series B-3**	**Common Stock**	**Series B-2**	**Series B-3**
9m End. 3/31/12	17,000	46,719	71,391	$98,000	$500,000	$500,000
FY 11	--	196,202	9,413	--	$1,700,000	$60,000
FY 10	--	296,518	--	--	$2,500,000	--
FY 09	--	119,776	--	--	$900,000	--
FY 08	--	18,137	--	--	$100,000	--
Total	**17,000**	**677,352**	**80,804**	**$98,000**	**$5,700,000**	**$560,000**

Source: Company filings

Chart Observations: Cash from operations (CFO) per share peaked in 2009 and has been under pressure even as significant acquisitions have occurred. Free cash flow (FCF) per share is significantly lower than CFO per share; the gap has been widening recently. Dividends per share are higher than EPS, CFO or FCF per share. Cash for dividends and Series B buyback is approximately 75% of CFO and 111% of FCF.



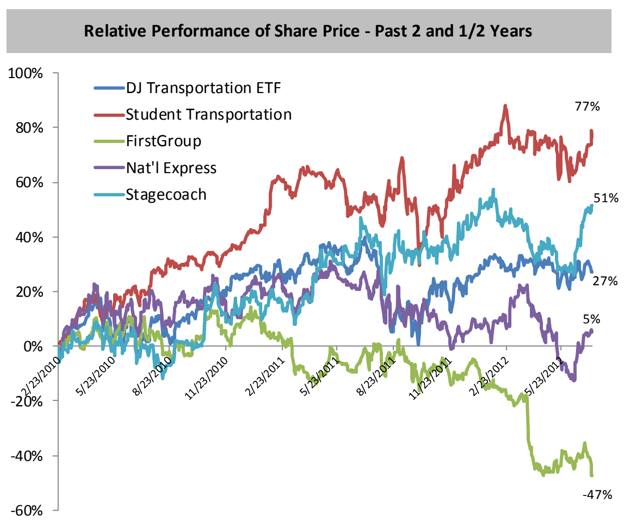


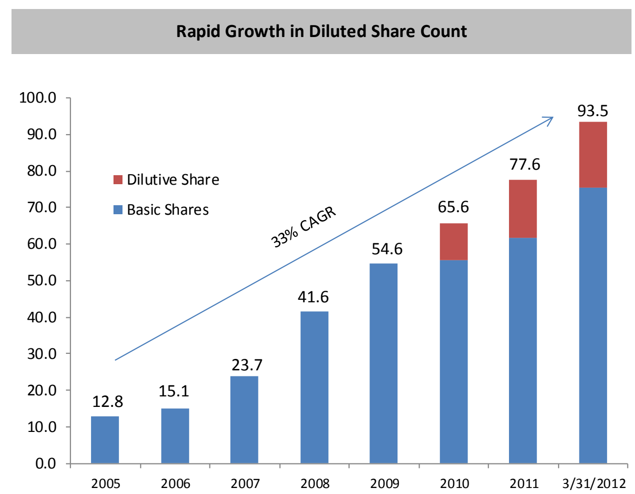
Valuation and Price Target

By almost every objective valuation metric, the company's stock price appears overvalued. We have analyzed the company from the perspective of relative stock price performance, comparable trading companies, historical valuation, broker target prices, and precedent M&A deal values.

Relative Performance

STB's share price has outperformed all its relevant peers and the Dow Jones Transportation Index in the past two years. This outperformance is despite the fact that the company's diluted share count has grown at a compounded average annual growth rate of 33%, and per share metrics have also struggled to match the rise in share price. In light of our previously highlighted concerns, STB's share price is terribly overvalued.





Comparable Companies Analysis

By analyzing a set of comparable companies in the student bus transportation and North American mid-cap trucking universe, we see that an appropriate valuation range is 6.0x – 7.0x Adjusted Enterprise Value to EBITDAR. We have adjusted our financial figures to account for sizeable off-balance sheet operating leases that are commonly used in the industry. We treat these operating leases as a form of contractual debt and capitalize them through an NPV analysis. Student Transportation makes use of these operating leases in their business. On an Adjusted Enterprise Value to Revenue basis, an appropriate valuation range is 0.8x – 1.2x

Bus and Transporation Comparable Companies

($ in millions, except per share figures)

Name	Ticker	Stock Price 7/24/2012	% of 52-wk High	Adj. Ent. Value	LTM EBITDAR	'12-'13E Revenue Growth	LTM EBITDAR Margin	P / E LTM	P / E 2012E	Enterprise Value / EBITDAR LTM	Enterprise Value / EBITDAR 2012E	Enterprise Value / Revenue LTM	Enterprise Value / Revenue 2012E	Price / Book Value	Leverage Debt/ EBITDAR	Leverage Debt/ Capital	Dividend Yield
Bus Transportation																	
FirstGroup Plc	FGP.L	$3.18	54.8%	$8,254	$1,460	-7.3%	14.4%	4.9x	5.5x	5.7x	6.9x	0.8x	0.8x	1.6x	7.0x	91.5%	7.4%
Nat'l Express	NEX.L	$3.28	77.7%	$2,972	$527	-1.4%	14.9%	10.4x	8.0x	5.6x	5.6x	0.8x	1.0x	1.1x	2.7x	48.2%	2.9%
Stagecoach	SGC.L	$4.28	81.9%	$4,265	$546	4.6%	13.4%	12.4x	9.8x	7.8x	7.9x	1.0x	0.9x	NM	3.0x	NM	2.7%
					Max	4.6%	14.9%	12.4x	9.8x	7.8x	7.9x	1.0x	1.0x	1.6x	7.0x	91.5%	7.4%
					Average	-1.4%	14.2%	9.2x	7.8x	6.4x	6.8x	0.9x	0.9x	1.3x	4.2x	69.9%	4.3%
					Min	-7.3%	13.4%	4.9x	5.5x	5.6x	5.6x	0.8x	0.8x	1.1x	2.7x	48.2%	2.7%
Midcap Trucking and Transportation																	
Knight Transportation	KNX	$15.27	80.6%	$1,268	$173	9.5%	19.2%	20.4x	14.7x	7.3x	5.7x	1.4x	1.2x	2.5x	0.3x	10.0%	1.6%
Heartland Express	HTLD	$13.71	78.9%	$1,023	$136	5.9%	25.4%	16.9x	15.8x	7.5x	5.9x	1.9x	1.7x	3.3x	0.0x	0.0%	0.6%
Marten Transport	MRTN	$17.12	74.0%	$351	$99	9.2%	16.0%	14.8x	10.5x	3.6x	2.7x	0.6x	0.5x	1.2x	0.0x	0.1%	0.5%
Celadon Group	CGI	$13.58	82.3%	$510	$63	8.6%	10.9%	14.3x	10.3x	8.1x	4.9x	0.9x	0.7x	1.7x	3.2x	52.0%	0.6%
Arkansas Best	ABFS	$11.18	40.7%	$230	$85	7.1%	4.5%	NM	10.4x	2.7x	1.8x	0.1x	0.1x	1.7x	1.5x	44.0%	1.1%
					Max	9.5%	25.4%	20.4x	15.8x	8.1x	5.9x	1.9x	1.7x	3.3x	3.2x	52.0%	1.6%
					Average	8.0%	15.2%	16.6x	12.3x	5.8x	4.2x	1.0x	0.9x	2.1x	1.0x	21.2%	0.9%
					Min	5.9%	4.5%	14.3x	10.3x	2.7x	1.8x	0.1x	0.1x	1.2x	0.0x	0.0%	0.5%
Student Transport.	**STB**	**$7.10**	**94.7%**	**$776**	**$68**	**9.2%**	**19.1%**	**NM**	**144.9x**	**11.4x**	**10.4x**	**2.2x**	**1.9x**	**2.6x**	**3.4x**	**51.9%**	**7.8%**

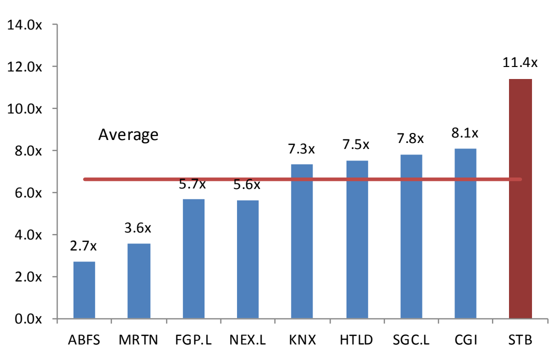
Source: Company filings

Note: Debt and EBITDA adjusted to capitalize off-balance sheet operating leases.

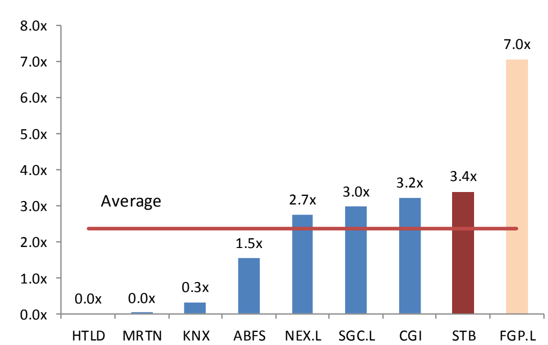
Note: 2012 figures calenderized to adjust for fiscal years ending mid-year

The following charts better illustrate the extreme overvaluation of the company's shares. The shares appear overvalued on an EV/EBITDAR and Price/Earnings basis. The company is highly levered, and its dividend yield is matched only by FirstGroup, which is distressed and subject to a likely dividend cut.

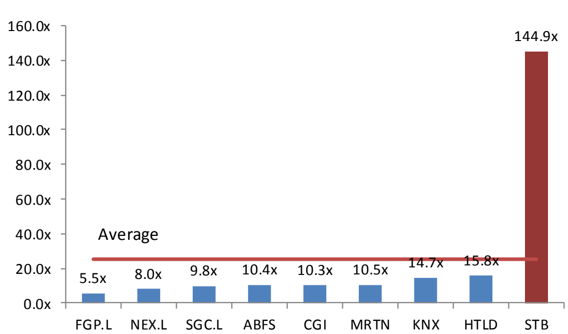
Adj. Enterprise Value / LTM Adjusted EBITDAR



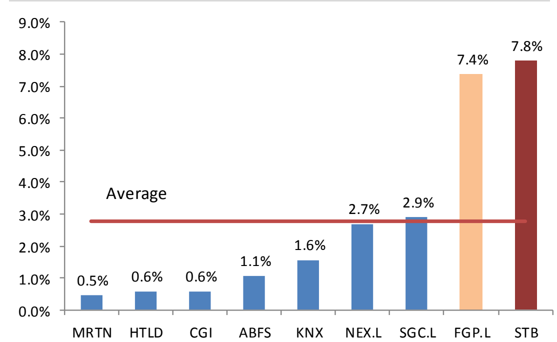
Adj. Debt / LTM Adjusted EBITDAR



Price / 2012E EPS



Trailing Dividend Yield



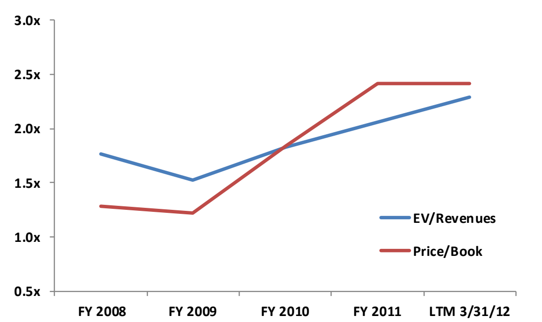
Note: Adjusted for off-balance sheet operating leases; figures calendarized

Note: Sustainability of FirstGroup dividend yield in question due to struggling business

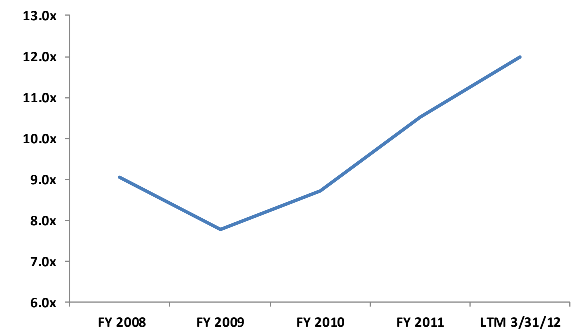
Historical Valuation

The following charts illustrate the company's historical valuation in the past few fiscal years. The most interesting observation relates to the company's enterprise value to vehicle fleet. A new school bus can cost up to $75,000, while the enterprise value to vehicle ratio at 3/31/12 implies a valuation in excess of $90,000. The average age of the company's fleet is approximately 6 years old. Put in this context, the valuation implies a 25% premium to the value of brand new vehicle fleet.

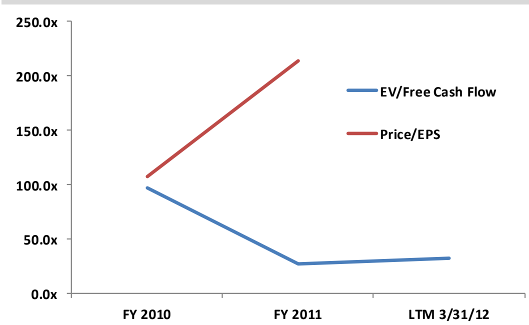
Enterprise Value / Revenues and Price / Book Value



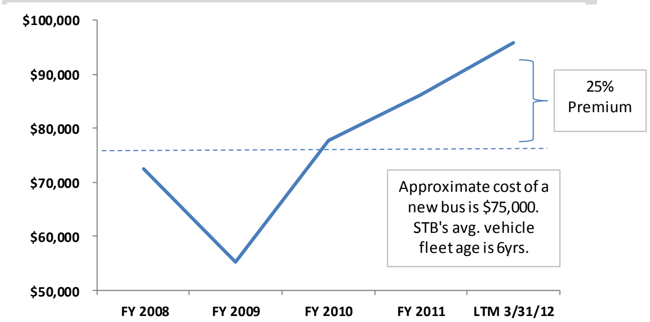
Enterprise Value / Adj EBITDAR



Enterprise Value / Free Cash Flow and Price / Earnings



Enterprise Value / Total Vehicles



Vehicles in Fleet	5,000	6,300	6,300	7,300	8,500

Source: Company financials
Enterprise Value Adjusted for Leases

Precedent M&A Valuations

Another sensible approach to evaluating Student Transportation's intrinsic value is to look at precedent acquisitions in the student bus and transportation market. Fortunately, there are ample transactions to review that point to a consistent firm valuation. A very relevant and recent transaction comparable is National Express' $200 million acquisition of Petermann in September 2011. Petermann is currently the 6th largest student bus operator in the U.S. This deal valued Petermann at 1.3x EV/Revenues and 6.8x EV/EBITDA. On average, the analysis suggests valuations in range of 6.0x – 8.0x EV/EBITDA and 0.70x – 1.3x EV/Sales.

Recent Transportation M&A Deals
$ in millions

Date	Target	Owner	Acquiror	Enterprise Value	LTM Sales	LTM EBITDA	EBITDA Margin	Enterprise Value Sales	Enterprise Value EBITDA	Price/ EPS	Price/ Book
Student and Bus Transportation											
1/9/2012	Transport St. Leonard		First Group	$8.8	--	--	--	--	--	--	--
9/13/2011	Petermann	Macquarie Cap.	National Express	$200.0	$149.9	$29.3	19.5%	1.3x	6.8x	--	--
11/15/2011	Dairyland Bus	Stagecoach	Student Transportion	$47.0	$35.7	$9.4	26.2%	1.3x	--	--	--
2/16/2011	Ocean State Transit		Student Transportion	$10.8	$7.2	--	--	1.5x	--	--	2.4x
1/11/2011	Ridge Road Express Way		Student Transportion	$23.7	$16.0	--	--	1.5x	--	--	1.8x
12/30/2010	Kevah Konner		Student Transportion	$3.7	$4.8	--	--	0.8x	--	--	1.3x
7/15/2010	Leuschen Bros		Student Transportion	$19.6	$12.0	--	--	1.6x	--	--	2.5x
6/1/2010	Illinois Central School Bus (1)		Carlyle Infrastructure Fund	--	--	--	--	--	7.5x	--	--
8/19/2011	USA United Fleet		MV Transportation	$20.9	$75.0	--	--	0.3x	--	--	1.3x
1/25/2011	Preston Bus Ltd.	Stagecoach	Rotala	$5.1	$12.2	--	--	0.4x	--	--	1.1x
4/1/2010	Mid-City Transit Corp/Wilkerson		Student Transportion	$9.6	$12.7	--	--	0.8x	--	--	3.1x
9/17/2009	Jordan Transportation		Student Transportion	$10.4	$7.2	--	--	1.4x	--	--	3.3x
8/27/2009	National Express		CVC Capital and Cosmen	$2,836.2	$4,600.0	$502.0	10.9%	0.6x	5.6x	12.9x	1.8x
8/1/2008	Elgie Bus Lines		Student Transportation	$14.4	--	--	--	--	--	--	2.6x
2/29/2008	A&E Transport Service		National Express	$23.3	--	--	--	--	--	--	3.8x
4/27/2007	Continental Auto		National Express	$894.9	$268.4	--	--	3.3x	--	--	3.0x
2/9/2007	Laidlaw		First Group	$3,522.0	$3,144.6	$452.7	14.4%	1.1x	7.8x	26.7x	2.4x
8/5/2005	Northstar / Walsh Transport.	Contrans Income Fund	National Express	$45.0	$22.9	--	--	2.0x	--	--	2.4x
6/26/2006	Stagecoach London Bus	Stagecoach	Macquarie Capital	$480.9	$409.8	$57.3	14.0%	1.2x	8.4x	--	--
9/1/1999	Ryder Student Transport	Ryder	First Group	$940.0	$683.0	$100.8	14.8%	1.4x	9.3x	--	--
8/14/1999	Durham Transportation		National Express	$178.5	$104.0	--	--	1.7x	--	--	--
						Max	**26.2%**	**3.3x**	**9.3x**	**26.7x**	**3.8x**
						Average	**16.6%**	**1.3x**	**7.6x**	**19.8x**	**2.3x**
						Min	**10.9%**	**0.3x**	**5.6x**	**12.9x**	**1.1x**
Trucking											
11/6/2006	J. Moyes/Mgmt		Swift Transport.	$2,517.0	$3,172.0	$493.6	15.6%	0.8x	5.1x	17.0x	2.3x
5/26/2006	Watkins Motor Lines		FedEx	$780.0	$1,000.0	$127.9	12.8%	0.8x	6.1x	--	--
10/27/2005	Transportation Corp of America		Goldner Hawn Johnson	$108.0	$255.4	$28.9	11.3%	0.4x	3.7x	37.0x	1.1x
2/27/2005	YRC Worldwide		USF	$1,467.4	$2,445.7	$170.6	7.0%	0.6x	8.6x	34.0x	2.6x
5/16/2005	UPS		Overnite	$1,689.0	$2,111.3	$225.2	10.7%	0.8x	7.5x	18.0x	2.9x
7/8/2003	Roadway		Yellow Corp	$1,263.5	$3,158.8	$180.5	5.7%	0.4x	7.0x	25.5x	2.3x
11/13/2000	FedEx		American Freightways	$1,184.5	$1,316.1	$191.0	14.5%	0.9x	6.2x	16.4x	2.5x
						Max	**15.6%**	**0.9x**	**8.6x**	**37.0x**	**2.9x**
						Average	**11.1%**	**0.7x**	**6.3x**	**24.7x**	**2.3x**
						Min	**5.7%**	**0.4x**	**3.7x**	**16.4x**	**1.1x**

(1) EBITDA muliple estimated based on market research
Source: Public information

Broker Price Targets

Student Transportation is currently covered by 4 brokers in Canada and 1 in the U.S., all of which have recently assisted the company to raise capital. The average analyst price target is $7.45 per share. Given the current stock price of approximately $7.10, the shares appear fully valued with limited upside potential.

Revenue	2012E	2013E
NB Financial	$370.0	$438.0
BMO	$377.0	$458.0
Scotia Bank	$377.0	$459.0
Raymond James	$374.0	$449.0
Stifel	$373.4	$438.0
Average	**$374.3**	**$448.4**
Growth	*23%*	*20%*
Std. Deviation	*2.9*	*10.3*

EPS	2012E	2013E
NB Financial	$0.10	$0.22
BMO	($0.03)	$0.10
Scotia	($0.07)	$0.09
Raymond James	($0.05)	$0.10
Stifel	($0.04)	0.07
Average	**($0.02)**	**$0.12**
Growth	*-160%*	*-744%*
Std. Deviation	*0.07*	*0.06*

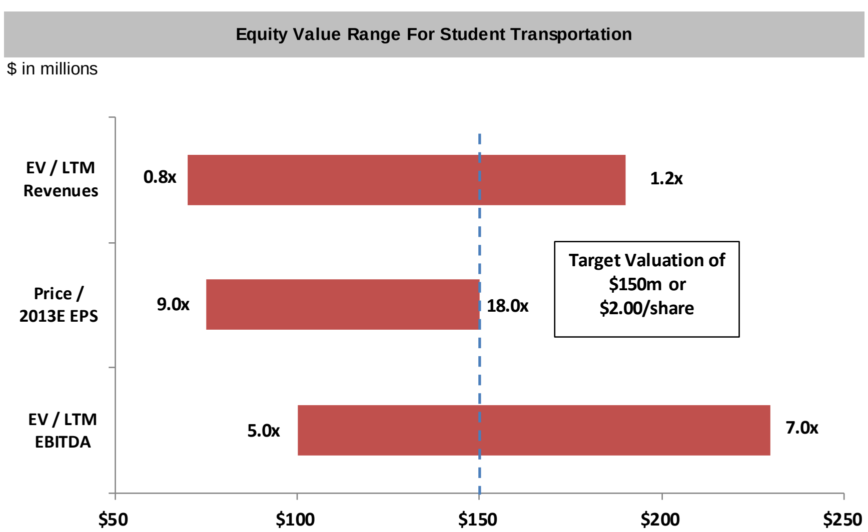
Adj. EBITDAR	2012E	2013E
NB Financial	$73.0	$85.8
Scotia Capital	$64.5	$76.3
BMO	$60.2	$73.6
Raymond James	$72.2	$90.1
Stifel	--	--
Average	**$67.5**	**$81.5**
Growth	*31%*	*21%*
Margin	*18.0%*	*18.2%*
Std. Deviation	*6.2*	*7.8*

Broker	Report Date	Price Target
NB Financial	5/9/2012	$8.20
Scotia Capital	5/1/2012	$7.00
BMO	4/1/2012	$7.25
Raymond James	3/27/2012	$7.50
Stifel	5/22/2012	$7.30
Average		$7.45
% Over/(Under) Value from Current Stock Price of $7.10		-4.7%
Std. Deviation		*0.46*

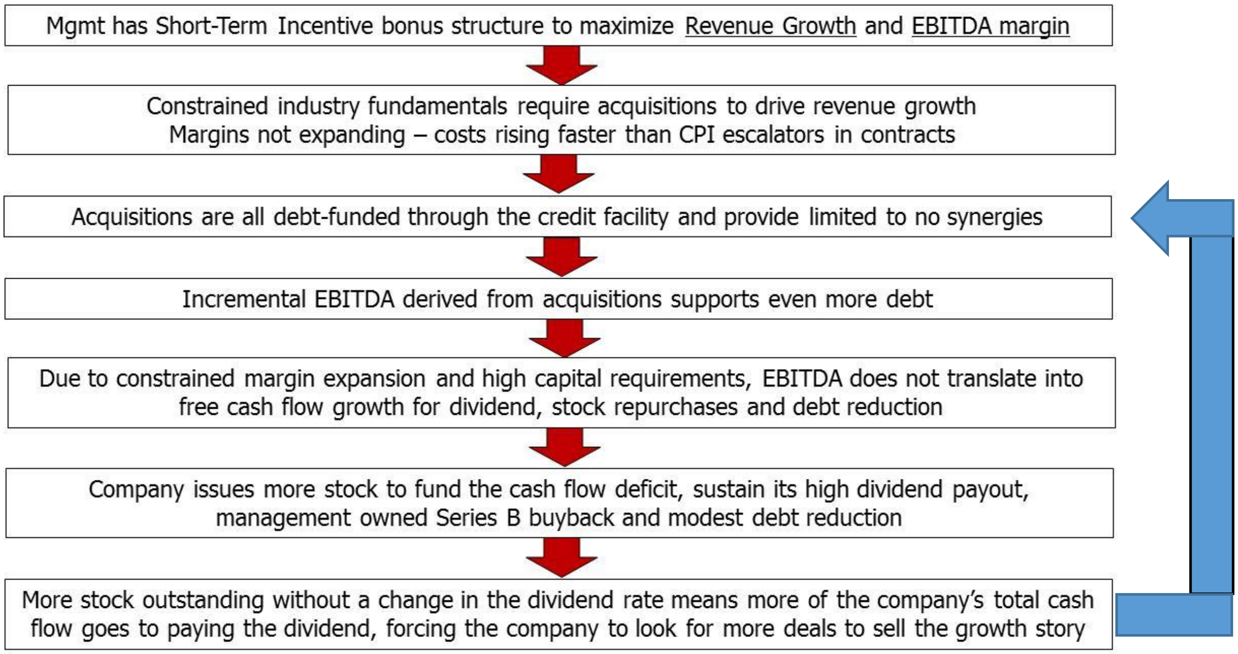
Source: Broker Estimates; Bloomberg

Target Stock Price

We arrive at our share price target of **$2.00** by applying realistic multiples to revenues, 2013E EPS and EBITDA based on the comparable companies and precedent transaction analyses. Given STB's current share price of $7.10, we believe the stock is a strong sell and materially overvalued.



Summary of Flawed Financing Scheme



The cycle of buying non-cash flow accretive deals, raising debt and stock, and paying out high dividends and stock repurchases cannot continue indefinitely. Raising capital from creditors and stockholders to payback stockholders with dividends is not a value enhancing strategy in the long-run.

Appendix 1 – Capital Structure

Student Transportation (STB)	
Stock Price	$7.10
Basic Shares o/s (1)	78.2
Market Cap	$555.3
Total Adj. Debt	$229.4
Less: Cash	($8.6)
Enterprise Value	$776.1

Book Value	
Book Equity	$212.3
per share	$2.71
Tangible Equity	($8.2)
per share	($0.10)

Valuation	LTM	FY 2012E	FY 2013E
Price/EPS	NM	NM	61.2x
Price/Book	2.6x	--	--
EV/Sales	2.2x	2.1x	1.7x
EV/EBITDAR	11.4x	11.5x	9.5x

Debt	Amt	Int Rate	Conv. Shares	Conv. Price	Maturity	Credit Availability	Callable	Currency
Credit Revolver	$22.2	4.50%			2016	$116.0		
Snr Secured Notes	$35.0	4.25%			11/10/2016			
Total Senior Debt	**$57.2**	**4.35%**						
Convertible Debt (1)	$12.1	7.50%	2.2	$5.15	10/31/2014		10/31/2012	C$
Convertible Debt	$46.2	6.75%	7.0	$7.25	6/30/2015		7/1/2013	C$
Convertible Debt	$59.0	6.25%	6.3	$9.50	6/30/2018		7/1/2014	US$
Total Converts	**$117.3**	**6.58%**	**15.4**					
Promissory Notes	$0.8							
Total Debt	**$175.3**							
Leases								
Vehicle Leases	$40.1							
Operating Leases	$25.9							
NPV of Leases @ 5.7%	$54.2							
Total Adjusted Debt	**$229.4**							

(1) Pro forma for 56% conversion of the 7.5% convertible notes as of June 30, 2012

Appendix 2 – Company Financials

Student Transportation's Historical Financials

$ in millions

	Fiscal Year Ended June 30,							LTM
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**3/31/2012**
Sales	$109.7	$132.9	$168.1	$205.2	$227.9	$267.2	$305.3	$355.4
% growth	*22.3%*	*21.1%*	*26.5%*	*22.1%*	*11.1%*	*17.2%*	*14.3%*	--
Cost of Ops	$77.6	$95.4	$122.3	$146.4	$163.2	$187.7	$222.4	$261.4
% margin	*70.7%*	*71.8%*	*72.7%*	*71.3%*	*71.6%*	*70.2%*	*72.9%*	*73.5%*
G&A	$10.7	$12.8	$17.1	$21.2	$23.5	$28.7	$31.4	$36.8
% margin	*9.8%*	*9.6%*	*10.2%*	*10.3%*	*10.3%*	*10.7%*	*10.3%*	*10.4%*
D&A	$15.7	$21.2	$24.5	$25.5	$28.7	$32.7	$36.5	$40.7
Stock Comp	$0.2	$0.9	$1.9	$1.4	$2.0	$2.0	$2.5	$3.6
Acquisition Expenses/other	$0.0	$0.0	$0.4	$0.0	$0.0	$0.0	$0.0	$0.0
EBIT	**$5.6**	**$2.7**	**$2.8**	**$10.6**	**$10.5**	**$16.1**	**$12.4**	**$12.9**
% margin	*5.1%*	*2.0%*	*1.7%*	*5.2%*	*4.6%*	*6.0%*	*4.1%*	*3.6%*
Adj EBITDA	$21.4	$24.8	$29.1	$37.5	$41.2	$50.8	$51.5	$57.2
% margin	19.5%	18.6%	17.3%	18.3%	18.1%	19.0%	16.9%	16.1%
Lease Expense	$2.5	$0.0	$1.1	$2.6	$3.5	$5.4	$8.4	$10.6
EBITDAR	**$23.9**	**$24.8**	**$30.2**	**$40.1**	**$44.7**	**$56.2**	**$59.9**	**$67.9**
% margin	21.8%	*18.6%*	*18.0%*	*19.5%*	*19.6%*	*21.0%*	*19.6%*	*19.1%*
Interest Exp	$12.3	$13.3	$15.8	$13.5	$10.4	$10.5	$14.5	$15.8
Avg Int Rate	14.3%	*12.1%*	*12.6%*	*12.1%*	*10.9%*	*7.3%*	*7.6%*	*6.0%*
FD EPS	($0.16)	($0.26)	($0.33)	($0.22)	($0.16)	$0.05	$0.03	($0.07)
Cash from Ops.	$11.3	$12.8	$10.1	$22.3	$35.5	$41.7	$36.3	$47.7
Capex	($2.0)	($22.5)	($11.5)	($28.3)	($36.4)	($36.6)	($13.6)	($22.8)
Free Cash Flow	$9.2	**($9.7)**	**($1.4)**	**($6.0)**	**($0.9)**	**$5.1**	**$22.7**	**$24.9**
% margin		*-7.3%*	*-0.8%*	*-2.9%*	*-0.4%*	*1.9%*	*7.4%*	*7.0%*
Financing Activities								
Dividends	($2.8)	($7.3)	($11.8)	($17.3)	($20.5)	($24.3)	($25.4)	($27.4)
Repurchase of Series B		$0.0	($8.5)	($0.1)	($0.9)	($2.5)	($1.8)	($1.0)
Businesses Acquired		$43.4	$10.1	$64.1	$12.5	$16.6	$54.0	$55.5
Net Stock Issuance	$52.0	$54.6	$7.3	$57.4	$35.5	$0.0	$0.0	$79.6
Net Debt Issued (Repaid)	$44.4	$26.9	$14.5	$32.4	($3.3)	$45.0	$63.5	($13.6)
Ending Cash	$1.7	$7.7	$4.0	$3.5	$0.6	$4.8	$3.7	$8.6
Total Debt	$86.1	$109.4	$125.5	$111.8	$95.5	$143.8	$191.9	$244.6
Basic Shares	12.76	15.09	23.72	41.59	54.56	55.65	61.79	75.43
Potential Dilution		--	--	--	--	9.96	15.85	18.08

Appendix 2 – Company Financials (Continued)

Student Transportation's Historical Financials

PROJECTION MODEL ASSUMPTIONS

Dividend Assumptions

Shares Outstanding at 6/30/11	61.8
New Stock Issued	12.3
DRIP shares issued	0.9
Conversion of Debt (2)	3.2
Stock Repurchased	0.0
Shares Outstanding at 6/31/12	78.2
Less: DRIP (1)	-14.9
Total Series B1-3	1.9
Dividend Paying Shares	65.2
Quarterly Dividend Rate / Share	$0.05
Annual Dividend / Share	$0.56
Annual Dividend Payment	$36.3
(1) Divident Reinvestment Rate	19.0%
(2) Pro Forma for conversion	

Financing

Cost of New Bus	$75,000
Cash Flow Margin on New Contracts	12%
2013 Maint. Capex	$30.0
Lease %	100%
Interest Rate	4.50%
Nat'l Exp Deal	$6.4
Interest Rate	4.35%

Debt Outstanding

3/31/2012	Amt	Int Rate
Senior Debt	$57.2	4.35%
Converts (2)	$147.3	6.58%
Leases	$66.0	5.70%
Total Debt	$270.5	5.89%

Student Transportation Projections
$ in millions

	FY 2011 30-Jun-11	FY 2012 30-Jun-12	Pro Forma Adjustments		FY2013 30-Jun-13
Revenue	$305.3	$364.8	$42.1	(2)-(7)	$406.9
growth	*14.3%*	*19.5% (1)*			*11.5%*
EBITDAR	$59.8	$69.3	$8.0		$77.3
margin	*19.6%*	*19.0%*	*19.0%*		*19.0%*
Interest Expense	$14.5	$15.8	$1.6	(8)	$17.4
Cash from Ops	$36.3	$47.4	$3.4	(9)	$50.9
margin	*11.9%*	*13.0%*	*8.1%*		*12.5%*
Maintenance Capex (leased)	$6.0	$10.5	$30.0	(10)	$30.0
Growth Capex	$7.7	$13.5	$28.0	(11)	$28.0
Total Capex	$13.7	$24.0	$58.0		$58.0
Free Cash Flow pre-Dividend	$22.6	$23.4			$22.9
Dividend	$25.4	$29.5	$6.8		$36.3
Series B Repurchase	$1.8	$1.0			$1.0
Free Cash Flow post Dividend and Series B	($4.6)	($7.0)			($14.4)

Dividend Coverage Shortfall

(1) Midpoint of management guidance from Q3'12 conference call
(2) Ontario: http://www.ridestbus.com/releasedetail.cfm?ReleaseID=658337
(3) CT: http://www.ridestbus.com/releasedetail.cfm?ReleaseID=658585
(4) Nat'l Express: http://www.ridestbus.com/releasedetail.cfm?ReleaseID=669787
(5) NH: http://www.ridestbus.com/releasedetail.cfm?ReleaseID=659294
(6) Assume 3% cancellations
(7) Adjusts for acquisitions closed mid FY 2012
(8) Borrowings of $6.4m to pay for Nat'l Express deal and lease finance maintenance capex at 4.5%
(9) Adjusted for incremental interest expense and cash flow margin of 11% on new contracts
(10) $30m of maintenance capex guidance as guided on Q3 conference call; assume lease financing @ 4.5%
(11) Based on announced new vehicles from contract awards at $75,000 per bus
Also includes $1m for integration of Nat'l Express deal

Appendix 3 – Revenue Focused Deals

STB's Recently Announced Deals: Focus on Revenue and Vehicles, Not Synergies or Cash Flow Accretion

Student Transportation Inc. Expanding in Pennsylvania
Growth Complements Experienced Regional Operating Team

CARNEGIE, Pa., May 31, 2012 -- Student Transportation Inc. ("STI") (TSX:STB) (Nasdaq:STB), North America's third-largest provider of school bus transportation services reported its subsidiary Student Transportation of America, Inc. ("STA") is expanding their operations in Pennsylvania state through a new contract award and two letters of intent to acquire two longtime school bus operators.

The Company said it has signed **two "non material" letters of intent** subject to final due diligence and customer consents to acquire two school transportation companies and also won one new contract in a similar area that together will add over **190 vehicles with annualized revenues of over $9.0 million**. Additional details will be disseminated upon closing of the acquisitions which are scheduled prior to the start of the school year.

Student Transportation Expands Through Major Acquisition;
Adds $36 Million in Annual Revenue, Increases Regional Density in U.S. Midwest

WALL, NJ (November 15, 2011) - Student Transportation Inc. (STI) (TSX: STB) (NASDAQ: STB), North America's third-largest provider of school bus transportation services, today announced it has signed an agreement to acquire Wisconsin-based Dairyland Bus, Inc. and related companies. The acquisition will add over **700 vehicles**, annualized revenues of over **US$36 million** and five locations to the Company's existing Midwest operations. The transaction and closing were contingent upon meeting certain conditions, most of which have now been met. The transaction is binding and will close after the requisite regulatory approval.

http://www.ridestbus.com/releasedetail.cfm?ReleaseID=623776

Student Transportation Announces Letters of Intent to Acquire School Bus Operators;
Revenue Growth of 11% Built-In for Current Fiscal Year

WALL, NJ (July 6, 2011) - Student Transportation Inc. (STI) (TSX: STB) announced it has signed four separate "non material" letters of intent ("LOI") subject to final due diligence and customer consents to acquire four school bus companies that will add over **150 vehicles** with **annualized revenues of over US$7.8 million**. Additional details will be disseminated upon closing of the acquisitions which are scheduled prior to the start of the school year in August. The company will fund the acquisitions through its existing credit facility. Management said the transactions will be immediately accretive to shareholders of its common stock upon closing and will be consistent with margins and purchase price multiples of previous acquisitions. "These acquisitions while small in size strengthen our existing operating locations by adding regional density to those areas," said Denis J. Gallagher, chairman and chief executive officer. "We plan on continuing the excellent service these companies have delivered and to provide our added value and expertise in safety and community service. They have very good drivers, top notch maintenance and support staff, and customers who value safe and reliable local service. Also, each of the new companies has some form of fuel protection clauses in place which is an important criteria for us when making an acquisition," added Mr. Gallagher.

http://www.ridestbus.com/releasedetail.cfm?ReleaseID=589274

Student Transportation Announces Three Letters of Intent to Acquire School Bus Operators;
Additional revenue growth for current fiscal year

WALL, NJ (December 1, 2010) - Student Transportation Inc. (TSX: STB) today announced it has signed three separate "non material" letters of intent ("LOI") subject to final due diligence and customer consents to acquire three school bus companies that will add over **550 vehicles** with annualized revenues of over **US$28 million**. A press release and additional details will be disseminated upon closing of the acquisitions which are scheduled to close in the next 30-45 days. The company will fund the acquisitions through its existing credit facility. Management said the transactions will be immediately accretive to shareholders of its common stock and will be consistent with margins and purchase price multiples of previous acquisitions. Final terms of the agreements have not been disclosed.

http://www.ridestbus.com/releasedetail.cfm?ReleaseID=534158

Appendix 4 – Promotion and Hype or Real News?

STB is increasingly dependent on releasing promotional "news" to attract new shareholders. Below is an example of a recent press release designed more to promote the company to investors, rather than to deliver material news for shareholders

Student Transportation Inc. CEO Predicts Historic Shift in Yellow School Bus Market

Cites Five Trends That Will Change the Way Kids Get to School

WALL, N.J., June 14, 2012 (GLOBE NEWSWIRE) -- Student Transportation Inc. (STI) (TSX:STB) (Nasdaq:STB) Founder and CEO Denis J. Gallagher challenged government officials and school districts to find creative solutions for America's aging public-owned school bus fleet and said he is ready to raise the capital needed to replace out-dated vehicles and increase jobs for domestic vehicle manufacturers that protect our students and the environment.

"By some estimates, the average age of a school bus in America has increased more than 50 percent in the last decade," Gallagher said. "School district budgets are being slashed and school-owned transportation departments are slow to order new equipment."

"Pupil transportation is the single largest system of public transportation in the United States and approximately 65 percent of all school buses are owned and operated by local school districts or states that lack the necessary capital to invest in new vehicles," Gallagher said.

"In South Carolina, for example, where the Boeing Corporation recently began production of the Dreamliner 787, the most technologically advanced aircraft in the world, students are transported to school in the oldest school bus fleet in the nation. There is a major disconnect here; the Governor and state legislators understand this and are working hard to provide solutions. Our solution for South Carolina, North Carolina, Florida, Texas and many other states facing similar issues is to let STI and other contractors bring in new capital. We need safer, more fuel efficient equipment on our roads and we need to create domestic manufacturing jobs today."

Gallagher cited five trends that will lead to a historic shift in the yellow school bus market.

1. Taxpayers will demand that local school boards challenge the status quo and contract transportation services. Doing so provides the capital necessary to upgrade fleets, improve service, save taxes, reduce long term pension costs, create new revenues for states and allow local school boards to focus on education.

2. Public-private partnerships will evolve and develop to where school districts and contractors share responsibilities to provide the safest, most cost efficient service by working together, utilizing facilities and taking advantage of private capital to invest in transportation so schools can redirect current budgeted dollars back into the classroom.

3. Parents whose school bus service is curtailed or eliminated by budget cuts will buy transportation services direct from contractors or through a partially subsidized program from their school district. The result will dramatically reduce costs for schools, reduce traffic congestion and unsafe carpools, and lower the environmental impact when large numbers of parents drive children to school. It is estimated that for every one bus taken off the road 36 additional cars are added.

4. The traditional yellow school bus will be transformed with technology that will connect students to a host of subscription services including Wi-Fi, real-time parental safety alerts and educational programming.

5. New investments by contractors will increase demand for CNG, propane and biofuel school buses creating a healthier environment for school children and lower costs of operations.

Gallagher said, "Our fleet of over 9,000 vehicles has an average age of only five years. Our access to capital today is tremendous. Our ability to manage drivers, install safety and maintenance programs, and provide new advanced technology systems is unprecedented. Our family of professional drivers, dispatchers, maintenance technicians, terminal managers and support staff are committed to providing the safest and most reliable service. States need solutions, these are ones that work. The school bus is <u>the</u> safest form of transportation and we can provide this service, hire the district's current employees and in the end, save teacher jobs."

Appendix 5 – Executive Compensation Benchmarks

STB compensates its CEO among the highest of all executives in the industry despite the CEO owning less than 1% of the common stock and running one of the smaller companies in the industry.

					Short-Term Compensation		Long-Term		
Company	Executive	Fiscal Yr.	Company Enterprise Value ($mm)	Beneficial Share Ownership	Cash Salary	Annual Non-equity Incentive Plan/Bonus	Share-Based Stock/Option/RSU Awards	All Other Comp.	Total
Swift Transport.	Jerry Moyes	2011	$3,060	40%	$508,400	$294,457	--	$9,206	$812,063
	CEO/Founder	2010			$501,292	--	--	$12,274	$513,566
Knight Transport.	Kevin Knight	2011	$1,348	7%	$440,000	$87,912	--	$171,100	$699,012
	CEO/Founder	2010			$403,462	$176,000	--	$168,010	$747,472
Heartland Express	Russell Gerdin	2011	$1,031	30%	$207,692	--	--	--	$207,692
	CEO/Founder	2010			$300,000	--	--	--	$300,000
Student Transport.	Dennis Gallagher	2011	$760	1%	$475,000	$484,750	$823,533	--	$1,783,283
	CEO/Founder	2010			$475,000	$168,940	$635,000	--	$1,278,940
Marten Transport.	Randolph Marten	2011	$414	23%	$536,757	$136,024	$225,720	$56,231	$954,732
	CEO/Founder	2010			$521,123	--	$373,140	$57,215	$951,478
Celadon Group	Stephen Russell	2011	$548	7%	$700,000	$375,000	$872,512	$47,301	$1,994,813
	CEO/Founder	2010			$700,000	$75,000	$923,028	$36,382	$1,734,410

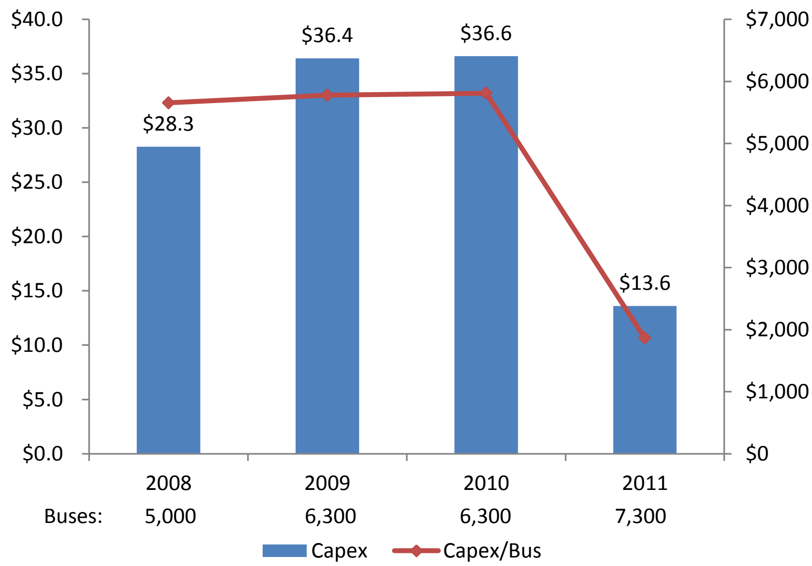
Source: Company proxy filings

Payable in cash, tied primarily to revenue growth

Payable in Series B Stock; puttable and entitled to dividends

Appendix 6 – Is STB Under-Spending For Capex?

STB reported a significant decline in capital expenditures in 2011 on an absolute basis and relative to its growing fleet of buses. This result begs the question: Is STB trying to artificially inflate its free cash flow, and boost its stock price, by under-spending on capital expenditures?



The significant decline in reported 2011 capital expenditures does not appear to be related to greater usage of off-balance sheet vehicle or operating leases.

As of June 30, 2011

FY June	Operating Leases	Vehicle Leases	Total
2012	$7.4	$8.2	$15.6
2013	$4.6	$7.0	$11.7
2014	$3.4	$6.0	$9.4
2015	$2.5	$5.0	$7.5
2016	$1.7	$3.0	$4.7
2017/after	$5.3	$0.0	$5.3
Total	$25.0	$29.2	$54.2

As of June 30, 2010

FY June	Operating Leases	Vehicle Leases	Total
2011	$7.6	$8.2	$15.7
2012	$5.3	$8.1	$13.4
2013	$3.8	$6.8	$10.7
2014	$2.7	$5.9	$8.6
2015	$2.0	$4.8	$6.8
2016/after	$3.0	$3.0	$6.0
Total	$24.4	$36.7	$61.1

As of June 30, 2009

FY June	Operating Leases	Vehicle Leases	Total
2010	$6.4	$5.1	$11.6
2011	$3.9	$5.2	$9.1
2012	$3.1	$5.2	$8.3
2013	$1.9	$3.6	$5.5
2014/after	$1.9	$4.8	$6.7
Total	$17.3	$23.9	$41.2

As of June 30, 2008

FY June	Operating Leases	Vehicle Leases	Total
2009	$7.8	$3.3	$11.1
2010	$7.4	$3.3	$10.7
2011	$5.9	$3.3	$9.2
2012	$4.9	$3.3	$8.3
2013/after	$5.9	$3.1	$9.0
Total	$31.9	$16.4	$48.3

Note: figures are annual future rental and lease payments under non-cancellable operating leases