Balfour Beatty

Half Year Results Presentation

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Balfour Beatty

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Phil Harrison, Chief Financial Officer

Questions From

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Introduction & Key Highlights

Leo Quinn, Group Chief Executive
Welcome to our 2018 half-year results presentation. I'm accompanied by Phil Harrison, my Finance Director, who you all know very well.

We'll get into the introduction.

Well, first and foremost, I think there's a lot to be proud of in these results. There are some very good trends in the business. And, before we touch on the actual numbers themselves, what I'd just like to touch on is what I think is the real priority, because any set of numbers defines a period in time, but what's really happening within Balfour Beatty is the transformation underneath that. And if I look at our Build to Last programme, here we're looking at creating a culture with the capability to take us for the next 10, 20 years.

And this underpinned by systems and processes which give me confidence that what we're creating here today is sustainable into the future. And that's really, I think, the value in the company.

If look at the increase in the backlog, I've always said I don't want to be defined by growth, and I do mean that, but the double-digit increase in our backlog to £12.6bn, underpinned by the disciplines that we've put into place under Build to Last, gives me a lot of confidence in terms of the quality of that backlog going forward. And, in later slides, I'll touch on some of the examples of that.

In terms of our Construction business, and the business overall, if you back out the Aberdeen one-time cost, we've got a 69% increase in our operating profit.

If you look at UK Construction, which has always been our challenge and our nemesis, we come from 60 - it was 89 very difficult projects we had to work our way through to. There are only five of those remaining at this moment in time. But, without Aberdeen, UK Construction is at 2.1%, which is inside the range of industry standard margins. And, at the same time, our US operation, and our Service business, is also within the range.

So you could look at it optimistically and say that we've achieved industry standard margins six months early, which I think is a very good outcome.

You know, the one thing in any business that doesn't lie is cash. And if you look at our average cash, £161m, which is up from £45m for the first half of last year, I think that's a stellar achievement, but it's not a one-off, and I'll show you later in my presentation how it's consistently improved half on half on half, and that's excellent.

And, if you put all that together, if you think about our operational disciplines and our ability to execute, our very strong balance sheet, the confidence we have within our portfolio of investment assets, £1.2bn, all of that has led the Board to believe that we're confident in increasing our dividend by another 33%, which is the same that we did last year.

So I think we're moving along the road to recovery very, very well, and the transformation that underpins it is something that I think will be sustainable for the future.

On that note, I'll hand over to Phil who will talk through the numbers, and I'll be back later. Thank you.

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Financial Review

Phil Harrison, Chief Financial Officer
Thanks, Leo. Thank you.

As Leo said, there's a lot to like about these results. I'm particularly pleased with the profit from operations, up 69% from a year ago at £66m. And, as Leo said, our performance on cash, despite the outflows on Aberdeen, average net cash at £161m was above our previous guidance.

Profit after tax more than doubled versus prior year. And, given this performance, the Board has declared an interim dividend of 1.6 pence per share, a 33% increase on prior year.

Let's now look at the results in detail.

Turning to underlying profit from operations, there were improvements in all of our businesses, and we remain on track to meet our guidance on industry standard margins in the second half of 2018.

Our confidence is underpinned by the fact, with only a small number of exceptions, we are now through our under-performing historical contracts, we continue to realise productivity and cost savings across our operations, and we have a higher quality order book.

For our investment business, profit was higher due to the third partial sale of our Connect Plus M25 asset, as we continue to realise value in a strong market.

Now, moving to the order book. As you can see, the order book has increased £1.2bn from year end, an 11% increase in the period, 10% at constant currency.

The Group continues to focus on disciplined bidding to generate a high quality order book capable of delivering profitable growth.

The Construction order book increased by 14%, 10% at constant currency, due to increased orders in the US where we booked our share of the LAX People Mover project, that's circa $600m, plus we booked over $500m of new school projects, mainly in California.

The UK order book was stable at £2.7bn as the business continues to be selective in the work that it bids, through increased bids margin thresholds, improved risk frameworks and better contract governance.

The £2.7bn does not include our share of the £2.5bn civil work on HS2, which we were awarded last year.

Work is underway to deliver detailed plans and costs for Lots N1 and N2, and our early contractor involvement scheme now expected to conclude in mid-2019.

At Support Services, the order book was stable at £3.1bn, as growth in Transportation was offset by an expected decline in Utilities.

Now let's look in more detail at each segment, starting with Construction.

Whilst revenue was down gross profit increased and overheads reduced resulting in increased profitability. The underlying profit from operations continued to improve under Build to Last, as all geographies had an increase in absolute profit in local currency and margin percentage.

In the US, revenue was 12% lower at constant currency following the reduction in order book during 2017.

Whilst profit was constant in pounds sterling it was actually higher in US dollars, and the PFO margin increased to 1.1% inside the 1% to 2% industry standard margin range for our US business.

In the UK, we reported profits of £5m. This includes a £15m charge on the AWPR project. I'll cover AWPR on the next slide. Excluding the AWPR project, we would have reported a £20m profit with an associated 2.1% PFO margin.

This performance, from the rest of the UK business, gives our confidence that we are on track for industry standard margins in the second half.

At Gammon, profits doubled to £10m as the business moved back towards a more normalised financial performance.

It is expected that revenue in the second half the year for Construction Services, and the overall Group, will be in line with the first half of the year.

In conclusion, all of our Construction businesses are either delivering industry standard margins or are on track to do so in the second half of the year.

Now, turning specifically to the AWPR project in Aberdeen. The map on the slide highlights that the majority of the road is now complete, and we expect everything in green - I think you can see green - to be open to the public by the end of the month.

The one remaining section, which includes the Don Crossing, is now expected to complete in the autumn.

In the last few months, our cost estimates, in part, due to complications at the Don Crossing, have increased. We now expect the cash outflow on this project in 2018 to be at £135m versus the previous guidance range of £105m to £120m.

The increased cost estimates has been partially offset by recovery positions that the Group believe are highly probable to be agreed, but there is a net charge in the first half of £23m, £15m of which is treated as underlying, with the remaining £8m treated as non-underlying as it represents Carillon's share of the project which we inherited following their liquidation in January.

Today, we're focused on completing the project to our revised cost and timescales as well as the continuing dialogue with Transport Scotland in order to reach a final commercial settlement on this project.

Importantly, we have started to demobilise the project, and this will accelerate over the coming months.

Now turning to Support Services. As you can see on the slide, profit from operations increased from prior year, and margins were stable at 3.1%. The 3.1% profit margin is within our Build to Last industry standard margin range of 3% to 5%.

Breaking down the constituent parts into a bit more detail, Gas and Water, the business remains in the middle of its current regulatory cycle. In Water, the Group has started to gauge on the AMP7 planning cycle, which will come live in the next couple of years, including negotiating the renewal of current contracts.

In Power, we saw increases in revenue and order book. We continue to see productivity opportunities in the business. That should translate to increased profitability going forward.

At Transportation, the underlying Highways market is stable, with multiple local authority contracts coming to market, whilst, at our Rail operation, our track partnership contract with London Underground is due for retender in the second half of 2018.

If we now turn to Infrastructure Investments, profits have increased by gains on disposable. And the most significant event in the period was the third partial disposable in February of Connect Plus, the company which operates the M25 orbital motorway for £42m of proceeds and £22m of profit on disposable.

This partial sale completes a combined 25% sell down of the asset. This is above previous market transactions and our Directors' Valuation. The Group retains a 15% stake in the asset.

The Group continues to see opportunities to invest in high quality projects with good returns.

We will continue to look to time asset sales to realise optimum value to shareholders.

Turning to the Directors' Valuation. Looking at the moving parts, both equity invested in new projects and cash distributions from existing projects largely offset at £38m and £39m respectively.

We still expect to invest around £60m in projects for the full year.

The sale proceeds of £108m are predominately from Connect Plus, and the first half of the year we received £104m, which is made up of £42m from the third partial sale in February and £62m from the second partial sale, which was completed in December 2017, with the associated cash funds being received in 2018.

The unwind of discount was circa £50m and, with the half-year valuation, again, rounding to £1.2bn.

If we move to half-year cash flow, we saw a good cash performance for the Group with average net cash of £161m for the first six months. This is substantially higher than last year, and above the £120m - £150m guidance range previously provided. We now expect full year average net cash to be in the range of £140m - £170m.

The key working capital movement in the first half of 2018 is the £55m cash outflow in provisions, primarily due to cash cost incurred on the AWPR project. This reflects the timing between previous losses booked to the P&L on the project, and the cash actually flowing out of the door.

So, overall, a good performance. And, with £366m of net cash at half-year, we continue to have one of the strongest balance sheets in the sector.

Before I move onto the balance sheet, one other point of guidance on net interest expense, previously we had guided to higher than the prior year, but a lower than expected pension expense in the first half, coupled with retiring some debt earlier than expected, means that we now see net interest expense at around £25m for the full year.

Onto the balance sheet. Most of the key items have already been covered, but it's worth remembering we hold the investment assets on our balance sheet at book value rather than at the Directors' valuation that I spoke about earlier.

I think one item to highlight on this slide are net retirement benefits, which, on an IS19 basis, has moved from a surplus £32m to a surplus of £184m. This is driven by actuarial changes, including a small reduction in life expectancy, and an increase in the net discount rate used to measure liabilities.

The next formal triennial date for the Balfour Beatty pension fund is in March 2019.

Finally, turning to our outlook, we remain on track for Phase Two. We haven't changed anything at all on our outlook. It is about industry standard margins in the second half of 2018 as we've put on the slide.

That concludes the financial report. I'll now hand back to Leo. Thank you.

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Business Review

Leo Quinn, Group Chief Executive
Thank you, Phil.

I'll start off with Build to Last again. Remember, the whole purpose here is Balfour Beatty is a company who's been around for over 100 years, and what we want to make sure is that we put a foundation in place for it to be here for the next 100 years.

We've done that through driving, effectively, what is a culture, capability and the behaviours in the company, and it's the way we behave around here that determines the long-term outcome.

In terms of lean, it's about cash in, it's about cost out, and it's actually about investing in a platform that's going to serve us to the future.

Interestingly, one statistic, we used to spend £114m a year cash on our IT infrastructure. Today, it's fully-functional, it works, it services a business in all the ways we want, and we spend less than half. So it's quite interesting how we've got quadruple productivity on half of the cost.

In terms of expert, people buy because of the people we employ. It's a people business, Balfour Beatty. This is about recruiting, training and retaining the best and the brightest.

Trusted is about doing what we say we will do, and delivering on our promises.

And safety is about making sure that anybody who comes into contact with Balfour

Beatty is actually safe, employees, sub-contractors, members of the public and the like, and is a leading indicator, I think, of future performance.

In terms of the actions we're taking within the Group, we continue to simplify the Group. Three or four years ago this was an extraordinarily complicated Group. I have no idea how we actually added up all the P&Ls and the balance sheet and came to a total.

This is about continuing to simplify and de-risk the company.

Geographically, as you know, we've exited the Middle East; we exited most of the regions. We're concentrated heavily in the UK, the USA and Hong Kong as part of the Far East. These are all quite stable places to actually work and, in my view, low risk economies.

Over the last period, what we've done is we've completed, despite selling our joint venture in Indonesia, we completed our last building, which was the World Trade Centre. It was in our economic interest to do that rather than past that onto someone else. And that has finished successfully and it will be a profitable project.

In Canada, we finished our last hospital, and that's the last project that we'll execute in Canada. That was the Vancouver Women and Children's Hospital. That was a successful project. It ran at a slight loss, but it's now completed and it's behind us.

In terms of Malaysia, we collected £9m on a two-year-old receivable. We were fortunately helped by the Government to get that money before the Government actually changed, so it was good to bring that cash into the company.

So, geography, again, we're continuing to simplify the company.

In terms of finances, we've got a strong balance sheet to start with, but we're continuing to focus on paying down debt. We've paid down £32m of our US private placement in the first quarter, we paid down £39m of our convertible, we will also be paying down the rest of the convertible, which is £200m odd at the end of this year, and then, in the 2020 mid-year, we're going to look to pay down the preference. So, in effect, from that point on, the amount of debt we have will actually be very small in the company. Again, de-risking the balance sheet.

In terms of commercials, we continue to look very, very carefully at the types of contracts we engage in. Our preference is really to engage in ECI-type contracts, which is early contractor involvement, where we can actually influence the schedule and the design of the project in order to make sure it's a successful outcome.

Beyond that, we look NEC Option A, which is like Cost Plus, NEC Option C, which actually allows for a target price with a gain paying formula in that. All contracts that we understand very, very well.

We've also found that, during the period, in the case of some our larger contracts, we've actually been able to negotiate a different commercial arrangement which actually helps the customer and our outcome far, far better. On the A14, we've realigned our interest with Highways England, and that's a £1.4bn joint venture, and it's all targeted around how do we deliver that successfully to budget on time.

And there are ample opportunities, even in mid-life, for improving the contractual arrangements that we operate under, which actually makes the outcome and the financial determination on the project much easier to understand.

And then, finally, we're looking to continue to operate and reduce the risk in our operations, our Gated Lifecycle process is up and running, our Project on a Page works really well, we've rolled out a standardised system in the UK around R12, which gives us better transparency in terms of financial performance. That will be rolled into our Services business partly this year, and then finished next year. We've rolled out JD Edwards in the United States, and that's actually in operation and now being moved to a point where it's much more value added. What we'll end up with is single instance, single country, and you can see the benefits of that in terms of the costs that will fall away.

On the back of all of this, we're still looking at taking out, potentially, another £25m of cost over the next 12 months in the business.

Looking at Build to Last, and the de-risking and the simplification and what has it delivered, first and foremost is we've got a flat order book I would regard, but the important thing about this order book is it's actually all been put together under the Build to Last disciplines, which means we have confidence in higher margins and better outcomes.

If you look at how our profit has performed from a loss down in 2015, half on half we've continued to improve, and, of course, delivering industry standard margins for the second half will see further improvement towards the second half of this year.

If I look at cash, and, again, this is a stellar record in terms of our average cash by half over the last three years, '16 through to the '18, and, again, every half we've improved, and we remain resolute and focused on that. And we're now going to start to see what I would regard as cash backed operating profit kick into this scenario going forward.

And then our safety, as measured by lost time incidents, you know, that continues to go down, which, to my mind, sites which are actually safe and clean are far more productive and therefore that will drive directly back to profitability.

If I look at the major projects that underpin our future, all of these projects, the top ones in the United States and these bottom ones in the UK and even here in Hong Kong, these are projects which run over the next three to five years, and one or two go out even beyond that. But, what's key is that these actually have all been reviewed through a Gated Lifecycle process. So we have a lot more confidence in terms of what's in them, what's the risk, how do we manage those risks, and, of course, in our Gate 5, we're into looking at the mobilisation, and in Gates 6 and 7, how these things are delivered through to practical completion.

So this here, for example, for me, gives me a lot of confidence in the outlook for the business, that we know what's in the backlog. And this is a strong foundation on which to enter into what is a growing market over the next few years.

And this chart I've used before, but we've updated it with a couple of areas. First and foremost is that, you know, there is a very large substantive growing infrastructure market. This is really the heartland of Balfour Beatty.

If I look at the United States alone, there's over $800bn that will be delivered over the next 10 years.

We're all familiar with the Fixing America's Surface Transport. We've got nationwide transport bonds and education bonds, and Phil's talked to some of the schools that we actually have booked in California which have come through under that programme.

Interesting enough, if you look at Los Angeles, I was there with LA Metro a month or so ago, and they've raised two sales taxes, the purpose of which is to purely underpin infrastructure in Los Angeles.

They've launched a strategy called 28 by 2028, which is actually 28 infrastructure projects delivered by 2028, which is in time for the Olympics.

Now, if that isn't a substantive amount of money, what they're also going to do is leverage those taxes through PPP, a little bit like the LAX People Mover, in order to actually get more financial leverage. That, in effect, almost puts Los Angeles on steroids in terms of the amount of money they're going to spend - probably more than a small country in most cases.

If I look the UK, we've got HS2, which we know about, we've got Heathrow, which has got Parliamentary consent, Highways England is continuing to spend, as is Hinkley.

A couple of things going on here. We've had the good news around Heathrow moving to the next step but, in the same period of time, the HS2 project has actually been delayed for a six month period while they re-profile the delivery and the budgets for that.

It is interesting, from our point of view, that we've got some challenges around deployment of manpower in these areas. Because these projects require a large number of people, we've got demobilisation happening in the likes of Crossrail Aberdeen. These are people that have got unique capability in infrastructure. We want to deploy them in, for example, HS2. And, while HS2 delays, we can't put those people on a job. So, we're going to have a slight planning challenge in terms of keeping capability for these future jobs.

And the reason this is important that we keep the capability is that demand out there far exceeds the capacity to deliver, which is going to allow us to be selective and allow us to choose what we engage in.

We are engaged activity in the programme of actually looking after our capability, which is our people, and you're all aware that we started the Five Percent Club where we're actively bringing on graduates and apprentices and young people into the construction industry so we've got a workforce for the next 10 years.

We're actively engaged in ensuring that we're recruiting and retaining the highest calibre through creating a great place to work.

And, if you look, our employee engagement scores continue to rise at the same time as our attrition rates singularly fall.

You know, I can't emphasise enough the single most important thing for our success, and the industry's success in the future, is actually keeping people in the industry. So it's really important, as jobs demobilise, we're able to deploy people to new growing contracts. That’s the most important thing we do.

We've spent, by the way, quite a bit of time, and we'll update this in the next presentation, around our employee proposition – it's quite interesting that young people today have very different values to ourselves in that they don't want to work 24/7, and they have other interests in life. And we've got to cater for that if we're to get the best people in the industry.

In terms of our Investments business, you've got to love this business because it's the gift that keeps on giving. This is a business that, over the last three and a half years, we've effectively continued to divest assets when they're mature, which is the blue bar. The light blue bar is the yield, or the ongoing yield, that we receive annually from those assets. And the red bar is where we continue to invest in new assets which are primary and will actually grow to replace the ones that we sell.

So you can see our business model is to actively sell assets at the maturity and actually invest in new assets.

We maximise our value when we use our project financing capabilities coupled with our delivery capability, and that's when we see the best returns. But what's fascinating here, and in terms of the gift that keeps on giving, we've yielded £500m of cash out of this portfolio over the last three and a half years, and yet the value's almost remained constant at about £1.2bn. So, you know, fabulous performance in terms of getting the businesses sold, continuing with the investment, yielding the cash, and still actually having the same value at the end of the period that we had almost at the beginning.

In terms of our future for our Investments portfolio, again, this chart has been updated, but what you can see is our concentration in the United States is about 53% versus 47%. If I look to the future it wouldn't surprise me for that to become 60%/40% or even 70%/30%. So we're going to be much more denominated in dollars in this area. And part of the reason for that is if I look at the UK market, if you look at PF2, there's no clarity around what that's actually going to bring for us.

If I look at the three major infrastructure projects on the boards at the moment, Silvertown, Lower Thames Crossing and the A303 which is the Salisbury Road, we've looked at those and the risk in those projects and the costs of actually bidding them under current terms make them very unattractive. So the fact of the matter is we're not actually probably going to pursue those. But at the same time given the people that we've got and the manpower, we've got more than enough work in the projects that I pointed out earlier. So it's a nice position to be in.

If I look at the United States and you can see how our portfolio strength is moving towards the United States, it's a much more - how do I say it, it's a more aggressive market in terms of there is much more optimism, people are prepared to take more risk, there is less risk being passed down to the contractor. So we see that as an exciting and interesting area that we want to play in and of course it's building on the Los Angeles People Mover that we won in the last quarter - or in the last half.

Further the assets remain mature. In the second half of the year, building on what Phil said, we're going to continue to sell down the assets in what we regard now as a very strong market. So good news there all round.

So finally thinking about, you know, what is our value proposition for the long term? Look, Balfour Beatty, I think has the right culture, the right capability and the right behaviours to be a disciplined contractor. And that capability is going to be key to our future success.

We have a very strong balance sheet which supports our entrance and growth into the growing infrastructure market. We are the largest UK Construction company and on a rising tide all ships rise, so that has to be favourable to us.

And then finally, our balance sheet is differentiated by the fact that it's underpinned by a £1.2bn Infrastructure asset portfolio, which is performing very well.

So we're a market leading company in a growing market, which gives me confidence that in the long term we'll be very successful and deliver above industry standard margins.

Thank you for that, over to you for questions.

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Questions and Answers

Unidentified Analyst
I think I asked this last time, so I'll ask it again, now that we've moved on six months. Obviously, your cash is building on the balance sheet and you're kind of more optimistic on that side, so I want to understand, at what point - or how you think about capital returns to shareholders? How do you - how should we think about that externally, perhaps, when you think there's excess capital on the balance sheet? That's question one.

And then question two on the Investment portfolio. Can you give us a sense how the portfolio has changed, because obviously historically it's been very much availability based UK PFI, which I think we all understand quite well. Perhaps we understand less well, some of the projects that are probably more conventional investment, just housing schemes or student accommodation, in the US in particular, I think you mentioned that there's more - the market is a bit more aggressive, so I wanted to understand what you mean by that. Does that mean more risk, potentially more return, and therefore, more volatility? Thank you.

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Leo Quinn, Group Chief Executive
On the first one in terms of capital return. Our first priority is to use cash to invest in the business we have today. And as we look at the pipeline of investment opportunities, those are our first choice.

We have also actively invested in plant machinery and equipment which we can actually put to work on our contracts. So again, that's another use of cash.

After that, we're looking at paying down our debt. Following paying down our debt, we look to dividend returns. And then if we've got surplus at that point in time, if I've missed anything, tell me, we would look to return surplus cash to shareholders. But I think, you know, that's probably - looking at the numbers, probably 18 months away, longer. And again, ultimately, it requires a decision by the Board.

In terms of your other one around the Investment portfolio, we're largely demand based across the portfolio. We have some availability, but it's really - it's less than 10%, I think. We've - I think we have one project in the portfolio which was effectively where we were investing in student accommodation at our cost and our risk, and that's actually been quite successful. But our business model is really to revert back to availability based in the majority of our assets.

I don't know if you want to say anything more on that?

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Phil Harrison, Chief Financial Officer

I think the key one, if you look at our UK assets, you know, roads, healthcare, their availability, student accommodation is demand proven. When you look at student accommodation, typically, we're on campus; we're usually in a relationship, a JV with the university. So typically, that is - to us, that is a very much higher level of demand proven, and that's what we like. We don't like speculative ventures.

And in the US our military housing, that's a 50 year concession. That's demand. And then our student accommodation in the US, very similar; we're typically on campus, we're typically working with the university body and both our interests are aligned in making sure it's 100% filled up.

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Leo Quinn, Group Chief Executive
My 10% was largely the UK and not the US side.

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Unidentified Analyst
Your point on more aggression?

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Leo Quinn, Group Chief Executive
Yeah it's more a question of aggressive in terms of they are much more willing to take on the risk of moving down a PPP route. You know that is what I mean by aggressive. It's not aggressive in terms, it's that they are very gung-ho and wanting to spend the money and actually do these projects. As with LA Metro.

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Joe Brent, Liberum
Good morning, three questions, if I may, just one at a time probably. Firstly, on the Support Service margin, I think, historically, you've talked about a 3% to 5% range; you came in at 3.1%. What is the scope to improve that margin? And what's the timeframe of that improvement?

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Leo Quinn, Group Chief Executive
Is that it?

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Joe Brent, Liberum
That's number one.

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Leo Quinn, Group Chief Executive
Sorry I was waiting for all of them and then I could hand them over to Phil them couldn't I?

I think in the Support Services, we've got a very high quality business in our power business. Our margins there have been sort of held back by one or two project challenges in the transmission area, but we see those largely behind us. So I can see that performing at a level of between 5% to 7% in the future. Rail performs well. Gas and water, I think, will be sub 5%. But I think the portfolio is well capable of achieving a 5% return.

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Joe Brent, Liberum
Thank you. Moving onto the dividend, you increased the dividend, I think, 33% in the first half, could you just remind us what the policy is and whether we should logically assume the same rate of growth in the full year?

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Leo Quinn, Group Chief Executive
Phil, do you want to?

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Phil Harrison, Chief Financial Officer
Typically we're one third / two thirds, we've stated it's progressive, ultimately the Board will take a look in March next year and determine, based up, you know, our progress through the year. But we have said a progressive policy.

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Joe Brent, Liberum
Thank you and finally from me, on the PPP disposals, clearly they are quite lumpy, as I understand it nearly all of the disposal gain in the first was M25, could you just give us some indication of what you expect in the second half, or what you think consensus is thinking for PPP gains in the second half?

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Phil Harrison, Chief Financial Officer
Consensus for the full year is around about £40m, we're not changing our view around that, so we did £22m in the first, so we'll be roughly there in the second I'll assume.

Again, what you've got to remember is that these things are a negotiation, we're not going to leave value on the table, so if we don’t the right value we won't sell the asset, if we see a stronger market we may well more.

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Joe Brent, Liberum
Thank you.

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Andrew Nussey, Peel Hunt
A couple of questions as well. First of all, the delays on HS2, you obviously highlighted what it might mean in terms of skills deployment within Balfour. But I just wonder, is there any other colour you could give on why there are delays and what that might mean for other infrastructure projects moving forward?

And secondly, just around the supply chain and obviously post the events earlier in the year, what change you might be sort of seeing in behaviours, whether it's the commitments from main contractors or financing terms, etc?

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Leo Quinn, Group Chief Executive
Okay, yeah look in the case of HS2 and in the case of any of the projects that we've put up there, these are large and they are complex. They require a great deal of definition, you know, to stay within the scope, within the budget. And I think all that you're seeing, in the case of HS2, unsurprisingly, is a level of prudence.

We're working together with HS2 to deploy people on to some of the early works contracts because the importance is actually keeping the capability. When you've taken 100 people off the largest infrastructure project in Europe with, what is it, 75 structures, 58 kilometres of highway and similar side roads, means these people are pretty valuable. And what we're going to do is work with the client to pay for them.

If the client doesn't pay for them, then we have to. So it's much more preferable to make sure they understand the value of these people and that they're very happy to step up for it.

And by the way, I wouldn't be surprised by the delay; I think it's just a question of regrouping. And I doubt I can think of many projects, you know, substantially less than £60bn that haven't been delayed.

The - on the supply chain, do you want to touch on that for a second?

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Phil Harrison, Chief Financial Officer
I'd say you're on a roll.

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Leo Quinn, Group Chief Executive
I'm on a roll. I've seen - there's nothing in the supply chain on - whether around Brexit or anything that we've seen at this moment in time. We haven't seen any behaviours.

We have some very special initiatives within Balfour Beatty, different to the rest of the industry, is that we've had a very conscious process of actually aligning around preferred suppliers. So for example, if I take all of our design engineering companies, there are three companies that we do the majority of our work with. And what's unique about that is all three of them have exactly the same contract, with exactly the same terms and conditions and can actually engage and enter into contract within basically 45, 48 hours within their own governance process. So that's really, really important.

We're now setting up the same level of collaboration with our subcontractors. I've said before, 80% of our revenue is done by 20% of our subcontractors. And the reason we want to do that is at the end of the day, we want to make ourselves easy to do business with. And therefore, you know, the cost and the time, that's money, and money that's wasted in bidding stuff is just crazy. So the idea that you can engage in a standard contract, you can do it quickly, just takes cost out of the equation and makes us a better supplier. So we think we've got a very constructive relationship with the supply chain.

What the impact of Brexit might be in that case, we're looking to cover that in our terms and conditions, where we are not liable.

The one thing that's unknown now there, I think, is Trump and tariffs. How is that going to feed through the supply chain? And then obviously, how do we make sure that, that's something that's passed on? Because the cost of doing business is not a risk that we openly enter into when we take on a contract?

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Andrew Nussey, Peel Hunt
Thanks.

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Howard Seymour, Numis
I've also got three if that's okay. Firstly on UK Construction, you highlight the sort of the three different parts of the business. I was wondering if you could give us some colour, because the three - you've got, major projects, regional and rail, operate on different margins. Is it possible to sort of discuss which of those at the moment is underperforming relative to what you'd expect, or whether it's more general?

Secondly, on US, Phil, you alluded to the fact that the revenue is down because of the order book last year, but there's more complex projects feeding through. So as the order book rises, do we expect that to sort of see a 12 month lag on that, or does it take longer to feed through, and whether there's mobilisation?

And then finally, just on Investments, you've alluded before at the fact that, on your valuation, you look at it on the premise of attaining more than book value. Firstly, you have done that on M25, and secondly, there's obviously quite a public bid out there at a substantial premium to that. Just whether you're mindful of looking again at your valuation on the premise of what is actually happening in the market?

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Leo Quinn, Group Chief Executive
Phil will do the easy one, which is the investment question. I'll do the first one. This actually might surprise you, you said we characterise our UK Construction by three pieces, the regional, the major projects and the rail. And you said which one is sort of underperforming, whatever. And do you know in truth, I don't think any one of them is. I think they're all making good contributions.

And again, the challenge with six months' result is it looks at a defined period. If you go back and look three to four years and look at the progress, it's absolutely stellar. And the good news is because of all the senior management in the room here, it's going to continue.

And regional is performing well, you know, it's a much more concentrated business. Our major projects is performing well. You have to remember that within the portfolio, with large projects, we do not look to recognise profit until the project is 25% through the - complete. And rail is delivering on a lower volume well, as well. So I think all three are okay.

Of course, the challenge is, is when you write off £15m associated with Aberdeen, it makes the overall number look pretty meagre. But again, we're moving in the right direction.

The question about the US being down and feeding through, just remind me what you were looking for there, Howard?

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Howard Seymour, Numis
Just saying that the order book is up, as these are bigger more complicated contracts do you sort of see a one year lag, i.e. does it start feeding through next year, or does it take longer because of the complexity aspect?

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Leo Quinn, Group Chief Executive
Yes. There's a real mix in that. In the US business, it's about 4.5 billion, round numbers. 3.5 billion is the - effectively the building business, which is universities, accommodation, Disney, leisure and those sorts of things. Those actually don't have a large lag to them. They feed through pretty quickly. And that business has performed strong in the first half of the year over a very challenging first half last year associated with the Texas region.

In the civils business, which is about 700 million, those are larger projects, such as the LA People Mover, Green Line in Boston. Those are projects which are large, and the profit recognition is delayed while they move to 25%.

So I think on balance, you've got a good coin operated business that turns every month and then you've got these large infrastructure projects which come through a little bit more lumpy.

And I think in second half, depending on timing, you should see Caltrain, which is one of the West Coast projects, achieve the 25% milestone on it. Is there anything on that you want to say?

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Phil Harrison, Chief Financial Officer
Only that just on the timing it's more likely the revenue is weighted to 2019 than 2018 for sure.

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Leo Quinn, Group Chief Executive
And on investments?

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Phil Harrison, Chief Financial Officer
Well, we think our valuation is appropriate, I wouldn't say that we're - we take an optimistic view, so we're on the prudent end. So you know at 20% valuation difference on the assets you could probably describe that to us as well.

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Unidentified Analyst
Just two please if I may, firstly just regarding the cash charts that you showed and particularly the improvements since the beginning of '15, could you just slightly search beneath that and if possible identify what the underlying cash flows of the operating business would have been if you exclude the £500m of proceeds from Investments, just to give us a flavour of what the operating companies are doing in cash terms?

And my other question was around the US portion of the investment portfolio and apologies but I actually have no idea and it's just an assumption that I've always had that most of the refinancing gains are attributable to the UK portion of the portfolio, a) is that true, or alternatively is the SPV structure of the debt exactly similar in the US as it is in the UK?

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Leo Quinn, Group Chief Executive
They look like your questions.

Laughter

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Phil Harrison, Chief Financial Officer
On the cash you know when you look at the £500m that we got from the Investment business, you know predominately - well all of it I have to say over that period went to pay for the losses that we incurred on the Construction business. I mean that is a fact.

I think if you now look at where we are as we go into 2019 and beyond, given that overhang has gone, the Construction businesses should start to generate, you know, operating cash flows, that's our anticipation, if you look at Aberdeen there's outflow of £135m this year, I'm not thinking that's going to happen again next year, so I think you'll see cash generation from our Construction businesses as we go forward now.

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Leo Quinn, Group Chief Executive
I think I'd just build on that, if you go back to 2014 when we sold Parsons Brinkerhoff that was 700 odd million, that went into balance sheet repair, and a lot of the cash has been generated over the last three years, both from operations, but primarily from Investments has really gone back into balance sheet repair.

I think if we you look at the balance sheet now and going forward I think we've just reached the tipping point whereby we're now going to start driving operating - all cash back profits or profits from operations, which it just shows you how long the tail on some of these contracts can be. Investments?

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Phil Harrison, Chief Financial Officer
And on refinancing - we do, we have a similar SPV structure in the US. It's not as how do you - generous as very early PFIs, so I don't expect huge refinancing gains on the current portfolio.

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Leo Quinn, Group Chief Executive

Just on that point as well, you raised one thing about - a lot of the assets that have been sold are in the UK. But if you look to the US there is a very large concentration in military housing. So in effect the opportunity there to sell down is a one or nought decision and that's a very big decision. So that's why you've seen more activity over here than you have in the US. And the other factor is that it's the UK assets that are mature in their lifecycle which makes them the most valuable.

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Unidentified Analyst
Sorry, were you hinting in the sense that if you look at the US military business, which is sort of the original US investment as it were, you're saying you can't really sell those on a sort of ad hoc basis, one here, two there, three here, it would have to be a completely packaged deal?

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Leo Quinn, Group Chief Executive
That's a single entity.

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Unidentified Analyst
Okay thank you.

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Leo Quinn, Group Chief Executive
But it's a fantastic business, so you've got to look at it in that light too.

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Marcin Wojtal, Bank of America Merrill Lynch
I just wanted to ask for a clarification on Phase Three of your Build to Last, which is when you expect to achieve a premium to industry standard margins. How literally should we take it, especially when it comes to timing when you say after 2019?

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Leo Quinn, Group Chief Executive
Look, I think at the end of the day you know we are the market leading player, I think it's not abnormal to think that we should have market leading returns by virtue of the fact that we've got the largest share.

The way I see this is it's a journey, it's not a sprint as all of a sudden we go from industry standard to way above, you know what we're going to look to do is each year is progressively improve on the year before. You know if that rising tide comes in early, you know, we'll benefit from that, if it gets delayed then you know you can push out the returns in accordance with that.

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Stephen Rawlinson, Applied Value
Just three from me if I may, two which I think are more technical points than anything else. Firstly, on Aberdeen, it would be a high quality problem if you were able to actually

reverse some of those provisions, but will we see them in the P&L in future if that happens and identify them separately?

Secondly, and this is probably me overlooking what average cash means, could you just sort of help me out there, whether that's daily, or month end, or just define it a little bit better?

And thirdly relating to the point about premium margins, I mean it is only the half year numbers, so perhaps we're going a bit too far in some respects in this case, but you know they would get competed away in a normal world of course. But the other element that I wanted to touch upon if you could very briefly this morning, you've talked about capabilities, but that was more to do with people than it was to with the technology and some of the thoughts that have been in the papers that you've produced about modular, about offsite and so on, could you just help us out a little bit as to whether those will also make a contribution and sort of what additional contribution they might be able to make to your margins?

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Phil Harrison, Chief Financial Officer
On Aberdeen from a technical point of view if we do get a positive result I would anticipate that dependent on size it may well go through a non-underlying, that would be the first thing to note.

On cash we use average month end and you're doing the technology one.

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Leo Quinn, Group Chief Executive
Yeah, because in terms of - I really don't care whether things are underlying or non-underlying, it's cash, and that's what is important, so the technical definition I think is for the accountants to worry about.

In terms of our capabilities, we have an active campaign within the company called 25 by 2025 whereby we're looking to take 25% of the work that we do onsite today and actually have it done offsite. That means it is actually done in a better more consistent manner, so hence higher quality. It should be at lower cost, and therefore it should all be safer. That brings to my mind competitive advantage in many ways because it just lowers the cost to serve.

That then allows us to set ourselves up for what I would regard as hubs. If you look at Heathrow at this moment in time in order to deliver their projects and their new runways most of the work is going to have to be done outside of Heathrow because they cannot cope with the traffic and the workforce going to site. So in effect that offsite assembly will then become a manufacturing hub for Heathrow specifically where it will be delivered by train to site. So all of those things give us competitive advantage.

We have initiatives around digitising the company in terms of how we sort of in effect ensure that we only do things once and that's what comes out of the other end. Today we touch data many, many times and that's very, very expensive in terms of time spent, but also data errors and things like that. I still receive my packages at home from Amazon with the same misspelt address that I put into the system ten years ago. So the fact of the matter is no one has touched that data for ten years and yet it still serves the same output.

We have some initiatives around electronic surveying, photogrammetry, all things which effectively bring more intelligence to the workplace and actually drive more productivity. That's an area of strong focus across all of the business. And actually I think we'll actually have a demonstrable deliverable bottom line improvement for us with the passage of time. But these aren't 12 month programmes; these are the next five, ten years for the company.

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Phil Harrison, Chief Financial Officer
Can I clarify something? Just to clarify on Aberdeen we have to maintain the same consistency in treatment so we'll always have to do split between Carillion and non-underlying and underlying.

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Leo Quinn, Group Chief Executive
Any more questions? Great Howard?

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Howard Seymour, Numis
Sorry, it's going to be an Aberdeen one as well, so sorry about this. But just really a bit more on the - I suppose the technical, not that I necessarily will understand them, on what's gone wrong. You alluded to the bridge before and your capability to rectify and then confidence in the fact that that's actually ring-fenced on everything you've done?

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Leo Quinn, Group Chief Executive
Yeah look, I mean Aberdeen there has been a number of challenges, whether it ranges from the utilities to the worst winter on record, a resequencing of operations which has caused delay, all of those have added a year to the programme. And you know given that the programme was a PPP which effectively was an all risks type contract it gets very difficult to separate out, therefore client responsibility and contractor responsibility. So as we go forward we would be looking to ensure that those types of risks are clearly spelt out. And in many cases if we don't feel they are clear or that the risk is correctly appropriated or applied we wouldn't do that contract.

So if you look at the A303 we understand the risks on that contract probably better than anybody because I think nine years ago we won that contract, which was then suspended or cancelled. And when we look at those risks and where those risks are being apportioned, as we look at it going forward we wouldn't be prepared to take on that contract under those circumstances.

So I think there has been an awful lot of good gained out of Aberdeen that actually will serve the portfolio in the future. But it's been a very expensive lesson learnt so to speak.

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Howard Seymour, Numis
Sorry, my question was more specifically when you look at - you know you've alluded there is one part of it left, what is the issue that you have?

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Leo Quinn, Group Chief Executive
Yeah the issue sort of sits with the bridge over the Don River and that is a question of the alignment - it's a design challenge and it's a question of the alignment of the ducts and the stressing so that when it's put under pressure that effectively the duct alignment and the stress put onto the concrete we haven't overstressed it. So that is what is actually under investigation at this time.

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Howard Seymour, Numis
Thank you.

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Leo Quinn, Group Chief Executive
Great, thank you very much, I appreciate you coming.

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