Balfour Beatty

2020 Full 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 & Highlights

Leo Quinn, Group Chief Executive

Good morning. I'm Leo Quinn, Balfour Beatty's Chief Executive and I'm joined today by Phil Harrison, our Finance Director. You know him very, very well.

Phil will take you through the 2020 Results, and I'll take you through the Outlook for 2021 and beyond.

It's obviously been an interesting, challenging year, and I'd have to say that what we're announcing today is really what I would have liked to have announced a year ago. So in a way 2020 feels like a little bit of a lost year. But I think the outlook remains very positively encouraging, and it remains positively encouraging for what I think are the following reasons.

Balfour Beatty is very well positioned geographically in respect of Hong Kong, the UK, and the USA. All of these markets will benefit from what I think will be a fiscal infrastructure investment over the next five to ten years.

And we're also uniquely positioned in a sort of a green goldrush in that we provide electrification for railways and windfarms, and the likes of that and also new nuclear power, which means we're uniquely positioned to take advantage of what effectively is the uplift in that market.

In terms of our order book, we have a record order book, some £16.4bn, but I think more importantly in that order book it's tilted towards a lower risk profile, which I think gives us a better outlook in terms of earnings.

We actually have to turn that backlog into revenue and profit and Build to Last has left us uniquely positioned over the last five years to have the capability to do that and to execute well.

Effectively we've invested in maintaining capability and building capability over the last five years, over the last 12 months we've paid the price to maintain that capability so that we can deliver that backlog for the future.

Those future earnings, for me, will deliver themselves in cash. And as you know in this business, I've always said the one priority we have is cash because cash is the one thing that doesn't lie in our business.

If you look at our cash performance over the last five years, what you'll see here is effectively every single Friday at 3 o'clock, I actually get a cash forecast. And this actual data, if you expand it, is the weekly cash flow for the last five years. And what you can see is, you can see the warts and all, peaks and troughs and how it performs over the period. But net, net, net what you can see is a steady march towards net cash in our bank account. And over the period our cash has actually increased by approximately £150m a year.

Over the last five years in respect of our gross cash, we've paid out from that our dividends. We've paid out from that our debt, over £425m of debt has been paid down. Over £110m in private placement has been paid down and also, we've covered some very thorny commercial issues over that period. And yet we've still managed to perform at this level, which I think is outstanding.

If I actually look at our cash requirements going forward the amount of debt, we have is quite minimal. We have a strong backlog with good earnings in there which we can turn to cash. And we also have an Investment portfolio of some £1.1bn, which effectively we'll be looking to actually trade, invest in and actually sell down over the next few years.

So when I think about all of that, I think we're actually in a very strong position to look at future cash returns for this Company.

I know as we've all worked from home over the last few months we've gone through the kitchen and invariably the television has been on and we've been tortured by things like Catchphrase or some other of these quiz programmes, but if I was to think about the best analogy, if you've actually watched Tipping Point or in America where the bases are all loaded, it just feels that we've reached that tipping point within Balfour Beatty. And it's that confidence which actually has had us increase our 2021 cash returns to £150m rather than the previous £50m that we've announced.

So, I think a rather optimistic outlook. I'll now hand over to Phil, that will take you through 2020 and I'll return and give you a bit more detail. Thank you.

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Financial Review

Phil Harrison, Chief Financial Officer

Thanks, Leo, and good morning everyone.

If we move to the headline numbers. 2020 was an unprecedented year for the Company and the countries that we operate in. The pandemic touched all aspects of our business, both good and bad as we adjusted to operate in this new environment.

The business has been very resilient. We maintained strong liquidity with a positive cash performance. The order book grew 15%. Our Investment portfolio was stable at £1.1bn and we returned to profitability in the second half of the year.

The strength and resilience of our business provides the platform to make the right long-term decisions such as repaying £19m for the UK Job Retention Scheme, reinstating the dividend and commencing a share buyback programme under our new capital allocation framework.

It also provides us with the confidence that 2021 will be in-line with 2019 for our earnings-based businesses.

Over the next few slides, I'll take you through the impact of COVID-19 on each segment.

If I move to Construction Services, this is a business area where operations have been most impacted by COVID-19. Despite site closures particularly in the second quarter of the year, revenue was resilient following a double-digit increase to the order book in 2019. However, profit from operations was materially affected.

UK Construction was impacted by the following four factors. Site closures, most notably in Scotland which was effectively closed in the second quarter of the year. Lower productivity as a result of disruption to operations, most notably in London. Additional operating costs across all sites and a lengthening of site programmes which triggered a reassessment of the Group's contract and forecast positions.

In the UK, the loss from operations at half year was £23m, which increases to a £34m loss after adjustment for the intended repayment of funds received through the Job Retention Scheme.

UK Construction did return to profit in the second half of the year by £8m. But specific sectors such as Aviation have seen a material slowdown throughout the year, which means that for the full year the UK reported a loss of £26m.

US Construction was also negatively impacted by COVID-19 as all geographies were affected, most notably Washington State where sites were closed in the second quarter and in Florida where the hospitality sector was materially impacted through the year.

Although US nationwide forecasts show a decline in the overall Construction market, Balfour Beatty is positioned in regions that are expected to perform better than the national forecast as demographic shifts continue to favour the Group's chosen states in the medium-term.

Gammon performed strongly, both revenue and profit increased in the year as the impact of COVID-19 in Hong Kong has been lower in part due to its experiences from previous viruses such as SARS.

Gammon has a material share of the Hong Kong market, which has historically benefited from significant public sector investment.

This appears set to continue with the government recently announcing ambition in its February 2021 budget to increase spend materially over the medium-term, including long-term plans for hospitals, housing, and low carbon infrastructure.

Now turning to Support Services, which has been a good success story in the year as most of our contracts were designated as critical infrastructure.

Revenue increased by 4% as a result of higher volumes of power and transportation. Underlying profit from operations for the year was broadly in line with last year at £46m as the increase in volume was offset by disruption caused by COVID-19.

The Group was able to accelerate road and rail maintenance programmes for some customers due to lower volumes of traffic in the year, but this was offset by other customers reducing maintenance expenditure given the economic uncertainty.

Following the decision to exit the gas and water sector, Support Services is now focused on power and transportation, both road and rail maintenance.

The power sector is expected to see a wave of new demand as the UK's Build Back Better initiative is underpinned by key environmental targets that are likely to result in more wind power and new nuclear generation capacity.

The Highways Maintenance market is forecast to see significant investment following the announcement of an additional £2.5bn in funding, which will increase local council budgets by 45% over the next five years. Further, over £700m of outsource contracts are up for renewal between 2021 and 2025.

And finally, the rail maintenance market also has a positive trajectory with an additional £10bn of funding for renewals as part of the latest Network Rail control period, CP6.

Turning to Infrastructure Investments. Underlying pre-disposals operating profit decreased to £8m primarily due to a revision for an estimate of historical military housing incentive fees which Balfour Beatty has proposed to repay.

The provision was calculated following the Group's own independent investigation, which is now substantially complete.

The Group's findings have been shared with the US Department of Justice, and Balfour Beatty is currently seeking resolution with DoJ.

As the investigation is still ongoing, we are not able to provide any further indication with regard to timing or quantum of any possible final penalty that may arise.

As a result of the market uncertainty generated by COVID-19 and the strong liquidity position of the Group, we did not dispose of any investment assets in the year.

In 2021 the Group will recommence selling investment assets, timed to optimise value to shareholders.

If I turn to Director's valuation, 2020 was relatively stable for the business as the value increased by 2% to £1.086m. The Group invested £46m in new and existing projects. Cash yield from distributions amounted to £72m. The continuing yield during COVID-19 demonstrates the essential nature of the Infrastructure Investments portfolio.

Unwind of discount at £83m is a function of moving the valuation date forward by one year. And operational performance movements resulted in a £39m decrease, partially as a result of foreign exchange movements which were circa £20m.

The next slide demonstrates the value created from the Investments portfolio. Before we look at disposals it should be noted that we have historically invested in approximately £50m in new projects each year. 2020 Was no different, with £46m invested.

The business continues to see significant opportunities for future investment in its chosen geographic markets, particularly in the US where the focus is on student accommodation, multi-family housing and public / private partnership opportunities.

When we invest in new projects, we do so where expected returns meet the Group's internal hurdle rates, including a two-time end-to-end multiple calculated as the sale proceeds plus distributions received over time.

Looking back, the Group has realised on average £100m of disposal proceeds per annum with the realised average end-to-end multiple greater than three times.

Looking ahead, the Group continues to see a strong secondary market for its investment assets and the ability to generate good returns through the active management of the portfolio.

Now if we move to cash flow. Another year of positive cash flow as we've generated a total cash inflow of £69m in the year, increasing the Group's net cash position to £581m. The increase has been driven by almost £300m of operating cash flows with working capital the most material line item.

The working capital performance in the year was underpinned by movements in net contract assets which benefited from a number of settlements during the year, both in the US and UK, including the Aberdeen Western Peripheral route contract earlier in the year and the mobilisation of a number of highway projects in the US.

The Group expects to operate with a working capital percent of revenue between 10% to 12%, with the range dependent on contract mix and the timing of project starts and completions.

In terms of other material movements during the year, in March we repaid $46m of our US private placement notes. And in July we fully redeemed £112m of the preference shares, which will save £12m per annum in interest costs. Following this redemption the Group now has no more debt to repay until 2023.

Now, turning to the new long-term capital allocation framework, Balfour Beatty understands the importance of delivering attractive total cash returns to shareholders, we are therefore committed to maintaining an appropriate balance between investment in the business, maintaining a strong capital position and cash returns for shareholders.

As such the framework comprises the following five points, two of which we have already covered in Infrastructure Investments, namely continuing investment in organic growth opportunities which meet the Group return hurdle rates, then active realisation of investment assets with disposals, timed to optimise value.

Following-on, we want to maintain a strong but efficient balance sheet which provides the financial platform to make long-term business decisions in response to both opportunities and periods of market dislocation.

In terms of capital returns, we're committing to pay a sustainable ordinary dividend targeted at a pay-out ratio of 40% of underlying profit after tax, excluding gain on disposal of investment assets.

The Board expect the ordinary dividend to grow over time in-line with earnings and an additional cash returns via share buybacks or other mechanisms depending on market conditions.

This will be broadly based on surplus cash from disposals from the Investment portfolio as well as the surplus of operating cash flows, which are not required to meet business needs, such as capital investment and pensions.

So turning to the outlook. What does this all actually mean for 2021? In 2021, we expect the earnings-based business to be in-line with 2019. Construction Services are expected to recover strongly whilst Support Services should continue to perform well.

Looking further ahead the quality and quantity of our order book provides clear visibility that we should continue to grow earnings into 2022.

In our Investment portfolio, we will continue to invest in opportunities that we believe will hit our minimum returns and have the potential to return three times our initial outlay.

In 2021, we'll restart this virtuous circle through asset sales from the portfolio.

As we go forward the cash generation from earnings and asset sales in excess of business needs will provide multi-year opportunities for additional shareholder returns over and above the ordinary dividend.

As Leo said at the beginning of the presentation, given our strong outlook we are increasing the initial share buyback programme by £100m, so the Group now expects to return £150m in the year.

At this time next year and based on business performance in 2021, we'll set out our additional cash returns for 2022.

Thank you, and I'll now hand you back to Leo.

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Business Update

Leo Quinn, Group Chief Executive

Right, thank you, Phil. As I said in my introduction the outlook for 2021 and beyond, I think, is quite optimistic and I'm very encouraged by it.

First and foremost if I look at the markets into which we play, if I look at the UK, USA, and Hong Kong it's been a deliberate strategy over the last five years to concentrate our efforts in those economies. I believe that they will be the economies that will recover first and strongest from the pandemic.

Secondly, as I look towards all the governments there will be a move towards fiscal expansion and specifically investment in infrastructure. Whether it's Biden's Build Back Better or Boris' Build Back Better, Project Speed, Acceleration, etc or in the case of Hong Kong the climate action investment in green. All of those will actually talk to what I think is a very encouraging, positive market that we're selling into.

If I look at the Green Agenda, you know, Balfour Beatty is uniquely placed to take advantage of these markets. You know, we're a major supplier of electrification of railways in the UK and also some in the US.

HS2 is our biggest order in this area, but there are other projects coming down the pipeline.

In terms of renewable energy, we're the largest provider to the likes of National Grid and SSE in terms of transmission cables and substations to take the wind power across and connect it to the grid.

And then finally in the case of new nuclear, we're supplying the cooling tunnels for the nuclear power station plus all the mechanical and the electrical, and we're working on Sizewell C, in terms of advanced studies on that particular plant.

So fundamentally in terms of green sustainable infrastructure we're very, very well placed for the future.

In light of that what we've done is we've republished and renewed our Sustainability Strategy for the future. We're looking at the environment in terms of carbon. We're looking at waste in terms of the materials. And we're looking at communities and social value and how we put things back into those communities.

We've set targets for CO_2 around achieving net zero, but actually going beyond that. In terms of Material 2040 looking at zero waste. And in terms of the community impacting over a million people.

In the interim, we've agreed to put in place science-based targets for 2030, an interim target for reduction and also £3bn of social value.

These are all very bold targets, but I think they're meaningful and they set out a very clear declaration to which we wished to be held accountable.

Sustainability - our Green Agenda is not something new. You know, we've been actively engaged in it over the last ten years, whether or not it's opening up quarries and using the rock for road base and then returning those quarries to their natural state.

But if I look across the Group today, in Hong Kong for example we've looked to replace site diesel generators with battery powered backup, which is an 85% reduction in carbon emissions.

On the HS2 project, we've specially built this slurry treatment plant whereby the 1.6km of tunnels that we'll build for the high-speed rail, the tunnelling material will actually be poured into the settling tanks, the solids will settle out, they'll then be pressed dry and that cake will then be used to firm-up the embankments and stabilise them. So effectively we're moving 250,000 cubic metres of materials and actually taking nothing offsite, all around the fact that we're recycling in situ, and this has gone on for many years on all of our projects.

And then in the case of actual people and actually investing, backing the next generation, as you know, Balfour Beatty and myself are a great driver of the 5% Club. The club today actually represents over 1 million employees in the UK alone and 60,000 of those are actually apprentices. So there's nothing more important in terms of sustainability than investing and sustaining capability so people have the skills in order to do the jobs required of them in the future.

And this is a very interesting study in Seattle whereby 26% of the project hours are undertaken by apprentices at the request of the client. And I think that's a great leadership example and we should see much more of that across the globe.

If I then look at the second area, we talk about the fact that we are selling into a growing market supportive of what we do, the second area is our order book. And you can see over the last three years, our order book has grown from £11bn to £16bn.

What's actually impressive about that is that we weren't actually even trying to grow the order book, it's just that we're positioned in the right place at the right time where our skills and capability lend itself naturally to take advantage of the growth opportunities.

You can see that we've exhibited growth here primarily in the UK around Infrastructure and also in Hong Kong. In the UK it's Highways, it's High Speed 2, it's Hinkley, it's Thames Tideway. The primary driver in Hong Kong is actually the airport infrastructure.

The two areas where we've seen decline are primarily in our Services businesses in the US.

In our Services business in the UK, we've exited the Gas and the Water business contracts which we've had in the framework for seven years plus. And we've exited those for two reasons. One is they're not making any money, and two is the onerous terms and conditions that lend themselves to our balance sheet are unacceptable, so we've said that we're not going to play in that market.

In the US, the reduction that you see here is two factors. First and foremost it's coming off an all-time high, in 2019 exchange rates have seen it reduced. And we've also exited the Water market in the United States in terms of our ability to actually execute those contracts profitably going forward.

So, I'm encouraged by our order book and I'm encouraged by the market that supports it.

What's actually more important than just the size of the order book is actually where the risk profile is leaning, and it's leaning towards what I think is a much more favourable environment in order to enable us to deliver satisfactory returns.

So, you can see right across the board, and I'll explain the nuance in the US in a few minutes, we're very heavily gauged towards public and regulated markets with a small amount in actually the private market.

Support Services, for example, is primarily now Power Transmission, Plant & Equipment, Road and Rail businesses.

In the UK, our Civils Infrastructure business is around Nuclear, Roads and Railways.

In the United States the model is slightly different because we have a lower risk profile where we do Construction Management where effectively we get a fee on cost. So, we're responsible for delivering against schedule, we're not actually responsible for the direct cost. And if costs rise, we get a fee on that cost or if they lower, the same.

So fundamentally in the US, we have a smaller Infrastructure business and a larger Construction Management Contract business, which means the US is generally a lower profile, lower risk business for us.

And in the case of Gammon, we're seeing a big impact in terms of tunnelling, roads, and airports.

Generally speaking the position of our backlog is such that I'm confident in our ability to deliver earnings growth. Going forward into the future, particularly in the UK with the new Construction play book, there's a much better fairer playing field for us to play on whereby it will actually be easier to ensure that we've got the right contracts delivering the right returns for the Company.

The final area I'd point out here is actually the nature of the actual business within the portfolio itself and the types of contracts. And you can see here in the case of the UK just how much it's grown over the last couple of years. And the three major reasons for this growing are effectively Highways, Hinkley and the likes of HS2.

But you can see that that's actually disposed in target cost. So, effectively, we'll have a target cost and, if we achieve that target cost, we'll achieve our margins. However, if we actually do better, we can get an enhanced return, and, if we do worse, we get a slightly lower return. But our actual returns are banded. And so, in effect, this is a much, much lower risk environment, which encourages us to play.

10% of our portfolio is in, effectively, cost plus, and we still have about 20%, which is fixed price, and that's an area that, over time, we'll look to reduce further.

So, fundamentally, we've got a rising market in terms of infrastructure, we've got a strong order book with a lower risk profile, and through our Build to Last, what we've built over the last five years is the capability to deliver on that. So, good market, good book backlog, good capability to deliver.

And, within Build to Last, we have Lean, Expert, Trusted and Safe. Lean was about cash in and cost out. And what you can see here is that our cash profile is such now that it's above the zero line, and you can see it's far less sign your soil, and much more forecastable and predictable. So, Lean, we're performing well.

In terms of Expert, which is really around employee retention, you can see that we're up year-on-year by almost 10 percentage points.

In terms of Trusted and customer satisfaction, two years in a row now we've been voted as the Most Admired in our industry sector by competitors, employees, and customers, which is a great accolade to how far we've actually come.

And then in terms of Safety, you know, safety, for me, is really a forward indicator of how the business is performing and the efficiency, and the effectiveness, and productivity on our sites. And you can see how this is continuing to trend down to achieving 0.1 for the first time, which is equivalent to one lost time incident, or accident, for a million hours worked, which is a really good target for us.

For the first time, what we've done is we've included our sustainability statistics and our C02 emissions, and you can see how they've nearly halved over the last five years.

So, effectively, all of these leading indicators talk very well to a prosperous future in terms of execution for the business.

In the last five years, what have they really delivered for us? I think it's really, really clear. From '14 to '20, we've delivered nearly £1bn of free cash flow out of these activities. Our overheads have actually halved from £470m to £226m. That's 3% of revenue, and we're looking to maintain that going forward in the future.

Our attrition rate has reached below 10% for the first time, and there's a real cost to churn in our business, so the lower that number is the better it is for us, and so, therefore, we gain the benefits there.

And in terms of earnings, we're still positive, but looking to 2021, we're looking at 2019 earnings, or getting back there, which is another £100m increase on our earnings for this year.

Also in terms of execution, we've driven an awful of efficiencies through our digital agenda. And, back in 2015/'16, what we were doing is we were standardising around a single platform, be it R12 or JD Edwards in the US. Around that, we created our project on a page so we could transparently look, real time, at how projects are performing, or our definition of real time.

Our data lakes meant that we could extract information in a way and a format that we need to run the business. And then, built on those data lakes, we've put in a better procurement system - in our case, it happens to be Jaggaer - and then what we did is we got hold of site productivity by actually access control and entry in and off of our sites, and the monitoring of labour.

We've looked design integration through BIM models and the ability to exchange seamlessness between consultants and ourselves to drive efficiency around the movement of data.

As we all know, this year has been interesting in terms of the likes of Teams, and that's done some remarkable things in terms of actually granting us quicker, faster access. And I was talking to our Head of HS2 the other day, and the material difference that Teams has actually made to getting faster, quicker decisions and executing, and mobilising jobs in a very safe, efficient way that we haven't done in the past. So, I see this as a productivity tool that will be with us for a long time and a lot of benefits.

Out in our field and our operations, we're now putting together digital models. So, we're effectively building things twice; building them once digitally and then executing. This is a picture of the M25, which we maintain, monitor, and keep open. And we can monitor all of our service and maintenance of the road service, response to accidents and the likes of this. So, this is a real step forward in terms of our efficiency.

And, most recently, we opened our Operating Skills Hub whereby, in conjunction with HS2, we're training young people in terms of simulation of autonomous vehicles and real live excavators and trucks as to how to acquire the skills to operate on site.

So digital, for us, has done well, and will continue to deliver, and it's an investment in the future.

Back in '15 and '16 - you can think of it as if we're building out a housing estate - we put in the utilities, the pipework, the water, the sewers, and what we've done is we've continued to build on that and will continue to build onto it into the future.

So, really, in summary, I'm optimistic about the future and our outlook for three reasons. We've got a growing infrastructure market, both in terms of the countries we're in, infrastructure investment, and the green, what I call goldrush. We've got a record order book, which is not only large, but it actually tilted towards a lower risk profile than in the past.

And our ability to execute, based on the skills of Build to Last, where we've built them over the last five years, 2020 was a year that we paid to maintain them, will allow us to execute, coupled with our £1.1bn Investment portfolio, leave me confident that cash will grow, both from earnings and investment, which we actually think will give us significant capacity for long-term shareholder returns, and gives us confidence today by announcing a £150m share buyback for 2021.

On that note, we'll hand over for questions.

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Questions and Answers

Telephone Operator

Thank you, Leo.

If you wish to ask a question, please press *1 on your telephone keypad. If you wish to withdraw your question, you may do so by pressing *2 to cancel. Please note, there will be a brief pause while questions are being registered. [Pause]

Our first question comes from Gregor Kuglitsch from UBS. Please go ahead.

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Gregor Kuglitsch, UBS

Hi. Can you hear me?

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Leo Quinn, Group Chief Executive

Indeed, Gregor.

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Gregor Kuglitsch, UBS

Yes. Good morning. Thank you. A few questions, please.

Maybe one, and you mentioned the Construction playbook and sort of the mix of contracts, particularly in the UK, but if you could just give us sort of a flavour of what that all implies for margin. And maybe it doesn't apply that much for margin, maybe it's more a risk point, so, thinking about the level of margin in the UK and the sort of variation around that.

And maybe related to that, and maybe that's more a question in the US, what you're seeing on new tenders. So, is there more competition? I'm thinking specifically on non-res in the US, whether it's become a little bit more challenging, or maybe it's not the case, but that would be interesting.

The second question is maybe a technical one, but you've flagged a few exits. So I think, in the UK, it's called the Services business and also in the US Construction, could you just give us some quantum of the revenue that is likely to fall away with that - maybe, I don't know, what time horizon. Maybe it's already happened. But that would be interesting.

And then maybe one for Phil, what your expectation is for average net cash for this year after, obviously, the strong performance of last year. Thank you.

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Leo Quinn, Group Chief Executive

Okay. I've leave Phil to deal with the facts and the net cash.

In terms of the Construction playbook, I think the primary advantage for the Construction playbook is it allows for a much more sensible dialogue with the client around terms and conditions because, quite often, you know, if the terms and conditions are onerous, such as consequential loss, or some onerous liquidated damages, it's really a case that we won't play. So, the first point is by having sensible terms and conditions, it gives us the chance to play.

The second is the Construction playbook is largely a two-step process, whereby you win by a virtue of capability, you can then sort of paid for your selling expense in terms of when you put your bid together, and then, finally, you can assess the risk. So, you have time to consider the risk and actually quantify it, and then you go back to the customer.

So, I think the playbook will be a major step forward for us, and the industry, by the way, not just Balfour Beatty.

If I look at US tender margins, it's a really interesting question. Over the last 45, 50 days, let's say 60 days now, we have unquestionably seen much more competition in our Construction Management business.

So, this is a business where we normally bid at like, for example, 4% - we have a 2% overhead, and we deliver a 2% return. The turnover's about £4bn as a business. So, we've seen that, in some cases, some of the numbers around the fee is actually, we think, quite suicidal, you know - below 2%. So, you know, invariably, we don't play. But you have to balance out the short-term and the long-term, and we're being very selective.

But I think we will, in the short-term, see pressure on the bidding in US margins, but I think that will normalise as the economy recovers more. And, of course, the Biden - what is it, $1,200 or whatever, or $1,400 for every family, that will see everybody going back to Disney and then, you know, hopefully, those projects will all reopen for us.

In terms of business we've exited, you know, you asked for revenue, the UK gas and water business - Phil will correct me - is about £300m a year, but you've got to understand, if it doesn't make any money, the revenue is largely irrelevant.

So, the two contracts we have in question is one in the UK, one in Ireland. The UK one has 14 more days to run, so that finishes at the end of March. And the Irish one runs until the end of, I think it's June or July, but it's that period.

So, the reason we didn’t go forward with them is that the terms and conditions associated with them would put our £8bn balance sheet at risk, and was onerous, and that, you know, if you're not making any money why would you do that?

In terms of the US business, in terms of water in the US where we're effectively trading down the last remaining contracts, that business, historically, was about $300m, I think, just there or thereabouts, a little bit below that. And it's a very unusual market because the client that we invariably sell and deliver to will only build a water treatment plant every once in 20, 25 years, or something like that and, invariably, they're a very inexperienced buyer, and you end up with lots of complications.

So, again, the risk profile around that was just deemed to be not worth the effort, and we've got plenty of other work in the likes of highways and schools and areas like that where we're focusing our efforts.

So, I think that just leaves the net cash question to you, Phil.

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Phil Harrison, Chief Financial Officer

Yeah. We're not giving guidance on average net cash at this point. Clearly, with the £150m cash share buyback, it's difficult to forecast how that will play out.

I think the more important thing is what we laid out in terms of how we're going to treat this as we go forward. So, clearly, we'll be updating everybody on what we think the surplus is, and what we determine is going to be the kind of next share buyback in a cycle.

So, it's a constant reassessment that we'll now do on an annual basis in terms of what we believe is surplus to requirements.

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Leo Quinn, Group Chief Executive

I think Phil feels that we've judged it correctly, and he doesn't want to be embarrassed by his riches, do you, Phil?

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Gregor Kuglitsch, UBS

Fair enough. Thank you.

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Telephone Operator

Thank you for your question. Our next question comes from Andrew Nussey from Peel Hunt. Your line is open.

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Andrew Nussey, Peel Hunt

Yeah, good morning, guys. I mean, I guess, following on from Gregor's question where you expanded on the US, Leo, could you do something similar on the UK in terms of that commercial sector, what you're sort of seeing in terms of headwinds, potential around receivables from clients who might be in a slightly tougher place, and margin outlook?

And, secondly, sort of more generally, obviously, historically, the aspiration to get sort of industry-leading margins, when we look beyond '21, you know, should we expect your ability to continue on that trajectory to improving and getting towards that industry-leading position? Thanks.

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Leo Quinn, Group Chief Executive

Yeah. Let's take the second one first, if we can.

As I look at '21/'22, if you look at the UK mix of the portfolio, I would be encouraged to see improving industry-leading margins. But I'd qualify that in one context, is, you know, not all infrastructure construction companies are the same. You know, we don't carry really a housebuilding portfolio. And, you know, typically, the returns in housebuilding, you know, would be between 20% and 25%. So, when you put that into the mix of construction, it would actually lean you towards the 5% mark.

But I would say, if you look at the mix in our portfolio, and the risk in our portfolio, I'd say I'd be extremely disappointed if we didn't start to see some, you know, earnings growth and that we were at industry-leading margins in '21, '22, '23.

I don't think this particular outlook, although we talk '21, is really about '21 in itself. This is really an inflection point for the business. And then I see us moving forward strongly in the future.

In terms of the headwinds, there will be headwinds, but I'm actually very positive around, you know, what the Government's doing, the need to restart the economy, the need to invest in construction, the need to get people back to work. And we're a very logical place to start in terms of infrastructure investment.

So, I'm encouraged by what I see in terms of the road pipeline. I'm extraordinarily disappointed by the influence planning still continues to have in terms of stopping jobs getting started, you know, and the reform of the planning system is required urgently, especially around our type of business. But I'm encouraged by road investment, I'm encouraged by rail investment, the nuclear investment. So, I think the outlook is very bright.

I think there will be this challenge around commercial offices in London and other regions, and I can see that reducing, but we don't have a huge exposure to that. We have some. But we are predominately large infrastructure.

Is there anything you want to add to that?

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Phil Harrison, Chief Financial Officer

No.

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Leo Quinn, Group Chief Executive

Andrew, does that answer your question?

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Andrew Nussey, Peel Hunt

Yes. Super. Thank you very much.

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Telephone Operator

Thank you very much. Our next question comes from Jonny Coubrough from Numis. Please go ahead.

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Jonny Coubrough, Numis Securities

Morning, Leo, and Phil. Can you hear me okay?

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Leo Quinn, Group Chief Executive

Yeah, fine.

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Phil Harrison, Chief Financial Officer

Yeah, yeah, carry on.

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Jonny Coubrough, Numis Securities

Brilliant. Three questions from me, please.

Firstly, on UK Construction, and I'd be keen to hear where you're seeing productivity on the ground now, and how that's progressed during the current lockdown, and also whether you're seeing any offsets from the digital productivity initiatives that you outlined in your presentation.

The second question would be on the Investments portfolio and what's leading to the increased investment in student accommodation, and also if you could give any kind of outlook for where investments, and disposals, could likely to be focused going forwards.

And then working capital - and I appreciate you're not giving average net cash guidance - but would be keen to understand, kind of, what that could look like in 2021, and also whether you'd expect there to be any impact on working capital and the payment terms from the VAT reverse charge.

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Leo Quinn, Group Chief Executive

Right, I'll do the first one and Phil can do the next three.

So, outlook for UK Construction, I suppose, on balance, I can see, provided the economy recovers and that we don't we have another outbreak of COVID, I would be, you know, balanced about it. I think it'll be a steady, positive recovery.

I would point out here and now, and I think it is important, is that we're not through the disruption that COVID has caused. And, interestingly enough, is that when we have somebody testing positive, you know, in some of our contracts, we found that there might be a couple of people get tested positive, the actual biggest issue is all the people that are around and associated with them who get pinged and have to self-isolate.

So, that does cause disruption. I'm hoping it's getting less and less, and we've seen reductions across some of our major projects where we saw, in January, after the Christmas period, people coming back. So, it's not clear blue water out there, but it is a very positive direction of travel at the movement.

If I look at UK Construction, I think highways will do well, HS2 will do well, Hinckley will do well. These are all big projects under control, where we're delivering and delivering very, very effectively. The digital agendas and the things that we've put in place around movement of materials, wireless access entry, and all these things, I think will enhance productivity, and digital mapping also allows us to do things remotely which, in the past, we've had to go out and do it on site.

I did make the point in my presentation around the impact that Teams is having in terms of access to people, the speed of making decisions and getting in front of people is really accelerating progress. There are disadvantages, you know, it's very difficult to train people, it's difficult to bring on young people, but it's having a material impact I think, and will do for a long time.

The airports, I think, will start to recover in UK Construction.

So, I would say 2021 is going to be a transition year for UK Construction where I think it will make steady progress. I think 2022 will be, I think, a very good year. And '23, beyond that, will be very strong as well.

I'll just touch on student accommodation only, and then you can just touch on investments.

We did have a number of student accommodation projects delayed whereby we are the - it's a design, build, finance and operate. There was some uncertainty around students coming from aboard and attendance, and so there were some deferments around building out campuses. We're now starting to see positive conversations about those being re-engaged.

And, of course, we make our best returns when we have a successful delivery of a campus where we're doing the finance and then the maintenance thereafter. So, I would say that market's going to come back again for us. It will be building this year for the student intake of 2022/23.

Phil?

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Phil Harrison, Chief Financial Officer

Yeah, no, I agree with Leo. Clearly, we've got a pipeline in student accommodation, both in the UK and US. We're very selective. Typically, we're on campus. It's been one of our key things, usually working with the universities, and we still believe there are good returns to be had there if you take a selective approach to it. So, we'll continue with that.

On the average net cash, we will report average net cash. That's a metric that we'll continue to show. I think, as I said in my comments earlier, you know, one of the key things here is around what's going to happen with working capital. So, what's working capital movements going to be? We've kind of set a range that we think we'll operate in, which is 10% to 12%.

All things being equal for 2021, I'm not anticipating huge swings in working capital for '21. I think we'll see more movement in '22 and '23 as our natural mix and demobilisation happens. So, I think we'll be relatively stable in '21.

Clearly, as we progress, and our performance is good in '21, we would anticipate that we'd have earnings growth and, therefore, we'd anticipate at least some cash to come from that.

In terms of the impact of domestic reverse charge, it will be a benefit to the Group as we'll be holding and then passing it back to the HMRC. So, it's a small benefit to us, but it's not material in the scope of the whole Group.

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Leo Quinn, Group Chief Executive

So, just reverted to one fact in terms of the weekly cash flow that I receive is that our cash flow year to date, on a weekly basis, is ahead of last year, and that's, obviously, encouraging and what we'd want to see.

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Jonny Coubrough, Numis Securities

Thanks very much.

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Telephone Operator

Thank you for your question, Jonny.

Just a reminder, if you wish to ask a question, or a follow-up, please press *1 on your telephone keypad. Thank you for your patience. There'll be a brief pause while the questions are being registered. [Pause]

Our next question comes from Joe Brent from Liberum. Please go ahead.

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Joe Brent, Liberum Capital

Good morning, gentlemen.

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Leo Quinn, Group Chief Executive

Hi, Joe.

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Phil Harrison, Chief Financial Officer

Hi, Joe.

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Joe Brent, Liberum Capital

Three questions, if I may.

Firstly, on the PPP, or the Investments valuation, a little bit surprised to that not growing despite the fact you've made no disposals. And I see a £29m operational outflow. Could you talk through that and why you've chosen not to reduce the discount rate?

Secondly, following up on an earlier question on Support Services, I know that the sales you've lost were not profitable, but could we have an understanding of what the future sales will be so that we can apply some margin? And is that margin that we'd apply now higher than the 5% given you've exited unprofitable areas?

And then, finally for me, could you just talk a little bit about some of the ongoing opportunities in the UK for PPP, notably wind? Is there an opportunity to invest in OFTOs as you have done previously?

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Leo Quinn, Group Chief Executive

Okay. Just to get the easy one out of the way, Support Services will operate between 5% and 6%, so above 5%.

Phil, do you want to talk about the PPP portfolio and £29m?

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Phil Harrison, Chief Financial Officer

Yeah. Joe, clearly, in Other, that's where we have the FX, which was circa £20m. So, that's probably half of the movement. And then we have ups and downs, usually, typically, in the normal area of performance. There's nothing that I can think that's abnormal in those numbers.

We always, at half and full year, do a full look at discount rates, and we do it by project. And we've determined that the discount rate is correct and within the right place. So, that's why it hasn't moved. It's where we think it's justified.

And then on kind of what do we see in the UK in terms of PPP? I still think PPP in the UK is still not fully formed from the Government. There's really no replacement to PFI, you know, PFI2. They have been talking about the infrastructure bank recently, and we're hoping some things may come from that.

We've looked at OFTOs in its current form, and we can't see that we can get to our hurdle rates currently in OFTOs in terms of the cost of capital. So, we're not, at this point, engaged in any OFTO area. We're keeping it under review. We do think that the whole area of climate and renewals will give us opportunities, but we see that more in the medium rather than the short-term at this point.

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Joe Brent, Liberum Capital
Thanks, Phil.

Going back to the Support Services question, you know, it's helpful to give us a margin range.

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Phil Harrison, Chief Financial Officer

Yeah, let me give you some colour that. So, Support Services, I think this year, we did about 4.3%. We've always said we want to operate consistently at the 5% level, and that's where we're determined to get to.

We did tell the market that we were exiting the gas and water in 2019, and we did guide people that we would be roughly, I think, between £50m and £100m per annum, would be the impact of exiting gas and water. And that's roughly the way we see it at the moment. So, I think, we'll finish the year at about £1.67bn, so I can see us operating, you know, in the high 900s as we go forward.

And, clearly, we see opportunity in power and in road and rail maintenance, but if you start from a base of the high 900s and apply the margin that we think, at the moment, I think our view is that we want to operate at that 5% level. Once we're there, we can think about going further.

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Joe Brent, Liberum Capital

Perfect. Thank you.

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Telephone Operator

Thank you very much.

A final reminder, if you wish to ask a question, or a follow-up, please press *1 on your telephone keypad.

Thank you again for your patience while questions are being registered. [Pause]

Our next question comes from Marcin Wojtal from Bank of America. Please go ahead.

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Marcin Wojtal, Bank of America

Thank you, and good morning. Some follow-up questions on Infrastructure Investments if I may.

So, you state that you are going to restart asset disposals. Do you see appetite from investors and valuations of assets for infrastructure investments back already to pre-COVID levels? So that's one.

And the second question, do you see enough opportunities in the UK and the US to actually grow the portfolio in terms of capital employed for Infrastructure Investments over the next few years, or it will be more stable, let's say?

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Phil Harrison, Chief Financial Officer

Do you want me to…?

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Leo Quinn, Group Chief Executive

Yeah, you go and I'll fill in.

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Phil Harrison, Chief Financial Officer

Yeah. So, on valuations in the secondary market, clearly, we're out testing. We think that the market is in relatively good shape. Clearly, there's a supply and demand, there's a lack of supply, so, clearly, you know, we view that as positive. So, we think we'll get good returns from whatever assets we dispose of in '21.

I think in terms of how we see the next few years in terms of infrastructure investments, as I said earlier, we do see that there are opportunities. There are opportunities probably to spend, as we've done in previous years, around about £50m a year into investments. We are selective. You know, we are trying to be very disciplined in getting the returns that we want from the business. Clearly, if we see opportunities greater than £50m to hit those returns of two times, or three times multiples, then we'll do that. But we're pretty disciplined in what we want to do.

We think there's enough capacity in the market in the UK and the US to support a £50m a year investment from the business. That, I think, will yield as we churn - and I talk about this virtuous circle - I think we'll probably see a stability around our DV and the actual size of the portfolio, notwithstanding anything that comes at us over the coming years, because it's naturally lumpy and we'll take advantage of the marketplace.

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Leo Quinn, Group Chief Executive

And, currently, I suppose our largest area of interest is student accommodation. It's well-funded and there's a lot of demand. So, that's where we're focusing our primary attention at the moment.

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Marcin Wojtal, Bank of America

Okay. Well, thank you.

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Telephone Operator

Thank you.

Ladies and gentlemen, as a final reminder, please press *1 on your telephone keypad to ask a question, or a follow-up question. Thank you. [Pause]

Thank you. We have a follow-up question from Joe Brent from Liberum. Please go ahead.

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Joe Brent, Liberum Capital
Hi. Just the one question, if I may.

We've mentioned student accommodation a number of times on the call, and my understanding is that some students are not kind of paying their rents, feeling that they've got a bad deal out of COVID. Could you tell us about some of the impact on any of your campuses?

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Leo Quinn, Group Chief Executive

Yeah. Look, it's not so much non-payment of rent, it's really the occupancy level, and I was just thinking of one case in Glasgow - we're about 60% occupancy. So, there is a hit this year in terms of rental income, but, for us, in the scale of it, it's actually very small.

But I think this will be an anomaly for 2020 and coming back into next year provided we release the lockdown as described. I think things will return to normal, but it's not material to us at this time.

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Phil Harrison, Chief Financial Officer

One follow-on from that, Joe, is that, for quite a lot of our student accommodation, we have agreements with the universities to take all of the rooms, so, to some regard, we are protected.

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Joe Brent, Liberum Capital
Thank you.

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Telephone Operator

Thank you. There are no more questions, so I'll hand back to Phil and Leo.

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Leo Quinn, Group Chief Executive

Well, just really to summarise, and before you all rush off is, you know, the presentation we made today, I think, really is the presentation we would like to have made a year ago.

2020 really has sort of been a bit of a lost year, but I think you'll agree with me, when you look at the numbers, 2020 was a command performance in terms of the fact that, despite the chaos, we've delivered.

But, as I look to '21 and beyond, I think we're looking at a very favourable market in a rising tide, we're looking at a strong order book with a risk-reduced portfolio within it, and the benefits of Build to Last have been sustained throughout 2020, so it's there to deliver on that backlog.

Earnings plus disposals within the Investment portfolio, I think, leave us very, very well-positioned for cash returns this year and into the future. So, look forward to delivering on that. Thank you.

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