Balfour Beatty

2021 Full Year Results Presentation

10th March 2022

Balfour Beatty

Charles Allen, Chairman

Leo Quinn, Group Chief Executive

Phil Harrison, Chief Financial Officer

Questions From

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Video Played

Introduction & Highlights

Introduction

Leo Quinn, Group Chief Executive

Good morning and welcome to our 2021 Full Year Results. Before we start this morning, I would like to introduce Charles Allen, our new Chairman. And Charles would just like to say a few words of introduction before we commence the presentation.

So, Charles, the floor's yours.

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Charles Allen, Chairman

Yeah, thanks very much and good morning, everyone. Leo very kindly agreed to be my simultaneous translator if you don't actually understand my Scottish accent, so there'll be subtitles here. Leo, thank you.

I've been with the Company eight months. It's been a great eight months. I've had a chance to visit 25 of our projects around the country. And I never fail to be impressed by the quality of people that I meet and the complexity of the projects that they make look easy.

I'm only frustrated, having worked in different sectors for companies like ISS that does Facility Management making 4% to 6% with all the complexity we have, we make 2%. So the big challenge is how do we make it more? And I know Leo has been turning the Company around with Phil and the rest of the Board, there's a fantastic opportunity to do more and more, and more. And that's what I could say to Leo at every Board meeting, more and more, and more profit that is.

So basically, thank you very much for coming along today.

The other piece of good news you may have seen is one of the things on my agenda was strengthening the Board from a D&I perspective. And I'm delighted to say we're bringing on board Louise Hardy, who's a Civil Engineer, she's been around the sector for a while. She worked on the Olympics, she worked on London Underground, and she worked for Bechtel. So a wide range of experience and I'm delighted to get somebody of her calibre joining our Board.

And that's great news because I think it sends a very strong message externally, but probably more importantly, internally to the ladies we have around the business to say, you know, you can do this and you know, really drive that D&I agenda. It's very important to me, it's something I've been involved with for 30 odd years, so I'm particularly pleased with that.

Hopefully, you'll agree that we've got a very solid set of results today and that allows us to move into this year with real confidence.

Thank you and enjoy the meeting. Thank you.

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Key Highlights

Leo Quinn, Group Chief Executive

Thank you, Charles. And in the spirit of inclusiveness and diversity, we went out of our way to ensure that when we chose the Chairman, we didn't pick a tall Chairman, because we can't have two of us. So there we are.

Anyway, thank you very much, Charles and you're very welcome to the Company. A great addition to the team.

Today we're going to look at the results for 2021. I want to draw your attention to this photograph here for a few seconds. This is truly something which is quite spectacular, it's the inside of the Channel Tunnel. And up on the top-left what you can actually see is a connector cable connecting the French National Grid to the UK National Grid. It carries 1GW of power and effectively serves 1.6 million homes bidirectional either way.

That's the kind of project that we take on and we do. Historically, we took this on at a fixed-price lump sum. It did deliver profitably. In the future we'll be taking it on a cost-plus basis. But a fantastic project and a real feat of engineering.

So today the results, 2021's performance an excellent year. Ahead of expectations and more importantly, ahead of 2019, which was the pre-COVID period.

Over the last few years we've actually transformed Balfour Beatty into what really is a resilient diversified Group, both geographically and the businesses that we actually entertain and the business models within that. Also the markets that we serve.

As we leave 2021, we go into 2022 with a very high quality order book with real clear visibility of the future. And the mix of that business allows us to actually predict and forecast very accurately. So, we're pretty confident with our 2022 forecast and expectations.

If I think about the markets that we serve, we're largely dominated by the Infrastructure market. And we're going into, and I'll show you later in my presentation, almost what I think is going to be a decade of infrastructure growth, which matches absolutely perfectly with the capabilities that we have within the Company.

We also have underpinning our balance sheet and also underpinning our share buyback our Investment portfolio, which is a £1.1bn asset. And not only is that an opportunity for us to actually put our negative working capital at work, but we've also got a very attractive growth portfolio both in the UK and the US that we're actually pursuing.

All of these things give me great confidence in that we'll deliver future profitable managed growth, and that underpins the fact that we've increased our share of buyback from £100m to £150m this year.

It's not only the markets that we're in which are really encouraging, but it's actually the platform that we've put in place. When we started Build to Last all those years ago, we talked about creating a foundation for the next 100 years, well this is the foundation we've created. And if you think about it, you know, what gets measured gets done. And the things we've got up here are important to us.

If I'm looking at UK voluntary attrition, prior to 2020 we were down at single digits in the high 9%. You can see that post 2019, we're now up at 14%. And what you've seen as a result of

COVID is people having a change in lifestyle, you know, they've decided where they want to work, where they want to spend their time and so we've seen some attrition there.

We've also seen with the Group's capability that there's been a high degree of people - attracting people away from Balfour Beatty, sometimes on some ludicrously high packages and the likes of that, which is really a testimony to the way that we train and develop our people. But we've seen attrition rise to about 14%, and that's one of our biggest worries.

Interestingly enough that's despite the fact that we've had our highest ever employee satisfaction scores at 76%. And also the question we ask is, do you see yourself being with Balfour Beatty in 12 months' time? We've had an 86% response rate that says they do.

So you can see that this is an area that we take very, very seriously because at the end of the day, we are a people business.

And the other areas that we actually look at and manage very carefully is obviously earnings. And you can see between 2014 to 2019 which is pre-COVID and '21, we've gone from a loss of £144m to a profit of £181m. The £181m beating the pre-COVID levels.

We've put in place an operating platform effectively that serves the Company well, and you can see the overhead costs of the business have halved in the last seven years and they're down over 2019.

That reduction is actually largely due to subsistence and travel and things like that. So, we will see 226 rising in the next 12 months, although our goal is to really try to keep it to that level.

And then finally, an astonishing statistic, if you actually look at the average net cash or debt between 2014 and 2021, that's over £1bn of free cash flow generated from the business, which is a great achievement.

If you think about our Build to Last programme, it's really gone through three phases. The first phase if you remember was actually self-help. We didn't go out to the shareholders for equity, we used our balance sheets and the assets on the balance sheets in order to fund the turnaround.

The second phase, which was 2017 to 2019 was we actually used surplus cash to actually pay down the scheduled debt.

And then third phase, which we're in now, last year and now this year we've announced a programme of share buyback, £150m the last year, £150m this year on top of the ordinary dividend.

And this is actually demonstrated very well in this graph. Here's our self-help period, here's the period of strengthening of the balance sheet and paying down debt. Just under £0.5bn of cash was put into that, and now here we are returning cash to shareholders, some £366m announced in the programme.

So if you think about our Lean, Expert, Trusted and Safe, this is an example of trusted to do what we say we will do in terms of delivering returns to shareholders.

So, very confident about the future. And on that note, I'll hand over to Phil.

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Financial Review

Phil Harrison, Chief Financial Officer

Thanks, Leo. Morning everybody.

Let's go to the headline numbers. In 2021 the total underlying profit from Operations for the year at £197m shows a significant improvement from 2020, as Balfour Beatty continued to recover from the pandemic, including recommencing investment asset disposals.

We reported profit from Operations from the earnings-based businesses of £181m, a strong rebound from 2020 and ahead of our expectations to be in line with our 2019 pre-pandemic profit of £172m.

Earnings per share in the period of 29.7 pence, is significantly ahead of 2020 and more importantly, 11% ahead of our 2019 results.

Both average net cash and year end net cash increased as positive operating cash flows and significant working capital inflows more than offset the first year of our multiyear share buyback programme.

Average net cash at £671m and a year-end net cash of £790m underpins the Group's competitive advantage and supports our long-term capital allocation framework.

At the year end, Balfour Beatty's order book at £16.1bn and the Director's valuation at £1.1bn were both broadly flat with the 2020 year end.

Given these results, the Board today is recommending a final dividend of 6p per share, giving a total recommended dividend for the year of 9p per share.

The Group is also announcing today £150m share buyback for 2022 as the next phase of its multiyear programme.

The buyback will commence immediately and is expected to complete during 2022.

Going into the numbers in more detail and turning to Construction Services. The business recorded an underlying profit of £79m for the year from the continued strong performance of Gammon with £30m of profit, US Construction broadly doubling its profit to £51m as we return to pre-pandemic levels, and UK Construction recording a £2m loss from Operations in the year.

The UK result was negatively impacted by performance issues at three private Residential projects in Central London. One of these projects was completed in November 2021 with the two remaining projects expected to complete in 2022.

Elsewhere, key UK Infrastructure projects such as HS2, Hinkley and Highways continue to perform well. In line with our focus on key Infrastructure projects, over 90% of UK Construction revenue was from the public sector and regulated industry clients in the year.

Importantly, in the second half of the year, UK Construction recorded an underling profit of £21m at a 1.6% margin.

Looking ahead, Balfour Beatty continues to be focused on public sector Infrastructure and will no longer bid for fixed-price Residential Property projects in Central London.

Now, turning to Support Services. After several years of repositioning the business to focus on power, road and rail maintenance it is now characterised by profitable recurring revenues underpinned by long-term contracts.

We saw a significant outperformance in 2021 as profit from Operations more than doubled to £102m as a result of the improved performance across the portfolio, the Group's exit from Gas and Water, and end-of-contract gains, one of them being the Channel Tunnel picture that you saw earlier in Leo's presentation.

This repositioning of Support Services has driven us to set a new margin target range for the business at 6% to 8% upgraded from our prior range of 3% to 5%. Specifically for 2022, we expect revenues to be around £900m following the completion of the Gas and Water contracts with the Group targeting our new margin range.

Turning to Infrastructure investments. Predisposal operating profits in the year increased to £14m are broadly consistent with the pre-pandemic level. More importantly, in June 2021 the Group recommenced asset disposals with the sale of its stake in the Children and Women's Hospital in Canada for the cash consideration of £20m. In the second half of the year we sold a bundle of UK assets for £48m and two US multifamily housing projects for £12m.

All transactions were above the Directors' valuation demonstrating strength of the secondary market for Infrastructure assets.

The business continues its disciplined approach to target a two-time return on its invested capital as we continue to see good market opportunities.

During the year the Group invested £19m in new or existing projects. The four new assets comprise two student accommodation projects, The Vanderbilt University in the US and Royal Holloway in the UK, and two US multifamily housing projects in Houston, Texas and San Mateo, Florida.

Moving to non-underlying items. This year there are two items that warrant mentioning given the overall £55m net charge after taxation.

Firstly, in December 2021 Balfour Beatty Communities reached a resolution with the US Department of Justice which brought to a close the DoJ's criminal and civil investigations into work-order incentives. Community paid a total resolution amount of $65m in January 2022. Net of tax and previous provisions, we have recognised £37m in our 2021 accounts.

Secondly, at half year the Group disclosed a contingent liability for potential rectification works on a development in London. At year end it has been determined that remediation will require replacement of the stone façade. We have taken a £34m charge net of tax, as this is our current best estimate for the remediation. The provision does not include any potential recoveries from third parties.

Now as we move to cash flow another year of positive cash flow in which we generated an inflow of £209m increasing the Group's net cash position to £790m. The strong performance was driven by operating cash flows and working capital inflows.

Most of the significant movement in the year was working capital inflows with the following key factors increasing contract assets. £110m of advanced payments from major projects in the UK Construction. £30m of advanced payments of highways projects in the US, and net contract inflows of around £30m from our close out of gas and water contracts as we exit from that sector.

In addition trade payables increased £43m following the introduction of the UK VAT domestic reverse charge for the construction sector, and the cost of settlement relating to the DoJ resolution. Which was as I said earlier paid in January 2022.

These items were partially offset by the timing of trade creditor payments.

Looking ahead some of this working capital benefit will unwind in the current year as we expect a small working capital outflow with a more material outflow in 2023.

The Group expects negative working capitals as a percentage of revenue to normalise between 11% to 13% in the medium term, it is over 15% at full year. With the range movements dependant on contract mix and the timing of project starts and completions.

Turning to our multi-year capital allocation framework that we launched during 2021, to recap on the main points our focus is to continue to organically invest in the business, where those investments can meet our Group hurdle rates. Continue to realise strong cash returns from asset disposals, maintain a strong but efficient balance sheet and that gives us competitive advantage and deliver a sustainable dividend and additional cash returns to shareholders.

Now turning to how the capital allocation framework translates into shareholder returns. The next slide here summarises our current position. For 2022 the Group expects its earning base businesses to deliver further profit growth in line with the Board's expectations, whilst the Infrastructure Investments the Group will continue to divest assets and make new investments in line with the capital allocation framework.

For 2023 and beyond the strength of the Group's order book and positive Infrastructure markets create visibility to deliver profitable managed growth and sustainable cash generation.

In March 2021 the Board reintroduced the dividend as a targeted pay-out ratio of 40% of underlying profit after tax, excluding gains from investment disposals. The Board had declared a full year 9 pence dividend for 2021, higher than at any point under Build to Last.

Finally, Balfour Beatty's £150m share buyback programme for 2021 completed during the year, and today we announced that we'll buy back a further £150m in 2022. This will bring our total shareholder returns announced since the start of 2021 to £367m.

And further forward with its transformed portfolio the Group is confident of delivering significant future shareholder returns in line with its multi-year capital allocation framework. Thank you, and I will now hand you back to Leo.

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Business Update

Leo Quinn, Group Chief Executive

Thanks Phil. Now let me explain why Phil's confident. First and foremost we have a geographically and operationally diverse Group. We put this in place over the last seven years, we have two distinct parts, we've got our operating businesses, and our earnings based income, and we've got our investment portfolio.

Why do they sit together so comfortably? Well the negative cash flow or negative working capital in an operating business fund effectively the investment portfolio and allows us to invest.

We're based uniquely in Hong Kong, UK and the USA and anything outside of that is peripheral. We're based in Construction Services, Support Services and those are the two primary businesses that generate most of our returns. In the Investment business it's split roughly 50/50 UK/US. And again this underpins our balance sheet to the tune of £1.1bn and also the sale of assets will underpin a return of capital to shareholders. So this is a good starting point.

The one elephant in the room at the moment that's facing the whole industry is inflation. And I think it's worth putting this upfront and then I'll show you our exposure in terms of our contractual mix in respect of that.

But again we've got two worlds here, we've got the Construction Services and Support Services, and we've got the Investments. In terms of Construction Services we do have quite a lot of contractual protection and that is where the supply and the sourcing of the material is actually the customer's liability, and basically, it's a pass through on cost. We also have protections within this in terms of indexing whereby there's an adjustment to an index which actually will then allow an inflation cost to come into the P&L.

But with all these things it's never fool proof and there's also a timing lag. So the real trick here is to get onto it early and make sure you're managing it proactively.

Other things that we do in terms of protection against inflation is buying out early, particularly in our US business and our building business which is about £4bn of revenue. And when I say buy out early what we do is we get awarded the contract and then historically between 90 and 180 days we place all the subcontracts in order to buy out the job and put the risk down to the supply chain. Two months ago we reduced that to 90 days and now what we're doing is buying out 85% of the job in effectively 30 days.

You have to remember that sounds great if you passed on the liability but even when you've passed on the liability if your subcontractor chain, or part of it, goes bankrupt it's your liability. So you have a responsibility to effectively actively manage your supply chain.

And what we are seeing with the hyperinflation in oil and some materials, is that it's beyond any organisation to absorb that, even large FTSE 100 companies. And so what we're doing is working proactively and responsibly with the supply chain to ensure that that is understood by the customer and that it is resolved with the customer. If you look at the thin margins we make, we don't really have the scope to absorb those sorts of deviations.

So in effect it really is about ensuring that the supply chain stays whole and that we're actually managing with the client and getting them to understand what the risks are. Because you can't afford for your supply chain to fail otherwise your project doesn't go ahead.

In terms of our Investment portfolio, some clouds do have a silver lining. In terms of investments a lot of our assets, the majority are actually index linked and in the case of the US and US multi-family housing it's actually linked to rate inflation increases in the rent of the properties.

So all in all I think we're quite well positioned but this is a very live situation and is something that has to be managed on a day to day basis.

This actually shows you our contractual exposure, if you look back to 2018 the way we've actually transformed the Group, apart from actually doubling the backlog of the order book, 50% of our portfolio was exposed to sort of fixed price, lump sum in one form or another. Today that's 14%. So the best protection you can actually have is to have a very limited exposure to that type of work and you can see how dramatically it's reduced. And this is important in giving us confidence in that we know that we can forecast how the business is going to perform in the future.

Moving on and looking at the business and again why Phil would be confident, is that we've got a very, very strong backlog at the moment. It's dominated by projects such as HS2 and Hinkley Point C. And they will actually be growing over the course of the next two to three years, particularly in 2022 and 2023.

Our Highways business has performed exceedingly well over the last three or four years, for those of you who use the M4, the works are coming to an end in April, so you'll be able to get free passage there.

What we are seeing with the delay in Smart motorways is that this business will actually start to decline next year. But the growth that we're going to see in terms of major projects, Old Oak Common and Area North, will actually more than absorb the skills and capability there. There will be ancillary works that will go on but not the type of major infrastructure that we've done with the M4.

In terms of our regional business we're largely working within framework agreements. And again we're seeing strong backlog and strong growth in our frameworks for the coming years. This is what makes me excited, this is actually the future pipeline that we're working and bidding at this moment in time. So again HS2 have the track slab, the catenary, it has the extension up to Crewe and then up to Manchester. We're actively engaged in looking to win all of that work, and we're very well positioned with the work that we're doing in Birmingham. But also, we've got a very high performance team on HS2.

In terms of nuclear and defence, there is the civil nuclear and there is actually the defence nuclear. Both of them are actually huge, six months ago there was a question mark whether Sizewell will actually go ahead, Sizewell C. When you think about energy security now and the situation that's going on in the world, it's undoubtedly in my mind that will proceed at pace. And also the nuclear defence, there's a £6bn to £8bn budget that will be spent over the next ten years in that area as well. And we're central to all of those conversations at this time.

Decarbonisation is a new area we're looking to move into as we clean up the industrial Teesside and Humberside. We were down selected as one of two to deliver to BP a new carbon capture scheme off the Teesside, this again is an exciting area, it's a new area, we're working with Technip in our consortium, and we've got some very good solutions being put forward this time.

And then last year Lower Thames Crossing a major highway, for us worth probably £2bn, was delayed, it will be coming out in the next few months. And again another growth prospect here.

If all of these were to happen my prediction is the industry doesn't have the capacity to actually deliver them. So this is going to be an interesting challenge for the next few years for the whole industry.

What's also interesting, let alone our capability in these areas, all of our specialist businesses whether it be temporary works, design and planning, whether it be ground engineering and piling, whether it be big civil engineering earth moving, mechanical, electrical, power transmission, all of these specialist businesses will benefit in these particular projects. So we're actually - not only are we doing the headline project, but all these businesses will be pulling through a lot of business on the back of that. So a very encouraging picture all round.

If I look at Support Services you know I just love this business because whereas we're forecasting 6 to 8, it does have the potentially to go way beyond that. And the reason is that our capabilities in these areas are so unique, and we do such a good job.

In the area of power we are currently putting in the transmission on the T-Pylons from Hinkley Point C through to the grid, we're up in Scotland connected to the grid via the Inveraray project. The skills and the capability in this area is really, really unique. And at this moment in time there's two big factors coming into play, look down the East Coast and you look at the green wind farms and how they connect to the grid, that's worth a few billion pounds in terms of onshore transmission.

If you look at National Grid's shareholder investor day, you'll see that they're actually forecasting that their Capex is going to move from £1bn a year to £2bn a year in the next five years. And a lot of that work is going to ultimately end up being dependent on the capability of this business. So we see strong growth and much better returns than we've had in the past here.

In terms of our road maintenance we have two constituent parts here, we have the M25 concession, and then we have our Living Places which is local authority roads. We've been driving the M25 contract for productivity improving the systems, the processes and effectively the output of profit and cash, and that's produced a strong performance.

In the local authority area we've delivered a consistent return and now we've just hit a point where these contracts with the local authorities of after five and ten years are now coming out to bid. And we've been down selected or shortlisted for Buckinghamshire and Northampton. And we're quite encouraged by that and if we win one of those it will be a material growth in that business.

In terms of the rail maintenance business, London Underground unfortunately doesn't really have a very big budget even for maintenance these days, and so this business is going to reduce by 25% to 30% this year. It's relatively small in the scale of this portfolio.

However, we're fantastically well positioned in terms of the Central Rail System Alliance, and we made this decision three years ago that we're going to move all our resources onto maintenance. And what's happened in the last three years all the capital projects have actually slowed and stopped, and all the money has gone into maintenance. So we found ourselves very, very well positioned and this business is growing for us.

The growth here in the next few years is going to be where the existing rail network starts to interface with HS2. And there's a lot of work which will come out through that in terms of connecting the two systems together. And again we're very well placed to capitalise on that.

So this Support Services business is not only going to hit the 6 to 8% margin, it's also going to start showing some growth for 2022 and beyond.

If I look at US Construction, again a tale of sort of two cities here. Our buildings business is restoring very, very strong, we're seeing really good recoveries post the pandemic, particularly in the areas of entertainment, airports and leisure.

We're also seeing, our branches are based in the southern smile when you look at all of the surveys eight out of the ten top growth cities in the United States are in the areas that we actually serve. So geographically we're very well positioned.

We continue to deliver on the Broward County project, Broward County is actually also associated with a PPP which we're actively pursuing at the moment which is to the tune of about $1bn. And it's the municipal offices which is collocated with this site. So we're very encouraged about the progress that we're making there.

In terms of the Microsoft campus, that's proceeding at pace, there is a particular challenge at the moment with the Teamsters and they've been on strike for eight weeks and there's been no concrete deliveries in Seattle but that will resolve itself with the passage of time.

The other encouraging thing we've seen here, we've just had a recent windfall just under $1bn is with the federal market. You know under the Biden infrastructure spend federal is now becoming an area that's becoming heavily invested. And we've actually just been selected on a major project in Washington DC which is very, very encouraging for us.

And again education's a big area for us, we see the P3 market in America sort of developing that area in the next few years.

In the area of civils, we're doing some major projects, the I635 in Texas, Caltrain in California. Caltrain recently has just gone through a renegotiation for us where we've achieved a two year extension on the electrification of that railway. And a $349m change order for the change in scope. We've got enough backlog for the next two and a half years in this business and our concentration here is really around delivering that profitably while we work out how we reposition ourselves to a profitable niche in this business.

We've already down focussed our selection, or down focussed in areas of the Carolinas and Texas, so those are the two areas that we deliver road. We're delivering infrastructure on the LAX Airport and Caltrain in San Francisco. As we deliver those over the next two years what we will be looking at, as well as the profitable niches that we're prepared to risk our capital in the future as we go forward.

If I look at Hong Kong the first thing is we've got a new CEO in charge of Hong Kong, that's Kevin O'Brien, Kevin was a Balfour Beatty employee 20 years ago went to Hong Kong. The last three years he's been a CEO of one of Jardine's businesses. This is - Gammon is a joint venture between Balfour Beatty and Jardine's, very experienced operator both in terms of civils and mechanical and electrical. So a good leader and a good addition to the team.

We have a strong order book here, about £2.6bn, all these numbers by the way relate to Balfour Beatty's share in pounds. So it's split 50/50 between civils and buildings, we've seen in the last couple of years an advance of infrastructure so that's started to come through to the fore.

We've got tremendous credentials, you know we've delivered, these are some of the marquee projects. The Central Kowloon Route which is a road and a road tunnel connecting East and West Kowloon. We've got the Advanced Manufacturing Centre which is designed to service high tech innovative start-up companies. And we've just completed the M+ Museum Building and the Lyric Theatre which is really the cultural district of Hong Kong.

The portfolio at this moment in time is demonstrated by the airport, over £2bn of business where we are providing the baggage handling, the people carrier and also the rebuilding of terminal 2 and the extension of that.

A big contract, very, very complex but very well managed by the team and we've worked for the airport for 20 odd years so a very good customer. Hong Kong's been a consistent performer, delivering a dividend of between £25m and £35m a year to the portfolio. So you can see it's very attractive.

If this isn't attractive enough when you look at the future and where you're going to see the investment, if you look at the proposed land development these blue circles and the number inside represent the amount of hectares of urbanisation that's actually going to go on.

So here you have Hong Kong Island down here, this is the northern territories so you can actually start to see the amount of investment that's going to go into re-urbanising those particular areas.

On the left hand side what you've got here is the mass transit NTR network and you can see the existing yellow rail lines and then the proposed lines. These are tunnels and railways and again this is a major infrastructure investment.

So if you look to Hong Kong for the next ten years, you're going to see a very interesting growth economy. And it is interesting since the Chinese have taken more of a role in Hong Kong, these projects are coming to market much, much faster. So there are some positives that we see associated with that.

Looking at our Investment portfolio, again we've got a new CEO in charge of our investment portfolio, that's Gavin Russel. Gavin is eight years with Balfour Beatty, he used to be the Group Controller, for the last two years he's the Finance Director of or the investment business and we've now moved him in as the CEO of the business. He brings great intellect, energy and has already started very, very fast.

The unique characteristic about this business is we've got under one roof the project financing expertise, we've got the management, the operational asset and also the construction capability. All of that allows us to actually manage and understand risk. And the idea that we can operate and maintain these assets means we can hold them to such time that we feel we've got the maximum value. This portfolio is a natural home for the negative working capital that we carry on the balance sheet.

Some exciting things that are going on in the UK at this moment in time just circa 3,000 student accommodation rooms that we're building and commencing to build. That was ran over the next four years and that's the University of Sussex and Royal Holloway.

And we've got the P3 that's going on in Los Angeles Airport at this moment in time. If you ever go through the airport, it's transformational the rate and speed at which this is going up. This will be completed the first quarter of 2024, an outstanding project.

As I said you know it's a high ROI business for us, great home for the negative working capital. The portfolio is positively correlated with inflation, so we have inflation indexes within the contracts and on the revenue. And again as I said the disposal underpins our share buyback programme.

Just a comment on sustainability. We launched our strategy a year ago in terms of Building New Futures in that carbon we're looking to go beyond zero carbon. Materials we're looking at zero waste. And then in community how we positively impact more than one million people. In 2030 we've now said that we're going to align around science based targets. We're going to look at a 40% waste reduction and also 3 billion of social value as measured by the TOMS indices.

We've made great progress in what we will be doing as early as I think in the first half is we'll actually be publishing our targets. And that's a major step forward in terms of this initiative.

In terms of recycling materials one of our statistics here is that we've recycled, repurposed and reused 99% of what would have gone to landfill on our HS2 project. I mean that's a phenomenal statistic. And the thing that's interesting about this is a lot of people think about it in terms of this is the right thing to do. The reality is this actually does add to the bottom line if you do it right. So the idea is that we're very pragmatic about, we're not doing this because it's a good cause, we're doing this because we make money from it.

And then communities what we do around the 5% Club and actually ensuring local supply chains and people get paid early is really important. We're well positioned to capitalise on what is effectively the green infrastructure growth.

So really in summary when you look at all of that and our balance sheet, and our investment business, we're really well positioned for 2022. We've got a transformed group where we understand the risk and we've got confidence in terms of what we can forecast. We've got clear visibility as I'd say almost 18 months and we've got a market which is catering to our capability and there's a decade of infrastructure growth.

I mean this is a great place to be at this time and it really underpins our confidence that we can comfortably return £150m of share buyback to our shareholders.

And on that note, we'll turn to Q&A. we're going to run the Q&A in the room first and then we're going to take people coming in on video conference. So Joe over to you.

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Questions and Answers

Leo Quinn, Group Chief Executive

going to run the Q&A in the room first and then we're going to take people coming in on the video conference. So Joe, over to you.

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Joe Brent, Liberum

Thank you, good morning. Three questions if I may.   On the UK margin you give the H2 level of 1.6%, could you give me an indication of when that could get to 2%, if anything held it back in the second half?

Secondly, I would be very interested to hear your view of what you're going to reinvest into the Investment businesses as a target?

And thirdly, on fixed price contracts, you've clearly reduced that figure over time, do you think we'll get to a point at any point where there's no fixed price contracts or is it always acceptable to have some because they have a different risk profile?

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Leo Quinn, Group Chief Executive

I'll give the first two easy ones to Phil, and I'll do the third one.

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Phil Harrison, Chief Financial Officer

Okay the easy one. Next year we're going to be back in our UK Construction margins 2 to 3%.

And number two, Investments, you know as we've said previously, we're targeting around about £50m a year into the investments business. That could come up or go down depending on the opportunities. As I said earlier, we're very disciplined in making sure we get the right returns out of that business, but you should anticipate about £50m a year. We already have commitments out in future years that will probably go over that £50m.

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Leo Quinn, Group Chief Executive

Your third point, if we got to zero fixed price contracts, I'd contest that we're not taking enough risk in the portfolio. I think it's healthy to have some fixed price work, for two reasons. One is it pushed you to your limit, but also it forces you to be very commercially strong, you know if everything was cost plus you could get very lazy.

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Jonny Cooper, Numis

Thanks. Three questions from me please. Firstly in terms of the overheads with which you showed there have gone down again over the last two years. Would you expect those to go up in line with revenue growth, and also if you'd expect any impact from wage inflation there?

The second one would be on the buildings business in North America. And you mentioned in the statement that tendering is back to pre-pandemic levels. Have you seen any signs there that cost inflation might be impacting customer decision making, in terms of driving up project costs?

And then the third one would be on the Hong Kong business, which is showing clearly good order book growth over the last year. You set out there the market opportunity, but I'd been keen to hear if you are seeing any change in the competitive environment based on the political changes? Thanks very much.

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Leo Quinn, Group Chief Executive

Okay I'll take the first one. I think it was 226 was the number, but I think we said that we probably will see that rise. I think the challenge to management is how do you stop it rising. It's not only wage inflation, as people have worked from home and not travelled, there hasn't been subsistence and the likes of that. That's now starting to creep back in. So under that circumstance we will see that increase but the idea is how do we minimise that increase.

In terms of the third one in Hong Kong and the market opportunity I think as you start to look at Hong Kong, what we're seeing over there at the moment is we're seeing turnover rates in employees of about 20%. And if you look at the ambition versus the capability, I don't think there's enough capability in the region to deliver all of those projects.

So I think what you'll see is that market will continue to grow for us but we're being squeezed. I think your demand is going to way exceed your supply and that if the economics work, means we should start to see margins improve over time in that area.

And the second one was buildings in North America, the pandemic and cost inflation. We are seeing cost inflation in the US, our mitigation at this moment in time is to ensure that we actually buy projects out as early as possible to fix the price. However, as prices do rise it does impact on the decision as to whether people will go or not go. And so you'll see that projects will actually get delayed and cancelled on the back of that, there's no doubt about it.

Now I think the other thing about inflation is first and foremost you know this may be temporary. So what we're looking at today we don't want to overreact to it either and I think there are other people who take the same view. So you do have to take a long term mind set on these things.

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Pam Lui, Morgan Stanley

Thank you very much. I've two questions please, the first one is regarding Infrastructure Investments. So in the US with the military housing investigation with the DoJ behind you which will allow you to move on. So what's next for the US military housing portfolio you have, is that to hold, is that to divest, what the potential buyer's universe look like, who are the owners of these assets in your view?

And then on to P3, education, can you talk about pipeline, how many projects are there, the value, and if you can't talk about the pipeline maybe talk about how your team on the ground go about to find these projects and evaluating them, and who are your competitors in the space?

The second question is coming back to Construction. I think you've talked about inflation management already, but I'm wondering whether you've seen any potentially issues with availability so any potential issues with availability of the product that may impact schedule to delivery? Thank you.

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Leo Quinn, Group Chief Executive

Do you want to do the military housing one or do you want me to do it?

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Phil Harrison, Chief Financial Officer

We'll both have a go if you want.

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Leo Quinn, Group Chief Executive

Alright then you go first.

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Phil Harrison, Chief Financial Officer

Look the military housing portfolio is a very big part of our investment thesis. If you look at our directors' valuation at the end of the year, actually military housing evaluation went up, that's on the back of strong growth in rentals on revenue housing. We see the asset as being able to grow so we're currently in conversations with the Army around refinancing certain assets to free up cash to build more houses. That's one thing that we're actively doing, and we're also actively looking at acquiring other military housing assets in the US.

The - if you like potential for others in the market, there's quite a deep I would say investment community that would be interested in the military housing asset. But at the moment our key here is to, one, ensure that with the monitors that we're bringing we get them bedded in, we get the business refocused on doing what it needs to do for our military service personnel and growing our business.

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Leo Quinn, Group Chief Executive

Yes, I think military housing represents an exciting opportunity. It does have via rental increases a link and strong correlation to inflation. And as Phil says you know it's valued at about 500m so very important asset.

In terms of P3 education, the first P3 in the US was Prince George's County in Washington DC district. That's already gone ahead, we've gone through the process, it's now into execution. There will be more schools, sorry Prince George County will be doing more parts of its school. That will be the first one, and again we've got a branch in that area.

What you're seeing is, I don't think you're going to see the education P3's going to sort of pop out like a jack-in-the-box tomorrow, I think it's going to be a slow burn because they're learning the rules, how to bid it and to put it together. Where we've got strength is education is a really core business for us. We dominate the Southern Californian market.

We think in the next five to ten years that most all education will go through this route of P3. So we're well positioned because we have a team on the ground that understands the financing, we have a team on the ground that know how to cost and bid it, and we have a team on the ground that knows how to deliver it. And we've got a team on the ground who knows how to maintain and manage it. So I think we're well positioned for that business. But it is early days.

And then finally availability of materials. I'm wracking my brains, particularly in the US in that we had more scarcity of materials six months ago whatever, but at the moment I haven't heard, I can't think of where it's a crisis anywhere for us at this time. Rebuy always a challenge, it is in the UK, but nothing comes to mind in terms of critical shortage. Apart from the Teamster strike in Seattle where no concrete has been delivery in Seattle at all, I think it's eight, nine weeks and the strike hasn't finished yet.

On the Microsoft project we, i.e. Microsoft, has instructed us to lay off 900 people because they can't do any work without any concrete. But that will come back, and it will restore itself.

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Gregor Kuglitsch, UBS

Maybe I guess three or four and maybe some of the sort of details for longer term. So I mean coming back to Hong Kong as a sort of risk, obviously it's a good business, but politically could it become a problem at some point in the future? And isn't it therefore perhaps one idea to diverse it when the sun is shining, rather than waiting if something bad happens?

The second question is on working capital. So I think you mentioned several times that you use sort of the negative working capital and take it into Investment. But in reality, it's partially true but you also have a very vast cash pile which probably is part of that, I think £700m odd versus the sort of £1bn negative working capital. So I guess the question is could you reduce that, are you reducing that to sort of make the true investment of working capital into the Investment portfolio? Which is sort of what you're saying you're doing but in reality, there's actually a cash component that's probably 70% of that.

The third question, and perhaps with reference to the Chairman's introduction around the margin and why is this industry making two and not four to six which other bits of the industry make. I guess it's always been one of those things, but do you see any pathway that that would change, and if so, how?

And maybe the fourth and final question, maybe a slightly personal one. So I think you've been here around, with the company for I think it's seven or eight years - seven right. I'd be interested to hear your enthusiasm for sticking around for the next seven years. Thank you.

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Leo Quinn, Group Chief Executive

I'll let Phil answer that one.

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Phil Harrison, Chief Financial Officer

You probably don't want to know what I think.

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Leo Quinn, Group Chief Executive

Well if you don't mind on the Hong Kong one. Look as a Board we obviously consider political risk, and these are sort of one or more decisions. You have to appreciate we are a true equity holder as a 50% joint venture holder. And we're not blind to what's going on in the world, and again it is a decision that you know will be made over time. We've got a great business there; it's really leading edge and as you say it's performing fantastically well. For the moment it's a hold but you know never say never, you just don't know. But we're not blind to it at all.

In terms of the vast cash pile, I was going to give a slightly facetious answer which I will give now. And that is that if we buy back any more shares there's going to be nothing left for you to buy. So the fact is I think our buyback is fit, appropriate, it matches all the constraints around what we can do in terms of not creating the wrong sort of market. It's cash that we can afford and as we develop more cash which you'll see coming from operations in terms of better cash back profits in the future, we'll be more comfortable in giving more back.

But I think if you don't think about it in terms of return to shareholder, think of it about the whole seven years in terms of the self-help, we didn't call for equity, the paying down of debt, now the return of capital. I mean a fantastic achievement and story, especially if you think in 2014, we were about to be taken over by Carillion, you know look at how the fortunes have differed.

And in terms of my energy, enthusiasm and propensity to want to stay another seven years, what do you think?

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Phil Harrison, Chief Financial Officer

Annoyingly so yes.

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Leo Quinn, Group Chief Executive

Look I get up every morning, I've got the best job in my view in the country. I get paid for doing it which is scurrilous, you know but I love it and the day I don't I'll go and do something else. But apart from that I'm sort of totally all in so to speak.

Oh the margin - do you want me to answer that one too. Phil.

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Phil Harrison, Chief Financial Officer

You are annoying then. I think there is a path and I think the path is around the risk transfer into contractually, things that we've done on HS2 and this whole idea around moderated fee. Because the thing that always gets you and what gets us down to those margins is if you like the unknown risks and the unexpected risks. So if you can take that variability out then I think there is a path to have better margins, and probably more consistent higher margin.

But it has to come with that realisation from the customer that there needs to be a better share of risk, which I think we've moved some way as Leo's demonstrated.

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Leo Quinn, Group Chief Executive

I think what's interesting is that I've always maintained this should be a 5% business and today Phil has proved me wrong. So when we get to 5%, I'll resign on that day.

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Phil Harrison, Chief Financial Officer

Looks like an upgrade for '22 then.

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Marcin Wojtal, Bank of America

Thank you. So the first question is on your civil Construction business in the US. So I was under the impression that it's probably not performing as well as you would like it to perform. So can you give us a little bit more detail, is it profitable, are you planning to restructure it or downsize it or maybe even you're contemplating an exit from that?

Then on some of the opportunities in the UK, Sizewell Nuclear Power Plant, I mean you mentioned £20bn but how much of that is actually an addressable market for Balfour Beatty? And maybe can you give us some examples of what you're doing in the defence sector, what is your capability there?

And lastly, something that was not discussed today. But do you see any exposure at all to the cladding crisis for Balfour Beatty in the UK? Because I believe you have delivered some residential towers, so can you give us some reassure here. Thank you.

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Leo Quinn, Group Chief Executive

Okay I'll do US civils, I'll do nuclear, I'll do defence, and you do the cladding.

So US civils, stating a fact, US civils in the 25 years we've owned it has not returned a dividend for the company. So on that basis we've been restructuring, repositioning that for the last three years because these are long cycle projects. I don't want to tempt fate but 2022 will I think be the first year where there'll be a material profit for our civils business, but it's taken a long time to get there. But also remember in the case of gas and water, gas and water will last three years in our Support Services with losing £1m a month for a contract that was signed in 2014 that we couldn't exit. So these long tails.

So the civils business, very focused strategy in terms of Texas, Carolinas and California, the airport and Caltrain. And we are looking at what is the right strategy for that business going forward but it's about being very selective. The good news is there's a massive rise in tide in terms of infrastructure spend so we've got the choice to be quite selective in what we choose to do as we go forward. We do have really good capability, we have great people, it's just what we've got to do is learn how to make money in that business on a consistent, sustainable basis.

In terms of nuclear, both defence and civil. I'm just going to pull a number out of the sky, let's assume that Sizewell is £20bn, I would say that we would be conservatively 10% of that. So in terms of what we also do, we're inside AWE which is Atomic Weapons Energy plant where we're building out labs and administrative offices. We're working in some of the docks in repurposing some of the docks, and the likes of that. So the defence nuclear is a large growth market and the budget is literally between £6bn and £8bn, which I now think will be £8bn. And the acceleration in that area will be dramatic.

The thing I would point out is that without Balfour Beatty, it was going to be very difficult for Sizewell to go forwards, because the capability and our size and scale means that you almost have to have Balfour Beatty as a partner, and also our balance sheet. And again the same with nuclear defence.

In terms of exposure, do you want to just take that one?

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Phil Harrison, Chief Financial Officer

Marcin, you're right we've got a very small residential portfolio. At the moment we have a small number of enquiries in from building owners which we're working through. We're not currently providing anything specifically on cladding, so we don't see it as a material risk at this point.

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Leo Quinn, Group Chief Executive

So we're now taking some questions over the Teams or Zoom.

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Telephone Operator

Thank you. Our first question is from Andrew Nussey from Peel Hunt, Andrew your line is open please go ahead.

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Andrew Nussey, Peel Hunt

Good morning, guys. A couple of questions from me. First of all if we look at the send half UK Construction margin so 1.6%. Clearly not sort of industry leading. Just really what reassurance can you give us in terms of when we look into FY22 in terms of recovery in that margin as implied by sort of the guidance you're giving for the earnings based businesses?

And secondly, in the US and the buildings business, and really taking on board your comments Leo around inflation pass throughs. Have you seen any particular pressures within the supply chain where you've had to wear maybe some insolvencies and leading into that discussion with your clients, or is that more just a flag of something which may occur rather than something you're beginning to experience? Thank you.

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Leo Quinn, Group Chief Executive

I'll handle the insolvency; you do the 2% or the 1.6.

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Phil Harrison, Chief Financial Officer

Andrew yes clearly, we've said in our outlook, and we've said today that we expect to continue to grow profitably in 2022 with our expectations. So I don't think we see an issue in terms of achieving where we want to get to in UK Construction for next year. Which clearly is going to be back into our stated ranges of 2 to 3 so that I think is clear.

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Leo Quinn, Group Chief Executive

I agree with Phil. I mean we've got a good backlog; we know the margin and the backlog, so I think we've got a strong, or a high degree of confidence in the forecast of 2022.

In terms of the insolvency I think you're right Andrew it was more flagging it. One of the things we did about four years ago is we put in a risk committee which actually looks at and vets the subcontract supply chain. So rather than, if I go back to 2014/'15 where the subcontractor was selected on being the lowest price, what we're really doing is we've got a system in place where we look very carefully at the credibility of the subcontractor to deliver on the job, the financial balance sheet they've got, etc. And so to that I don't recall having a conversation about a bankruptcy in our supply chain outside of the one in Nashville. This was 2016, so no I don't.

And the other thing by the way in the US the way it contracts is we'll place our order with a customer, we will then place it to a subcontract base, that base will either be bonded or with Sub Guard. Which means that if a subcontractor does go broke the insurance company will chip in in order to fund and pay for the job's completion.

Allow me to assure you even if someone comes along and pays all the money to complete the job, that is not an ideal situation. So getting the subs right in the first place is really, really critical. And that's been initiatives that we've gone into great detail since 2016 and beyond. So I think we've got quite a robust process and quite a good track record in terms of performance.

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Andrew Nussey, Peel Hunt

That's great, thank you.

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Leo Quinn, Group Chief Executive

Look, thank you all very much for coming and listening online and look forward to seeing you for another check-up in six months. Thank you.

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