Balfour Beatty

2022 Full Year Results Presentation

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Balfour Beatty

Leo Quinn, Group Chief Executive

Phil Harrison, Chief Financial Officer

Questions From

Arnaud Lehman, Bank of America

Jonny Coubrough, Numis Securities

Andrew Nussey, Peel Hunt

Graham Hunt, Jefferies

Gregor Kuglitsch, UBS

Video Played

Introduction & Highlights

Introduction and key highlights

Leo Quinn, Group Chief Executive

Good morning, everybody. Welcome to our Full Year Results for 2022. I'm Leo Quinn, Balfour Beatty's Chief Executive, and I'm joined by Phil Harrison today, Chief Financial Officer.

I think it's fair to say this is a strong set of results, and I think is a real testament to the transformation of Balfour Beatty to a well-balanced, lower risk group.

There's a lot in these results to be pleased about and I think, if you're a shareholder, and I bring your eyes to the right-hand side of the slide, over the last three years, we've committed to return £570m of cash to shareholders, £450m of that commitment is via share buyback, and the balance is actually in dividend.

Now, that in itself is pretty good, but if you look at that against the backcloth of where our average net cash finished, the average net cash finished £130m higher than it was last year. So we've done all of that and generated more cash within the Company, and, of course, that does bode well for the possibility of future cash returns.

If I take you to the other side of the slide where we're looking at expectations, you know, we clearly exceeded expectations across all of the businesses, and all of the earnings-based businesses operated within the industry standard margins, with the exception of our Services business, which actually beat the 8% to 10% range that we set, and I think it came in about 8.4%.

Also beating our expectations was the valuation of our Investment portfolio at £1.6bn. The thing that excites me about that, and I'll touch on it later, is the fact that, you know, the assets themselves are strong correlated with inflation, which does bode well, and some of my best lines and statistics will actually be stolen by Phil in his presentation, so you'll have to hear them all twice.

Then in terms of positioning for growth, this, perhaps, is the most important one for me because the idea of this £17.4bn backlog for us gives us really good visibility in terms of future workload. And in an industry where we're always competing for capability and resources, the fact that we've got a good line of sight on the next exciting project and the fact that we can see where employees will be deployed, this allows us to keep, retain and attract the best talent that we can.

When we talk about capability, I often show these slides, and in their own right, standalone, these are about the most sexy photographs you could ever get, but really what underlies them is an incredible capability that Balfour Beatty has, and it's something that we've built up over a long period of time.

Up on the top left is the LAX airport, which is the People Mover that we're building, which is taking people from the car parking area through to the terminus. And the capability to pull this off is that, clearly, I mean, this is a heavily-trafficked area, in terms of putting the foundations in for this, we've had to actually move utilities and actually get piling into the ground. We're working at heights; we're connecting this structure to the live terminals.

I mean, the things and problems and challenges that we overcome are just phenomenal, and building that capability is something we want to keep and reuse because, every time we reuse it, we actually get more productivity and more benefit.

If I look at the next slide, which I've shown you before, this is the heads that were, sort of, dropped into the Bristol Channel and where the tunnels terminate for the cooling of the nuclear power station. These barges are the size of football pitches. But in this area, we're working in a marine environment, we've got heavy lifting, you know, you can't imagine the challenges of doing all this in a nuclear type of environment where this is going to last for 60 years and it's very, very heavily regulated. You know, some really skills in that.

But I suppose the highlight of this year's achievement is the bottom left, which is actually the Marston Box. This is a case of offsite manufacturing where, effectively, we built two carriageways to the side of the M42 motorway. The top of the structure will actually take the High Speed 2 rail train over the M42. This was slid into position over Christmas in a ten-day blockade. Had you done this via traditional methodology, you'd have actually disrupted the M42 for two years in terms of lane closures and the like, so a phenomenal achievement.

And then this last one here is, you know, we, as an employer, have to be a great place to work because, as you all know, people have choices, and what we want those people to do is we want them to come back to Balfour Beatty and we want them to stay here their whole life.

As you know, we do a phenomenal job in terms of bringing in apprentices and graduates, and we have 600 to 700 at this moment in time that we're training. We're doing a great job in keeping all us old people because we cancelled retirement five years ago, but we're doing a great job in terms of employee engagement and satisfaction, and for the first time, we scored 80% across the global business, five years ago, we were in the low 60%s. So you can see all the things that we're doing to try an encourage people to stay and work for Balfour Beatty, provided you can perform.

So, sustaining capability is own single most competitive advantage at this moment in time, and we get rewarded for it with the results that you've just seen. So, on that note, I'm going to hand over to Phil and you can take them through the facts.

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Financial Review

Phil Harrison, Chief Financial Officer

Thanks, Leo. So, good morning, everyone. Let's start with the headline numbers, and we're pleased to say that each of these has improved in 2022. Revenue grew 8% in the year to £8.9bn, which was a 2% increase when excluding foreign exchange movements.

Profit from underlying operations increased by 42% with a strong improvement in UK Construction, and an increase in profits on the disposable assets from the Investments business.

When including the net interest credit and negligible tax charge, which we flagged in the December Trading Update, profit for the period increased by 49%.

Earnings per share of 47.5 pence were up 60%, which takes into account a reduction in shares following the 2022 share buyback programme.

Our total orderbook at £17.4bn has grown by 8%, or 2% in constant currency, while the Directors' valuation increased to £1.3bn, up from £1.1bn, largely due to the portfolio's strong correlation with inflation and the strengthening of the US dollar versus the pound.

During the second half of 2022, we made the decision to have a third-party valuation expert review the portfolio at year end, and our valuation is consistent with theirs.

Average net cash at £804m, and year end net cash at £815m continues to underpin the Group's competitive advantage and supports our long-term capital allocation framework.

As a result of this strong performance, the Board today is announcing a final dividend per share of 7 pence, giving a total dividend for the year of 10.5 pence.

Moving on to the business units, let's start with Construction Services – the business delivered underlying profit of £149m, which is an 89% improvement on 2021. This reflects the strong recovery in UK Construction, which is now within the 2% to 3% industry standard margin range.

Profit at US Construction increases with a small improvement in the PFO margin achieved, and at Gammon, there was also a small increase in profit although revenue grew by 32%. The margin percentage returned to a more normalised level.

In the current year, we expect Gammon to deliver a similar performance into 2022, and we expect increment margin improvement in the UK and the US businesses.

Moving on to the order book, which grew 10% of £15bn for Construction Services, in the US, we grew by 11%, which is unchanged at constant currency, and in Hong Kong, our 50% share of the Gammon order book increased by 12%, which was a reduction of 3% at constant currency.

Let me cover UK on the next slide. Our expectations for further improvement in UK Construction are underpinned by the order book, which has grown by 9% in the year, and we have continued to de-risk. The shift away from fixed price projects means that 90% of the UK order book is now represented by lower risk target cost and Cost Plus work. This is a huge shift from only four years ago, and highlights the improvement in the Group's resilience.

Moving on to Support Services, and 2022 was the first full year since the Group decided to exit the gas and water sector and reposition the business to focus on power, road and rail maintenance. As expected, this has resulted in lower revenue, and we look to grow the business from this new baseline.

The performance during the year was particularly strong, and this resulted in profit from operations of £83m and the business outperforming the 6% to 8% target margin.

I should mention that 2021 benefited from the exit from gas and water and end of contract gains. We did see a smaller repeat on contract gains this year.

Support Services is underpinned by long-term contracts which we added to successfully in 2022. Key wins included road maintenance awards for Buckinghamshire County Council for the next eight years, and East Sussex County Council for the next seven years.

Looking forward to 2023, we expect Support Services to deliver towards the top end of its 6% to 8% industry standard margin target range.

Turning to our Infrastructure Investments business where we chose to sell five assets during the year, resulting in £70m of gain on disposals. As a result of the disposals and having fewer assets in the portfolio, operating profit, excluding gain on disposals, reduced by £3m.

The net interest income on sub-ordinated project debt increased by £12m in the year, largely due to prior year impairments not repeating.

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

During the period, the Group invested £30m in new or existing projects, including a multi-family housing project in San Antonio.

Moving to the valuation of the Investment portfolio, which has increased by 17% to £1.3bn, driven largely by operational performance and the strengthening of the US dollar in the year. The £139m operational performance increase includes, amongst other things, £47m of gains on disposed assets and around £80m from inflation and rental growth.

Inflation growth in the UK portfolio in 2022 averaged 12.5% and US military housing rents, set annually by the military, will see a 12% increase this year.

Considering the strong correlation with inflation and rental growth, we have included a sensitivity assumption in the table on the right, and you can see that a 1% change has a more significant impact on the US portfolio, with an average of 33 years left on military housing projects, so that's one of the big drivers.

At year end, as part of our normal six-monthly review, we made some assumption and methodology changes to the Directors' valuation model, which has resulted in a net increase of £28m or about 2%. Having considered the risk and maturity of the projects, secondary market transaction experience and the impact of recent rises and long-term interest rates, the discounts raised for the UK assets and the US military housing assets have been reduced, which has increased the valuation by £54m.

For the US military housing portfolio, there were specific changes made to rental growth rates, overheads and tax. In total, these changes reduced the valuation by £26m, with benefits from the growth rate and tax changes more than offset by the change to overheads.

We also engaged, as I said, a third-party valuation expert to independently review the portfolio at year end, and I'm pleased to say that the Directors' valuation is consistent with their conclusions.

If we move to the Directors' waterfall, I've mentioned many of the changes here, but let me quickly show you the Directors' bridge, which takes us to the year-end valuation of £1.3bn. We've invested £30m in new and existing projects and received £93m of proceeds from the 5 assets we chose to dispose. The distributions received from our investments of £89m were largely offset in the year by the discount unwind.

We then have the operational performance and foreign exchange followed by the assumption and methodology changes which we've isolated at the end, all of which were covered in the previous slide, which all combined to take us to the £1.3bn.

Let me move back to the overall Group, starting with cash flow, which has been well-managed, again, in the year, average month end net cash of £804m, was £133m higher than 2021, and the closing balance of £815m was £25m higher than the start of the year. As previously forecast, we've seen a £50m working capital outflow in the period while all other items are largely in line with expectations.

Looking to the future, having recently concluded the triannual pension negotiations with the Trustees of the Balfour Beatty Pension Fund, we now expect pension deficient payments this year to be £11m lower than 2022 with the Balfour Beatty Pension Fund element reducing from £35m to £24m per annum.

The Company and the Trustees have reconfirmed their commitment to a journey plan approach which targets self-sufficiency by 2027.

Despite lower deficit contributions, I do expect cash to reduce in 2023. We're forecasting a working capital outflow of between £75m to £125m in the year as we move towards our long-term target of 11% to 13% of revenue.

Turning to our multi-year capital allocation framework which we've been following since 2021, we continue to see a range of opportunities to invest in organic growth, and Leo will touch on this in his section. We delivered five examples in the year of us realising value from the Investments portfolio, and will continue to do this with a higher Directors' valuation demonstrating the opportunities available.

The balance sheet remains strong and we have raised new US private placement debt, which has extended the debt maturity profile of the Group.

These factors give us the confidence to grow the dividend with 10.5 pence per share recommended for the full year dividend, up 17% on 2021, and we are reconfirming today that this year's share buyback programme, which commenced at the start of January, is for £150m for the third consecutive year.

We continue to expect this framework to be in place for a number of years to come and to give our shareholders confidence in the returns available. This is underpinned by our confidence for 2023, which I'll recap on now.

We expect PFO from the earnings-based business to be broadly flat with 2022. This includes incremental PFO improvement in Construction Services, driven by the UK and US businesses, and Support Services' profit from being towards the top of its targeted range. In Investments, profit on disposals for the full year is expected to be in the range of £15m to £30m as we continue to realise value from the portfolio.

Moving below PFO, we expect a small increase in net finance income, and, finally, we expect the effective tax rate to be close to statutory rates, which, for 2023, are 23.5% in the UK and 26% in the US. With that, I'll hand you back to Leo.

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Business Update

Leo Quinn, Group Chief Executive

Great. Thanks, Phil. What's actually quite interesting, just for a second, departing from the numbers, we look at the headline numbers all the time and how the businesses perform. But I think what you've heard from Phil is underlying this, you know, strengthening the balance sheet, the independent valuation of the portfolio, what's gone on with the pension, the management of debt, I mean, it’s not about just managing the revenue and the backlog and the profit. There's a whole balance sheet here which is very effectively and efficiently managed, and I think, you know, we should recognise that because that goes straight to value in the Company.

So, let's, sort of, level set everybody because I sometimes forget just the overall size of the Group, you know, which is over £9bn, and we operate in 3 geographies. The UK, between Support Services and Construction is about half, you know, the US Construction is about 34%, and then Hong Kong's about 17%, so it is a diversified and a very large group.

I'm quite grateful it's no more complicated than that because I couldn't imagine, sort of, having the Middle East, Australia and all these, sort of, things that hung off the portfolio in the past and actually having adequate control. And in a world where auditing's getting more and more difficult, you know, clarity and transparency is just so important to us.

The other side of the portfolio is, you know, we've got this extraordinarily valuable asset in terms of the Investment portfolio, which I'll touch on in my first slide in terms of it's US and the UK but the benefits it brings to the Group truly remarkable.

And this sums it up very, very nicely. First and foremost, you know, we've got a diversification of assets across geographies, which is important because you never know what the next surprise is going to be. We talked about ad nauseam and £1.3bn, but the strong correlation with inflation is really important.

Phil pointed it out in his presentation, that the military housing asset, which is our largest asset, increased by some 12% in terms of the rental income this year, so this is a business where, believe it or not, inflation's our friend, and there aren't many of those these days.

The other thing I'd bring your attention to is this chart on the bottom left-hand corner. There's an interesting story here because, if you can go back to 2015, John Laing made an offer of £1bn for the Investment portfolio, and that was at the same time when Carillion were actually bidding to take us over as well. We rejected both, but it is interesting that the portfolio, in 2016, was worth £1.2bn, it's still worth £1.2bn, £1.3bn, but in the meantime, we've realised just under £1bn-worth of value out of that portfolio. So, what an incredibly good decision to hang on and manage it ourselves and actually, you know, eek out the assets when they're at maximum value. So, a real success story.

And then, if I look at, sort of, the future, I look at Investments, it's a store of value but it's also part of our growth engine, and, again, the growth has to be carefully managed, but, you know, we had this outstanding success with the Purdue University which really describes our business model. You know, just under 1,000-room student accommodation. Balfour Beatty designed, financed and actually operated the asset. It was built by Walsh Construction because it was in an area that we don't have a presence, so we gave it to a partner to do.

We ran it for three years, we had 100% occupancy with also a big waiting list post-COVID and, again, we disposed of it at three times book value and a £40m profit. You know, that's a phenomenal achievement and, of course, it took 5 years to do it, it wasn't quick, you know, because, by the time you get the financing, by the time you build it, and you actually run it to optimal occupancy, you know, there's a long gestation period, but when you look at those returns, it's certainly worth it.

And based on that business model, we've got assets on exactly the same format, both in the UK and the US. At this moment in time, we're at a bit of a low, we only have three, but we're obviously continuing out there looking to cultivate and grow new business.

The other business that was quite interesting that we really don't spend a lot of time on is we have a portfolio of about nine US multi-family housing assets, and this is a business where we'll buy up a residential block, usually in the Sun Belt or the Southern Smile, 400 or 500 apartments, and our model's very simple. We go through hundreds of opportunities and we might find one from that. And what we're looking to do is increase the occupancy level from

about 92% to 93% to 94%, and then what we look to do is upgrade the apartments in terms of bathrooms and kitchens and the like and get a higher rent. And when you put those two multiples together, we get a very good yield.

So, we've invested, over the last eight years, about $80m in this business. We've actually sold assets to the tune of $120m. We have nine assets in the portfolio today, and they've actually valued at $70m. So, you can see it's a nice little business, although small in the scale of things.

If we look at US P3, this is where we see the growth in the future, but it isn't growth in 12 months, this is a 10-year trajectory. We are, of course, at the moment, financing building and will operate the LAX People Mover, which takes people from the car rental area over to the terminus, so we're invested in that very heavily, and that will be completed about the end of 2024.

We're also looking at a couple of other assets in this area, and we've been shortlisted in Prince George's County Schools in Washington DC, which will be quite a large one if it comes to fruition and we're successful.

So, again, a very disciplined approached to the market. We want to make sure that we're actually investing in things that we're pretty confident we can get a return on, so a nice business and very nice returns.

If I move to really what I think is the heart of Balfour Beatty and that capability I talked to you about at the beginning, you know, this is the portfolio that that capability really manages, the ability to manage a £1bn+ contract. And when we look at infrastructure, what we're looking at is the total of infrastructure, it's not only things like HS2, it's the nuclear power, it's the net zero carbon, it's the track slab, it's the highways, but, fundamentally, this is a large portfolio for us.

The important thing here is there's actually a baseload of businesses, whether it be our rail, our highways businesses, our power, which effectively are a recurring baseload for us. So, all of this stuff here is really on top.

Now, at a time when you're hearing that the Government is looking at reducing budgets and restricting spending, the first point is they're still spending, and they're spending an awful lot of money in this area. Energy security is a real priority, transportation remains a priority, and although you may see a reduction, what we'll probably see is a growth year over year in terms of this particular portfolio.

I point out one very important fact is nothing's being cancelled. What we've heard is things are being delayed and pushed out. So, fundamentally, it'll just be the same amount of money over a longer period of time, which actually, in some ways, quite good because it does underpin continuous earnings.

If I look at energy security, after food security, I think it's the number one Government priority, and you can see we're well-placed in all of these areas, and here's, sort of, a little diagram of how we depict this market. We think the available market to us is about £50bn, and you've got to remember this is going play out over the next 10 to 25 years, but we're operating, and we're effectively in all of these areas in different ways.

Just recently, we signed a memorandum of understanding with Aker and one with Holtec. Aker make concrete bases for floating and gravity pylons for wind farms. Holtec are actually an SMR, which is small modular reactors, for nuclear. We're the largest supplier for transmission and switching stations for the likes of National Grid and SSE. That’s actually pulling the wires and the cables, not building the transformers and the like.

We're very big in terms of Hinkley and Sizewell and working on both of these projects at this time, and we're actually doing FEED studies in terms of carbon capture with the likes of Technip and BP and the others. So, fundamentally, we're playing in all of these spaces, and so, in terms of our infrastructure portfolio, whether it be roads, whether it will be high speed rail, whether it will be energy and energy security, we're very well-placed, and we see this as a future in aggregate growth area for us.

If I move to the United States, I mean, this is a strong, well-performing business over the last three or four years, although, in the last 12 months, we seen some pretty dramatic changes in the marketplace. And if we start from the Northwest and move over to the Mid Atlantic, up in the Northwest, you're seeing two real trends coming into play at the moment.

The first is the tech companies are struggling with their revenues and, of course, you're constantly hearing about downsizing and restructuring. Interestingly enough, that's not the biggest challenge that we face. The biggest challenge we face is people not going back to work. So, where people are building out campuses in order to house their employees, they're finding that people aren't coming back to the office, and therefore, they don't need the campus they're building. So, things are being deferred and delayed, and they're looking to see what happens over the next 12, 24 months. So, the Northwest is proving to be slightly challenging.

In terms of California, complete contrast, it's one of the biggest bond raises that we've seen around schools, over $20bn. We're one of the leading providers of schools in Southern California, and that business, for us, is actually booming.

When I move to Texas, Texas has always been a really, really strong business for us, but this is actually influenced by interest rates, and what we've seen in our order book is we've got the largest, up 60%, awarded but not contracted order book that we've seen, but we've got the lowest contracted business. So, effectively, we've got this pipeline which is all sitting there, waiting to be passed over to go into Construction, but, because of the high interest rates, the developers are not sure that it's going to be successful, so they're not pressing the button. So, we're in a real pause here. And, again, because we've got some great capability, we're looking to deploy these into markets where we see growth.

In terms of the Southeast, again, this is actually booming for us. It's booming around leisure, hotel, hospitality. Florida is on the up, a lot of work from SeaWorld, Disney, Universal and places like that. We're seeing growth in airports, across the piece, by the way, but we've been successful in both Raleigh/Durham and Jacksonville, so, again, good growth happening in this area.

And then, when we go up to the Northwest, the Federal market is really, I won't say tsunami, it's the wrong word, is the real growth that we're seeing, and last year we're won a couple of large projects, both with the military and the Fed. This year, we're seeing a pipeline of more business coming along. So, the economic stimulation that you're seeing from Biden and some of these things, we're seeing mostly in the Washington DC area. Again, a good business.

In aggregate, what does that all mean? You know, I would say flat next year to slightly improving, so, again, a good business and we've got great capability, and we do benefit from this Southern Smile in that you've got the population migration where people are coming down to the South.

If I look at Hong Kong, I suppose the interesting statistic, for me, is I haven't been to Hong Kong in two years and one quarter because it's effectively been locked down. The business has continued to perform well, it's a 50/50 joint venture with Jardine Matheson, it's consistently delivered a HK$30m dividend for the last five years and is a strong performer, has about 11%

market share. The airports and the colony has actually opened up recently. We're seeing strong growth in terms of airport traffic, hotels, leisure and the likes of that. So, this economy is actually on the up.

If you look at Macau, all of the gaming licences have been renewed, and they've had to put HK$15bn on the table to invest in leisure and improvements for the future. So, Macau's going to be good.

The Development Bureau have announced HK$100bn of Hong Kong expenditure each year going into the future, and that was confirmed, I think, as of Tuesday. So, fundamentally, this is a buoyant market. I think we're going to see a lot of growth here.

The Development Bureau's investing in datacentres, community housing, MTR in terms of infrastructure, and MTR are actually one of our largest traditional customers, so we see ourselves doing a lot in the areas of rail and the airport and things like that. So, Hong Kong, I think, you know, consistent, steady performance with growth in the medium term.

Moving on to the next slide, we're all very interested in sustainability, you know, how we can do more with less. We're totally committed to our sustainability targets at 2040 and 2030. We're doing some exciting things in terms of communities and investing in people. Our big thrust is how do we get young people into the workplace and, of course, you know, started the 5% Club and that’s something we push across all industries.

But the most exciting revelation we've had recently is, over the last few months or so, we've actually launched what was effectively a zero carbon construction site, and this was at the Edinburgh Botanical Gardens. And apart from the usual thing like zero concrete and materials and this, where we've really tested the water is around can you truly run an electric-powered construction site?

And it's quite clear, today, working with JCB and Sunbelt, that we've got all the assets that are electric but we don't quite have the infrastructure to make them work. And if we're going to have big track construction equipment, it's going to have to go to hydrogen, so we're working with the likes of Siemens and others in that area.

So, really excited about what we're seeing, what we're learning, and this is actually to be shared not only in Balfour Beatty but across the whole industry, because, you know, it's a little bit like safety, you know, zero carbon and sustainability is something that we all need to join resources in in order to optimise the output for the benefit of all. So, very heavily focused on this, and this is really exciting.

The other area which is gaining great traction is we all know that construction and infrastructure has been criticised for productivity. And so, over the last couple of years, we've been working really hard internally but also with partners and some clever geeks in terms of how we actually bring real innovation into the construction industry, innovation that drives productivity. And we think, overall, there's about a 15% productivity improvement to be had if we can get this right.

But we've made investments in terms of digital permitting. I don't know if any of you realise, in order to dig a hole in the ground today, you actually have to have a paper permit signed off, which is usually about four pages, and then, when we sign them off, this gets stored in a cardboard box, and then it gets sent to…... Melton and stays there for 20 years and we then pay for it.

We've totally digitised the permitting system so that it's all done on tablets or iPhones. It gives us, effectively, full traceability, it drives up productivity so we don’t have queues of people trying to get a permit in order to start to work, but more importantly, it actually improves safety.

Over the last six months where we've actually been running this, what we've seen on HS2 is actually world class safety performance which, effectively, is zero LTIRs based on the fact that, because it's digitised, we can fully track every operation, and we can actually see where everybody is on the construction site and whether they're actually carrying out the work they're supposed to be in the right place.

The fact that people know you've got that transparency has changed behaviour and, as a result of that, we've seen four months of zero LTIR, which is just, you know, world class by any standard. Think about rolling that out across the whole of the UK construction industry and globally, massive improvement.

In terms of our control rooms, we've taken 19 different feeds and consolidated them into one control room, so we've got one version of the truth, and we're seeing the productivity gains in our Living Places business come through almost immediately on the back of that, and we give our customers true transparency to the actual worksite that we're on.

And then, in construction management, last year, we rolled out our AIMS, and aims is primarily around scheduling and tracking. So, what we're doing with great efficiency is just-in-time delivery, whether it be concrete or aggregates, which minimises the idle time and ensures, effectively, that we're in the right place at the right time, and, of course, there's a huge sustainability benefit to that.

So, net net-net, you know, with the inspiring things we're doing around digitisation coupled with sustainability, we really do think we're at the forefront of our industry and we want to stay there.

So, really, in summary, if I think about how we've performed and what we see in the future, these are what we've delivered. If you look, we've got an order book or a backlog which we've grown over the last five years. Size isn't important, what's important is the risk in it, and the risk has been materially reduced.

If you look at earnings, strongly recovered. We're now beyond pre-COVID performance, and, again, we don't see it stopping there.

If I look at our average monthly net cash, I mean, it's quite a story, isn't it? I remember September 2014, our cash flow was minus $1bn outflow, and here we are, today, with this average cash of nearly £1bn coming into the company. What does that do? That gives me confidence that the graph you see here at the bottom in terms of shareholder returns, in terms of buyback and dividends, are underpinned by cash and, therefore, I'm confident in continued further shareholder returns.

So, great results, exciting business. I'll hand over to you for questions.

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Questions and Answers

Arnaud Lehman, Bank of America

Thank you very much, Phil and Leo, for this presentation. I have three questions, if I may. Firstly, could you comment on the cost inflation? Obviously, materials, I'm assuming are starting to fade. On the other hand, we're operating in countries where general inflation is high, so I'm assume wage inflation is going to become more of a topic. Are you confident that you can pass that on to your customers into selling prices?

My second question is on the comment you made on 2023 Construction. It sounds like you're quite optimistic about profit improvement there. Is it volume driven, more work, or is it margin improvement?

And lastly, looking at your Directors' valuation of the Investment portfolio, there is £139m increase coming from what you call operational performance, which you say is played between inflation, rental increase and gains on disposals. What can you reproduce, I guess, on an ongoing basis? What is the split between these values, components? And are you confident you can maintain the valuation around the £1.3bn? You're getting nice dividends out, you're selling a few assets, can you offset that with more operational performance? Thank you.

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Leo Quinn, Group Chief Executive

Okay. I'll do one and two and you do the third one?

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Phil Harrison, Chief Financial Officer

Okay.

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Leo Quinn, Group Chief Executive

The cost inflation, look, it's something that has to be managed in a regular basis. I think we do a good job through our procurement to minimise inflation in the first place, but if you look at the construct of our portfolio, in most cases, we've now included inflation-type clauses if they're not already in the contracts. So, most of the inflation is actually absorbed by the customer. It would actually be unthinkable and inappropriate for us to absorb that inflation on £1bn contracts, so we're very keen to make sure that that is understood by the client, that that's their risk and not our risk.

We do have some fixed-price contracts which are still on the portfolio which we're working through where we have to absorb that, and, in some cases, it results in losses on the contract, but that's now in the minority, and if you go back to Phil's slide, our exposure in terms of backlog us about 10% of the overall backlog. But it is something that we manage, even if it's the client's risk, because they don't want to be paying more for it either.

So, I would say there is some abatement, you know, obviously, rebars are going down, unfortunately, concrete's not responded in the same way, but hopefully, it will go down.

Wage inflation, we operate in a range of about 5% to 6% in terms of the total benefits we give to our employees, which, we think, is actually probably the right sort of level to be competitive in in the industry.

In terms of profits for 2023, Phil and team have put guidance out there, you know. They sometimes accuse me of being a little bit hallucinogenic, but I'd have to say that, you know, we're in a good position, we've got a good backlog, it's lower risk, so, you know, we're confident that we've got a good future ahead of us and we can generate cash and continue the returns. Phil?

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Phil Harrison, Chief Financial Officer

On the portfolio, clearly, it will depend, in the short term, on inflation. Clearly, we've seen some substantial inflationary effects near term which is driving the operational performance, you get 12% increases in UK and the US. If that moderates, then, clearly, the operational performance line will be smaller.

But, for us, we continue to invest in that business which should create more value for us, two times return is what we're asking for, we'll still dispose. So, I think net-net, the portfolio will ebb and sway, it could increase, I doubt it'll actually come down that much because we continue to invest in that business.

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Arnaud Lehman, Bank of America

Thank you very much.

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Jonny Coubrough, Numis Securities

Thanks very much. Could I ask, firstly, on overheads other net operating expenses in the P&L, I think, if we were sitting here a year ago, we were expecting those to go up as a combination of inflation and a return to business travel, but they've head pretty steady despite the revenue growth, so that's the outlook there? Do you expect those to be maintained as growth comes through?

And then, secondly, on the outcome of BBPF triannual review, could I ask, firstly, if there's any mechanism there for accelerating payments if you accelerate shareholder returns? And then, secondly, given the net cash position you have and given the funding position's improved, is there any argument to buy out the pension scheme?

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Leo Quinn, Group Chief Executive

Okay. He's right on those two, they're both your territory.

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Phil Harrison, Chief Financial Officer

Are you doing the first one, Leo? There's three there.

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Leo Quinn, Group Chief Executive

Oh, is there? I only got two. Well, you do the first two and I'll do the last one.

. . . .

Phil Harrison, Chief Financial Officer

You're doing the last one?

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Leo Quinn, Group Chief Executive

No, then do it the other way round, you do the last two and I'll do the first one then.

. . . .

Phil Harrison, Chief Financial Officer

I'll do all of them, there you go, that's easier.

So, operating expense, the businesses have done very well in keeping, you know, their cost base very tight. I think we will see some increase. Clearly, there's wage inflation that will come through, and as Leo said, we're, you know, with the contract structures we have, that will predominately pass on to the customer, so we'll see some of that in operating expense. But I think we always are looking at how we can be more efficient in that base, so it'll come up, but I don't think it'll be significant for us. That's the first one.

Acceleration of or is there a mechanism in the pension scheme in terms of share buyback to accelerate deficits? The answer to that is no, there is not an acceleration mechanism in the latest agreement with the pension scheme. And I can't remember the third one, it was pension something.

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Jonny Coubrough, Numis Securities

Is there an argument to buyout the pension scheme given the position?

. . . .

Phil Harrison, Chief Financial Officer

We keep it under review. I think it's not quite there yet, but it's certainly in our minds at some point, but remember, we're running this to self-sufficiency, so, you know, that's the key thing, and we're on track to do that by 2027, and then, clearly, cash contributions from the Company falls away.

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Andrew Nussey, Peel Hunt

Again, a couple of questions. First of all, when we look at the UK Construction margin, sort of, the low 2% against the 2% to 3%, sort of, industry standard, can you give us some help around the mix between major projects and regional projects in terms of the returns being earned there?

And, secondly, on the Support Services side, the 6% to 8% margin target, can you, again, just give us a little bit of a feel between what the returns should be between utilities and transportation now that those, sort of, two areas are beginning to normalise?

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Leo Quinn, Group Chief Executive

Looks like you're going to be busy.

. . . .

Phil Harrison, Chief Financial Officer

I thought you'd do the first one.

. . . .

Leo Quinn, Group Chief Executive

Look, at the end of the day, if I look at our UK Construction, the Major Projects is a slightly higher return than the run of the mill regional Construction, but that's largely because the nature of the contract is such that, you know, it's Cost Plus and incentivised fee, whether it be HS2, Hinkley and whatever, so there's very little risk.

You always do run the risk that you could have disallowed cost, i.e., you've incurred costs that you're not authorised to do so, so that actually be deducted, so you will always carry a reserve in light of something like that. But, fundamentally, you know, Major Projects is really the better performer in the portfolio. Phil?

. . . .

Phil Harrison, Chief Financial Officer

And then, when we talk about Support Services and all of this thing, we run this as a portfolio, so we're not about to start the aggregating and talking about individual, you know, elements of utilities and transport, so we're really not going to do that.

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Leo Quinn, Group Chief Executive

I think one thing we can say, we have recently, over the last 18 months, renegotiated a lot of the frameworks because they've come to an end, and it is a different era now. You know, if you go back six or seven years ago when a lot of these frameworks were entered into, some of the terms and conditions and the risks that were passed to the contractor were quite scary, and what we've done is we've moderated a lot of those.

So, what it means is you might not be getting more margin, but you've got more certainty in terms of delivering the profit that's in the job in the first place. So, risk mitigation, in terms and conditions, is even more important than actual margin percents.

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Andrew Nussey, Peel Hunt

Okay. Thank you.

. . . .

Graham Hunt, Jefferies

Thanks very much. Three questions from me, first one on the US. I think you made some leadership changes there recently, just wondered if you could update us on your, sort of, longer term strategic objectives there and provide some colour on those changes?

Secondly, on balance sheet, I think this will be the first year, i.e., 2023, where balance sheet cash has come down. Does that mean that you're broadly happy with where the balance sheet is at the moment?

And then, just quickly, on London projects, I think you still have a couple of buildings contracts in London. Could you just give us an update on those? Thanks.

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Leo Quinn, Group Chief Executive

Okay. Well, if I do the balance sheet, you can do the operational one [laughter]. So, US leadership, you're right, we've recently transitioned on the overall leadership of the US from Leon to Eric. Eric's 15, 18 years with the business, was part of an acquisition all that time ago. Again, that was a managed change of leadership. Leon's done a fantastic job for the last five years. It's like all things, you hate to lose great leaders, but people have, sort of, life goals that they want to achieve, and so Eric coming in has been very well-managed and, funnily enough, it's been a very smooth transition.

He fully takes over the 1st April, but over the last month, he's been doing Leon's job and we've been paying Leon and him for doing the same job, but from April onwards, we'll be only be paying one of them. So, I think that's going well.

In terms of London jobs, there's two still outstanding. We've actually renegotiated those in terms of their finish and compensation for them. At the moment, they're on track, they should be finished around the first half of the year. You know, we've got a very good line of sight in terms of cost to complete and that's fully absorbed within our balance sheet, but you never know until these things are over, but we'll be very happy to see the back of them because they have dragged on for a long time, but I think they're fully quantified. Anything you want to touch on on that?

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Phil Harrison, Chief Financial Officer

No.

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Leo Quinn, Group Chief Executive

And then, in terms of the balance sheet, go on, Phil, I'll give you a go.

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Phil Harrison, Chief Financial Officer

I was interested in what you were going to say. On the balance sheet, yeah, we're comfortable with the cash and it will be a decline in terms of cash, but that's where we are in our kind of cycle on the portfolio of contracts, which we said we'll move back into, or continue to move into

line on the working capital percent. So, we'd assume that cash will come down, we're comfortable with it.

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Leo Quinn, Group Chief Executive

I think it's fair to say that our cash has been declining for the last five years, or the forecast at least.

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Moderator

We do have a question on the conference call, so, we'll go to conference call now.

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Telephone Operator

We will now take a question from Gregor Kuglitsch on the conference call. Gregor, please go ahead.

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Gregor Kuglitsch, UBS

Hi. Good morning. Thanks for taking my questions. I've got three actually. So, just back on the working capital, I think you, sort of, ended at 15% of revenues, obviously, talking, I think, 11% to 13% if memory serves me right. What's the risk that goes lower, you know, as yields go up, so that, you know, your customers actually have an incentive to hold on to their cash, which, I guess, they didn't have for ten years or so? Do you have see any of that or is it, sort of, contractually agreed? That's the first question.

The second question is can you remind us, on HS2, how much is, sort of, the annual revenue contribution now and, sort of, when it does it peak and when it does it tail off? I appreciate, you know, the postponement doesn't mean it's going to be, you know, indefinitely deferred, but obviously, at some point, I guess there will be a bit of a headwind, just want to know what when and how big that could be?

And then the third question, a strategic one, is, again, going back to, sort of, Hong Kong, I mean, it's been a good business, but, obviously, geopolitically getting a little bit tricky. What's your view on your ownership? Do you think you're the best owner of that business? Thank you.

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Leo Quinn, Group Chief Executive

Do you want to do the working capital?

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Phil Harrison, Chief Financial Officer

Yeah. We're trying to move back into the range of 11% to 13%. At this point, we're not getting any particular pushback across the Group on, you know, milestone payments, a change of

attitude from customers. You know, the whole model is built on this. If they want to do that, then we're going have to raise prices and we're going to have to have more margins to cover what we're doing, but we're not seeing that at the moment.

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Leo Quinn, Group Chief Executive

Okay.

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Phil Harrison, Chief Financial Officer

That's that one. Do you want to do HS2?

. . . .

Leo Quinn, Group Chief Executive

HS2, yeah, look, first and foremost, it's extraordinary, it's very early days in terms of the what the plan is around HS2, so we have a little insight, I wouldn't say it's actually too profound at this moment in time. So, it would be very difficult to say what the direct impact is and when the peak years and whatever, but there's no doubt, it is going to be pushed out a little bit. But the point is, is that it was building, you know, it was this year's volume in terms of what HS2 will deliver would almost be 80% above what it did the prior year. I think what you might see is that the growth in that will be tailed off.

I'll go back to what I said in the presentation, it's not about cancelation, it's just about delays, so, basically, you're going to have a steady stream of earnings for longer, which, actually, personally, I like, and on a programme which, potentially, could be very overheated in terms of how do you get the people to deliver it, you know, and taking a breath is not going to be a bad thing in terms of performance and productivity. So, that's where we are on HS2.

Yeah, really profound question on Hong Kong, Gregor, and it's one that's, sort of, crossed our minds and I'd have to say it's obviously a very difficult one because nobody quite knows what China will do, especially in light of what Russia has done. But I would say that I think our asset value is about £100m or HK$100m in Hong Kong, roughly, on the books, something like that, and, you know, we can look at measures to protect that investment in terms of, you know, how you manage the balance sheet and where you place debt.

So, all I would say is we've made no decisions, but we are, sort of, conscious to see that we don't end up with, sort of, a stranded asset in the event that something does happen. And, of course, we all know that, if Hong Kong was embargoed for any reason, you'd see a lot of the measures that have been laid against Russia come into play. So, we're cognisant of it and, funnily enough, I'm over with the Chairman and the Head of our Audit in ten days' time for a week, so, obviously, that's something we'll be thinking about, but it's not a big number in terms of the value of the Company, but it's a very nice dividend stream and earning stream.

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Gregor Kuglitsch, UBS

Thank you.

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Leo Quinn, Group Chief Executive

They're good questions, by the way, I thought, yeah, very profound. That's not saying that your or the other questions were bad ones at all, no, they were good.

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Phil Harrison, Chief Financial Officer

Dig yourself out of that hole!

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Leo Quinn, Group Chief Executive

Not as good.

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Telephone Operator

There are no further questions.

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Leo Quinn, Group Chief Executive

Great. Well, if there's nothing else in the room, thank you for your time. Thank you to my great team in getting this through with the auditors and getting it delivered on time, Herculean efforts all round, so, you know, well done, well done. Thank you. Thank you for coming.

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END

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