Balfour Beatty

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2023 Full Year Results Presentation

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Balfour Beatty

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Introduction & Key Highlights

Leo Quinn, Group Chief Executive

Good morning everybody. Judging by the size of the audience it looks as if you all delayed your summer holiday just to see these results. So I'm Leo Quinn, Balfour Beatty's Chief Executive. I'm joined by Phil Harrison our Chief Financial Officer. And we're going to give you an update on the half year performance.

First and foremost – a strong first half and the progress that's been made is in the areas that you'd like to see it made. Earnings are up some 12% overall but if you dig below, you'll see the UK earnings business is up some 60%, Hong Kong is up 40% so very encouraging.

Cash continued to be strong at just around £700m, if you actually add back the share buyback which is just under £100m it's almost flat with last year. So again, strong encouraging first half.

The most important thing about the business at the moment is just where we're positioned for future growth and to my mind it's never really been as encouraging or optimistic. Our growth is driven by things like sustainability, net zero carbon, the likes of that. And it doesn't matter whether you look at the demand side or supply side we're very, very well positioned. What I mean by that if you think about the supply side whether it's offshore wind farms, whether it's nuclear power stations, all forms of clean energy, we're actually a major player in that and that's a rising time for which we'll benefit from enormously.

And then finally in terms of delivering to shareholders, it is interesting we announced our capital allocation model some three years ago. And in that period of time we've returned some £600m in terms of cash and share buyback which is a third of our market cap.

So very encouraging in terms of the earning-based businesses are doing well. The market in which we sell is actually growing and the return to shareholder is substantial and we sort of see future returns to shareholders as well.

I want to point out here what effectively are some our critical national infrastructure projects. And these are very, very important because our fortunes do rise and fall on how we execute on these contracts. It always helps to start with a good contract, make no mistakes, because they always come into play.

But if I take you round these, you know, the top left-hand picture that you see is actually a National Grid job where we're doing the power transmission and underground cables from Hinckley Power Stations through to the grid. This job has been successfully completed it was a fixed price lump sum.

The reason this is important is as we go forward and we see a growing energy market and energy security market, the nature of these contracts is going to change under the SD framework, where we'll have inflation protection and this two-step process. So you can see in the future we'll be de-risking these jobs which actually will bode well for margin returns.

On the top right what we have here is this is Old Oak Common, and we are going to do a showcase at some point Old Oak Common, this is London in the Acton area. And what you're seeing here is actually the box section that's being built. You can see the size and scale just be judging the two engineers that are in the base. This will constitute some six platforms for the new HS2 rail line and that will connect with the Elizabeth Line and the Great Western Railway, another eight platforms. So this will be a huge station, it's actually the largest station under construction ever in the United Kingdom. Very exciting project and it's where HS2 will currently terminate for London.

The other end of the line which is actually Curzon Street which is actually in Birmingham. If you take the train into Birmingham New Street, the last three minutes of your journey will actually see this project unfold. And there's three major structures in this area. What you're seeing here is actually this is the Y shape piers and the bridge deck which will be cast in the next week or two. And you can see this unfolding before your eyes. It's an incredible project and it's incredible for one reason, I started my career building a bridge in Balfour Beatty some 40 odd years ago. And that single bridge is a major project, there's three of those going on all in the same area and it's all governed under one project office so it's a very lean operation, it's very, very impressive.

And then finally if I look at Hong Kong to prove the international capability that we have. This is the T2 airport, and this is one of the roof structures, this is approximately 70 metres by about 36 metres. And it's actually being assembled on the ground and jacked up into position.

So these major projects, this is what we do, this is our unique capability, it's not just about the engineering, it's about the contract and the commercial terms to manage this. And we forecast at this moment in time that we're on for our full year earnings around these projects.

So what I'm going to do is I'm going to hand over to Phil who'll sort of treat you to some facts and then I'll come back and treat you to the future.

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Financial Review

Phil Harrison, Chief Financial Officer

Thanks Leo. Good morning everyone. Let's start with the headline numbers. Revenue grew by 9% in the first half to £4.5bn which was a 6% increase when excluding foreign exchange movements.

Profit from the earnings-based businesses increased 12% with strong profit growth in UK Construction. However Group profit from operations reduced by 6% with lower profits from the Investments business partially due to the timing of disposals.

The benefit to the Group's net finance income of higher interest rates was offset by a higher tax charge as there was no additional deferred tax assets for UK tax losses recognised.

When taken together this resulted in an 8% decrease in profit for the period, however earnings per share increased slightly 13p as the Group's share buybacks took effect.

Our £16.4bn order book has reduced by 6% in the period or 3% when excluding foreign exchange movements. And the director's valuation of the infrastructure portfolio remained at £1.3bn.

Cash outflowed as forecast with period end net cash of £710m and average net cash of £695m.

In line with the policy for the interim dividend to be roughly one third of the prior year's total dividend the board today is announcing an interim dividend per share of 3.5p. Looking forward to year end we remain on track to deliver full year earnings expectations.

Moving on to the business units, and let's start with Construction Services. Profit from operations increased by 33% to £65m driven by UK Construction and Gammon.

In the UK revenue growth of 23% which is driven by increased HS2 volumes which alongside improved delivery across the portfolio took the profit margin to 2% compared to 1.5% a year ago. As a result profit increased by 67% to £30m.

Touching on HS2, earlier this year we were asked by the client to rephrase work on our Area North contract. Having now worked through the change order and rebalanced the workload, the adjustments have had no material impact on our forecasts. And we expect UK Construction to deliver ahead of the 2.1% profit margin achieved in 2022.

Looking beyond the UK, US Construction delivered £21m of profit which was in line with the first half of 2022. And Gammon grew revenue and profit by around 40% driven by the major Hong Kong airport projects.

The Construction Services order book reduced by 8% in first half or 5% constant exchange rates. In the UK and Gammon the increases in activity of HS2 and Hong Kong Airport which have driven the revenue upwards, have in turn reduced the order book.

In the US we continue to see delays in commercial office projects going to contract, particularly in Texas, as customers waited for more positive economic news. With US inflation reducing to around 3% we have started to see some early signs of awarded work progressing to contract.

We've also had some further US awards in the first half which are yet to go to contract. Including a $650m project that's Raleigh Durham Airport in North Carolina with contract awards will come in stages, phased over the multiyear project.

I'll touch quickly on our £5.9bn UK Construction order book. As its contract mix is a great indicator of the changes to the business as seen. Not only does the volume of future orders provide visibility for the short and medium term, but the weighting of orders by contract type also reflects the improved risk profile. 84% of the order book is covered by target costs and cost-plus contracts which protect the group from inflation risk and the majority of the fixed price work is priced over two stages, allowing for the additional risk mitigation.

We also continued to work almost exclusively with public and regulated clients which reduces risk further. We will continue to favour those projects with lower risk contract terms that provide stability and predictability to the Group.

Moving on to the Support Services business which comprises our Power, Road and Rail Maintenance businesses. Revenue reduced by 7% in the first half driven by the timing of power projects. Support services PFO reduced by £6m to £30m due largely to the lower revenue in power and higher costs in the road maintenance business where two new long-term contracts were launched.

As we bring the new contracts onto our systems and align them to our ways of working, additional costs are required upfront, but this is built into our expectations when planning the projects. With these two new contracts now in place revenue from the road maintenance business is expected to be higher going forward.

Looking towards the second half we continue to expect the full year PFO margin to be towards the top end of our 6 to 8% targeted range with all three businesses performing well.

In the medium term the power business is poised to see significant growth as the industry responds to the government's need to invest heavily in the grid. Last weeks were appointed to SSEN's £10bn ASTI framework and we're also bidding on National Grid's equivalent, Great Grid Upgrade Framework with project delivery expected to begin in 2025.

Moving to the Infrastructure Investments in our Infrastructure Investment business our pre-tax profit has reduced from £24m to £14m due to two main factors. We made no disposals in the period compared to £7m last year. By its nature disposals are lumpy and we continue to target gains on investment disposals in the range of £15m to £30m for 2023.

In the US there's been an increase in military housing costs related to the independent Compliance Monitor's first year of work.

Within the pre-tax profit there's also an offset between operating profit and interest receivable of £3m driven by higher interest rates on the subordinated debt provided by the Group to some joint ventures. It is important to note that this does not impact the cash distributions received by the Group but does require the returns to be presented differently in the accounts.

Looking to the second half and our planned disposals, we are currently engaged in marketing a number of assets which we plan to close out by year end. We will continue to be disciplined in our approach and our priority remains focused on maximising value.

Let me take you through our valuation of the portfolio now. As a reminder at year end we had our valuation independently verified by a third-party expert and the methodology used for the half year valuation has not been changed. During the first half of 2023 we've invested £24m in new and existing projects, including the addition of one student accommodation project in Florida. We expect to make further investments in the second half as we continue to see opportunities to invest at our target return rates.

During the period we received £33m of distributions from the projects and the function of reducing the discount by six months increased the valuation by £42m.

Foreign exchange rate changes have had a negative impact. 58% of our portfolio's value was in North American investments and the weakening of the dollar has driven a £39m decrease.

And finally operational performance as reduced the valuation by £16m as higher US insurance premiums and an increase to our estimate of costs related to the monitor's work were reflected in the period. These costs were partially offset by UK student accommodation rent increases. This has resulted in a valuation reducing marginally but still remaining around £1.3bn.

Our cash flow performance in the period has been in line with our expectations, with the closing balance reducing by about £100m. Operating cash flow remains strong, it was marginally higher than the prior year. And the two largest outflows being working capital and the share buyback programme were both flagged at year end.

We are expecting a further working capital unwind in the second half and continue to expect the full year unwind to be between £75m and £125m.

We've also given guidance today for 2023 average net cash which we expect to be in the range of £650m to £700m.

One other item worth noting is the pension deficit payments of £13m which have come down from £29m following an agreement with the trustees of our largest pension fund earlier in the year. The contributions are expected to remain at this lower level in the medium term and for self-sufficiency to be reached in 2027.

I'll finish with our capital allocation framework. We are continuing to invest in organic growth opportunities with not only further additions to our investment portfolio, but also by investing in capability across the earnings-based businesses which Leo will talk to shortly. We also expect to realise value from the investment's portfolio, and as mentioned we're planning for disposals in the second half of 2023.

We have taken active steps in the first half to further strengthen our balance sheet and have refinanced our revolving credit facility by replacing the old £375m facility which was due to expire next year with a new £475m facility which runs to 2027, with a further one-year extension option.

The board has declared an interim dividend of 3.5p per share which is aligned to the policy being roughly one third of the prior year's full dividend.

And finally we're on track to finish 2023's £150m share buyback programme in the fourth quarter of the year and continue to expect the capital allocation framework to be in place for years to come.

With that I'll hand you back to Leo.

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Business Update

Leo Quinn, Group Chief Executive

Thank you. I'll start here but I'll just reflect on something that Phil said. When you think about the capital allocation model our number one priority for cash is to invest back in the existing business. And given the rising tide and the size of the opportunity, now is an ideal time to invest in selling expense to cope with the demand for bids that are coming out in the marketplace. So we'll see that investment in selling actually increasing.

If I point you towards the slide, on the left-hand side I showed you this slide last time and it's worth just going around it to understand as I said last time, we're sort of like internal side, we're the enabler that makes a lot of these things possible. But working all the way from submersible, semi-submersible platforms with the likes of Aker in terms of the future of offshore wind farms. We're one of the largest supplier of pylons and transmission cables for the grid to help de-risk the grid.

Small modular reactors, we're looking to play with whole tech, but there's an awful lot of players coming out in the market and it's all quite an interesting space.

Whether it be fusion or conventional energy, nuclear energy, the likes of Hinckley, we see growth with Sizewell, so again exciting in that area.

We made a small investment in terms of EV charging to capitalise on the demand in that market. And we're in active feed studies and the like around carbon capture and hydrogen.

So the space is actually very, very exciting and since we spoke about this six month ago what we've seen is that the what I would call the mobilisation risk in terms of these are such big markets and such big opportunities, it's too expensive for any one company to go in on their own.

So what the government is doing is it's launching the ASTI Framework which is about de-risking the grid, it's looking at carbon capture and it's looking at small nuclear reactors. And it's actually putting up a sum of money to enable these things to happen. We at this moment in time are working on feed studies and enabling work to make these real so we're actively engaged in actually setting the stage and the foundation to make these things possible. So it is very exciting, and I'll touch on it in the next few slides. But this is a growth market for which we are uniquely positioned to actually capitalise on it.

In our Support Services business which also feeds into the same market. In our power T&D we're off to a very good start but I'd point you again to SSEN's ASTI framework, that's already been put out and bid. National Grid will probably make some decisions around the first quarter of next year. I would anticipate between 25 and 30 and maybe even towards the end of '24 there'll be an additional £2bn to £3bn worth of business over that five-year period which is substantial growth. So in terms of that power T&D you're looking to the upper end of doubling that business by 2027/'28.

In terms of Road and Road Maintenance, again nice business that we seem to manage very successfully. You know, we won two contracts in the first half of year with East Sussex and Buckinghamshire and we're mobilising those. We're targeting one more local authority next year, again so what we're seeing is good double digit returns and we're seeing good growth in that area.

In terms of Rail, the CRSA contact is performing very well, also the London Underground in terms of the upgrading of the Piccadilly Line was our power traction is doing well. We see growth coming in the areas of the Midland Mainline Electrification but also there's the track slab from HS2.

And again in line of investing all of these take substantial resources in investing. And the challenge at the moment is it's like London buses, there's three of them coming at once and we've got to work out how we handle that peak loading.

But the stuff we do here is very traditional, we put cables across the Highlands, you know, we operate central monitoring stations for road maintenance. And we actually repair railways, this is the Nuneham repair where the line was shut for ten weeks and we put a small team in there and actually restored the bridge, the foundations at record time and released it back to the client early.

I want to point this out in light of the slide I showed you with the pictures of what we're doing. What's interesting in that first slide was if you look at the transmission job which is on the top left, the old framework was fixed price lump sum. If I look at the HS2 those particular contracts were de-risked for inflation, and they were incentivised - cost plus an incentivised fee. What we're looking to do is move all of these frameworks into areas whereby the inflation risk is not ours, it stays with the customer which is fair because that's actually where the returns are ultimately. And that we understand how we de-risk the contract in order to make sure that that de-risking improves margins.

So in the case of cabling here we've talked about the ASTI framework and the size and scale of this opportunity but what you see is a pylon and the wiring, what you don't see is what we do underneath it. So we have specialist design capability, we actually do the piling, we do the power cap, we put the roads in in order to reach these items. And the way this will be contracted, and bid will be a two-step process.

So effectively we'll put our team together with the client's team, we'll look at the DCO's, we'll look at the engineering, we'll look at the actual execution of the job. And then when that phase one is done we'll then decide on what basis we perform through to the final contract. So that two-stage distribution most of the risk will be designed out in phase one before we actually enter a final contract is phase two. Substantially different to where we are today.

And if I look at nuclear power stations, the important thing about Sizewell is Sizewell is the intelligent replication of Hinckley. So the lessons to be learned from Hinckley will be transferred here. We carried out all the marine works in the tunnels and we'll be doing the same here. But we're looking to add the enabling works and the earth works.

Just as a matter of interest the earth works here on Sizewell are substantial but they're about 20% of the earth works that we've done on N1, N2, on HS2. So you can see we're uniquely qualified to do that. And in the enabling works we'll be doing things around the preconstruction design, we'll be looking at the ground engineering. The biggest piece of it will actually be the diaphragm wall which actually will surround the whole site.

Interesting enough the last time we built a diaphragm wall at Sizewell, Sizewell B 40 years ago, so we're redoing what we actually did for Sizewell B, for Sizewell C. But again this unique capability underneath all gets applied to the success.

And why is this important, because ultimately it gives the client better assurance, it comes with our safety standards, it comes with our quality workmanship. So what you see for example in the power business is this element delivered here, what you don't see is how all this is delivered across our other businesses including our plant and fleet.

So this is a substantial opportunity but it's also substantially de-risked in the way the order book has been managed in the past, very, very exciting.

In the United States, really not much different from what I reported six months ago. Two challenging areas, we've got the North West, which is funded really by the tech sector, the Facebook's the Amazon, the Microsoft, the likes of that, we've seen that market slowing.

In Texas, which is largely a developer market, influenced by interest rates, we've seen that slow. Interestingly in Texas is that the work is piling up. We've got our largest order book of awarded but not contracted. The challenge is until the developers get certainty, they won't move it onto contract and so we've got a lot of pent-up demand here.

What we are seeing is still strong growth in California in schools. The federal market in Washington DC is going well. And of course in Florida with Mickey Mouse and Universal we've got great growth in hotels and leisure and the likes of that so exciting.

We're not standing around waiting for growth to actually happen, we are investing. So what we've done is we've investing so what we've done is we've invested in Jacksonville and Sacramento as two new branches. As you know our business is a local business because it's a local supply chain when you're in building and construction. And under that scenario we're seeing really good activity in both of those, in particular Sacramento. And then our smaller branches we're actually we're actually doubling down investing in the Raleigh's, the Austin's and the Phoenix in order to grow those and that's on top of the base business that we've seen. So we see 24, 25, seeing some really good growth and revenue in those new areas.

Also we're focussing on the airport market, we just won a contract in Sacramento for effectively bridge connectors which is something we took from LAX. We just won another contract in Raleigh and one in Jacksonville and those three are just under $1bn and they'll be delivered over the next two years or so. So again a lot going on there.

Finally in terms of the infrastructure in the civil market there is growth in that market and of course there's the Biden Inflation Reduction Act. But the US market is still fixed price lump sum, so the risk actually sits largely with us. So until that matures in line with what we see in the UK, we're just going to be more cautious in terms of the large projects that we endeavour to take on in that area.

But again the US is a solid performer, just waiting for the dam to break so that we can be more optimistic about the outlook for next year and the year after.

In the case of Gammon, which is our joint venture with Jardine Matheson, in their market they are a substantial player, very high profile, very, very strong brand, very good business. It almost replicated what we do in the UK in terms of capability, all those things around piling, concrete delivery design, temporary works, all of this goes on in Gammon. And it is a £2bn business so it's not far off the size of the UK business, about half.

Basically this is a very, very strong market, it's centrally planned, and since the change or the formalisation of government, what we've actually seen is that the markets moved forward very, very positively.

Historically we've seen a very strong building market and residential with interest rates higher, we've now seen that starting to fall off, but infrastructure is beefing up and again substantially in terms of building the infrastructure which is supporting the focused markets around the region of tech, IT, data centres, R&D centres. And a lot of this is going to be supported by the roll out of five MTR new stations and the rail tracks associated with them.

We've just bid one station with MTR and that will be circa £1bn. When that's completed it will come with the deck platform and then what they'll do is they'll build out commercially on top of that commercial and residential. So you can see by actually putting the station in it positions you well for the next phase of building on top of that. So we're seeing again strong growth with MTR.

All the customers we deal with in this region are long established relationships. And that's important because when things go wrong, we know how they behave and how they respond. And MTR has been a customer for a very, very long time as have many of our building customers. So we're very selective In what we bid in.

There's not any growth by the way in Hong Kong and around there, there is the Northern Metropolis which we've talked about before. There is the Macau Casino which are growing as well so this is a vibrant market, we're only constrained not by opportunity but actually by capability and people that we can hire.

Interestingly enough the government in Hong Kong recently have just changed the rules around bringing in expert labour. Which is going to relieve the pressure on head count and capability which actually will help spur growth in the future.

If look at our Investment business, Phil has talked to this ad nauseum, the second half, we're looking at the divestments in that business. But, as we've always said, if we're not getting the right return on those investments, we're not out to rush out and sell them for the sake of selling because these are actually performing yielding assets, so it really is a question around do we just want to keep the yield or do we actually want to take the capital gain.

We continue to make investments. As you know, we invested in EV charging, a company which we named, Urban Fox, that was a small investment, but the premise of the strategy was around we have good relationships with local authorities and there's really good demand for EV charging at the moment – outside London, satisfaction levels are really low. So, we're quite optimistic about that as long-term play.

We've invested £24m in assets, the largest was Tallahassee, Florida, which was a student accommodation. We also completed the build of the Vanderbilt student accommodation in Nashville, and we also won the William & Mary College in Virginia. So, again, there's a lot of stuff going along under the surface here.

We're really committed to student accommodation in the UK and the US. We've got two major projects in the UK which we're trying to get to close in the second half of the year.

US multifamily housing, we continue to invest in that. P3 is the biggest opportunity here. As you remember, the LAX People Mover, which is this P3 here, is a P3, valued at about £2.6bn, and we're looking to capitalise on that, and the bid we'll be doing is the Prince George County Schools in Washington DC, and that, again, is the biggest opportunity that we've got on the plate the moment.

The unfortunate thing about P3 is it just seems to take years to get these things to fruition, so there's a heavy upfront investment before you get the returns. And, of course, you know, we're looking to actively play in the UK energy transition market.

If I look at Building New Futures, nothing new here in terms of carbon materials and communities in that we've maintained our 2030 strategy and targets, we've made fantastic progress under the leadership for sustainability, we've completed our work on the pathway to decarbonising for Scopes 1, 2 and 3. We'll be submitting, in the second half of the year, to the body of the Science Based Targets in order to ensure that we don't exceed the 1.5 degree temperature rise globally. We've confident of this going through very well.

It is interesting, between Scopes 1 and 2, which is what we do internally around carbon and energy, versus Scope 3, Scopes 1 and 2 actually only equal 3% of our overall carbon footprint, so you can see that it means we've got an awful lot to do with the supply chain to represent the other 97%. And although we've made great inroads in terms of reducing idling, changing out diesel to electric and the likes of that, it's still, sort of, just a small microcosm on the scale.

Areas where we've made great progress, and the area I'm focused on the most, is really around how to do we drive more social value because we have the ability to put things back into communities in order to make communities better places.

We've spent £125m in locally generated economic value by placing work with local suppliers. We've trained over 2,000 days of training for people coming into the business, and interestingly enough, on this one here, we've trained or taken out over 300 people who were long-term unemployed and put them into jobs, so we're giving people what are the basic skills to make them productive members of the community. And I think, you know, the social benefit that comes from what we do just in our day-to-day is fantastic. This is one job, we have 600 other jobs, and, across the Group, we're trying to do these things all the time.

And, of course, we still run The 5% Club, which is around getting young people, whether they're apprentices or graduates, into the workplace early and giving them skills for life.

So, finally, we're on track for the full year. We're positioned really well to capitalise on growth, whether on the demand side or the supply side. You know, over the last three years, we've delivered £600m return to shareholders, we're confident about future returns. The business is

in good shape for the full year, and we're confident that we'll deliver on expectations. Great, great future for the growth of this business.

And, on that note, I'll hand back to Phil for all the questions.

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Questions and Answers

Arnaud Lehman, Bank of America

Thank you very much for the presentation. I have two questions related to the US, please. Firstly, we have seen some companies, more in the building products world, relisting in the US and saying there was an advantage of being a US listed company with a US head office to operate in the country because, you know, America is buying American. Have you felt, in the private or the public sectors, that being a British company listed here was ever a problem when you bid for contracts relative to the locals, and is there a way to address it?

And my second question on the US is your positioning. I think you're positioned more in the commercial sector, which is suffering a little bit at the moment. There are more opportunities coming up in the infrastructure space. You mentioned that there were more lump sum fixed contracts that were probably a bit more risky on your side. When do you expect that to evolve, if ever, and how easy would it be for Balfour Beatty to progressively transition from the private sector to the public sector in the US? Thank you.

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Leo Quinn, Group Chief Executive

Okay. So, on the British element, and even on the question of relisting, I think everything goes through phases. I can remember, what, 20 years ago, people talking about the capital asset pricing model, and you've got too much cash on your balance sheet, and you should give it back to the shareholders. And, of course, the answer is, you know, if you don't like the way we run the balance sheet, you can always put your money elsewhere.

I think it's quite important that markets go up and down and, at the moment, it might be vogue to want to list in the US, but I'm sure the UK market will come back. And when we see a bit of growth in the UK market, which is probably predicted in the next couple of years, I think everybody will be rushing back here.

So, we're very comfortable with where we're listed, and we don’t necessarily see the opportunistic move to the US as something we're going to waste time on. You can contradict me, by the way.

And, in terms of being a British supplier to the US, I think we're treated fairly, you know. At the end of the day, it's about capability. If you can deliver some of these residential commercial theme parks, like we delivered Avatar, you know, these aren't just things you, sort of, buy off the

shelf, there's a real capability there. So, I think people buy on capability and that's what we bring to the party, and we're long established in all the areas that we're in.

In terms of the positioning, look, we're really clear about the fact that, you know, we're in business to, sort of, make returns and de-risk the portfolio. I'm happy to have a business which is half the size and double the profit because it's about returns, it's not about being busy fools.

So, the commercial market in the US is challenging in terms of the infrastructure commercial market, and where we do well is roads in Texas, roads in the Carolinas and things like that. You know, we've done well in California in the LAX People Mover and things like that, but these are challenges, and if you're being awarded large jobs of $1bn on a fixed-price lump sum basis you've got to be really, really careful.

So, we'd rather, sort of, keep a presence in the market and wait for the market to, sort of, normalise in terms whereby when people don't bid at stupid prices, then, all of a sudden, the developer or the client has to go back and rethink how they come to market, and we're seeing that in the UK, you know. In one region in the UK I won't name, north of Hadrian's Wall, but we were looking at roads in that area, and we just reduced to bid because the commercial arrangements were just unsatisfactory. They've now come back and said – Look, well, okay, well on what basis will you bid? – Because if you don't have anybody tendering you can't get the work done and, you know, those authorities have to get the work done. Do you want to add anything?

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Phil Harrison, Chief Financial Officer

The only thing is we probably wouldn't get the quality of research in the US.

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Arnaud Lehman, Bank of America

Fair point. Thank you.

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Leo Quinn, Group Chief Executive

That's a good answer for you.

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Jonny Coubrough, Numis Securities

Thank you. Three questions from me, please. Firstly, on Support Services, how quickly can you scale the business and what's the lead time on adding capability there?

Secondly, within the UK highways and the delays in the market, is there any impact from that on maintenance contracts, and also could your share of the A66 grow?

And then, thirdly, on US construction and in terms of the contracting model, I'd be interested in your thoughts on how that's faired through the emergence, or reemergence of inflation post COVID, i.e., have subcontractors been caught out by the reemergence of inflation and do they now want more contingencies in contracts?

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Leo Quinn, Group Chief Executive

Yeah. On the Power business, let's just understand the process. So, basically, your bidding is six to nine months in terms of the framework into how you play in it. SSE have completed theirs; National Grid is in process. Once you've done that, there are, with DCOs, which are consent orders, as to how you will deliver things on the ground, you know, environmental and all of these items, planning and the likes, that effectively is almost a two-year design process.

Now, the government is actively consulting at this moment in time on how do they reduce that because everybody complains about the cost of projects rising, but the primary reason for them rising is we don’t have environment consents, we don't have planning consents, and even when there's a judicial hearing that says, you know, you can go ahead and do the work, the local authority still has the final say. So, the government is consulting on how do we reduce the timeline.

So, if we can reduce that timeline to a year rather than two years, we'll be putting shovels in the ground, you know, in the middle of 2024. So, we're engaged now with SSE and putting our teams together to do the consenting and to do the design, and then you've got, sort of, like a three-year construction period. So, there's a bit of a movable feast.

So, the way we think about it at the moment, we say, all right, two years for design and consents, and then three years to build. There is some seasonality in those businesses, by the way.

Your second question around UK highways maintenance, look, the UK roads, unfortunately at the moment, with potholes and the likes of that, are a bit of a disaster, so I don't see any drawing back from that. It's not something that we can actually do.

On the A66, you know, when the project is given the go-ahead, it's highly likely that our share will increase, but, you know, at the moment, we're still waiting for the actual notice to proceed. But in terms of highways, there are half a dozen highways out there at the moment which, you know, we're very interested in.

But, in terms of the portfolio, if you look at where government money is going, obviously, they don't have an endless pool of it. I think in the medium to long term, you'll see highways start to reduce, but it'll be pumped into other areas.

And then, finally, in terms of US construction, emergence of inflation, I'll do this one just to be quick, the majority of our business, i.e., £4bn out of £5bn, is buildings. The contract process is that we put together the cost and then, for example, we'll put a 4% fee on that – 2% plus will be overhead and then the remainder will be profit. That contract is then built out with all of the subcontractors offering their formula at fixed price lump sum, so they take the inflation risk. And underneath that, they then ensure that either with a bond or some sub guard that they can deliver that, and basically their house is on the line around that, and quite penal if they get it wrong.

So, fundamentally, that risk is passed down to the supply chain in the case of US buildings, and it's quite important to remember that. It's a lower-return model but it's actually a lower-risk model. Do you want to add anything to that?

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Phil Harrison, Chief Financial Officer

Well, the only thing I would say is that, if you look year on year, I think, you know, the supplier market is tighter, subcontractors are under a bit of pressure because of this inflation impact. So, we clearly look at the quality of our subcontractors, keep a very close eye on it. We've not seen a huge amount of contractors going bust at this point, but, clearly, it's something that we keep an eye on.

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Leo Quinn, Group Chief Executive

Yeah, it's not in our interests to allow any subcontractor to fail, and on the same basis as we'll work with our customers, you know, if there's an inflation risk which wasn't anticipated in the initial contract which was struck four or five years ago, you know, we will go back and work with the customer to see how can we mitigate that in the same way we'll work with our supply chain to try and do the same. You know, the disruption that's caused by a bankruptcy goes far beyond just the cost of fixing a supplier, yeah.

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Joe Brent, Liberum Capital

Good morning. Three questions, if I may. Firstly, on the US margin, I take the point it's lower risk, lower return, but, having delivered 1.2% both halves, could you give us some indication of where you think that should settle?

Secondly, if memory serves, at the Full Year, you talked about the risks around perhaps Chinese capital controls and no one knows where those relationships go, but, clearly, you've got a lot of capital tied up in Gammon. Is there any way you can de-risk that?

And, thirdly, I think this one's for Phil, the working capital absorptions are around 15% stable at the year-end level – sorry, minus 15% and you've grown sales, so why are we not seeing a working capital inflow rather than outflow in the first half?

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Leo Quinn, Group Chief Executive

Well, I think we'll give Phil the first two and I'll do the third one, shall we? Do you want to try that, the second half expectations for buildings in the US, 1.2%?

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Phil Harrison, Chief Financial Officer

Well, we are anticipating that margin will increase into the second half. It usually does. However, the US, at this point, probably from a revenue point of view, we think is going relevantly flat. So, we will still some margin growth.

We're still committed to our 1% to 2% range, so that's still our key focus to drive that margin up, but, clearly, we're in a place where we'll make very small increases in that, you know, tenths of percents.

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Leo Quinn, Group Chief Executive

And in terms of China, it's a good question. I think our asset, from memory, I looked at this six months ago or so, but our asset base is about £70m, it's not a lot, although we hold a higher amount of cash, but that's part of the rules of Hong Kong, you actually have to have a certain cover, don't you, to do business there, which is actually quite clever, which means you can't suck out all of the cash and let it run on negative working capital. Is there any more on that?

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Phil Harrison, Chief Financial Officer

Look, the precautions we're taking on Gammon, we distribute all of the profits annually from Gammon, so we don't leave anything that isn't required to run that business. We don't guarantee anything in terms of guarantees from Group levels on anything, so, clearly, it's a very standalone business and, therefore, operates its own kind of banking, so it doesn't call upon our kind of Group balance sheet. And I think we've always taken a view that, I think, at the moment, we run quite a thin, I think, cap there. It's probably in our books at about £75m, I think.

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Leo Quinn, Group Chief Executive

Yeah.

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Phil Harrison, Chief Financial Officer

But the key here is to extract our earnings out on an annual basis.

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Leo Quinn, Group Chief Executive

Yeah, and I think Phil's made the key point, is that it is a totally separate independent balance sheet, unlike when we had the Middle East, the Middle East leveraged our balance sheet, which was one of the reasons why we divested of it, Hong Kong's not in that position.

In terms of your working capital question, Phil would be upset if I answered it, so I'm going to let have a go.

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Phil Harrison, Chief Financial Officer

No, no, you have a go [laughter]. It's really around the project mix, and, as we've said, US, where we have some very big mobilisation payments, we had a couple of years ago on actually a major set of roads and on our P3s, we've seen that now starting to unwind.

In the UK, the UK's more balanced to project bank accounts, so we don't see as much working cap benefit in the UK versus the US. So, it's that dynamic that's playing out there.

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Leo Quinn, Group Chief Executive

I couldn't have answered it better.

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Andrew Nussey, Peel Hunt

Good morning. A couple of questions from me. First of all, on UK Construction, I think, Phil, you said the key driver to the revenue growth was the ramping up of HS2. With the rephasing of that project, is revenue growth going to be harder to achieve in UK Construction over the next couple of years, or have we reached a sort of, normalised, sort of, run rate?

And, secondly, in terms of the US investments and the Monitor, what are they actually monitoring, and are they providing any observations to you which have relevance to the broader military portfolio and actually multifamily housing in general? Thank you.

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Leo Quinn, Group Chief Executive

Over to you.

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Phil Harrison, Chief Financial Officer

Oh, right. HS2, look, we completed our analysis of that. We don't see it in our forecast a '23 or '24 issue. I think the issue becomes these are deferrals and delays. So, I think, as people do understand, that usually costs more ultimately in a construction world, so one could anticipate that maybe revenues will tick up past that period as we have to finish the job. That's HS2.

On the monitor, monitor has wide-ranging access to the whole of the military housing business. They're looking at our compliance processes, our ethics, our culture, and they go across the whole of the 55 bases that we operate in the US. So, as you can imagine, it's a very wide-ranging and large exercise. And, as they report out, we take those things onboard to improve the process.

They're monitoring our plan and our plans to improve the process, and then they'll audit those things that we'll put in place, so that's what they're driving forward on, and we welcome it, we welcome the support, and we want to improve the military housing controls and compliance in that business.

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Leo Quinn, Group Chief Executive

Yeah, it is interesting because we're in a world where there's more compliance. You know, there's a lot of attention paid to speak up and whether or not, you know, we're getting the voice from the grassroots of the organisation, the top of the organisation, and then how we're acting on it.

And we have seen, across the whole Group, not just in military housing, how the number of speak ups have actually increased and how we investigate them and the likes of that, which is good because it leads to a very transparent, a very clean culture. So, we actively encourage that, but I think that's happening across all corporates in this day and age, so, you know, I think we're just, sort of, a little bit ahead of the trend in some cases.

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Andrew Nussey, Peel Hunt

Okay, thank you.

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Stephen Rawlinson, Applied Value

Hi. Just a couple from me. Just on that issue of compliance, perhaps a related with question with regard to ESG, I mean, 2030 is getting closer. When we first started talking about 2030 it was a long way away, but it's not now. Who's going to actually pay for ESG? Are customers will to pay, because some of the modern equipment that's coming out that's hydrogen-powered and so on is presumably a much higher cost, and are they looking for the burden of the margin for that to come on you, and how will that pay out over the next year or two, or is it something that customers in a cost-plus environment are willing to fund?

And, secondly, in the capital allocation model, and you didn't mention M&A as a likely flow of funds, and that's not been a feature of anything that's happened in the last few years, but, in an environment where technology, IT, you know, we keep going to these sorts of meetings and we hear about digital and so on, are there some technology areas or skillsets that M&A might fill the gaps in, or are you just content with what you have and believe that you can develop that internally?

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Leo Quinn, Group Chief Executive

Yeah, well, look, first and foremost, you know, you're right, 2030 is, sort of, a year nearer than when presented the same results a year ago, but, having said that, you know, customers aren't putting their hand up and saying – Well, I'll pay extra for reduced carbon and the likes of that – The expectation is you'll do that off your own back.

Some of the government contracts, they're prepared to fund some innovation and some ideas, but, generally speaking, it's a competitive world, and even if we said, well, we're going to increase prices, if someone's bidding at, sort of, a lower price, you know, you don't want to be surprised that you don't win the job either, so you don't even get a chance to implement those sorts of things.

So, look, there's no doubt that everybody wants to go to Heaven, but nobody wants to die, so we're all trying to be net zero carbon but paying for it also is a challenge.

The other thing as well, some of the technologies don't actually work. You can actually electrify a crane and it can go up and down do loads, but, if you track it more than 100 metres, the battery's dead. So, there are still technology challenges in innovation, and hydrogen's very nascent in the field, and we've got pilots of all these things out. We're subsidising a lot of them, the clients are subsidising them, but look, something's going to break through, and you don't

want to be, sort of, at the back of the class when it happens. So, like any big corporation, we invest in many things, and we hope that some of them pay for the loss leaders.

In terms of M&A, we don't really do it. We'll acquire capability but, you know, as I've always said, if I want to acquire a big project where I want to lose money, I'll bid it directly rather than buy an intermediary. There's no point in that. But there are some exciting areas out there where, you know, but it's at the small end, and I think, in our industry, this is the most, what's the word, undercapitalised, digitised business in the economy because of the way we do things.

And, you know, we do have some competitive advantages, you know, for example, we've worked with a small company called SiteAssist in terms of digital permitting, which has an inference on, by following process, you save lives. It allows you to digitise and obtain permits anywhere on site and to track every single worker, which means you can be more productive, and then it gives you better assurance. Every single move and process step is tracked and photographed, which actually, believe it or not, gives you better assurance but actually better productivity, and it's actually safer. So, there are things that we're investing in.

We're also doing, on the treasury side and the financing side, we've done some major investments with who's the company, I've forgotten their name – obviously, you don't know either – but, anyway, where's Andrew? Who's doing our treasury software that we're working with? He's somewhere in the audience? Bloomberg and the others.

So, look, we're active, there's real productivity in the back office to be had, so we're there at the forefront of it., and if we can get that productivity into the field, that's where the money gets spent. If we can drive productivity there, that means we can deliver at higher margins. Causeway – that was the other company I was thinking of, yeah. Glad one of us knows!

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Graham Hunt, Jefferies

Hey. I think just three questions from me. First half margins in UK Construction were very strong. I wondered if you could give us an updated view on where you see those margins going to in the mid to long term and what your ambitions are there?

And then, secondly, you said that you're stepping up investment in selling expenses. Are you seeing a more competitive bidding environment in the UK as we see some of these projects coming online?

And then, the third question on capital allocation, you're guiding to the balance sheet down about £100m, £150m this year, are you still comfortable with your shareholder returns framework, and, assuming you come in line with that guidance, should we expect a similar balance of dividends and buyback for this year as well? Thank you.

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Leo Quinn, Group Chief Executive

Do you want to do the first one and the third one and I'll do the second one?

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Phil Harrison, Chief Financial Officer

Yeah, can do. I thought you would have a go at the UK. It's mid to long term, so that's always your –

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Leo Quinn, Group Chief Executive

I'm going to correct you!

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Phil Harrison, Chief Financial Officer
Oh, right, that's fine then [laughter]! Look, we do, and we're still committed to moving our margins up in the UK. As we've said, we think the range is 2% to 3%. We want to get to the top of the 3%, and I think that's still achievable, and we can still do that. Clearly, Leo has an aspiration as well.

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Leo Quinn, Group Chief Executive

Well, look, I think it's reasonable. If you at our capability and what we do and compare with anybody, EPCs, all across the industry, the fact that we're not earning 4% to 5% is just ridiculous. So, it comes down to the right contract, it comes down to flawless execution and it comes down to the right delivery mechanisms, and we have all of that within our portfolio. And, as our market has been maturing over the last four to five years, the possibility of that is still out there.

Now, every time I raise that range of almost double of what Phil's saying he has me drug tested, and I've passed on every occasion. So, the point is, this business is worth so much more than it's valued at this time, and if you look at the cash generation, it's, sort of, very easy to see how we've been returning 10% at our end. We've got 10%, 11% annual return on the business between buyback and dividend. So, you know, there's an engine in there, what we've just got to do is make sure that Phil adds the numbers up correctly and reports it. The investment, what was it?

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Phil Harrison, Chief Financial Officer

More competition in the UK.

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Leo Quinn, Group Chief Executive

The truth is, if you actually look at it, the number of people that can do the kind of stuff we do it's actually quite small, but the client, it's in their interest to make sure they go through a competitive process so that everyone falls on their sword and actually offers up the highest scope, the quickest delivery times and lowest cost. So, it really comes down to you have to be confident in what you're doing so that we are setting the benchmark for margin return at the right price.

You've got to remember, it's really important that we do this because we're not in the business of just taking cash out, we're in the business of reinvesting, and, in many of our businesses, especially the Power business, it's three to five years to train up the next cadre of people, and that's really at our cost. If the margins remain low, we can't make that investment, and, therefore, the industry, in the long term, suffers because it just doesn't have the capacity to supply.

So, the way I see it is that, you know, there's always going to be competitive activity, but, I think, in most cases, people know who they want to pick in order to deliver the job, but you have to go through this song and dance process so that they can be confident in their own mind they're getting best value.

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Phil Harrison, Chief Financial Officer

Yeah. The other thing I would say is that I think it's the volume of bidding that we see coming forward that means that we want to make an investment in sales expense as well. There's just a sheer volume issue that we see ahead of us over the next few years.

On capital allocation, we're committed to a multiyear share buyback. We're not coming off that in terms of what we've said. We're not going to make any commitments at the half year on what that value and what the shape of it is versus dividends and buyback. We'll do that later in the year when we know where we're going to land and what excess cash we've got and what we want to do with it.

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Leo Quinn, Group Chief Executive

And, if you think about it, you know, you're always looking to allocate your capital to where you get the best return. I can't think of a better return than buying back our own shares at this time, and, you know, can you imagine, what, 18 months ago, we were £2.30 or £2.40, you know, we're now at £3.40, and we're still incredibly cheap. So, it's a good use of cash, isn't it?

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Facilitator

Leo, we've got some questions on the webcast which Jim's going to share with you.

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Jim Ryan, Head of Investor Relations

So, we've got three questions from Gregor at UBS – So, what is your expectation for sustainable working capital levels and cash returns into 2024? Is your ambition to grow earnings in the earnings-based businesses in 2024 after a flat '23? And then, thirdly, you commented you will invest into overheads to seize the growth opportunities. What is the quantum?

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Leo Quinn, Group Chief Executive

Phil, you do the first one and I can do the second one.

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Phil Harrison, Chief Financial Officer

Yeah, sorry, gives us the sustainable one again? I mixed it up with the second one.

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Jim Ryan, Head of Investor Relations

Expectation for sustainable working capital levels and cash returns into '24.

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Phil Harrison, Chief Financial Officer

Yeah, look, kind of, medium term, we've said that we want to be in the 11% to 13% range of working cap. Clearly, we've had years at 15%. I still believe we're going to see another working cap outflow next year. That will move us down towards that. I think we're probably not going to get down, in the medium term, to the 11%, but I think we'll get into the 13% range.

So, that's where we think we'll have that sustainable level, it's probably more now at the 13% level rather than the 11%. That's the sustainable one. And then ambition to grow next year, 2024.

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Leo Quinn, Group Chief Executive

I'll answer that one in, sort of, a different way. The challenge around predicting the timing is, you know, the framework's coming through, you know, the consent order's being applied and whatever. Now, if the government consultation accelerates these things, it will benefit everybody and save billions, not millions, billions.

So, my forecast, at the moment, is you'll see an uptick in earnings in the second half of '24 with a strong uptick in '25, but if some of these things come forward, I think you'll see a much better second half, a much bigger uptick second half in '24. So, '25 is going to be a very positive year for us. That's my forecast, I think. I don't know if you want to build on that at all.

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Phil Harrison, Chief Financial Officer
Well, all I'd say is that I wouldn't anticipate anybody changing their '24 numbers as yet. Clearly, you will have a better visibility as we do the full year.

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Leo Quinn, Group Chief Executive

And then the last one is, you know, like all these things, let's say we up our selling expense by £5m in order to cope with this sort of like tsunami of bids, you don't quite know that you're going to win them all.

Now, if you were to win them all, that would obviously come through with a substantial increase. So, there's a little bit like, as Phil says, as you get to the end of the year and we know what's actually come in, we know the successful outcome of one or two already and we know the quantums are over £1bn, so the point being is it's a little bit too early, but we're very optimistic, given our market share and the strength of our capability, that we're going to be a significant player right across the board in all of these areas. Again, just a little bit too early to say, with any degree of, sort of, fact what that number will be, but it will unquestionably be very positive.

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Phil Harrison, Chief Financial Officer

I think we have to be clear, it's not going to be in the tens of millions, so it's probably in, you know, the high millions.

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Facilitator

Thank you. There are no further questions.

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Leo Quinn, Group Chief Executive

That was optimistic for Phil! Great.

Well, thank you all for coming. I hope you enjoy your summer holiday after this event, and we'll see you in six months' time for the next checkup. Thank you.

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