Balfour Beatty

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2019 Half Year Results Presentation

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Balfour Beatty

Leo Quinn, Group Chief Executive

Phil Harrison, Chief Financial Officer

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Introduction & Highlights

Leo Quinn, Group Chief Executive

I'm Leo Quinn, Balfour Beatty's Chief Executive. There is a live webcast so that's probably on the webcast.

The first slide I'd like to put up is actually our Balfour Beatty 110 years. In January this year the company's been around for 100 years, which I think is a phenomenal achievement and you'll love that graphic I'm sure, so the way we build it with cranes and trucks.

First and foremost it plays very nicely into the fact that our Build to Last programme has always been designed to actually put in place a platform for the next 100 years of success, and that's building on the 110.

Today we've announced what I think is a strong set of results and is a continuation of the progress that we've made over the last five years.

Encouraging to see that our profits are up some 29% and beneath that our Construction Services in the UK has actually improved by some 41%. So it's nice to see that.

If you remember back in 2015 I think we had 79 distressed projects, so it's good to see those work through the system.

The real highlight is actually the cash. And I think last time we presented our cash, for various reasons, wasn't as strong as we would have liked it to have been. But our average net cash during the period is £290m, which is a huge step up from where it was last year, and our closing was £425m. That's cash in the bank as opposed to overdraft.

And our financial strength is underpinned by a £1.2bn Investment portfolio, which has the benefits of a strong yield but also has the benefits of as the assets mature we choose to sell them off.

We've got a strong performance the second half of the year. The first half was a little lighter than the prior year.

In terms of our growth in orders we've used the word, managed, because we don't want to get ourselves back into this position we were in and where the industry was in terms of forced growth, where you have to grow your top line in order to keep feeding the cash flow to keep funding the losses.

So it's really important for us that we're highly selective in terms of the risks that we're taking and, you know, this is the first time we've really allowed the order book to grow on the back of what we think are very good, solid projects.

And then finally, our confidence in the future is underpinned by a 31% increase in the dividend, and this is the third year in a row where we've had a 30% increase.

Behind that is some of the leading indicators and what's important about this next slide is not so much the Lean, Expert, Trusted and Safe, but this is a five year trend of continuous improvement. And it really doesn't matter what you measure but provided you're measuring something and holding yourself to account, if it keeps improving something good's got to be happening underneath it.

In terms of Lean we're looking at cash in, cost out, but more importantly how we're investing in the infrastructure to support the next 100 years of the Company which will allow us to drive the productivity.

And as you see in the next slide our overheads continue to reduce in absolute terms, not only as a percent.

I'm encouraged if you look at we're £400m improved cash flow ahead of where we were back in 2014. And each year that line keeps rising and it flattens out around the zero point. So that's a very encouraging trend.

We're an industry that's based on the capability of its people and you know, it's up to us to create a great place to work in order to keep our employees with Balfour Beatty. And you can see for the fourth year in a row our Employee Engaged Index has actually risen, and the number of participants in that survey is the highest level it's been in the company in the last five years.

So I think everything's going well here. This is important to attract people in and also to retain people within the company.

Our Trusted is about doing what we say we will do, and this is more a case of our customer satisfaction. And we measure that, and that's remained at 97% for the period

This is an incredible progression, and I think Safety is a sort of a leading indicator of how the business is going to perform. And five years ago to think we could actually halve it, which is an improvement by the way, less accidents, is quite unimaginable. But we are there.

We were recently recognised with the Construction News Safety Award and the quote was - we're not only leading the industry, we're setting the standard for the industry. And I think that's a great accolade to all of the work that the senior managers do top to bottom in this company to make sure that we send people home safely every night. So a great track record in terms of five years of improvement, and hopefully another five years.

If we actually move onto some of the hard numbers behind those particular trends, if I look at the average net cash for the half year period forward, back in 2015 we were overdrawn to the tune of £16m. Today we're net cash of £290m. For our Earnings Based businesses, at the end of the first half of 2015 we'd lost £180m. Today we're generating £63m.

By the way, the amount that we generate, in my view, is absolutely derisory, but the point is if you look at the trend and if you project that forward you can almost become optimistic and encouraged.

If I look at operating expense, in 2015 our overhead was £212m. On the same volume we're £137m, that's a £75m improvement in the first half. And I think we're talking about £185m improvement in the year, which is an improvement of about £10m over last year.

And then in terms of attrition which, you know, this is a real cost to the business, particularly our business where you've got records, history and the likes of that. To have gone from 15% down to 11%, and we still have a target of 10%. I think that's a really encouraging place to be.

And from a brand and an industry point of view I do feel we're sort of the place that people actually want to come to work today. So it's great to have a brand that's being restored to its former strength and the place that people do actually want to come to.

So on the back of that what I'll do is I'll hand over to Phil, who will now treat you to some facts.

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Financial Results

Phil Harrison, Chief Financial Officer

Thanks, Leo. Good morning everyone. Let's look at the headline numbers. I'm particularly pleased with profit from operations up 9% on relatively flat revenues as we continue to focus on operational delivery.

At a pre-tax level profit increased by 14%.

Another highlight is the order book, which increased again under the Group's Managed Growth Strategy, which we'll cover later.

We also saw year on year improvement on average net cash with our first half performance at £290m, up more than £100m on prior year. Given this performance the Board has declared an interim dividend of 2.1 pence, a 31% increase on prior year.

Now let's look at the results in detail. Turning to underlying profit from operations, in the earnings based businesses profits increased by 29% to £63m, which contributed to the overall 9% increase in the Group's underlying profit at £72m.

Looking at the constituent parts, Construction Services improved by 41% to £45m, and Support Services by 6% to £18m. Following significant disposals in 2018, Infrastructure Investment profits from operations decreased £8m to £25m.

Order book, we saw an increase of 5% from year end 2018, an increase in both absolute terms and the constant exchange rates.

The Construction order book increased by 4% due to increased orders in the US. In the first half we booked significant buildings projects across our US regions, at the Wharf project in Washington DC, Block 216 in Portland, Oregon, Jacksonville International Airport in Florida and a significant commercial office in Plano, Texas.

The UK order book remains stable at £3bn. As a reminder, it does not include our share of HS2, the £2.5bn Civil work or the £1bn Old Oak Common station in London.

Work is progressing to deliver detailed plans and costs for the Civil works for Lots N1 and N2 under an Early Works contract, work we now expect to complete by the end of the year.

Importantly, our financial forecast for this year and next do not rely on HS2 going ahead.

In Support Services the order book increased 7% to £3bn following growth in the Transportation sector, namely the award of the Central Track Alliance by Network Rail where we've booked £250m of the expected £1.2bn of work under the ten year framework agreement. And we also saw the re-award of the London Underground infrastructure contract for a further four years.

Now let's look in more detail at each segment starting with Construction. In the UK revenue increased 7%, the first time revenue has increased under Build to Last. Profit from Operations showed an improvement to £17m with an associated margin of 1.7%. We expect that for the full year UK Construction will be within the 2% to 3% industry standard margin target range.

In the US, revenue increased 10%, 3% at constant exchange rates, the PFO margin was consistent with last year at 1.1%. We anticipate margin improvement in the second half of the year as new work booked in 2018 progresses.

At Gammon, revenue was lower in the period as the timing of revenue from project starts compared to last year is more heavily weighted to the second half. Importantly, margin performance improved to 2.4%.

Now turning to Support Services, as you can see on the slide Support Services revenue decreased by 7% as expected following the conclusion of the Area 10 Highways Maintenance contract and lower volumes in the Power Transmission business.

Importantly, profit from operations and PFO margin for the period increased to £18m and 3.6% respectively. We continue to expect the full year PFO will be broadly in line with prior year.

Breaking down the constituent parts into a bit more detail, in Power new business wins in substations and powerlines for National Grid will feed through into higher volumes next year.

The Gas and Water business is moving towards the end of its current regulatory cycles. In Water, the Group has started to engage an AMP7 planning cycle, including negotiating the renewal of current contracts.

In Transportation, the underlying highways market is good with multiple local authority contracts coming to market.

Whilst at Rail, our partnership contract with London Underground, as I said, was renewed at the start of 2019 and in March we got the ten year Central Track Alliance contract to design and deliver track renewals and associated infrastructure works across the London North West, London North East and East Midlands routes.

Moving to Infrastructure Investments, the business continued in its strategy of optimising value through the disposal of operational assets while also continuing to invest in new opportunities.

Following significant disposals in 2018 underlying profit from operations decreased to £25m, with both predisposal operating profit and profit from disposals lower than the prior year.

It is worth remembering that the Investment portfolio is integral to the Group, a constantly regenerating asset base that interlinks with our Construction and Support Services businesses.

As examples, in the UK Investments and Construction are working on a major student accommodation project at the University of Sussex. And in the US, our Civils and Building businesses are working with investments on the LA Airport Automated People Mover.

The Group continues to see opportunities to invest in high quality projects with good returns. In the US the focus is on student accommodation, multi-family housing and public private partnerships. In the UK the focus is on student accommodation and public authority led regeneration schemes.

We continue to look to time asset sales to realise optimum value to shareholders with more disposals expected in the second half.

Turning to the Directors' Valuation, looking at the moving parts we invested £11m in new and existing projects whilst cash yield from distributions amounted to £32m as the portfolio continues to generate cash flow to the Group net of investment.

The sale proceeds were £26m from the sale of Borden Data Centre in Canada and three multi-family housing assets in the US. The unwind of discount was circa £45m, with the period end valuation again rounding to £1.2bn. This equates to 169 pence per share.

If I go to the next slide, this slide shows all the Investment disposals that the Group has made since 2015. Each bubble represents one disposal, the size of the bubble represents the sale proceeds received, the colour of the bubble represents whether the asset was sold either at or above Directors' Valuation. Dark blue is above DV.

On the left hand side of the graphic we have the end to end multiple for each project at the point of disposal. This is calculated as the sale proceeds plus distributions received over time divided by the original equity investment.

The graph demonstrates that the Group continues to make strong returns from its investments. Over the period we've realised £650m from the portfolio, with the majority of the disposals above DV. Returns have averaged over three times the initial equity outlay and we continue to target a minimum two times return on new equity.

Now if we move to cash flow, I'll start by highlighting the good average net cash performance for the Group at £290m for the first six months. This is substantially higher than last year, and for the full year 2019 we have now increased to a range between £280m to £300m.

Now moving to the waterfall, the total cash movement in the period resulted in an £88m increase to the Group's net cash position to £425m. The increase came primarily from the £94m operating cash flow with working capital broadly neutral.

It is worth pointing out that the adoption of IFRS 16 the operating lease cash flows are no longer categorised in operating cash flow but in financing activities. These amounted to £24m in the period. Other flows were as expected.

Negative working capital as a percent of revenue stable at 10.7% versus full year at 10.3%. You can find additional information on working capital splits as well as IFRS 16 in the appendix.

My final comments before I hand you back to Leo, a good first half performance in terms of profit and cash. We continue to be selective in the work we bid for and we continue to focus on operational delivery.

Therefore the Board expects the Group to deliver a full year performance in line with expectations.

So that concludes my remarks. I'll now hand you back to Leo.

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Business Update

Leo Quinn, Group Chief Executive

Right, thanks Phil. Back to Build to Last, we're creating a platform on which to build the future of the business here. But at the same time, and underneath that, we've also created what I regard as a geographically and operationally diversified company.

Today over 50% of our returns come from outside of the United Kingdom. And although we're a British listed company, it's sometimes overlooked just how much comes from Hong Kong and primarily the United States.

In the case of investments you've seen over the last four to five years where those ratios have actually switched. We used to be about 44% in the US and 56% in the UK, we've now switched that round.

The operationally diverse portfolio we have is the different business models we operate within the various territories. And if I spend a few minutes in terms of the US, although we're looking at bookings here, in revenue terms the US building business is about 80% of our turnover. And that operates on the basis of Construction Management so we receive a low fee in that area in the order of 4 to 5%. But we actually take a much lower risk because the risk is passed down to our supply chain.

The remainder, which is about £700m to £800m in in our Civils business, which in some ways is slightly Neanderthal in terms of how it contracts. And it hasn't matured to the point of where the UK business and market is, and I'll explain that in a few minutes to you.

But there's an awful lot of hard bidding goes on in this area where it's say a fixed guaranteed maximum price which can carry superior returns but also can come with super challenges. You'll have noticed from the industry that some of the competition have had some big challenges recently.

In the terms of Gammon, I'll touch on this in a bit more detail, but this for us is a full service model, again primarily guaranteed maximum price. But our focus on Gammon is really around the dividend and I'll explain that.

If I look at the UK in terms of UK Construction and UK Services, again very different models in terms of our UK services is primarily focused on long term engagement with customers. Ten year contracts which actually demand of you to be more productive at

the end of the cycle, rather than at the beginning. And there is lower cost invested in securing this work because it runs over ten years but they can be equally challenging over time. And UK Construction is a myriad of construction or contracting models, which I'll touch on on a later slide as well.

In the case of our Investment portfolio which is really the jewel in our crown and will continue to be, not only in terms of its size but the security of the income that comes from it. And the flexibility it affords us if we want to sell down assets of the peak as Phil has described.

This works best when we have a model that we design, build, finance and operate. Where we're a full service provider and there are a number of models which I'll touch in the next few slides which portray that.

It's not fool proof, it can actually go wrong. But today as we use this asset to our advantage, we seem to be building better, with long term returns in this business than we have in the past across the whole portfolio, i.e. delivering profit to construction and delivering finance profits to the infrastructure business.

If I move to the US, I talked about geographically diverse. You're aware of our Southern Smile in terms of all the way from Seattle, around through California, Texas and up into the North, the Mid Atlantic and the Carolina's. That's referred to as the Southern Smile. And as the population gets older it migrates to the northern parts of the country. So we've seen population growth which brings with it accommodation, housing, infrastructure and the likes of that which actually caters to what we do.

We're also diverse in terms of our customer base and who we cater to and they are very different markets. And there's value in that diversity because not everything rises and falls at the same time. If I look up in the northern area we're primarily focused on the tech sector, companies like Amazon and data centres, Microsoft and their campus and things like that. As I move down into California our primary building focus is largely around schools. If I go down to Florida here we're actually engaged in the likes of Disney, Universal, hotels, leisure and the likes of that.

And if I look at the final areas of our building business in terms of Texas, the Mid Atlantic and the Carolinas. It's primarily offices and residential accommodation, mostly construction or concrete build frame or concrete frame buildings and the likes.

As I then look towards the other side of our portfolio, which is actually the more hard bid areas. In the area of Texas we're one of the primary deliverers of roads. We've had a very successful Horseshoe delivery. We've got a very successful project with the Southern Gateway. And we recently were the winner of a 1.7bn I-635 highway project. That's an area where we work closely with the client, we've had a 20 year relationship and it is a very successful business for us.

Our other big civils infrastructure activities are in California where we're into rail and water treatment plants. And in the Carolinas where it's the same all the way down from Washington, down into the north of Florida here.

So those are our two particularly strong business models. It turns over about 3.5bn annually. In terms of our investment portfolio in the US it's about 650m and that is primarily our military housing asset and other unique locations.

If I look at the prospects for this market, I'm going to refer you here to the right. There's no shortage of opportunity in the US at the moment and there's an awful lot of growth.

Our challenge is being particularly careful and selective in what we go for and because a lot of the business models are around hard bidding in that area we need to sort of start to change some of these. Because the risk tied up in some of these major infrastructures are so large they can't really be absorbed by a single company. That doesn't mean you put together a joint venture and absorb that risk over multiple companies, it means you either play on the basis of a cost reimbursable or you decide not to play.

If you look at this chart as well you'll see there's 55 stars which actually represent all of our military housing assets across the United States. We look after 43,000 residential homes for the military on a 50 year concession.

It's serviced by 1,200 employees who are committed to providing the highest possible service. And many of them actually have a service background so they are intimately connected with that industry.

You'll be aware from the press recently that we've had reports around allegations in two of our bases, Tinker and Mountain Homes of issues around the processing of work scheduling orders in terms of repairs. You know, we've looked into this, we take the matter very, very seriously and what we want to ensure is that we have an independent review. So in order to ensure the independence we've appointed external counsel and there is an investigation underway.

Given what we know today we see no reason to change either our financial forecast or our Directors Valuation in respect of that asset. And if there are any further questions on that we'll take them during the Q&A.

If I move to the UK, it's hard to think that a country the size of the UK is geographically diverse. But I can assure it is and we do operate all the way to Scotland, down to the London area and the south.

The point I'd like to talk about here in terms of the UK business models is that if I look here up to the top right where we're looking at things like Scape, Regional Investment Programme, which is Highways England and the new Central Track Alliance. These

are invariably long term partnership arrangements. Scape's four year has been the regional programme and the CTA and is actually a ten year programme.

What they hold in common is the fact is that most of the work is actually constructed under what is an ECE, which is an early contractor engagement. And what that means in simple terms is that the customer pays for us to put together the scope, the cost and the schedule of the job. And once we understand the risk and the client understands the risk, we then decide whether or not we proceed with that work.

This is transformational, I'm especially going to touch on large projects, this is transformational in terms of where the UK sits today compared to Civils work in the United States. And I think that you'll see in the future that the Civils in the United States will start to evolve to a much more collaborative model. This long term engagement does give security of work and underpins a good reliable workforce.

If I look at the areas over here, some of our major infrastructures work with the M4 for example. Hinckley, and I'll even include HS2 in that discussion, is that these are major infrastructure projects, they carry with them very, very high risk if you get them wrong. But the good thing that's happened in the UK as a results of whether it's Interserve or Carillion and all of this, is that the way we engage with our compliance today is completely different to the way we used to engage.

So what we're doing is we are actively working and collaborating with the likes of Hinckley, HS2 and M4 to engage with them early, whereby we put together the cost, the schedule and the scope. And then we work through what is practical and what is feasible.

And what we are starting to see is models emerge which effectively is like a cost incentivised fee. Where our fee and overhead is guaranteed on the contract and then there's a pay and gain formula which is in a tight band that says if you over perform you'll get a small marginal improvement, if you underperform you'll actually get a small marginal loss.

And that band is important because what it means is that you never drive contracts into loss when they can't manage. If however you don't perform you'll simply recover your overhead and you won't make any profit from it but you don't end up with a disastrous scenario that's occurred.

So this market is changing and evolving and again this is I think a really important indicator as to where we'll see other markets around the world change in the future as well.

If I also look at the future prospects here, the fact of the matter is that there is a very ripe infrastructure market sitting out there at the moment. As you know we were selected on N1 N2 which is the Birmingham area for High Speed 2. We were also selected for Old Oak Common which is currently in dispute, there's been a protest

against the bidding process and HS2 is taking that to court in early September to have that presided over and a decision made. At the moment everything is on hold in respect of that. Our position in that contract is purely as a construction manager where we get a fee for our service.

If I look at this pipeline ahead here, all of the work we were looking at at this moment in time is invariably some form of collaborative bidding as opposed to just simple hard bid. And things have actually changed, you know, some contracts have come out in the last year and they've actually been no tenderers for it and so the Government and the Associations had to go back and change how it's going to procure in the marketplace, which just shows how the market is evolving.

Phil talked about our investment business with Sussex University. Where we make our best returns is when we actually act in concert with our investments, financing and our construction building and we make a wall to wall return on the basis of that. And we've got a couple of big projects, the concession on the M25 which runs for 30 years which is running well. And the Sussex University who we've recently completed the first thousand rooms in their upgrade programme. So an important market to us and one that actually I think is being de-risked all the time that we work within it.

If I look at Hong Kong we're in a joint venture with Jardine Matheson, 50/50. It's about a billion pounds worth of turnover from us and the most important takeaway actually from this business is that Hong Kong for us is an annual dividend. This company has its own balance sheet, it bonds on the back of its own balance sheet, it takes risk on its own balance sheet, it is a strong balance sheet but it's primary purpose for us is the dividend that it yields each year.

It's a full service construction company in terms of the fact we do ground engineering, we mix cement, we deliver it, all the way through to the mechanical, electrical that goes on.

We have a variety of infrastructure projects ranging from the M&E on the tunnel, to the viaduct that we just recently completed. We're engaged in some of the major building infrastructures in the centre of Hong Kong in terms of the Lyric Theatre. Interestingly enough it sits over a railway line, how you have a concert with a railway underneath is another mystery to me and then the M Building Museum. We're even in the area of waterparks and the likes of that so this is a full service business.

The business model over here is still hard bid, which means that you really have to know that market and you have to be ingrained in it. However, what we're now seeing is signs that that's moving towards a more collaborative model in terms of the first NEC contracts and the first early engagement types of contracts. So I think a challenging market but I think the future looks bright here.

The amount of work that's coming down the pipeline is phenomenal over in Hong Kong. Particularly around the fact they've got a ten year hospital plan, they've got a ten year residential housing plan, they've also got a supporting infrastructure plan. So this is a very buoyant market and although there's the short term chaos that's going on in Hong Kong, it's not something that long term I would spend a lot of time worrying about.

So really in summary, I think Balfour Beatty at this time in all of our chosen geographies have a strong position in the infrastructure market. And we're going to see that grow over the next ten years.

My number one challenge and priority is how do we recruit and retain the people in Balfour Beatty in order to deliver that work. And as you know we're strongly engaged in bringing on apprentices and graduates into the industry. But we're equally engaged in ensuring that those people who have got 40 years of experience don't retire at 60. So to help them along the way we've cancelled all retirement at 60 for our employees and the fact of the matter is I'm sure they'll be engaged and wanting to stay a lot longer in light of the future challenges and work that's coming.

We've spent a lot of time in embedding, what I would describe as a risk management culture. Whether that be in our Gtech process, whether it be on our Project on the Page. But for us it's really, really important that we understand the risk. We might not always get it right but the fact of the matter is we're involved, we're engaged and we're making the decisions as to what we will and what we won't do at a very high level. And that involvement is critical to our future success and our future improving margins.

Under Build to Last we've put in a platform which is capable of growing the business and scaling it. It helps us in terms of how we manage our financials, how we drive productivity through the company and also how we scale it. I believe we've got a truly scalable model if we ever wanted to use it.

And I'll give an example, under the Central Track Alliance we've just recently trooped over 500 employees and contractors from various companies around the United Kingdom into our system. And to date it's gone flawlessly, that's a major task because it's not only about moving someone's employment file, it's about giving them a new car, a new van, a computer, a telephone, everything needs to be up and running and working. And when we took over 165 employees from Carillion a couple of years ago, that went seamlessly for us and I'm sure this will go seamlessly as well. All that leads to driving more productivity and cost out.

And then finally, the strength of our balance sheet, and in particular the strength of our investment portfolio, I think leads us ideally to the point that in the future we can see strong cash distributions from the company. And as I've said before our first priority is always going to be next year, we've got £110m preference shares with 10% coupon on them. We've got a £25m private placement so that's our first priority to get those paid

down and those are the singularly most value accretive things that we can do within the company.

So on the basis of that I think we'll hand over for Q&A and we take any questions that you care to offer.

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Questions and Answers

Andrew Nussey, Peel Hunt

Good morning, couple of questions if I may. First of all on the infrastructure business you said there's lots of opportunities out there for investment. I'm just wondering what the market is like for asset sales at the moment in order to maximise the value for the group?

And then secondly, in the US if we work on the assumption of more collaborative working. Should we expect a greater shift to Civils over the building business over the next probably, two to three, maybe five years?

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Leo Quinn, Group Chief Executive

I'll do the second one first if I can. I think it all depends on the risk, there's absolutely no shortage of opportunity. And in the last 48 hours we've looked at high speed rail in California, we've looked at Express Way which is the high speed rail to Las Vegas, etc. And it all comes down to the basis to which they want to actually to contract.

Now of course from a client's point of view what they want is a fixed price guaranteed lump sum. Well, you know, not on this planet, it just cannot happen, you can't take those risks on board.

So I think it's very much a question of I could see the civils business growing to a certain extent, you have to remember we've only got limited capacity and limited number of people. But at the end of the day it's going to have to be on terms that means that we're not carrying the risk of delivering their high speed railway to a certain schedule and that it's work collaboratively overcoming the challenges that will come.

If you compare that with the way HS2 has been handled, you know, it's working on a very tight budget. And what they've realised is that they're better to work on a cost adjusted incentivised fee with the contractor and not try and pass down bonding costs and liquidated damages, etc. Because ultimately the risk stays with them whatever happens so we've got to get the US and the US client base to the same point of view.

If I let Phil touch on the asset sales.

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Phil Harrison, Chief Financial Officer

I think our - as you've seen and demonstrated over the last five years, we've been very good at extracting value as we go into the market. The Investment team has done a great job there. Values are still strong, the secondary market is strong, there is if you like a lack of assets into the secondary markets. So there is, I think, a pent up demand there so we'll continue to time and extract the best value from those assets. We don't see that, at this point, changing.

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Howard Seymour, Numis Securities

Two if I may on unrelated areas. Firstly, could I just ask on the military house, thank you for the slide, very useful. You alluded to the fact that you don't see any sort of impact on DV. Two questions there. One, is there an actual scheduled timetable going on in terms of what's going on in terms of the allegations that we can understand?

And secondly, in what circumstances could you see a change in the DV on the basis of the allegations? And I don't know if you can put any quantification on that as well?

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Leo Quinn, Group Chief Executive

First and foremost putting it in context we are talking about 2 military bases out of 55. And allegations made by two ex-employees, in the second case one work order. So the challenge is that, I've got to be very careful of my words here, the challenge is that you want to make sure that we review it independently, which then means you're then, despite working with the Air Force, you're then forced to go down through a process and it's never easy to communicate and get all the I's dotted and the T's crossed.

So it will take time, I can't tell you how long that will be but I know it is as equally challenging and embarrassing for the customer as it is for us. So it's in all of our interests to try and move this forward as expeditiously as possible.

In terms of circumstances. I can't think of any but Phil might have a thought on that?

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Phil Harrison, Chief Financial Officer

I mean what we've reiterate is that we have no knowledge today that would make us change the DV. I don't really want to speculate on future occurrences', we'll deal with that when they arise.

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Question

And secondly, just on payment terms in terms of the UK, which again has been quite a sort of contentious area I suppose. You can see that the payments have come down. Just really thoughts in terms of where the Government is on this at the moment, they seem to be a little bit less draconian perhaps than they were. But do you perceive that you'll continue to see the payment days drop over a period of time from Balfour's and the industry point of view?

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Phil Harrison, Chief Financial Officer

We've been on a process over the last 18 months, pre anything that's happened this year to improve our processes in terms of actually collecting cash and paying our suppliers on time. The industry is very complex when it comes to invoicing, making payments, just because of the difficulties that go on day to day on sites and changes that occur.

But over the last 18 months we've improved all our metrics significantly. We have an action plan that has been approved by the Prompt Payment Code, which we're working through, that we will consistently, I think, deliver improvements as we go forward, which is our commitment.

I say our first commitment is actually always to our supply chain, because we live and breathe what we do and how we deliver by our supply chain partners. So it's essential to us to make sure that they are paid and also perform.

The Government itself has brought out new guidance, it made the guidance earlier in the year that said that you would not receive, or you would be reviewed, if you were below 95% payment to supplies within 60 days. In the last three weeks they have reduced that to 75%. I think that's in recognition that the processes and the improvements that need to be made across industry is going to take more time.

But we're committed to improving and as you can see our results this time around, again, is an improvement.

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Leo Quinn, Group Chief Executive

I think I'd just build on that in one way. First of all we're totally committed to paying to terms. But beyond that we're totally supportive of our supply chain. So it's not a question of whether we follow the code, the fact is it's in our interest and getting the job done on time that we're philosophically supportive of paying our suppliers on time. So I see it as it's ingrained as part of our culture.

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Gregor Kuglitsch, UBS

I've got I think four, some should be easy, some maybe not. But just on the military housing could I have two questions there? So the first one is the two bases how much are they of the DV so that we can sense of what the risk is? And just to be 100% clear are these contracts all structured separately on an SPV basis with non-recourse to the Group, so just so we can understand what they're maybe thinking about contagion risk of some sort.

And then the second question is on incentive fees, so can you just give us a sense of how much of either the whole portfolio as a percentage, the incentive fees represent as part of the value, because obviously that's the bit I think that's been kind of under discussion?

And finally, obviously we're not privy to the contracts, but are there any clauses in the contract where you can get fined for I guess this kind of misconduct?

Sorry this was kind of three questions and it's only supposed to be one.

So the second question is you're mentioning on the UK Construction business that the sort of contract terms are changing with lower risk and more collaboration. How much of your book, or your business is actually on those new terms, because I guess there's still - not everything is like that but I would want to know how much is actually in that sort of lower risk phase where your loss potential is lower?

And then the third and final question perhaps is could you just give us an update on what the resolution is with the Scottish Department of Transport on the Aberdeen bypass on any potential settlement of the final contract? Thanks.

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Leo Quinn, Group Chief Executive

We could have done a separate presentation for you couldn't we.

Laughter

Phil, let's take the military housing one because that's an easy one - we'll get that out of the way for you and then what we'll do is I'll tie off the Construction one and the Transport Scotland and the Aberdeen Peripheral Bypass.

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Phil Harrison, Chief Financial Officer

So on military housing, I think you asked are these bases in separate SPVs. We - the two Air Force - the Air Force bases are in separate SPVs, Tinker is in a project wrapper that we call AMC West. So we have 21 project companies in our portfolio that add up to the 55 bases.

They are non-recourse debt, there are not cross defaults - and I think that's important to recognise.

On incentive fees we make a statement in the - and I'm just trying to - I think it's 13$% is the figure that we have told you in the statement. And that is all air force bases the 21.

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Gregor Kuglitsch, UBS

And the DV?

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Phil Harrison, Chief Financial Officer

And you can roughly extrapolate that to the DV.

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Gregor Kuglitsch, UBS

And then just - sorry before we move on, the sort of two entities, the SPVs, so AMC West and I guess I don't know Mountain Home. How much is that of the entire - is it 2 out of 20, so 10 - 10% roughly?

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Phil Harrison, Chief Financial Officer

No.

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Gregor Kuglitsch, UBS

Of the DV?

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Leo Quinn, Group Chief Executive

I think rather than sort of answering that now - we'll just take it offline and give you the answer to it.

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Gregor Kuglitsch, UBS

No problem.

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Answer

The percentages are of the military housing portion of the DV, not the whole DV, so the percentages merely relate to the element …

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Phil Harrison, Chief Financial Officer

They don't relate to our £1.2bn if you put it into …

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Gregor Kuglitsch, UBS

Of the £500m.

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Phil Harrison, Chief Financial Officer

If you put it into the £1.2bn context it's immaterial.

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Leo Quinn, Group Chief Executive

Your questions were around UK Construction - how much of the portfolio falls into that more collaborative side. Do you know it's obviously very difficult to measure it because you've obviously got your historical contracts which are trading through and you do have a complete myriad. But I'd have to say the portfolio is dominated by what I think is the collaborative type of engagement.

If I think of Highways England and I think of their revenue. If I take the Scape partnership in that. If I take our Service contracts, I'd say the portion is large. And with the likes of HS2 as and when it comes into the portfolio it will be even larger. And I think that's actually also in self-preservation because I think the client base is realising that it has to work collaboratively on these projects otherwise it will have no one to do them in the future. And you know there has been a lot of failures on the back of the old model.

In terms of the resolution of Transport Scotland we continue in good faith dialogue with Transport Scotland. There is an impending deadline which in December proceedings have to be filed with the court so that we don't sort of exhaust the statute or the limitation of the statute on the claim. So it will be coming to a head by the end of the year either in court or some sort of resolution.

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Gregor Kuglitsch, UBS

Thank you very much.

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Marcin Wojtal, Bank of America Merrill Lynch

Hi, so the first question is on your dividend which was increased 31%, so can you explain how did you get to this number, does it strike your profits from operations and can you maybe help us a little bit to try to forecast your final dividend for the year on that basis?

Number two, just going back to contract structures, in the US you've got a couple of large Civils projects in Los Angeles and also in Texas. So are those fixed priced contracts or there are some elements of profit sharing or cost plus perhaps?

And maybe lastly on working capital, which was quite solid I think in H1, but what do you expect for the second half, because I think as you show in your results release there was some progress on the receivables, but there is at the same time a build of payables. So I'm just wondering if this is sustainable - what we saw in H1?

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Leo Quinn, Group Chief Executive

So obviously I've no idea how Phil determines the dividend so it would be good to hear and answer to that question myself. So if you can do the dividend and the working capital I'll do the Texas contracts?

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Phil Harrison, Chief Financial Officer

Oh you want me to start - well the Board determine the dividend. The dividend - we look at a number of - or the Board considers a number of things, clearly dividend cover, the progress of the business. The 31% is actually a little bit around the maths because we prior year did a 33% increase.

If you actually look at the split, or split is typically one third / two thirds, if you extrapolate what we've done now you'll work out that if the Board does declare in the same ratio as last year it would be a 33% increase full year, if the Board determines that at full year, but that's up to the Board at full year to do.

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Leo Quinn, Group Chief Executive

So we'll leave the Board to determine that will we?

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Phil Harrison, Chief Financial Officer

Yep.

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Leo Quinn, Group Chief Executive

And the working capital?

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Phil Harrison, Chief Financial Officer

Oh working capital, working capital - I think we're looking at being relatively neutral through the full year. I can see us being plus or minus full year £20m or £30m, but clearly we're not anticipating anything of the size of last year. As you know that was predicated on some very specific things around outflows on Aberdeen, the US revenue declines that we experienced last year and some of the payment progress that we made. So we're not anticipating those things to repeat in the second half this year.

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Leo Quinn, Group Chief Executive

Okay and the answer to the question - so the last question was about the nature of the contracts in the US. So in the case of LAWA which is the LAX People Mover, that's a design, build, finance and operate. So that's taking the full portfolio risk there is also a maintenance contract on the back of that. We are not part of that long term maintenance contract on that job.

I was visiting the job - or I visited the job should I say two weeks ago and at the moment it's on programme, it's a little bit high on the schedule for breaking ground, but things look to be well within the range of where we've struck the forecast.

In the case of the University of North Carolina where we're doing a thousand room student accommodation that is a design, build, finance and operate. That was actually - I was there four months ago and that actually is proceeding very well.

Interesting enough that is our top performing construction team in the United States and I'm very, very confident that that will come in on time and schedule. So everything I saw gave me confidence and we're already on that campus going other work, this is a run on from that work.

In the case of the I-635 which is the interstate in Dallas, that is a hard bid job. It is in joint venture, the Texas is our most successful highways construction operation. We delivered the Horseshoe Bend project which was 500m at a double digit margin. A very capable team. The same team is actually delivering the Southern Gateway which is on programme at the moment. And this is actually 25 miles up the road from those two projects.

So it would be a bid around a high degree of confidence because of our previous experience in the area, but also working with the client.

But make no mistakes 1.7bn is a big road project, a lot of dependencies, there is risk in it, it's a question of our ability to manage the risk, but I would have a high degree of confidence in this team in that geography.

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Stephen Rawlinson, Applied Value

Hi, can I ask four questions, sorry about that - four unrelated questions. The record is seven by the way set by Mark Stockdale, so you know I'm still short on that one.

Just the first one, on the £150m you've got to find next year on the prefs and some other chunk of change that you've got to find, how would the manifest itself in the P&L coming through next year and 2021, because obviously the interest cost was about £15m I think on that particular item last year. So how could we expect that to drop

through and would you repay it in cash or might it be repaid in shares and we should be thinking of that as well.

Secondly, with regard to risk - you mentioned risk in the UK context in relation to Construction; could you just talk about it a little bit in relation to Services, because obviously we've had things like the Outsourcers Playbook and so on?

And in the text of the statement this morning you talked about managed 5% growth by maintaining disciplined bidding practices, sort of the implication being that actually perhaps you could have grown a little faster on the order book if you hadn't maintained them, or perhaps also it might be that the Government is coming back with tender documents that improve the original terms given the fact that nobody bid in the first place?

Thirdly, you talked a bit about growth, how should we be thinking about that, because you talked about the platform for growth?

And finally, forgive me on this one, also the pension - the discount rate has gone down to 2.2% from 2.8%, which has increased the net liability and you have seen a £16m outflow in the first half in cash. How would we be thinking in future about the cash flow item related to the pension fund deficit funding?

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Leo Quinn, Group Chief Executive

Right, well given the first one is financial I better take that - I'll do that one, but the prefs will be paid down out of cash. I think from memory they carry an £11m coupon a year.

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Phil Harrison, Chief Financial Officer

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Leo Quinn, Group Chief Executive

12. And that effectively will go back to earnings and cash flow and it will just go into the pot and then we'll decide how that gets distributed or used either in the future to buy down shares or pay a bigger dividend and whatever.

But after 20 years of the prefs it will be nice to see them gone at a 10% coupon -

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Male

I don't think so.

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Leo Quinn, Group Chief Executive

Nor does one of our Board members who is the holder of them.

On the pension I should probably take that but that's an easy one so I'll give that to Phil.

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Phil Harrison, Chief Financial Officer

I can't remember the pension one, you'll have to take it.

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Leo Quinn, Group Chief Executive

The question was the reduction in interest rates - the fact is our pension is hedged for a reduction in interest rates so it doesn't penalise us. But you can have a go.

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Phil Harrison, Chief Financial Officer

I mean that's the - it's not the actuarial valuation it's just the IFRS calculation, so we just adopt the normal discount rates that are prevalent in the market.

I think the more important point is that we're in the triennial re-evaluation year, so we're working through that this year and we hope to conclude that at the end of the year. So that's our current …

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Stephen Rawlinson, Applied Value

In terms of cash flow going forward what should we be thinking with regard to that given the £15m I think of unusual - of abnormal payments in the first half?

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Phil Harrison, Chief Financial Officer

Yeah and you should - it'll be roughly the same in the second half, so we're not changing any of our assumptions around cash that we've given to you previously.

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Leo Quinn, Group Chief Executive

Okay and the Service one is a really interesting question because like everything you know it looks perfect on the outside, like a sausage, but you're never quite sure what the contents are. So I'll try to unravel some of the contents and make sense for you.

The portfolio is made of rail, service and maintenance, local road maintenance, gas and water, with gas and water being very different and also power.

Within that the road maintenance business with many local authorities has been well established for - oh ten years plus and is actually well understood, well managed and we're fairly comfortable about the forward projections in that area.

We haven't seen a lot of growth in that business because of some of the suicidal bidding that has gone on in the last few years. But what we've done is we've maintained our portfolio and as we get more productive over time we get better returns.

In terms of our rail service business, obviously that's a strong business for us, we're considered to be a very good supplier and we've just added the Central Track Alliance to that, which is £1bn over the next ten years.

And we've recently won the Welsh Rail contract there as well. So I think we see strong growth happening there. The nature of the contract, I can't actually remember what terms it’s signed up on, but I'm fairly confident that the terms would be very acceptable because they would align with where we’re contracting today.

In the area of Gas, Gas is a challenging contract because it’s coming to the end of its period and there is always goals for increased productivity, so that remains a challenging area. On the other hand where Water is at the end of its AMP period and we’re rebidding that, but Water remains a good business or fair terms. There are always odd nuances around the recognition of profit and the likes of that and you could write a bible on that.

And then the final area is Power. Power is a business which has the highest barriers to entry, that is invariably struck on a contract by contract basis. It’s an oligopoly in that it’s primarily SEC and National Grid. And we fully understand those terms and know how to work with them. We see revenue growing very rapidly in that area over the next two to three years because of the Hinkley electrification and power transmission lines.

This year Power is actually probably at its lowest revenue level, its cost basis being adjusted to match that revenue level. So as we see ourselves growing in the future, we’re rather optimistic about improving returns in that area.

Sorry about the vagueness of the reply but it is actually a really complex number of businesses tied up in there.

And then in terms of growth I think there's no doubt we could take on more business and grow, but I think that would be reckless. So what we've done is where we can't live with the terms is, we've worked with the client, we've never rejected, we've worked with the client to get them onto a platform and basis where we can go ahead.

And sometimes, you know, within our frameworks some of the terms that are asked for are quite Neanderthal, which we will never sign up to, but we find that as we work with the customer we can get to a point where it is workable and there isn't there isn't the risk transfer that was previously thought. So we're a great believer in managing to a successful outcome on terms which are acceptable. But generally I see terms in the UK moving to much more sensible than they were in the past.

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Stephen Rawlinson, Applied Value

Thank you.

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Leo Quinn, Group Chief Executive

Any more questions. Hopefully we'll have another good set of results.

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Phil Harrison, Chief Financial Officer

Over here, one more.

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Leo Quinn, Group Chief Executive

So we'll do this and one more because I know people have got schedules and it's just after 10am. So please carry on.

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Analyst, Jefferies

Just three questions from me please. The first one is on the supply chain. So given the importance and close relationship you have with the supply chain and the upcoming VAT changes possibly adding some pressure on their cash flow I was wondering if you see any consequential impact on Balfour Beatty besides the invoicing which you flagged in the press release?

The second is on Gammon. I appreciate that selective bidding is very much the priority, but with bidding trends seemingly improving could we see some further growth coming in, higher growth coming through in the coming years?

And finally, sorry to go back on the military housing, but have you identified any scenarios whereby the maintenance concessions could be revoked without compensation? Thanks.

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Leo Quinn, Group Chief Executive

Okay, I'll have to get you to talk about the VAT implications. But on the new arrangements logistically and process wise it's a nightmare for the industry. For those of you who don't know, the responsibility for collecting VAT is moving from the Government collecting it from the subcontractor and supply chain to the main contractor. I think that's the right way of describing it isn't it? And you know, the change in process and systems is huge and it is an extremely challenging task. And I'm not sure everybody'll be ready on the prescribed date associated with that.

In terms of the VAT and cash flow implications?

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Phil Harrison, Chief Financial Officer

It's too early to say what will be the impact. We've got a team; we've got the systems in place. We're well ahead of doing what we need to do. We'll just have to work with our supply chain and deal with the issues that arise.

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Leo Quinn, Group Chief Executive

In terms of your question on Gammon, I could answer that generally in terms of the UK, USA and Gammon. Our issue isn't around opportunities to do work. The issue is around the risk involved with the work and the margin associated with that. So I don't see, in the current market globally - we're entering into what I think is an era of we're a supplier constraint, even if we want all the work, we don't have the ability to man up and deliver it.

So we're not short of opportunity. What we're short of is the right terms and then for the limited workforce we have, how we engage it to the best advantage. And that applies to Gammon as well as in the US and the UK.

In terms of military housing, I'd probably have to go back to my statement. There's nothing that we know of whereby service could be taken away or would be taken away. You've got to remember these are allegations, nothings actually been proven at this moment in time and we're investigating it. And our statement says that we know no reason to change either our financial forecast or our Directors' Valuation for the business. Probably that's the only sensible of asking or answering the question.

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Analyst, Jefferies

Thank you.

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Leo Quinn, Group Chief Executive

Any last questions? Otherwise you're all free to go.

Can I thank you for your time and patience and I look forward to a successful day.

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