Balfour Beatty

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Leo Quinn, Chief Executive Officer

Phil Harrison, Finance Director

QUESTIONS FROM

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Video Played

Highlights

Leo Quinn, Chief Executive Officer
Good morning, I think you'll agree with me we do some really cool stuff in this business. Normally I'd start off with the financial highlights, but today what I'm going to do is start off with the things that underpin those financial highlights. And as I said last time, it's a little bit like an iceberg, you know the financial results you see is the 10% at the top and what we're really interested in is the 90% of what's going on below it in order to make it possible.

As you know we're just coming to the end of our 24 month self-help plan, and I have to say, you know, we've used every single day of that 24 months in order to get this plan in place. And I think one of our highlights was actually divesting ourselves of our Middle Eastern presence, and that managed to run over into this year, so we missed it by two months. But when you hear what we've achieved in the last 24 months, I think you'll see it's very, very impressive. And of course that forms a foundation for what I think are the future benefits that will flow to Balfour Beatty.

First and foremost, in terms of our measures we laid out a target in terms of LEAN in that we were going to take - and improve our cash flow by some £200m cash in and £100m cost out. And as you can see we've actually blown that away with £400m in and £123m out.

We've continued to simplify the Group over the last 24 months. We've divested ourselves of our Indonesian joint venture. We've divested ourselves of our BBIP, which is our Balfour Beatty Investment Partner asset, which was an asset that was consuming about £50m of cash, and wasn't necessarily generating a return and was a joint venture which effectively was a challenge to manage. We've divested ourselves of our Middle Eastern business. We've exited Chile.

So fundamentally the portfolio that we're managing as a Group is a lot more simpler today than it actually has been for a long, long time. And we are not stopping there, there are more actions that we will be taking in the future.

We’ve also de-layered and upgraded our management right across the organisation. I think you'll see later that 80% of the senior management is actually new to the company or new to their position. In the last 12 months we've actually consolidated the United States under a single leader, we've consolidated our M&E in the UK, under a single leader, which is called BBIK and that's with Simon Lafferty. And also we've actually put a new leader in charge of our Power business.

Now it's very interesting, every time we upgrade our leadership and we put a new person into post they immediately come along and open the cupboard door and find a load of things that we've never actually seen before and actually put them on the table. Now that's actually good news, because I'm a great believer in transparency, and I'm a great believer in bad news early is good news. So these results actually have absorbed all of those challenges that we've actually seen and some of them were actually surprises. So underlying there's a lot more gone on than actually appears on the surface.

We've looked at improving our risk management and we've strengthened our governance and controls, all the way through to our gated lifecycle process. The R12 that we put in place 18 months ago is now starting to drive real benefits and giving us real time transparency into jobs as they mature, which allows us to actually understand what's going on and to intervene earlier if necessary. So we're seeing great benefits from that.

Our customer satisfaction has now increased from the 80s up into the 90s. So despite all of our legacy challenges and the projects that we have out there, our reputation with our customers is actually improving, which I think is a great sign and is confidence in Balfour Beatty.

In the medium term and the long term we're operating in markets, primarily the United States and the UK, where the mood for fiscal expansion and infrastructure improvement has actually heightened. And we're seeing a lot more emphasis around that, both in terms of the Fast Act and bonds delivered in America. But also in the case of the UK, airports, new nuclear, motorways, HS2. So we're facing into what I think is a very favourable market.

The progress that we've made to date and the strength of our balance sheet now gives me confidence, and the Board, that we can reiterate and affirm our targets for not only Phase Two, but also if I start to think beyond Phase Two, given our scale, given the fact that we've integrated 45 companies in this last two years into a sort of single Balfour Beatty it gives us confidence that there's actually - that the targets that we've put out there are going to be achievable.

The business at this moment in time has real momentum, which I think you can see within these particularly numbers. The bookings are up in constant currency terms 4%, revenues down 3%. I want to be careful that we don't define our progress by top line growth because I'm not actually interested in top line growth, what I'm interested in is profitable growth and earnings growth in the company. So it's really important that it's the quality of what we're booking and our assessment of risk in terms of what we're taking on. And that means where we don't understand or we're not comfortable with that risk we will actually walk away from the opportunity.

We've become much more selective in the last 18 months at the first stage of our gated lifecycle, whereby we're not going to go down a route and spend money on something that we don't feel comfortable that when we win it that we can actually deliver it. So our close rate has actually gone from one in three to one in two in that period of time.

In the areas of profit, we're seeing profit across the Group. In terms of the second half we've delivered £67m of profit. And although the number is small in terms of UK Construction, the second half of the year was a £2m positive, which is a dramatic turnaround.

The real key thing in these numbers, both in terms of the quality of the backlog and the profit is the actually momentum and the trajectory that you're seeing in the business. And we've come an awful long way in two years. Our balance sheet strength at £173m of closing net cash and despite all the assets that we've sold and the fact that we've reinvested we still have a DV of £1.2bn for our investment portfolio, which I think is excellent. And again, you know, the Board's confidence in the progress that we're making is underpinned by the fact that we've reinstated the dividend last year.

So finally, you know, we've got a real positive trajectory in the business and I think we're off to a really great start in terms of entering the second phase of our Build to Last programme. And on that note I'll hand over to Phil.

Financial Review

Phil Harrison, Finance Director
Thanks Leo. I'll start with the headline results for 2016; I'll cover most of these items in separate slides later, but just to make a few comments on the overall numbers. In 2016 the Group returned to profitability, order book, revenue, profit from operations, earnings and net cash are all improved year on year, as the progress made with Phase One of Build to Last translated into improved financial metrics.

Group revenue increased 4%, but was down 3% in constant exchange rates, consistent with our strategy of a disciplined and selective approach to bidding. Importantly following two years of losses the Group returned to profit with underlying profit from operations of £67m. The positive trajectory on our financial metrics gave the Board the confidence to reinstate the dividend during the year. I'm pleased to announce that as anticipated the Board have declared a final dividend of 1.8 pence, bringing the total for the year to 2.7 pence per share.

I'll cover the order book on the next slide, I'll also talk about the Directors' valuation and our net cash position on later slides. But it's worth remembering that these underpin our balance sheet, which remains one of the strongest in the sector.

Now moving to the order book, as you'll see the order book was up very strongly in 2016, increasing by 15% to £12.7bn, stripping out the benefit of foreign exchange, the growth is 4%. The key driver was the Construction order book, which increased by 23% to £9.6bn, 6% at constant exchange rates. Importantly there were double digit increases in both our core markets, with the UK up 11% and US up 10% at constant currency.

It's worth talking about the UK growth for a moment. During 2015 we focused on improving the quality of new orders, and by that I mean using more realistic cost assumptions, increasing the margin and enforcing better terms and conditions. In the short term it resulted in lower order intake in 2015 as the business adjusted to these higher thresholds.

The growth we have seen in 2016 is controlled and without compromising on our improved bidding disciplines. In addition there has also been a shift towards a lower risk contract portfolio. Approximately 45% of the value of new UK regional orders in 2016 were two stage tender projects. This represented a material increase on 2015, with two stage tenders generally replacing standard project contracts.

In the US there were a number of notable contract wins in the year. In Infrastructure the Group won a contract to build the 52 kilometre Caltrain rail corridor, between San Francisco and San Jose, whilst in Buildings major awards included multi-storey mixed use projects in Dallas, Washington and San Francisco.

Turning to Support Services the order book was stable at £3.1bn; we saw inflow in the Transportation business, offset by the expected reductions in the Gas and Water businesses as we progress through the regulatory cycles.

At the end of 2016 we have an improved order book both in terms of value and quality, which provides greater cover for 2017.

Now a slide on the financial performance of each segment, starting with Construction Services. The Construction Services segment has been the source of the Group's poor performance over the last few years. Looking at the overall results, revenue was up 7% at £6.9bn, but was actually down 1% at constant exchange rates. I'll now discuss each part of the business in turn starting with the US.

Balfour Beatty

If we strip our foreign currency movements revenue declined by 2%, driven predominantly by our exit from stick frame residential building work. This was one of the causes of our profit underperformance in 2015. Importantly the US did return to profitability in the year and with an operating margin of 1% it is just at the lower end of our industry standard margin target for the region.

In the UK revenue was down 6% as expected, with the greatest declines in areas where we had the greatest contract issues historically and where we managed the order book down last year. The loss from the UK Construction business was £64m, representing an improvement from prior year. The loss in the period was caused by three main factors, additional losses incurred on historical contracts, low overhead absorption, due to the lower revenue base, and newer projects, not at a stage where it's appropriate to begin to recognise gross margin.

Rail is relatively immaterial, in fact going forward we'll include this unit within UK Construction.

In the Far East revenues at Gammon were up, but profits were down; as we've been more conservative in how we recognise profit at the early stages on larger projects.

And in the Middle East, post the 2016 year end we made a complete disposal of the business to our former joint venture partner.

Progress continues to be made on returning the Construction Services business to profitability, with the second half seeing a £37m profit after the first half loss of £60m. This demonstrates a significant positive trajectory, despite the overall loss in the year. As indicated at the interims in the second half UK Construction Services returned to profit following substantial losses over the previous two and a half years.

Now moving the UK historical contracts, this is the same slide I have presented before, a tracker of 89 UK contracts that have been distorting the profit and cash performance of the Group. We have made good progress in closing more of these contracts out, we're now continuing on site in only nine jobs down from 36 in December 2015. This means we reached our year-end target of practical or financial completion on 90% of these jobs.

There has been good progress in taking projects from practical completion to financial completion, where we've now reached final accounts on over 70% of the UK historical contracts. Going forward we have four contracts finishing in 2017 and five contracts that will complete in 2018. We do not expect to present this slide again, as we remain focused on achieving industry standard margins for the UK Construction business by the end of 2018.

Now moving to support services, revenues in the year were down 12%, this was mainly in the transportation business where revenues from Highways England declined due to lower capital spend on a number of contracts and due to the completion of our Area 4 contract. The prior year also included a rail grinding contract, which is now complete.

Revenues in the Utilities businesses were also lower, with lower volumes from overhead lines in the Power business and lower revenue in Gas and Water as the AMP6 contract mobilised.

Importantly, profits improved over the prior year, which as we explained at the time was unusually low for a number of reasons. Profits in the year were £34m, which represents a 3.1% margin, again, just at the lower end of our industry standard margin target.

Moving to Infrastructure Investments the Investment business delivered a strong performance during the year, Investments made significant progress in simplifying its operations by exiting Balfour Beatty Infrastructure Partners, an infrastructure fund run at arm's length and focused on secondary opportunities and exiting from the Australian market. In total 16 assets were either sold or part sold in the period, with all transactions either at or above the Directors' valuation.

Profit from operations at £89m was lower than the prior year, predominantly due to a reduction in profits on disposals as a different mix of assets were sold, despite an increase in proceeds to £189m.

In the near term there are no plans for material disposals in the first half of 2017, we do anticipate disposals over the next 24 months, but they will be timed to maximised value. These transactions are by their nature lumpy; however we look at our Investment business in terms of asset valuation, rather than earnings driven, so timing is less critical.

Pre-disposal operating profit decreased to £24m due to the effect of previous disposals and net interest income remained broadly consistent year on year at £26m.

We'll now look at the new projects and the complete disposals in the period. If we look first at the new project wins, you'll see that we're continuing to win new projects as we actively invest into the front end of the business. These are the projects that will generate the future growth in the Investment portfolio.

There were four new wins in the year; in the UK we invested into a new private rental housing project, with the purchase of a site in Manchester New Cross. In Canada we won a datacentre project in Borden. And we continue to expand in the private rental housing market with the acquisition of two stakes in the private rented and regeneration sector in Alabama and Georgia.

There were also eight complete disposals in the year, firstly we sold the student accommodation project in Australia, this was our only asset in Australia. At the bottom, the big cluster of pins represent the disposal of the portfolio of seven BSF schools. There were also a number of part disposals during the year, including a 30% interest in the M1/A1 and an 80% interest in five street lighting projects.

If we now move to the Directors' valuation, the Directors' valuation was broadly maintained at prior year level, at £1,220m, despite material disposals of £180m. The Group continued to make substantial investments with £65m allocated to new and existing projects. Equity was invested in student accommodation projects, hospitals, regeneration developments and waste projects.

Looking further down at the bigger numbers at the bottom, firstly the unwind of the discount on NPV, which is always positive, increased the valuation by £90m, there was a small reduction due to operational performance movements, which was more than offset by the FX benefit on the value of our North American assets, at circa £85m.

Overall a very strong performance, with no material change in value, despite the disposals completed in the year.

We'll now look at the strong cash flow performance in more detail. Overall we did better on our expectations on year end cash and average net debt, net cash at year end was £173m and average net debt for the year was £46m. The total operating cash outflow before pension deficit payments and working capital movements was £58m, relating to the losses generated by the Construction business. This was a £189m positive swing from prior year.

On the next line you'll see a working capital outflow of £48m; this is expanded into more detail on the top right hand side. This was a better performance than anticipated as we continue to drive cash disciplines across the business and we benefited from £50m of legacy contract cash flow timing than will now flow out in 2017. So working capital better than expected and over Build to Last Phase One favourable by £130m.

Now moving back to the left hand side again, Infrastructure Investments as I previously said realised £189m of disposal proceeds, offsetting this is the £65m we invested in the front end for the future growth of the portfolio.

Finally, we made £41m pension deficit payments in the year, going forward our agreement with the trustees on the triennial valuations mean now our deficit payments will be circa £30m per annum going forward.

We'll now turn to my final slide showing the Group balance sheet. As you can see the Group balance sheet has seen a reduction in the year with equity holders' funds of £757m at the year end. Most of these items such as cash and working capital I've covered in previous slides. It's worth remembering we hold the investment assets on our balance sheet at book value, rather than the Directors' valuation I talked of earlier.

One item to highlight on this slide is the net retirement benefit liabilities of £213m which is £85m higher than the year end, than last year end I should say. This is consistent with market trends in the second half of 2016 and due to our hedging capabilities it is probably at the lower end of what others have seen.

However, as previously reported probably the most important development is the progress we made on the triennial review of the Balfour Beatty pension fund in conjunction with the trustees.

In conclusion, we continue to maintain a strong balance sheet, underpinned with low average net debt and an investment portfolio of £1.2bn. This gives us greater flexibility as we enter Phase Two of Build to Last.

I'll now hand you back to Leo.

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Leo Quinn, Chief Executive Officer
Thanks Phil. We had to change the mic apparently I’m not sure that the introduction actually works so we’ll see on the replay.

. . . .

Phil Harrison, Finance Director
You're not doing it again are you?

. . . .

Leo Quinn, Chief Executive Officer
I could if it was requested.

. . . .

Build to Last

Leo Quinn, Chief Executive Officer
Build to Last - let’s just recap for a few minutes in terms of where it is that we’ve come from. Back in 2014 we had our burning platform. And if you’re going to pull off a transformation the easiest place to do it from is when you’ve got a burning platform and we certainly had one. Over a decade of acquisitions, 45 in total, and forced growth led us to a point where we were haemorrhaging cash. And to be quite honest if I go back and think about 2014 when I joined you know survival was not mandatory it could have gone either way.

As I look at our balance sheet today and the performance in the company, I think under Build to Last I mean we've transformed this company in 24 months. And I don't know many companies that can take that amount of change that quickly that I've seen. And Build to Last was really around this is a 100 year old company and it's how do we put a foundation in place for it to be here for another 100 years. It's not about a quick fix and sort of turning around the P&L and making it look good. This is a step by step slow transformation to build the company back to greatness. So hopefully you'll see no great sort of innovations that all of a sudden miraculously turn the P&L around.

The planks of Build to Last were first and foremost we were going to simplify the Group and you've seen the actions we've taken around that already. We're going to strengthen leadership and you can see that 80% of the leadership has been upgraded or new to the company or new to the position. We're going to improve governance and controls which you can see through the gated lifecycle. And then we're going to actually look at transforming the culture, people in companies ultimately respect what you inspect. So it's the measurements that we're putting in place that it actually controls the behaviours and how people act in the company and this is a really important part of actually sustaining this transformation into the future.

The four planks around Build to Last were LEAN, Expert, Trusted and Safe and what I'll do is I'll take us through the progress in each of those areas.

As you remember we defined LEAN as £200m cash in and £100m of cost out. And as you can see we've actually delivered £400m cash in and £123m cash out. And if you go back to 2014 what you can see here is at the peak we had in one 12 month period a £600m cash outflow from the company and that is real haemorrhaging of cash.

And as you see the actions we've taken in 2015 and then again in 2016 have moved the cash curve up considerably, we still have the sign your soil amplitudes, where in fact that gap is actually the improvement in cash flow. And our strategy around this was actually although very simple was really, really challenging.

We took a very, very big gamble and that gamble was that we were sufficiently sloppy in our management of working capital that we could take about £300m out of that and that we had enough assets that will mature in their life in our Investment portfolio and attractive enough that we could actually do those sales. And we were successful on both counts. We improved our working capital, we actually divested our assets and reinvested in the portfolio at the same time, we suspended the dividend and we actually got lucky from foreign exchange, all of those helped drive the cash flow to the business.

In the Investment portfolio one of the real credits here is the fact that it is not easy to sell 20 odd assets. And to execute that flawlessly is a real testament to the competence and capability that we have within that business while at the same time continuing to invest in the future portfolio.

So in terms of the cash over a 24 month period, job done. The most important thing is the disciplines that we've put in place will stay with us for the next five years and longer.

In terms of cost out this is an area where I'm particularly proud because when you look at the organisation it is £8bn, it has all of the costs that we had and centrally we had over £500m of indirect overhead costs. How do you address it? We made a really bold decision very early on, we said the businesses have the responsibility to sell and deliver and all over back offices will be provided as a service whether it be IT, HR, finance, health and safety, etc. And it's only by driving the scale economies in those that we're able to drive out the costs.

And we then engendered a load of initiatives around My Contribution in terms of engaging our employee's actively in terms of bringing benefits to the table. The business has delivered over £40m, the support function's took out over £20m. IT was probably the biggest transformation because two years ago we were spending over £100m and the most interesting thing about that £100m was it didn't actually work, we didn't get any benefits for it. Today we spend half that amount and it works really efficiently; even to the point a very simple example is we meet the executive team every Monday at 1 o'clock for an hour, we now do it over video con and we have eight or nine different people dialling in on the video con and we can see everybody on the screen. And it works and that's the way we will work as a company now.

We've driven procurement both in the US and the UK and we've also driven a property strategy, we've taken 25% out of our property costs and about 35% out of our square footage.

We continue to simplify the portfolio, I talked about this earlier in terms of leadership, we've unified the United States under a single leader, the UK M&E is under a single leader and Power has been upgraded as well. And we've actually cleaned out in terms of we've sold our joint venture interest, Middle East and Indonesia. So all in all the Group is getting simpler. So all of the benefits that you've seen today we've really got a momentum, which means there's more to come in the future.

In terms of Expert this is a really key area for us and we laid out the strategy that Expert for us is about recruiting, training and retaining the best and the brightest. People don't buy because we're low cost, they buy because we have the best engineering capability and the best project managers. And the most important thing to ensure that we have the best and the brightest talent is to ensure that we actually have the best possible leadership. So the idea of making sure that our top leadership is top notch and also the next level is important. If I take the top two levels we estimate that about at least 65% of the people in those posts are new to post or new to company which is quite a change over.

The other thing that we've actually been doing and spending a lot of work on is that we make and lose money on jobs at the coal face and the quality of our project managers determines or had a huge influence on the performance of the job and the returns that we actually make. So we spend an awful lot of time now matching the competency and the experience to the risks and the complexity of the jobs that we take on board. And so what you can see here is this is actually a scale here where we've got blue, bronze, silver, gold, platinum and what we do is we grade all of the competencies of our project managers and we match them to the particular task. That way the probability of a successful outcome in terms of profit and customer satisfaction is much, much higher so this is really important to us.

We're also looking at our labour loading and making sure that we optimise as people leave jobs they get redeployed to jobs where they can actually add value. In terms of our company retention rate we're now down at about industry average we were actually two years ago losing I think just under 20% voluntary on an annual basis. That sort of haemorrhaging can't continue. So we're now low double digits in terms of turnover which is about the industry norm.

We continue to invest in our apprentices and graduates through our 5% club, really important if you actually look at the market demand in the future you've got to be investing in people today in order to ensure we've got the competencies and capabilities to deliver in the future. So our model as a company as we grow from within so recruiting early is really, really important.

And then of the course the future's all about digitisation whether it be BIM, whether it be drones, we've trained I think six private pilots to fly drones over jobs and to do surveys for us, whether it's 3-D scanning, whether it's virtual reality. All these things are now coming to the fore and they're actually becoming economically viable and a source of competitive advantage for us so we're driving our competitive advantage through our experts.

In terms of Trusted it's very simple it's about doing what we say we will do, and in this area here we've put the gated lifecycle process in place. We're doing an awful lot in the early stages of the gated lifecycle, one to decide what we pursue and then when we pursue it do we actually end up getting the returns for the risks we're taking on board.

I think in the UK about 42% of our jobs are actually two steps so effectively we do a beauty parade, we get selected in terms of overhead recovery and margin and then we actually build up the costs of the job together. So again we're de-risking the whole process and we're getting paid for our selling effort at that time.

We're creating the digital briefcase where all of the documents from birth to death of a project are actually archived. One of the challenges we found from looking at some of our legacy projects is that getting the paperwork and all of the data, the back-up claims and disputes has been incredibly labour intensive. By putting this in place we won't have that in the future, we'll be able to go to one place and digitally pull out all of that information. And it's funny my measure of success in terms of how this works is that what we'll see is a reducing audit fee although the audit itself will be more profitable than it is today in cash terms so you can look at that fee in the annual report.

Site mobilisation, really, really important for us, we historically used to set up every job with an individual project manager and if you look at the life of a project manager he might do five, six jobs in his lifetime. So invariably you're putting him into a new situation where he's got to establish all of the supply chain and everything else. We've stopped that now, we now have a central hub. So we're effectively mobilising or demobilising a job every single day and it's really important that these things get set up properly, they've got communications, they've got IT, they've got telephone, you know they know who the suppliers are for all these things and that's driving real efficiency.

A really simple example the other day in London there was one job demobilising and they were going to have to spend £10,000 to take away the office furniture and have it scrapped. And not three miles away was a new job starting up which was just about to spend £60,000 on furniture and equipment and so for a 10p phone call we put them in touch with each other and transferred all of the assets over to the new job, which is just a sensible way to operate. I'm convinced that in the future that will be saving us millions of pounds and millions of pounds in cash as well.

This might seem very boring but one business management system, if you think about we are 45 acquisitions, we've launched in the UK now, one single BMS, business management system and that means there's one way of doing things across the company so one maternity policy, one set of HR policies, one set of finance policies. So this standardisation just removes all of the ambiguity and actually takes unnecessary costs out of the business and I'm a real believer that this will drive real efficiency.

One of our mantras in the company is to collaborate relentlessly. And for us this is around how do we take our scale, our expertise and work together to win work and deliver things efficiently. The example I give is we recently won £100m plus job called ElecLink and that ElecLink is actually a combination of our power skills and our directional drilling capability from rail, without those two things coming together we couldn't do it. This also talks about you know we buy our plant internally through our internal organisation which has all the safety standards and is set up to serve what we need, rather than each job being able to go out and buy its own stuff.

So all of these things I think is driving a much more trusted organisation whereby we can be more confident that we can deliver what we said we can do. And from our shareholders point of view a strong balance sheet is really important, two years ago I spent my first six weeks talking to the banks in terms of wondering whether the balance sheet was going to survive. And in between that and talking to customers that said, we if we give you the job will you actually be here to deliver. You know I don't have any of those meetings any more, in actual fact I'm able to delegate the bank ones to Phil. So Trusted is really around doing what we say we will do.

In terms of safety I can't emphasise this enough, this is a ticket to play, you know we talk about it's our licence to operate, if you are not safe in this industry you will not have a business. And it's really,

really important that people understand that it's not only Balfour Beatty that's driving this, our customers are driving this as well.

What we've seen over the last year or so is that our lost time incidents have actually started to decline but it's declined in light of the process we've put in place about driving observations. We have our own company app whereby if you walk around with your iPhone you can pull out your zero hard app and you can type in an observation positive and negative and there's a strong correlation between observations and actually running a safer organisation, so really important that we drive this.

I'm a great believer in safety by design. And what I mean by that is how do you take the activity off the job site and do it in a factory or do it off site therefore you minimalise the interface that occurs on site and therefore by being safer. In terms of making safety personal we'd run a programme where we bring people from the outside in to talk about their experiences personally after a traumatic accident, they may have lost their partner or they may have been seriously injured but when you see the impact that has on people's lives it's quite shocking. And the idea is we want to wake people up to the fact that they're responsible for managing their own safety and they've got to be aware of it and we're putting time and effort into that. Every accident is reviewed; the lessons learned and then actually sent out, not only in our organisation, to the whole industry.

And then finally you know the sentencing guidelines have become quite penal; fines have gone up almost tenfold in my opinion. So this is an area where just the economics of getting it right first time makes sense so zero harm, licence to operate is absolutely critical for us.

This is an important slide because one of the unique things about the Balfour Beatty portfolio is the fact that over half of our revenue is actually sort of US denominated. And at a time where we're going through what I think is probably a period of a year or two of whether the UK pound is going to be weak, to have a strong dollar and a strong footprint in the United States I think is a real asset to our portfolio.

And against that backdrop what we're seeing in terms of US Construction, UK Construction is a very, very favourable market and infrastructure. In the US we've talked about the Fast Act in the past which is fixing America's surface transport, $300bn there are infrastructure bonds being released in California and education bonds, I think the education bonds are about $35bn.

Our footprint in the United States is actually it's very interesting and it's very clear, we work in California, we work in Texas, we work in Florida, Georgia, the Carolina's and up to Washington DC which is referred to as the Southern Smile. Within that on the infrastructure side we do three things, we do Roads, we do Railways and we do Water so that's the matrix that we work within. And if we go outside that we actually have a risk assessment and invariably we don't want to be outside those areas. On the vertical building side we do commercial, we do high rise residential luxury apartments and the likes of that. So our US business is extremely well positioned for what we see is the growth in infrastructure.

If I can just touch on UK infrastructure, we've talked about this ad nauseam, we are going to start to see I think jobs being awarded, HS2 will probably awarded in the next three to six months, these things are usually delayed. But there is huge emphasis by the UK government to actually ensure the economy remains stimulated during this period of uncertainty around Brexit. You can see there's the HS2 Highways England is a £5bn budget, energy and new nuclear is a big area, airports and tall buildings in London are still being commissioned and placed. So we see both the UK and the US which are our dominant markets as very strong.

In the areas of Support Services I'm very bullish about Power, I see the Power supply chain consolidating and I see us as having some of the best engineering capability in the sector. In fact our engineering centre's quite unusual because every company I've looked at for the last 10/20 years they've outsourced all of their engineering abroad, we've still retained ours in the UK and it's very unique in terms of power allowing transmission. We do have an Indian capability alongside that but I can see this area, by the way a loss this year in Power moving to profit very rapidly in the next 12 to 18 months cover.

And then in the area of Rail we contracted our rail business primarily on the basis that we were losing money on doing projects. We now have a very solid base, we're now actually making a return on our projects, we're contracting correctly. So I see Rail for us actually although CP5 and CP6 there's a funding challenge there, I see us taking share over the next 12 to 24 months in Rail because we're portably the most competent supplier to deliver what the customer needs. And we are I think the only rail supplier that's delivered electrification, we've done the London to Maidenhead line and there's a desire to make sure that gets extended.

Gas and Water I see being a cost plus business and a fee on recovery, so I think that will stay the same as it is today. So with Support Services you know I think good prospects going forward.

And then finally if I look at our Investment portfolio I talked earlier about the depth and strength of capabilities we have with investments. We are waiting for PF2 to see what impact that has, we were disappointed with their announcement in the budget but we've got the team able to capitalise on that opportunity. In the United States we're waiting to see what actually is going to happen around the US taxes and corporations repatriating cash back to the United States and what that does to actually drive the stimulus so that's quite interesting. We've got a strong pipeline of opportunity both in the UK and the US; so a good outlook for our investment business going forward.

This is actually one of the most important slides that we've got out there and you know Phase One I think targets delivered. But forget the targets they're meaningless, what we're looking at is the momentum in the business going forward which is extremely strong. And remember all the stuff that's happened in this iceberg, in this bottom 90% it's only just starting to build momentum. Last time I talked about the idea of a stick man on a box you know giving out a message, Build to Last and day one I was there on my own. We do have I think thousands of people that are now pointing in the right direction all driving the company to a better outcome.

As we look towards 2017/18 these industry standard margins I think are well achievable and given what we've achieved to date and the momentum I'm quite confident we can deliver these. In the case of UK Construction we're already at the 1% and Support Services we're at the 3% so it's not exactly the high bar of the industry but it's one step at a time, we don't want to get flashy about this.

And more importantly this is our earnings part of our portfolio, if we look at our asset part of the portfolio our assets don't change the sum of the parts valuation, but because we have a strong balance sheet now we can be much more discerning in the timing that we sell assets and how we reinvest that money.

And it was quite funny one of the analysts wrote a story that you've made the first 24 months look so easy by deciding not to sell as many assets you're making long term EPS targets even more difficult so you've introduced your own challenge. Which my answer was look our focus is how we maximise shareholder value in the long term not in the short term.

And then finally 2019 and beyond I'm confident that with 45 acquisitions actually integrated into a single Balfour Beatty we've got the strength in terms of scale and volume to make this a company that far exceeds the industry standard margins. So I think all in all you know we'll take it one small step at a time but I think a huge outcome for 2020 and beyond. Thank you.

Questions and Answers

Joe Brent, Liberum Capital
Good morning . You don't get off that lightly. Three questions if I may. Firstly maybe for Phil, you talk about I think practical completion, could you just make the distinction between construction completion and financial completion on those legacy contracts?

Secondly I expect for Leo, I understand that you're delaying your PPP gains and you'll get better value but I just wonder why you'll get better value by holding those assets for longer?

And thirdly you've achieved your cash and cost targets. Is there anything more you could say going forward about what you'd hope to achieve in terms of cash and costs?

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Phil Harrison, Chief Financial Officer
Practical completion, what we mean by that is we get certified that the job is complete so we can actually take people off the job so we actually demobilise at that point. Financial completion is when we do the final accounts. So if you like that is the final closure where we draw, except for any defects and there's a defect period going forward, but where we draw a line under the account and we've reconciled all the values and all claims have been settled. So that's what we mean by the two.

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Joe Brent, Liberum Capital
And when do you think you'll get to financial completion?

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Phil Harrison, Chief Financial Officer
Financial completion, we've got five jobs that will finish in '18 so typically after that you're about six months after that. So if you want the final kind of finish to these 89 you're talking about 2019.

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Leo Quinn, Group Chief Executive
Okay and the idea around delaying the sale of PPP. I think what we're saying is we will sell the assets at the right time. And let me tell you what's gone through my head and how I think about this. You have a good performing asset with a high yield and you're looking at it and you say well we can actually sell this today and we can actually turn it into cash. When you do that there's no change in the value of the portfolio but then what do you do with the cash? If you're not going to return it to shareholders you're actually going to go and put it back into another asset. So you've then got to look at what's the quality asset I'm buying with the cash and am I going to get the same yield? And so the way I look at it is why would I sell a good asset to actually put it into a risk adjusted another asset where I've got to wait three to five years for it to mature? So I'm looking at it and saying the decision I'm making is what's the best value? If this was my money what would I be doing? And so that's the decision process I'm going through. And the timing of it, it will be sooner if it's actually a good return and I can get a better return with the money, or it will be later if I don't think I can actually reinvest it in a better return. So it's only common sense the way I look at it.

And then in terms of further progress around cost, cash and all those sorts of things. I think what we've done in terms of looking at the industry standard margins, what we've done is we've turned those targets into things which are much more measurable externally that you can see. So I'd be pretty sure we're going to be looking to improve our margin returns on every project. We're looking to continue to drive productivity through the Group. And all those things will come together at a point in time to deliver industry standard margins. So in a way our cost reduction and continuing to cost reduce is sort of underpinning the risk of volatility and margin return.

Gregor Kuglitsch, UBS
I've got a few questions. The first question is on the margin targets. I think you've sort of spoken about them before but now you're sort of formally putting them out there. So the question is are you at this point quite confident that you can hit the midpoint from a P&L standpoint in 2018? That's the first question.

The second question is on Support Services. You made two points, one is that you're bullish on the outlook, obviously you had revenue decline last year so if you can give us a steer as to where that's trending? And then the second point you made was that part of it was loss making. If you could quantify that, what the impact was on the margin because obviously that creates an easy comparison basis?

And then my final question is on simplification. I think you've simplified quite a lot; you exited Middle East and a couple of the smaller geographies. Obviously the big one that's left is Gammon which obviously still sits there and it doesn't really seem to be fitting into your presentation today. So the question really is strategically do you think this is an asset that Balfour Beatty should hold over the medium term?

Leo Quinn, Group Chief Executive
Right just on the first one, stating the obvious but I wouldn't be wanting to put a target out there that I didn't think I could meet. So I think we have a plan in order to meet the targets and I think given the momentum that we have in the business and the fundamentals I'd have to say we're sort of confident - no we're comfortable with those targets, I've got to be careful.

In terms of Support Services we've seen good progress in Rail from a virtually a loss two years ago to a profit this year. Gas and Water will continue on its journey to sort of exercise its cost recovery and fee basis contracts better. In our Power area we had a write off in Power towards the end of the year under new leadership. We see that returning to profitability and over the next two years we think that will be a good performing at least 5% margin business for us. So Support Services I think is on a good trajectory.

And then in terms of simplification, we're going to simplify everything that we possibly can within the company so that it's more manageable and it's more transparent. We don't really refer to Gammon because it's largely a joint venture and so what we do is we take effectively a dividend from it each year. It's part of the portfolio, it's a good business, has a strong market share. No plans other than to keep taking the dividend at the moment.

Gregor Kuglitsch, UBS
Thank you very much.

Andrew Nussey, Peel Hunt
Good morning. Again a couple of questions if I may. First again going back to sort of the margin aspirations. Within Support Services obviously you give the revenues by Transportation, Utilities. In terms of the margin aspirations should we expect much difference between those two businesses?

And secondly in UK Construction, just get the feel around the regional business and the major projects and the differing trend lines there please?

Leo Quinn, Group Chief Executive
Why don't you touch on the Transportation Utility margins?

Phil Harrison, Chief Financial Officer
Within the Support Services I would say our Transportation margins on Highways is higher than for instance our Rail Transportation business. If you look at Gas and Water I would say they're at the lower end. And Power typically if we're doing overhead lines can achieve very good margins. So if you blend them all together that's how we come to the three but that's the kind of returns that we get.

Leo Quinn, Group Chief Executive
In terms of UK Construction obviously the numbers have been very opaque by virtue of the losses and the distressed contracts over the last two years. We're now starting to get quite a lot of clarity around that. In UK Construction for example under our BBK which is Balfour Beatty Kilpatrick where we've merged our M&E businesses, the building M&E business lost in 2014 £120m. We've now got a much more professional and structured group around that so I see that returning to profitability in 2017. And funny enough I'm actually very, very encouraged with the quality of the leadership and the disciplines and the management of labour because we have a 2,000 workforce in that area.

In terms of regional Construction, we're starting to see that return to profitability on the back of the losses. We're much more selective in our bidding. We're very comfortable to become a smaller business but whatever size we will be we will be profitable in that.

And then in the area of major projects again slightly different arena in that these are big projects, big scale, big cash flows. We are one of the market leaders in these areas. We see that sort of performing over the cycle at least industry standard margins. You do find as with Construction you do get jobs where it's materially higher and then you get others with a surprise that's materially lower. But on average we see that as much more forecastable because it's fewer larger jobs than what is a multitude of regional jobs.

Howard Seymour, Numis
Two from me if I can. Firstly on the Investments. Obviously on the one hand you're talking about the disposal proceeds but can you talk us through the pipeline of investments that you've got over the next two to three years, whether there's any lumpiness in that? Because it's always been regarded as a self-invested business so whether that would sort of create any ripples from that point of view.

And then second sorry apologies back on the industry standard margins, but you've alluded to the 24 month margin. Do you see it relatively linear or a sort of skewed distribution to that, i.e. do we just go straight in or do I take that half that from these 2017 numbers or not?

Leo Quinn, Group Chief Executive
I can give you a forecast if it would help. I've got the budget with me.

Laughter

On the Investments, look the investments is lumpy. It's deal-based for example. You know some of the things that are in the public domain in the pipeline today is we've got the East Wick Sweetwater project which is the Olympic Park. We've got the Sussex University where we're just in the process of raising the bonds for that at this moment in time. And on the US we've got a number of student accommodation projects and the likes of that, we've also got student accommodation in the UK. So we do - it is lumpy by virtue of the fact that the size and scale of these things is quite material. The pipeline I'd have to say - I'd have to just check with Ian, I can't remember how many projects we've got but there's quite a number at this moment in time, yeah it's a lot. So what you do hope is that over a two year period it sort of - there's enough volume and activity going through that it sort of comes out as even on the halves, but life doesn't quite work as simply as that. But I do see the next six months there's a hell of a lot of activity in terms of the investment side going on, an awful lot of activity.

In the industry standard margins and the trajectory, I'd have to sort of give that to my Finance Director because as far as I'm concerned I want it as soon as possible but he seems to want to make sure it's managed correctly.

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Phil Harrison, Chief Financial Officer
I think what you'll see is that '17 we will make progress but I think the bigger progress will be in '18 as we come out of the - as we trade out of not just the losses that we've had but of course we do have some order book at lower margin so we've never booked those losses but they have to trade out. So you'll see that trade out in '17. So it's probably more of a ramp in '18.

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Howard Seymour, Numis
I'm sorry - you alluded to Rail before and the potential to grow that business. Do I assume that that's organic as in the business just we need more workers …

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Leo Quinn, Group Chief Executive
Rail is organic and it's taking share yeah. And it's taking share because what we've managed to do in Rail by consolidating is our delivery performance is very strong and the customer recognises that and they don't see that universally across the industry so they actually want us to do more. And that's a strong position to be in.

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Kevin Cammack, Cenkos
Two please from me. Firstly if I look back over the historical track record of what the US business has achieved I suppose you know you've pretty consistently as a Group historically performed within the parameters that you're now targeting but it's not probably clear to me what actually has to happen in the business to go from say the 1% to the 2%. I understand there's a sort of mix that might be relevant but underlying that is there one or two things that you can point to that would be the difference between those parameters of margin?

And the second question I had was just sort of two parts on the cash flow. The slide that was breaking down the working capital, am I right in - could you just run through what that I think £60m was an inflow from provision. Is that just literally the unwind on the provision made on the legacy contracts, just to be clear, and is that the figure that you were talking about sort of repeating itself at £50m going forward?

And lastly sort of related to working capital but also I suppose back to this margin point, have you at all changed - I mean I know you talk a lot about de-risking the business and all the rest of it, but have you in any sense changed when you are recognising profit on new business that's won? So your comment about '18 being the stronger drive than '17, is that all about actually what's gone into the workload in the last 12, 18 months arguably is - you're having to wait a longer period for that to actually in accounting terms recognise profit on that?

Leo Quinn, Group Chief Executive
I'll take the first one and Phil can take the last two if that's okay. So in the case of the US as you said I mean we've been performing around the 1%, so what's going to actually drive us to 2%? I think we publicised that we wrote off $90m in 2015 in the US as we sort of came to terms with some of the contracts. Last year we put all of the US under Ray Bond in order to run it. And in doing that we've effectively brought the governance of that whole business together. The $4bn vertical business has never really been integrated into Balfour Beatty. It has pursued a strategy of growth because by growing it we keep the cash flow ahead of it and also the profit. We've stopped that now and said we don't want to grow. Between I think 2013 and 2015 we booked about $1bn of stick frame which is probably the low end of construction and the low end of sort of subcontracting and on that we chopped up a net loss, and that's now working through. The last of that will be finished this year. So the way I look at it is the previous losses and write offs, the nature and the type of work that we've engaged in to get top line growth which actually put the bottom line at risk is all stopping. So I see it as a much more concentrated portfolio.

The other thing I see is on the infrastructure side which is the roads, the bridges and whatever, I do see more volume coming through in that area and our ability to execute in there is very strong. So historically there's been two major contract write offs over the last five years. Going forward there will always be surprises but that business should perform in the area of 3% or at least 5% in terms of the infrastructure. So if I put all that together I think there's a very sensible path allowing for some contingency to get back to the 2%.

Phil Harrison, Chief Financial Officer
On your provision point talking about is that contract losses, our contract losses actually on that slide run through construction contract balances. So the provision number - and that increases down to, they're actually non-underlying items. There's £25m of sentencing guidelines that we brought to your attention at the half year. That's where typically if you've closed a contract that's where your defect provisions go as well. And we did take, in the second half we took a reassessment of our industrial diseases which means that asbestos is the bulk of it and we've taken a £14m charge in non-underlying for that. So that's the provision movement.

And Kevin I didn't quite catch your final question, sorry.

Kevin Cammack, Cenkos
You talked about the £50m figure for '17.

Phil Harrison, Chief Financial Officer
Yeah the £50m is in the contract balances, it's not in the provisions.

Kevin Cammack, Cenkos
That's clear, thank you.

Marcin Wojtal, Bank of America Merrill Lynch
First I just want to confirm what is the amount of cash that you expect to come out of the business as you complete the remaining legacy projects in UK Construction?

And related to that compared to the expectations you had let's say 18 months ago on those problematic projects on the cash side and perhaps recovering some of your claims, have you been able to outperform your own expectations on the legacy contracts or it's been more or less in line?

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Phil Harrison, Chief Financial Officer
If you look at it, it's in line. We've had some good news that we wouldn't have expected and we've had some worse performance. But on balance we've kind of come in where we said we would come in. We are anticipating a further £50m to outflow 2017. If we can hold it back to go into '18 we would but that's what we currently believe will flow out on these contracts.

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Marcin Wojtal, Bank of America Merrill Lynch
So £50m is the final number?

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Phil Harrison, Chief Financial Officer
At this point that's what we're estimating.

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Sam Bland, JP Morgan
Just on the UK Construction business, I think you gave an update at the half year that said if you remove the 89 problem contracts the UK business was I think breakeven or slightly profitable. Just wonder if maybe some update there on what that was like in H2? See the momentum excluding the 89.

And then again on UK Construction, are there some contracts there which although they weren't bad enough to be put in the 89 they are still kind of underperforming and so mechanically you'll get an uplift in margin as those particular contracts roll off? Thanks.

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Phil Harrison, Chief Financial Officer
I haven't got a precise calculation on the 89 in the second half. What I would say is yes we did perform better if you strip those out, for sure. I think when you look at - I think what I've said is that the - clearly from an accounting point of view you have to book the losses when you see them as losses. If you've got a lower order book or lower gross margin that isn't a loss that will just trade out normally.

In the back of our - in our appendices we actually give you a graphic that shows you our gross margins on contracts pre 2014 and our gross margins that we're doing today in 2016. And you'll find that actually the curve has tightened considerably. So in other words yes we do see a better performance in our contracts that we have at the moment.

If there are no more questions thank you all for coming and see you in six months for the next check-up.

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