Company: **Balfour Beatty plc**

Conference Title: **Q3 IMS Conference Call**

Presenters: **Ian Tyler, Duncan Magrath**

Date: **Thursday 10th November 2011 – 13h30 GMT**

Operator: Good day and welcome to the Balfour Beatty Internal Management Statement Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Ian Tyler, CEO. Please go ahead.

Ian Tyler: Thank you for joining this afternoon to discuss the Q3 Interim Management Statement that you'll see we released this morning. If you'll allow me to summarise the developments in the period before Duncan and I take your questions. Starting with the order book I'm very pleased to report that at 15.5 billion it remains in line with the level reported at the half year with a small increase in the US construction order book offset by a reduction in UK construction. In a challenging environment of government austerity and shortage of privately financed work this is no small achievement by the team and a testament to the resilience of our business, our geographical spread and diverse capabilities in end markets.

Overall that has not been any material change in trading conditions since our half year results which we announced on 17th August. Our trading performance continues to be consistent with our expectations so rather than repeat the information we've presented in the press release let me just touch on a few new developments.

First of all having targeted India as a growth market with good infrastructure opportunities we took tangible steps in October. Soon after opening our office there we signed a memorandum of understand with TATA Projects to jointly identify and pursue infrastructure opportunities in both India and Sub-Saharan Africa. We believe this will add to our established professional services presence in India and help to develop our full range of capabilities in the region.

You may also see that Balfour Beatty Communities has been selected for the privatisation of family housing under the Northern Group Military Housing Privatisation Project. This project has a 50 year term with an estimated project cost of approximately $470 million.

Also a couple of days ago we sold our 50% stake in the Blackburn Hospital PPP concession achieving proceeds above directors' valuation.

So to conclude we continue to believe that the medium and long term prospects for infrastructure markets remain positive. In the meantime we are managing our business on the basis that market conditions will continue to be tough and we remain confident of making progress this year.

So having said all that, I will now turn the call over to the operator for questions.

Operator: Thank you. If you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered you may remove yourself from the queue by pressing *2. Again please press *1 to ask a question. We will pause for a moment to allow everyone to signal.

Our first question today comes from Howard Seymour from Numis. Please go ahead.

Howard Seymour: Good afternoon gents. Probably a pretty obvious question Ian but an important one in terms of order book and wins at the moment, really relative to where the margin is at present and your expectation on the work that you're winning, I suspect it's important obviously in construction notably in the UK and the US market so thoughts on that please?

Ian Tyler: I don't think the position is any different to the position that we talked about at the interims. Clearly the market conditions are competitive, they've always been competitive but certainly they are very competitive at the present time. The real issue as I said before is not so much that base level margins are falling away but we do genuinely have the issue where the market conditions simply do not allow us to make the exceptional level of return on some of the projects that we've seen in the past, particularly the mix of work on balance – and again there are some exceptions to that as you've seen – but the mix of work is tending towards a larger number of slightly smaller projects and smaller projects will tend to carry if not lower margins, there will be less of them, they will have higher margin type work. So the underlying pressure on margins is downward but it's more a mix issue than it is a sort of underlying market issue. Does that help?

Howard Seymour: Yes, that's fine Ian. Can I ask a second one which is totally unrelated I'm afraid, really just on India obviously. You mentioned the new office and the MOU. It's probably a slightly unfair question but what's the sort of timescale at which point you reckon you'd start seeing success from that? Do you expect it to be a long lead time? It's a big market but there's obviously quite a lot of work out there as well, but just thoughts on that.

Ian Tyler: The problem is not so much that there's a very long lead time in the sense that there's a huge amount of work that we have to do to get into it. What I don't know until we try is how successful we will be in our first few bits. Inevitably when you're doing something for the first time, our bids – and of course the bids have to be appropriate to the market – we will tend to find…the first bids will inevitably be high I suspect and we will end up finding where market conditions are more particularly where the underlying cost structures are in the market and that's what I can't gauge, but to your point exactly the arrangement with TATA, there are a number of projects that we're looking at right away. This isn't something that's going to happen in 1-2 years' time. There are a number of projects particularly in things like power transmission in the market there which we are starting to look and starting to plan our strategy around. So the work to get after this market is happening here and now. What I can't do realistically is to predict exactly how quickly we'll start to see work come through, but this is not a year or two.

Howard Seymour: Yes. Thank you very much.

Operator: Thank you. Our next question today comes from Mark Hake from Bank of America. Please go ahead.

Mark Hake: Bit of a pregnant pause there before me! Just a couple of questions guys, obviously she was vetting me to see whether I'm appropriate to ask a couple of questions! Two things, just on the issue of India, what was the logic of using the same JV partner for Sub-Saharan Africa and I suppose why Sub-Saharan Africa rather than South America or South East Asia or why not just focus on India I suppose is the first question? Then secondly any comments about bad debts at all in the UK? Any sort of trends or themes as far as bad debts are concerned?

Ian Tyler: Ok, let's take those in turn. Your question on India is a very good one. The answer to the question is quite straightforward and it really comes down to TATA Projects. TATA Projects are a very competent player in a number of markets and they are very competent EPC player in a number of markets. Their ambitions are certainly into India but they also have as a number of other players of their type do, they also have some real interests in other parts of the world in the case of TATA Projects in Sub-Saharan Africa. The direction of your point is absolutely right. Our focus in this is in India. Our focus is and indeed TATA Projects' focus is in India, but there are definitely opportunities that they have, customer and project opportunities that they have whether the technical skills and some of the larger project management skills that we have would definitely support them and they are very keen to work with us to enhance their capabilities in those markets. So we're being led by opportunity there based upon some of the work that they've done in those markets. Does that answer the question?

Mark Hake: Yes, it does. Thank you very much.

Ian Tyler: I'll let Duncan talk about bad debts.

Duncan Magrath: In terms of bad debts we haven't really seen anything. Given that a lot of our customer base obviously is publicly owned although that doesn't seem to be a guarantee these days and regulated utilities, there has been no impact on us really at all. Obviously the thing that we're probably more focused on is making sure the supply chain stays healthy and that's probably a more critical issue for us.

Mark Hake: Ok, brilliant. Thanks a lot.

Operator: Our next question today comes from Manu Rimpela from Deutsche Bank. Please go ahead.

Manu Rimpela: Good afternoon gentlemen, three questions if I may. Firstly on the margins so referring to the first question, is it related to that you are not able to win the large scale projects that you have to focus on the smaller or is it just so that there are no large scale projects available at the moment? The second question related to working capital, can you just comment what should we expect for the fourth quarter and the end of the year in terms of trends? Finally on the 2012 outlook, how should we interpret the order book? It was flat in the third quarter and it has been seeing some healthy growth over the last 12-18 months, so are we seeing a levelling off or order intake or is it related to mainly seasonality or can you just elaborate on that one?

Ian Tyler: Ok, those are very good questions. Your first question, no, unequivocally the nature of the work that's around in both the US and the UK in particular, less so in places like Hong Kong, you'll see we did win the XRL project in Hong Kong which is a very large project, but the nature of the very large projects are simply not around on the horizon at the present time and if you just compare the big things in the areas in which we operate and that's particularly true on construction but as we said before it's also true on the professional services side as well. Obviously there are some large projects around but they are very large projects, things that we've been generally successful in winning, there are very few of those at the present time. There are some exceptions to that and we can see things like at some point in the next 12 months nuclear new build will come up and those will be very large projects, but there are certainly in the UK and the US very few of those at the present time. So it's not as though we're not winning them, they're just not out there. Your second point was cash.

Duncan Magrath: Yes, in terms of working capital our traditional cycle is an outflow in Q1, an inflow in Q2, an outflow in Q3 and an inflow in Q4 and this year is no exception. At the interims I referred to the fact that the inflow for the second half overall would be positive but it wouldn't be as strong as the 100 million inflow that we had last year and I still effectively reiterated that in the statement. I think cash flow with the scale of the business we are can be lumpy but at the moment that's how I see it panning out for the rest of the year.

Ian Tyler: Your last question was how do we interpret the order book through 2012? Do you have any comments there Duncan?

Duncan Magrath: I think we've seen certainly in the third quarter you've seen the continuing of the trends that we saw in the first half and obviously in terms of the shape of the order book basically each of the divisions was very much in line at the end of the third quarter with the end of the first half. There was in terms of within the construction business we talked about the order book in the US being up slightly offset by a decline in the UK and I think you will see that flow through in a revenue context next year and that we will see some revenue growth coming from the US as that order book flows through and we will probably see overall a decline in revenue in the UK construction business. I think in terms of the other patterns you can pretty much take it from the half year position which was support services obviously we had a lot of work in the first half and that will flow through next year and professional services overall is reasonably stable.

Manu Rimpela: Ok, thank you gentlemen.

Ian Tyler: Ok.

Operator: Our next question today comes from Olivia Peters from RBC. Please go ahead.

Olivia Peters: Hi everyone. Firstly I just wanted to get a sense of can you provide us with the discount rate at which the hospital PPP was actually sold at? Also maybe we could focus a bit on support services, how are you seeing pricing there? Is there increased competition in the market and how are you differentiating yourself? Also in your statement and we've sort of touched on it a little bit you are very much focused on the medium to long term. I was wondering if you could maybe talk about the short term drivers, maybe potentially Qatar or Saudi Arabia?

Duncan Magrath: Ok, perhaps I will pick up the PFI sale. As you know our directors' valuation is at 8% post tax or 9.4% pre-tax and we sold it for in excess of the directors' valuation so I think you might have to do your own guesstimates but it's effectively below those levels in terms of the discount rate. The reason one person's cash flow is another person's cash flow but effectively we look at our valuation, we exceeded it. I think it was a straightforward question.

Ian Tyler: Your second point was…

Duncan Magrath: Supports services, pricing and differentiation.

Ian Tyler: Yes, that is a very good question. Bear in mind we operate in a whole lot of different markets in support services from FM through to highways maintenance through to rail renewals through to work on utilities and power. Each of those is different and it would be very difficult to generalise. I think it's fair to say that the pricing in those markets, it actually doesn't matter what the state of the market is. It is a very competitive market and your point about differentiation is absolutely the key point. The only way in which we achieve margins that rise above the very low levels is where we have elements of differentiation. Our differentiation in all of those markets is around asset knowledge and it always has been. It's enhanced by the capabilities in Parsons Brinckerhoff and in our construction businesses. If you look at what we're doing for example in road maintenance we are very clearly, you can see from some of the wins we've had, we clearly are offering a service which others can't offer by virtue of the capabilities that exist in the group particularly the capabilities that come out of Parsons Brinckerhoff. That works in some circumstances and doesn't work in others. That doesn't mean to say we win everything. In that sort of market there are some customers for whom price is everything and there are some customers who are genuinely looking to do something radically different. Most of our work is won in the latter category. We tend not to win purely on price. The FM market again is if you look at things like Romec which we announced in the first half, those are very large contracts. Ultimately pricing there, the core margins there, they are very competitive but we will create value add and the whole deal is we'll create value add of Romec based on the performance that we deliver around the Royal Mail estate and that I think offers us huge opportunities. If I take things like power in particular and utilities, the process of regulation always drives competition. I don't think it's any greater now at the present time but at any point in time each of our customers is under more or less pressure from the regulator and they have to permanently find ways of reducing their costs. They look to us to find ways of reducing costs and we have to respond to that. It's not so much a margin issue, it's just about that we have to be continuously innovative as to how we deliver to the bottom line. So margins overall are always under pressure, they're not going to take off but we do achieve the margins we achieve there by being different from our competition. I think that was the essence of your question and you're absolutely right. The short term versus medium term versus long term, since we studiously don't define what we mean by any of those terms it's slightly difficult to answer the question. Anything you do by my definition of short term which is kind the rest of this year and 2012, we do have to bear in mind that we have in any of our businesses – it's no different in professional services – we have an order book and ultimately what we do next year to a very large extent is already locked in with what we're doing. Things like Qatar as a good example, as we've said we're starting to make progress in Qatar and that will certainly start to produce bottom line profit particularly out of the professional services business. Saudi is a little bit of a longer term play, actually if I take the Middle East and take that as the thrust of your point there, probably Kuwait is a more immediate prospect for us than Saudi. Saudi would be largely around the power sector but Kuwait will be a much broader market for us. Those are real opportunities. We'll see some of that coming through next year but as always these things have a lead time and that will be some of the underpinning of growth in 2013 and 2014. Is there anything else you want me to cover particularly there?

Olivia Peters: No. Just on support services in terms of being innovative as far as cost reduction is concerned, can you outsource costs to say India for example? Is that something you'd do? How do you intend to innovate is what I'm asking?

Ian Tyler: The answer is it depends on what the customer is looking for. The obvious point is in the local authority market if we want to innovate such that we just deliver short term cost reductions; it is a question of re-engineering their processes. There's nothing magic about that. That's something which we do in our own business and we do when we operate in other people's businesses and there is a lot of cost in the local authority market to take out. That doesn't require offshoring. That requires simply having a greater focus on process management. Bear in mind our process management is largely around the management of assets. Much more importantly the key issues for some customers are not short term costs, they're particularly around long term life cycle cost of the assets and that's particularly where we're working with a number of local authorities not just to think about how we take costs out today but how we take the whole road network for example and make it deliver more than it could otherwise do. That actually brings in many of the skills that exist in Balfour Beatty around the world, but it very much depends on what the customer wants. If the customer is simply looking for short term cost reduction then there's a lot we can do but we actually have less differentiation there than we would in other customers where their focus is in different places.

Olivia Peters: Ok, thank you.

Ian Tyler: Ok.

Operator: Ladies and gentlemen, as a reminder to ask a question at this time please press *1. Our next question comes from John Messenger from RBS. Please go ahead.

John Messenger: Hi, good afternoon. Three if I could, one big picture, two sort of specific. On PB and the guys in the US, obviously the US transportation you mentioned in the statement, the issue around any kind of new six year programme. Are the guys in the US basically managing the business now with a view that any new programme probably is a 2013 event after the election. Is that kind of the assumption? Obviously there's a lot around up and down with the Republicans getting a bit more loose with their money but generally flat for the period and then we hopefully get something in spring of '13. Is that kind of their planning assumption, just to understand where they're coming from?

Ian Tyler: I think that's right. Again I'm just picking up the rumblings in the US at the present time. Nothing is done until it's done, but it looks like they're heading towards a two year transportation bill which will take them the other side of an election and that would tee things up reasonably well. If you think about it then if you're going to have a six year authorisation which I think everybody wants to do for that to happen the other side of an election, so there does seem to be a bit of a plan there and indeed again if you believe the current plans and they are from both parties, the two year transportation bill will be at current funding levels, so for what that's worth that is reasonably good news. What it still does mean and our guys are practical about this, there are still going to be a lot of the very large transportation projects which we would regard as absolutely core ground for us and therefore will represent growth which will not come forward under a two year bill now at the margin. We won't see those coming forward until we get a much longer authorisation and as we said that's probably likely to be 2013, the other side of an election. That's really where we're thinking about it at the present time. Having said all of that the market remains reasonably…there is a reasonable amount of activity in the market and we continue to perform very well albeit on projects that are of shorter duration than we might wish.

John Messenger: The second one was just – and this may have all been sorted out but obviously there's quite a lot of construction press coverage around Unite the union I think in Balfour Beatty Engineering and potential kind of strike action. Is all of that still ongoing? Is that a risk in the second half? I guess bigger picture wise how much of the UK is unionised in terms of Balfour Beatty?

Ian Tyler: There's a lot there that's probably the wrong forum to be commenting. Genuine discussions with the unions are still ongoing. There is a clear issue there about how the contractual structures in the industry change as technology changes which is what this is all about and as I said I certainly don't think it's a threat to the second half or indeed the first half of next year or anything else? I think it's something which is a very, very important issue but an issue in a small part of our business. It isn't going to fundamentally affect the business overall but we do have to and I wouldn't believe all that you see in the press in term of where we are in the discussion with our people and with the industry and it's not just us, it's all of the major players in the industry. It's an important debate but in terms of the performance for Balfour Beatty 2011-2012 it's not a significant issue.

John Messenger: The final one was just – and maybe over to Duncan for this one – in terms of Blackburn and the gain clearly you haven't disclosed it, because it's wrapped up in underlying profitability these days? I guess if I think about what happened in the first half with the 14 million on the A50, that was a 2 million book value, 14 million directors', so seven times higher and sold for 16. When we have trawled back Blackburn was a 5 million equity figure, a five year piece of data that probably with dividends retained and everything may have changed the shape a bit but in terms of quantum I'm just concerned that when we all think about the group making progress for the year…is there a material number that we all need to think around because obviously you don't want to have…at the half year when people see 14 is there and people question the underlying versus the underlying.

Duncan Magrath: If you add the two sales together then we have effectively hit the 20 million of gains that we said that we would make roughly on an annual basis, so effectively those two disposals have meant that we've achieved that in the current year.

John Messenger: That's again against the book value rather than against the directors'?

Duncan Magrath: Correct.

John Messenger: Lovely, thank you very much.

Ian Tyler: John, your point about underlying profitability, absolutely, I agree with all of that. There's nothing in that that isn't fully opened and fully disclosed. We're not trying to hide disposal profits in the underlying profit figure. We've been very clear about what we're doing with that.

John Messenger: Absolutely. All of that wrapped up for about 20 is, when we think about the group making progress for the year, about 20 effectively is part and parcel of that progression effectively, isn't it?

Ian Tyler: Correct.

John Messenger: Brilliant, thank you.

Ian Tyler: Thanks very much.

Operator: From Oriel we will take our next question from Mark Howson. Please go ahead.

Mark Howson: Hello, good afternoon chaps. Just a couple of questions if I may, firstly can you give us the state of play on Barking Power Station, the sale; and also is your views on potential cash receipts or otherwise on that baked into your expectations or not on this point?

Duncan Magrath: In terms of Barking Power I think in terms of trying to come up with a valuation in the current market is not trivial which is why potentially the disposal of it is complicated from a valuation perspective and I think as we've said before reasonably complicated from a pre-emption perspective. In terms of will we achieve something this year I am still of the belief that we may, it's not a dead certainty, that's for sure, something could drift into next year. In terms of proceeds then, it's obviously not a working capital issue so you can ignore that from a working capital perspective, so obviously it will just depend on the timing of it and how we dispose of it.

Mark Howson: Secondly just on a follow-up question to John's, you mentioned also the strike issue and it relates to a small part of revenues that you would have for 2012. Could you just give us all some sort of expectations as to what that sort of revenue is that has a potential strike threat or otherwise about it?

Ian Tyler: I haven't given that a moment's thought Mark. It's in one part of our electrical…our energy electrical services business, essentially our M&E business and I'm just trying to think how I can […] that. It relates directly to revenue of no more than a few tens of millions of pounds… for now. I don't want anybody to think that we don't take the issue very seriously, nor do I want anybody to think that kind of because of what you read in the paper that the matter's out of hand. None of that is true, but in terms of the financial impact of it and what it impacts to the group, it is very, very small indeed but I can't give you an exact number on that.

Mark Howson: Great. Just finally from me can you give us a feel for the current revenues that you already have in places like Qatar, Kuwait and Saudi?

Ian Tyler: I can give you a reasonably clear view on Saudi. It's very close to zero. That's not entirely true, there's some professional services work there. All of the work we do in those places at the moment, they are small and they are part of our professional services business. In total the aggregate was up until the work that we are in the process of bidding and winning, the aggregate revenue in those territories would be less than £20 million. I haven't got an exact number for you on that but it would be of that order.

Mark Howson: Thank you.

Ian Tyler: Ok.

Operator: We will take our next question from Andrew Gibb from Investec. Please go ahead.

Andrew Gibb: Good afternoon gents, just a couple of questions from me please. Firstly just on the order book, I wonder if you could quantify the movements in the States and in the UK in terms of the up and the down there?

Duncan Magrath: The scale of the order books is pretty similar now and it's roughly just around 5% up and 5% down in each of them.

Andrew Gibb: In each, brilliant. Just to stay with the order book, in terms of visibility going into next year I was wondering whether you could quantify the kind of revenue cover you've got as we go into 2012 at this stage?

Duncan Magrath: The coverage is very similar to previous years. There's no real difference whatsoever and basically on the construction business it's around 60-65% in terms of secured orders. As you know we're very conservative in terms of what goes into our actual order book. If you take into account where we're a preferred bidder then it's around about 75%. The figures for the other divisions again are very similar year on year. The order coverage of something like professional services is slightly less, so the overall balance is around 60% in terms of secured and about 65-70% in terms of ABNC.

Ian Tyler: It doesn't move around significantly from year to year.

Andrew Gibb: No, absolutely, I just wanted to get a flavour. Just lastly on the public sector in terms of the UK construction, we're starting to see the declines come through in the numbers. Is there any specific area that's particularly weak or is it very much broad based in terms of the cuts coming through at the moment?

Ian Tyler: The cuts are coming through absolutely as planned, so we are seeing less work coming through for example in education, that's certainly a major part but again that has been clearly a major thrust to the government production. The highway spend is another good example. We have certainly seen and you will have seen that we have announced a number of projects in the highways sector but as compared to the amount of work that was coming out to market 3-4 years ago it is substantially down. I do make the point that there is nothing in there that was not expected even before the comprehensive spending review last year, so none of that's new. Equally healthcare there are a number of projects, again I'll talk about the major projects. The very large healthcare projects like Birmingham and those sort of things are not around at the present time but there are two or three projects on which we're bidding which are reasonably large but there are simply less of them. All of that is starting to come through in both the order book and the prospects, but all of that is factored into the comments we talked about just now of visibility of future orders.

Andrew Gibb: Brilliant, that's great. Thank you very much.

Ian Tyler: Ok, thanks.

Operator: We will now take our next question from Kevin Cammack from Cenkos. Please go ahead.

Kevin Cammack: Good afternoon to you, just a couple actually, a couple of ones have been answered. Just coming back to the Balfour Beatty Communities announcement the other day, two things around that. First does that make a relatively instant addition to your 146 million loss, directors' valuation of North America in PPP? On a wider question around that, obviously we've seen how you've started to monetise the UK portfolio. Can we expect or is it as easy to do that in respect of North America and are there any plans for that to happen? That's the first question. The second one is quite awkward, I'm not sure how to ask this but you've obviously made a number of quite open references to the contract, the large scale contract completions not just in the UK but some in the States as well and hitting certain milestones on current projects that are scaled projects going through. Has this been done to sort of nod and wink through the natural course of settling and completing these large scale works, you're likely potentially to be running quite a surplus provision? You've got a healthy profit to release as we go through this year and next year type of thing, or was it just showing off that you'd done these fantastically good schemes.

Ian Tyler: The answer to the question is I don't think we were doing either of those. I think we were just pointing out the fact that we do actually do something useful in society. I'm not sure that's necessarily…

Kevin Cammack: I wish I could say the same!

Ian Tyler: Wouldn't hear a word against you. The simple fact of the matter is we are completing a number of projects and we are seeing projects perhaps on average slightly smaller ones coming through into the order book and we'll be saying the same things in the future. We're not saying anything about bow waves of profit or anything else. It is absolutely true that those type of projects we will be most conservative on those projects because they are some of the higher risk projects and we will generally release profit on those more at the back end than we would at the front end, but in the context of all of our business, all £10 billion of revenue and £15 billion of order books, that doesn't fundamentally change the shape of profit one way or the other. The embedded profit in the order book is really the issue that gives rise to that. I think in answer to your question, no, we were just showing off.

Duncan Magrath: I will pick up your first question, in relation to Balfour Beatty Communities, they are structured slightly differently to UK PFI and therefore our return over time very much comes much less from the equity component and much more from the fees that we had for maintaining the bases and then also further down the track these are 50 year concessions in which there is subsequent construction activity that comes out of those concessions either through further new builds or refurbishment activity, so they are much less easy to and we have less desire frankly to move them on necessarily than the UK PFIs, so I don't think you should expect the same process in the US, as what we've been talking about in the UK. In terms of the impact on the valuation, yes, that will contribute an element straight away - into the valuation.

Ian Tyler: Thanks a lot for that. I think we've got to draw things to a close at the present time. Thank you very much indeed for all your questions there. If anybody has any other questions feel free to give me a call, give Duncan a call, give Basak a call and we'll certainly do our very best to answer them. Thanks very much indeed. Bye now.

Operator: That will conclude today's conference call. Thank you for your participation ladies and gentlemen, you may now disconnect.