Balfour Beatty 2014 half-year results

Transcript

11 August 2014

Telephone Operator

Good morning ladies and gentlemen, welcome to the Balfour Beatty 2014 Half Year Results Presentation. My name is Dave and I'll be your coordinator for today's conference. For the duration of the call you will be on listen only, however at the end of the call you'll have the opportunity to ask questions.

If at any time you need assistance please press *0 on your telephone keypad and you will be connected to an operator. I'm now handing you over to Steve Marshall, Executive Chairman to begin today's conference. Thank you.

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Overview

Steve Marshall, Executive Chairman

Good morning everybody and thanks for attending this morning's call at short notice. I'm going to start with the decision to reject Carillion's merger proposal, the sale process for Parsons Brinckerhoff and then move on to Group priorities. Duncan is then going to cover the interims and then Nick Pollard will update you about the progress in Construction Services UK. We will aim to be as crisp as possible so that we can provide you with a full opportunity for questions and we'll also be available later on.

We've brought forward our interim results announcement scheduled for this Wednesday to coincide with this morning's statement on the rejection of Carillion's merger proposal. We judge this appropriate in the circumstances, so apologies that we're not able to actually present that to you in person today.

I am required to make some regulatory health warnings. We are still in an offer period until the 21st of August and until then the Code restricts our ability to provide forward looking information unless this has been reported on by accountants or approved by the panel.

There are other restrictions, such as a confidentiality agreement that prevent us going into details of the merger discussions. That said, as always we will do our very best to provide as much information to you as possible.

A case in point is our revised Investments Directors' Valuation, which as you know we had intended to provide alongside today's interim results. The information is ready to announce, but we are not now permitted to do so without the benefit of an independent valuation. This wasn't practicable at such short notice. So we intend to publish this information as soon as we can.

More generally the Group's executive team is now working hard on a limited number of very clearly set out priorities. As Nick Pollard will illustrate shortly, we believe we're taking an optimal approach to restoring value in our UK Construction business and as we will explain, for the Group as a whole. And today we've published a fairly detailed summary of events to assist the market in understanding why the Board has taken this decision in the interest of the company and of its shareholders.

I will now turn to the Carillion discussions. These were entered into for the right reasons, because we perceived an opportunity to enhance shareholder value. The proposal has also been rejected for the right reasons, because in the Board's judgement the risks involved are significant.

We've announced the original terms that were negotiated with Carillion over some weeks prior to our agreement to engage. Also, the revised proposal received from them more recently, which does not materially address the fundamental concerns that we have.

As you will appreciate the timing of the original approach was less than ideal, we had a large M&A transaction in flight and of course an interim executive structure. To mitigate these risks we negotiated upfront terms that we regarded as beneficial to Balfour Beatty's shareholders, and the explicit support for the PB sale that we relied upon.

Aborting the sale of the PB business at this late stage would create a number of significant risks. No strategic logic has been advanced for its retention and it cannot make sense to so obviously warehouse a major people business simply to enhance profitability, without a strategy for it, and whilst the global professional services sector rapidly consolidates around it.

The value risk to Balfour Beatty shareholders from a failed auction or from the merger subsequently failing to proceed has been largely unaddressed in this revised proposal.

The Board also judges that there are very substantial financial and operational risks. We're not at liberty to comment in detail on the combined business plan that was proposed, so I will talk in general terms.

To achieve bankable synergies whilst substantially downsizing a very large UK construction business is very challenging. As you run out the project base and reduce revenues the underlying level of costs you have to remove is very significant. And that is before you even get to bankable synergies. In addition there would be increased restructuring costs and cash and working capital outflows. Balfour Beatty believes that such an approach would create unacceptable operational and financial risks.

Our own more measured alternative approach is well underway and Nick will cover it. And in a progressively recovering market we believe it will be value maximising with a manageable cash flow and risk profile as we implement it.

Furthermore the cost savings achieved will be 100% for the benefit of Balfour Beatty shareholders and will support a progressive return to peer group margins in a larger UK construction business. And finally, if discussions had continued there was a detailed mutual due diligence process still to be undertaken. Firstly, you do not lightly expose your entire business to a competitor and then potentially to any other legitimate bidder who might present themselves if you have serious reservations about the transaction and its deliverability.

Secondly, although Carillion were keen to accelerate the announcement date to the 28th of August, Balfour Beatty judged that there was a risk that this might not be achieved.

Not least, given our own due diligence requirements of Carillion; accordingly there was a significant risk that the PB sale process would have failed ahead of any transaction outcome.

And turning to the Parsons Brinckerhoff sale process, notwithstanding the unhelpful publicity the process is moving ahead well and in line with the Board's expectations. Strong competitive interest is being maintained, indeed round three bids are expected very shortly. As you know M&A transactions aren't bankable until they are signed, but the process is now well advanced.

At the point of announcing a transaction, and not least the sale price itself, the Board will set out its thinking on the application of proceeds. This will result in a beneficial outcome for all key stakeholders, and that's to say shareholders, funders and the UK pension plan. However, it's anticipated that we will return up to £200m to our shareholders.

As a Board we will also consider the implications of the disposal on the dividend. This is likely to be reassessed at year end and as we've consistently said, our prudent approach to the Group balance sheet will be retained, we will also assess what is a sustainable and appropriate level of ongoing dividend cover, given the characteristics of the new Balfour Beatty Group once Parsons Brinckerhoff is sold.

Overall we believe that concluding a successful PB sale transaction at full value will result in a beneficial outcome for all key stakeholders.

Now to the key group priorities for the balance of the current year. As I've said many times the Board is committed to restoring shareholder value. For any business, broad success in your chosen markets is paramount. If you lack the managerial, or financial resources to credibly achieve your strategic ambitions, in other words if you are spread too thin, something normally has to give.

To address this, the Group is being refocused and simplified. We intend to conclude the PB sale process, are otherwise tightening the geographic footprint and improving the risk profile of the Group. And Group wide our bidding disciplines have been strengthened where necessary.

As this simplification process proceeds over the coming months there will be new opportunities for further indirect overhead and shared service efficiencies to be achieved.

A few comments on our UK Construction turnaround - we see a managed rather than dramatic overall downsizing. And we do see a place for a profitable Regional business within the portfolio. As you know only too well the CSUK business has recently been subject to a reorganisation. The healing process is underway, but certainly not complete. It has a full systems migration this autumn to get all parts of that UK business onto a common ERP platform. The investment has largely been made; the benefits are to come in future years.

Our targeted approach will limit operational risk and reduce working capital and restructuring cash outflows as a result. There's no reason why we cannot return to peer group margins. All of that said, it is very important to be consistent and to not overreach, it remains the case that the legacy contract portfolio is being worked through and so some short term risks still remain. Nick Pollard will shortly provide you with a more detailed update on the CSUK business.

The search is well underway to recruit a top flight Group Chief Executive to drive the Group's recovery and that is clearly a Board priority. He or she will also develop a longer term strategy around the core of a post PB Balfour Beatty Group. The core is our strong Anglo American construction and specialist services presence, with significant US market opportunity and UK market margin recovery potential and an Investments business that is value creating and synergistic. The Group will retain its Far East and Middle East joint venture investments to the extent that it judges they continue to be value accretive.

So our intention is to provide an incoming Chief Executive with a more focused, simplified and substantially de-risked Balfour Beatty Group and with some financial flexibility to take things forward.

The Board is firmly of the view that this approach is in our shareholders' interest and that it merits their support.

Finally back once more to value, the Group will remain open to future value creation opportunities. In considering these it will take into account the executional and transactional risks involved and the significant recovery potential that we see within Balfour Beatty's businesses. Now over to Duncan.

Financial Review

Duncan Magrath, Chief Financial Officer
Thank you Steve and good morning everybody. I will keep my comments relatively brief, partly because there is little in here that we have not already told you about, but also due to the different forum we are presenting in today.

As we highlighted in our recent trading statement our results for the first six months of the year have again been dominated by the poor performance from our UK Construction business, which has again masked some good performance elsewhere across the Group and in the continuing strength of our Investments business. For instance over the last 30 months we have generated £309m of UK proceeds for an average increase over the Directors' Valuation of 52%.

First let's look at the headline numbers. At constant currency we have seen a broadly stable picture for both revenue and order book for the first six months of the year. Overall total profits after corporate activities are £37m, down on the £54m from last year, due to the issues within our UK Construction business.

Average borrowings for the period and period end both increased over the last year, principally due to the reduction in negative working capital. There are three reasons for the working capital movement. Firstly a seasonal unwind that we always get in first half. Secondly an underlying reduction in UK Construction as expected at the start of the year. Thirdly - higher levels of positive working capital in Professional Services and Support Services. Finally we have kept the interim dividend in line with last year at 5.6 pence.

The Professional Services order book was down 4% at constant currency, with stable order book in the US and rest of the world and reductions in the UK. Revenue performance was up 1% at constant currency with a broadly stable performance across all geographies.

Turning now to Construction Services, here again the overall order book was broadly stable; however reductions in the UK construction order book were offset by increases in the rest of the world, principally due to the continuing strength of the Hong Kong market. The US order book increased slightly at constant currency, despite the very strong revenue growth in the period.

Revenue grew by 6% at constant currency in the period, with a 7% reduction in the UK being offset by a very strong growth of 14% in the US and 25% growth in the rest of the world, in Dubai, Hong Kong, and Singapore.

Now to give you just a little more colour on the US Construction business with an update to the slide I showed you back in March. You can see on the left hand side continuing strength in the order intake with the building business booking more orders in the period than at any time in the last five years.

On the right hand side you can see that there has been a slight fall back in the ABI readings and also our book to bill ratio as the revenue ramps up. But we remain confident of the continuing growth of our business in this market.

In our Civil and Rail business the market is less buoyant than the building market, although it continues to move towards larger scale projects which should favour our business model.

Turning now to Support Services - overall the order book was down 4% in the period, despite a big jump in the water sector as the AMP6 order cycle comes through into the book. As anticipated the order book in Power has been reducing as we work through the large contracts with National Grid. The Transport order book has also come down slightly as we work through to the end of our Rail renewal contracts.

Revenue was down 5% in the period, declines in Power, as highlighted back in March and in Water coming to the end of their five year cycle, outweighed the growth in Transport with the increase in the Local Authority work won last year.

Now Infrastructure Investments - you can see from the slide that we have achieved financial close on six projects since the year end, five of them on the other side of the

Atlantic. We were also very pleased to win the Aberdeen peripheral road where we were appointed preferred bidder in the period.

This demonstrates our ability to continue to feed new projects into the funnel to ensure that whilst we have an active disposal programme we continue to replenish with new projects.

It is probably worth reminding you of our recent track record on asset disposals. I'm not going to go into detail on this slide and all of this information has been previously published, but just to say that over the last 30 months we have generated £309m of UK proceeds for an average increase over the Directors' Valuation of 52%.

Turning now to our Directors' Valuation. As I noted on the previous slide the proceeds we received for the two assets that sold in the first half significantly exceeded our expectations and were 82% above our Directors' Valuation. This, combined with challenges from investors, analysts and not least the Chairman, triggered a much more detailed review of the Investments portfolio in the first half. We have looked at each of our UK concessions and considered the specific discount rates, recognising the maturity and individual risks of the projects.

We have only looked at our UK portfolio as there is a more active liquid market against which to benchmark these rates. We have also looked at the underlying cash flows to reflect expected cost savings. Finally we also looked at inflation assumptions, although this has the smallest impact of the three elements. Unfortunately as we are in an offer period in order to publish the Valuation we need an independent valuation report, but this was not possible to commission and prepare in the time available. We will publish our valuation as soon as we are able to.

Turning now to the profits by segment. Working across the slide from left to right we start with Professional Services. Performance was in line with our expectations and with last year. We saw reduced losses in Australia and a sequentially better Q2. We also saw improved profitability in the UK. There have been some delays in both US Transportation and US Power, although we anticipate both of these recovering by the full year.

In Construction Services as we have previously announced operational issues in the Engineering Services business has resulted in a very poor performance for the first half and it's outweighed a good performance in US Construction. In the Middle East we are seeing growth in our Dubai based Construction business offset by a poorer performance from our M&E business which is consolidating back into Dubai. Whilst we see strong growth in the order book and revenue in Hong Kong and Singapore profit performance continues to lag as the growth is largely coming from large complex Civils projects; where our profit take policy means this will only feed into profit in future years.

Now Support Services which had a very good performance in the period with good operational delivery across the business, but particularly in our Highways and Local Authority Roads business. We also benefited from the Network Rail contract which was scheduled to end at the end of Q1 being extended through to the end of July.

In Infrastructure Investments performance in terms of P&L and gains on disposal continues to be very strong. Overall for the Group total profits after corporate activities are £37m which was down on the £54m from last year.

Turning now to cash flow, the key item on this schedule is a working capital outflow of £191m. There are a number of different movements within this and therefore it is easiest if I take you through each of those segments in turn, which I will do on the next slide.

Starting at the top left hand corner, you can see the graph for Professional Services. This has increased in the period partly due to delayed receipts in both the Middle East and to a lesser extent in the US business, but also is probably a reflection of management stretch, whilst they have been managing through the sale process. Clearly a successful sale process will crystallise this working capital into cash, which may be before the year end.

Turning now to Support Services where working capital has also increased due to the large contract with National Grid which I have previously mentioned. We continue to work with the client to try and bring this back down to a more normal level. I would anticipate the year end position for Support Services being closer to a neutral working capital position.

Looking now at the US Construction business you can see that we have been in a reasonably stable pattern now for the last two years. With the negative working capital being seasonally lower at the half year and then increasing again at the full year. This combined with the continuing growth in revenue will I believe generate a working capital inflow in the US Construction business in the second half of this year.

Finally turning to Construction Services UK - in March I told you I anticipated a £60m outflow in 2014 on an underlying basis. The £60m outflow represented a reduction in just over two percentage points in the negative working capital as a percentage of revenue figure. So you can see about half of this has occurred in the first half. On top of this we are also seeing a working capital outflow as a result of the revenue decline and we are likely to see this continue in the second half.

We remain mindful that working capital in the UK could be impacted by broader utilisation of project bank accounts, or government legislation, but for the time being we see the impact of this on our business as being reasonably limited.

Now to summarise, it has been a difficult first half with poor performance in UK Construction, but our order book has remained stable and we have seen good performances from a number of parts of our business. We have experienced working capital outflow in the first half, but are expecting inflows in the second half. We have maintained the dividend at the same level.

Our first half trading and financial performance is in line with our most recent trading update. The performance of our UK construction business, which we believe is recovering, remains a work in progress. To give you further details on this I will now hand over to Nick Pollard, CEO of UK Construction. Over to you Nick.

Construction Services UK

Nick Pollard, CEO, Construction Services UK
Thank you Duncan, morning ladies and gentlemen. I'd like to run you briefly through some of the journey that Balfour Beatty Construction Services have been on in the UK over the course of the last 12 months or so.

The slide you've got up in front of you - overview, indicates the timing and nature of the different stages of work that we've been engaged in to turn around the performance of our regional major projects and Engineering Services business unit. In each case this turnaround has followed a structured phasing and process - progressing initially through diagnostics and stabilisation; then strengthening and monitoring; and finally the realigning and improvement of performance, profits, competitiveness, customer relationships, capability and know how. All of this to drive the business up the competitive curve; essentially working to restore our company to the consistent performance and top reputation that we've previously enjoyed.

In the Regional and Major Projects business units the turnaround is pretty well progressed, and whilst without any doubt there's much more work to do, there are some clear signs of improvement to share with you. However, as you know from earlier in this year the progress to turnaround the Engineering Services business is less well advanced. We started work to turnaround that third and last business unit in the last four or five months, after Engineering Services began showing signs of distress during Q1 2014.

With the Engineering Services business we're now through diagnosis, and are just completing strengthening and have in place monitoring. We've been stabilising performance and have begun realignment of the business, but as yet we do not have the unwavering application of process, nor the depth of bench strength in the operational team to which we aspire, and which together will remove the volatility of performance.

Turning to the second slide and taking the businesses in turn then, in Regional last year the work was mostly diagnosing what was wrong, observing, listening, testing, measuring and then beginning to stabilise that business. We put a lot of effort into crafting a plan of action, known to our staff as 'The Road Ahead'. We talked that through to secure their buy in, face to face with our leaders, our managers and employees through a whole series of roadshows and workshops.

We made sure we communicated and focused on the plan through business reviews, personal incentives and team targets. We carried our people with us, lifted spirits, secured transparency, escalated problems and began fixing the issues that had damaged business performance in the preceding couple of years.

Bidding disciplines were tightened last year as part of this process, including the setting of minimum margin hurdles, which we've kept progressively under review as the market moves, whilst making sure that the rigour of bidding reviews is significantly improved.

Operational improvements have also been at the heart of gripping the business performance, in particular improving the quality of project controls, risk management and governance.

By no means are these all perfect everywhere yet. Some places are blindingly good, whilst others are much slower in implementation and capability. The process of reviewing and controlling projects inevitably depends upon the experience and skill of the manager conducting the review. So we've been putting a lot of emphasis into training and developing our people, equipping them with the right tools and techniques and making sure that when we appoint someone new, whether that's organically from within the business, or from external companies it's into the right role in a way that aligns their capabilities, experience, and skills to their accountabilities and responsibilities.

To build a single team in Q4 2013 we realigned our brand to be singularly Balfour Beatty for Regional Construction and Major Project works alike. We appointed a new managing director in Q1 2014 and you may have seen recent announcements to better align and strengthen the regional leadership team towards our future pipeline of work and opportunities.

We've also put in place lead and lag measures and metrics, not only around business performance but around the implementation of our change programme. Importantly those measures and metrics have included a significant amount of work to make sure that we're thorough in securing customer feedback, that we listen to our customers, and that we follow through on what we've learnt.

We've drawn heavily on the experience of our US colleagues, as well as the best of British industry expertise in developing collaborative behaviours, building trusted relationships with customers and suppliers to secure the best outcomes for each other. We've used their feedback to continually improve our bidding quality, as well as our delivery in the field.

And this brings me to the third point on this slide. Central to improving and realigning the business has been the strengthening of the governance of bidding. We’re now continually selecting and preferring larger scale contracts, particularly those comprising repeat business for customers with whom we've been able to build collaborative relationships and gain a deep understanding of their needs.

By being selective in our bidding we are reducing exposure to the places, sectors and customers with poor quality pipelines. The recent move to trade more selectively in the Southwest reflects just this. In future we will direct our time and effort to the areas where we believe there is better quality of profitability to be had.

But of course it's no use just winning good quality bids if one doesn't execute and deliver well. So we've been simultaneously improving operational control, introducing tools, techniques and measures that bring visibility and granularity of project performance right the way through our management structure. This is important in enabling us to intervene and to place support behind our teams wherever necessary to improve profits.

We're connecting a strengthened front line on site with the work that we've been doing to centralise procurement. And through that combination leverage relationships with both our global supply chain and local SMEs, who are able to bring additional value to regional projects on modest scales. In Construction, though procurement can be global, execution of work is always local.

On key projects the introduction of visual planning, lean tools and techniques have been providing better control than before and have helped secure some significant project turnarounds and improved margins.

The Regional business requires a national footprint with a local focus. It's founded on strong collaborative relationships with customers and embedded supply chain knowledge bringing the ability to work locally. Its purpose is to profitably deliver infrastructure and buildings of modest scale, but in reasonably large volume. In a slowly improving market we've already begun to see an increase in both the scale and quality of profitable opportunities, handled by our experienced Construction teams.

In a warming market, with limited resource pool the quality of work and the opportunities are important to us in retaining and developing the very best people in our industry.

So turning to the next slide, we're seeing improvements in our performance and the lead indicators suggest our strategy is starting to work. As we've been more selective in our bidding disciplines the regional business has been moving up in project scale, from June 2013 through to June this year we've already seen a reduction in revenue from live jobs at the smaller end of the market, described here as less than £5m. My expectation is that that proportion will be around 15% by year end, bringing with it economies in terms of the overhead and supervisory structures, as well as in the enabling functions that support all the different sites.

As a result of stabilising and strengthening the business we've also seen the number of unprofitable delivery units reduce, in June last year a third of them were unprofitable. At the moment it's three units, a sixth - and the purpose behind the announcement of restructuring in the Southwest and London is that by the end of the year our target is that we'll be operating with 17 local business units rather than 20 and that all of them will be trading profitably.

On the bottom part of this same slide we show our regional bid margin on new orders, which you can see has encouragingly been moving upwards as we see the opportunities in the market begin to come through in better quality, much more suited to our offering.

So turning to the next slide on the Major Projects business, the key issue when we reviewed Major Projects in Q3 2013 was that the team hadn't been winning work in the volumes and quality that historically had been the case. This was partly because of market conditions with less major infrastructure schemes coming through in the UK, but it was also because our bidding quality had not been successful.

We've strengthened the leadership team and our work-winning team, changed our attitude and behaviours and consequently begun changing our fortunes. We've been more thoughtful, engaging early with and listening to our customers; working hard on collaborative behaviours and consequently we've been more successful.

Our bid focus remains tight - transport, renewable energy, nuclear decommissioning and new build, together with special complex projects. At the turn of the year we also moved a selection of the smaller building projects within Major Construction across into the Regional business, where they would be better aligned with the skill sets and capabilities that those types of building works require, and where they would provide better continuity of employment for our people.

In winning work we've made sure that we're correctly presenting our considerable credentials in areas which are of rapidly increasing importance to our customers. The environment, truly sustainable business propositions, engagement with local communities, creation of apprenticeships, opportunities for people from disadvantaged backgrounds, and by collaborating closely we've been cutting out risk and waste for our customers, ourselves and our supply chain partners.

Although the major infrastructure market may be set to improve in future years, depending of course on government policies and UK economics, we've already seen our order book pick up by 6% since June 2013. And if we include our ABNC contracts, those awarded, but not contracted, then the total has risen by 26% over the same period, albeit from a low base. This is really encouraging, however, we must bear in mind that most of these projects effectively don't come to book until 2016 at the earliest because of the significant lead time in project procurement and development, typically associated with these sectors.

So then, this is a business that's in great shape and has the capabilities to compete and win against the best in the world, designing and constructing the increasingly complex and challenging infrastructure necessary for UK society and our economy to flourish.

Turning to the next slide on the third and smallest business, Engineering Services, a tier 2 M&E building services contracting business. Engineering Services for the last few months has required intense work, reviewing the business top to bottom, diagnosing and then starting to stabilise its performance.

We have an intensive management focus to extricate us from those projects which have caused us losses through a twin process of performance turnaround and commercial renegotiation. We're making steady progress towards a more detailed level of control, but we're certainly not fully out of the woods yet.

We've taken a number of steps to strengthen our leadership, changing almost the entire executive team, commercial director, two regional directors, finance director and the introduction of a chief operating officer. The last appointment is the final one, which was the announcement of Mark Hoyland, who joins us later this week on the 14th of August as the Managing Director for this business.

We've commenced our withdrawal from geographies and customers that have only a poor quality pipeline, and I confirm that we've stopped bidding work for other tier 1 contractors in London and the Southeast where all of our bidding is now in association with other Balfour Beatty Group companies, providing an integrated approach where we can control the design and deploy our skills and facilities in BIM technology and offsite manufacture to add value for customers and ourselves alike.

We've also stopped bidding for M&E work in the Southwest, although of course we're still working there concluding current contractual obligations.

Finally, and just for the avoidance of any doubt whatsoever, we are continuing vigorously to pursue Engineering Services' contractual entitlements in relation to a number of the legacy contracts and to recover monies that we believe are fairly due.

Turning to the next slide on the cross divisional matters that support and affect the performance of each of those three business units we've been describing. Our overhead and the cost improvement plans are well established. Now they've cut some £40m off CSUK's overhead over the course of the last couple of years. Nonetheless, although our overhead has fallen in line with revenue reduction, we should be more efficient. Some of the changes already taken will help us make that step alongside measures to provide more efficient back office through the Balfour Beatty shared service centre.

The implementation of a single ERP platform for CSUK starts live in parts of the business in Q4 this year, concluding in Q1 2015. When that's completed we'll have an enhanced analytical capability, in turn providing many more navigational aids, tighter operational controls and helping us to consolidate procurement further.

From my personal perspective we simply need to keep the foot on the gas with all of the measures implemented, really make them bite, deliver profits, and at the same time identify and accelerate our work on procurement by engaging more collaboratively with our suppliers to identify and eradicate wasted effort, all to the mutual benefit of the bottom line.

We must do more to simplify our business processes, enhance governance and at the same time reduce our business risks. Underpinning all of this is the fundamental fact that the construction industry is still highly dependent upon individual intellect, skills, knowhow and perhaps most of all ethics, behaviour and belief. And thank God engineering is still about people.

There's much to be very proud of in Balfour Beatty's history. It's what's driven the company's brand, and we need to take care to carry our people with us as we accelerate the pace of the turnaround in the coming 12 months. It's a good time to be doing all of this, for commentators such as the CPA note that the market is showing signs of recovery which means that on top of any enhanced profitability from being better there's opportunity gently to move our bid margins up as demand increases. Good people always command a premium.

Now, turning to my final conclusions slide. In a nutshell The Road Ahead, our performance turnaround plan, has been in place since Q3 2013. Our people understand it, have bought into it and they've been executing on it.

The key points then. Developing collaborative customer and supply chain relationships, increasingly more selective and thoughtful bidding, driving operational excellence in delivery, encouraging, developing and retaining the best people, securing permanent cost base improvement. All of this through a progressive, phased approach to reduce business risks and generate profit.

The lead indicators show the plan is working. Our people are committed and engaged. Delivering on these forges the means of navigating safely through the short term risks that remain whilst also bringing the opportunity and potential for our company.

Thank you. Steve.

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Steve Marshall, Executive Chairman
Thanks Nick. Conscious of time we're now going to go straight to questions. Please be kind enough to identify yourself and the firm you represent, and as I said, recognising the constraints on us we will do our very best to be open and helpful. If we could go straight in please.

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Questions and Answers

Telephone Operator
Thank you. Ladies and gentlemen if you'd like to ask a question please press *1 on your telephone keypad. If you change your mind and want to withdraw your question, please press *1 again. You will be advised when to ask your question.

The first question is from the line of Will Morgan from Goldman Sachs in London. Please go ahead Will.

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Will Morgan, Goldman Sachs
Good morning everyone. I've got four questions if that's okay; some of them are very brief though. First one is you talk about in the event of a sale of PB a £200m return of capital. Can you just maybe walk us through slightly how you did that math? I just wondered why you were being very specific about £200m.

Second question is you talk with regards to the Carillion rejection about the risks of achieving synergies while you were managing down the size of the UK construction business, I just wondered that this is something that presumably you are going to have to do anyway, and therefore that is a significant challenge for the Balfour Beatty business standalone. I mean were there plans for an even more aggressive reduction in the event of a merger? I just wondered if you could elaborate a little bit on your point there.

The third question just relates to the UK turnaround. I mean there's obviously a lot of talk about good things here. Just one question I had is in terms of the monitoring of projects, could you just maybe be specific in terms of what actual reports you've got to board level from the sort of ground level of projects, and whether you could just give something specific in terms of what kind of reporting change is there in terms of what you see on your desk regularly to monitor the projects that are going on?

And the third question is a very bitty numbers question. But on I think slide 23 you had some little pie charts at the bottom which showed the split between the kind of Major Projects and the Regional business etc, and it looked like Regional was 65%, 70% and maybe 20% Major Projects. So I just wondered if we looked back a few years ago when the business was maybe a bit more kind of mid cycle, I just wondered if that split would have been materially different, and if so what it might have looked like vaguely? Thanks very much.

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Steve Marshall, Executive Chairman
All right. We'll do a combination response to your various questions. Duncan is going to pick up the first one.

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Duncan Magrath, Chief Financial Officer
Yeah, hi Will. Essentially we basically are not going to go into the details or the calculation and clearly what we actually end up doing will be dependent when we've got a completed sale transaction. But essentially we did look across - particularly the individual stakeholders looked at effectively what's the strength of balance sheet we needed to retain which is obviously important to our customers, debt providers and surety providers, what we needed to pay into the pension fund and what we needed to look to see we could distribute to the shareholders. And I guess that's the methodology we went through.

We obviously looked at forward projections for the company and I think it was important today to give some indicator of the likely or the potential level of return that shareholders could get. And so essentially that was why we were giving an indication today, although clearly dependent on an eventual sales transaction.

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Steve Marshall, Executive Chairman

All right, and if we come onto the second one which was about the correlation between downsizing a business and the level of synergies that are achievable in those circumstances, we'll break the response into two parts. Because we can obviously talk most fulsomely and eloquently on Balfour Beatty's plans, and I'm going to ask Nick to give you a flavour of that in a second.

We can't comment in detail on the combined business plan of which we were given sight of, but we have given an example in our comments that the implications of dramatically downsizing a large construction business are significant, that you have to first of all outrun the loss of margin if you radically downsize the contract base. And only then, once you have done that with cost reductions, would you be in a position to then actually create genuine cost savings that could flow through to value, some of which might be true synergies from a combination, others of which Balfour Beatty can achieve for itself 100% for the account of its shareholders.

And as also I covered in my remarks, clearly if you dramatically downsize a business you end up with a much smaller business that is capable of earning peer group margins. So that alongside the working capital outflows and one off restructuring costs implications, the shape of such a plan would for us be pretty high risk. But that's the broad thing. I think, Nick, it's worth making a few comments about our own plans.

. . . .

Nick Pollard, CEO, Construction Services UK

Certainly Steve, thank you. Will, morning. The point is there's little point just exploding the whole business. You know, there is a rising market out there and our plan is about a phased, staged approach that refocuses our business on the parts of that market where we can make good money. And there's no reason to turn our back on the parts of that market where we can make good money.

The other point is that to make good money you need to take three communities with you. You need to certainly take your employees with you because that's where the talent and the skill lies. You must also take your customers and your supply chain with you, because actually the only way to deliver construction is to have that kind of integrated approach.

So from our point of view it's a question of making sure that we make sensible changes that people understand them in those three communities, and that we take people with us on that journey, but that we make the journey as quickly as possible but without causing unnecessary collateral damage on the way. So that's the approach we've taken with it, that's why we've put so much hard work into communicating the plan and to making sure that we have routine updates for our people on where they are, how they're doing and kind of what's happening next, a kind of a culture of you know no surprises, but moving forwards as quickly as possible.

So that's the focus, that's where we're headed. I think you also asked about reporting changes, so whilst I'm kind of on mic here if I can just deal with that. The kind of reporting changes are for instance we've now got a dashboard that reports at a granular level every single project, every single month. We can see the shifts visibly. Myself, my executive colleagues on the leadership team of CSUK, we can see performance diced and cut by delivery units or by business stream, nature of contracts, size of contracts and so forth. And that capability will be reinforced by the ERP platform that Steve was banging on and I was banging on about earlier on the call, on the formal presentations.

So that's kind of where we're at. We're about getting reports in granularity that allow us to analytically understand what's going on, and to be better able to intervene when we start to see anything sliding away at any scale of size.

. . . .

Steve Marshall, Executive Chairman
And just to add to what Nick said, the question sort of also talked about visibility at board level, and I do come back to the focus and simplification of Balfour Beatty. We get to see, because Nick is coming along on the Board in some detail, discussing it with us and surfacing data to us, a great deal of information on the journey that those businesses are taking. And a much more focused group, less hopping on aeroplanes and more focusing on those two major businesses that we have is the right way to take Balfour Beatty forward. And that way you can be focused on the metrics, the key drivers and on your customers, and really understanding your marketplace in conjunction with the guys who are actually running these businesses every day.

. . . .

Nick Pollard, CEO, Construction Services UK
Hear, hear.

. . . .

Steve Marshall, Executive Chairman
And then the pie chart question at the end Duncan in terms of how has the mix changed was the final question I think.

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Duncan Magrath, Chief Financial Officer
Yeah, I think the M&E business, Will, probably hasn't changed very much. I suspect there's been probably a ten percentage point shift between the Regional business and the Major Projects business. That would be off the top of my head, I don't actually have the figures in front of me but something of that order.

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Will Morgan, Goldman Sachs
Okay, that's very clear. Thanks a lot.

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Steve Marshall, Executive Chairman
Thank you.

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Telephone Operator
The next question is from the line of Howard Seymour from Numis in London. Please go ahead Howard.

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Howard Seymour, Numis
Thank you. Morning gents. A couple from me if I may. Just starting on one that you mentioned Steve. You mentioned on the sort of the key Group priorities, retaining the profitable Regional business on UK construction turnaround, just really the thought process on two aspects. One, Major Projects within that because obviously Nick outlined on that a more confident outlook, so why you've specifically said a profitable Regional business as opposed to larger business, i.e. is Major Projects potentially non-core?

And secondly I suppose the same question on rest of world. It was actually a bit better than I thought it would be. I noticed the margin slipped but what do you need to think about in terms of your sort of rest of the world businesses to decide if they're core or not?

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Steve Marshall, Executive Chairman
Okay. Right, let's start with the first one. For the avoidance of any conceivable doubt Major Projects is absolutely a core business of Balfour Beatty, and Nick has covered the progress that we're already making in that business. But I mentioned that, you know, we'd had sight of the combined business plan, I'm not in a position to comment on its contents. But clearly our largest business is our Regional business, what is it Nick, £1.7bn of our turnover?

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Nick Pollard, CEO, Construction Services UK
£1.75bn, yeah.

. . . .

Steve Marshall, Executive Chairman
Something of that nature. So the lion's share, as the pie charts say. And any downsizing proposal would clearly significantly take the size of that business into account. It is a business that in terms of where we play and which markets and which segments within the UK, Nick is actively reviewing and has already made changes as he set out. But underneath it all there is a viable, profitable business that is capable of making returned progress to peer group margins. And that is in Balfour Beatty's shareholders' interests to retain that, we shape it and trade forward with it.

Rest of the world - sorry, go ahead.

. . . .

Howard Seymour, Numis
No, go on, after you sorry.

. . . .

Steve Marshall, Executive Chairman
I was just going to address the second part. I mean if you make an assumption of a post Parsons Brinckerhoff Balfour Beatty, in practice outside UK and North America, our principal rest of the world operations are our two joint ventures. Neither of which we manage although in different ways we contribute to them, i.e. Gammon in the Far East, and our Middle East JVs. And the purpose of the comments I made up front was merely to signal that they are not as strategically core as our Anglo American construction presence and the investment business that overarches it, but we are perfectly comfortable holders of those investments providing, as in all other areas of the business, we see the ability for them to be value accretive over time. So that remains our position.

. . . .

Howard Seymour, Numis
Okay, thank you. That’s very clear. Can I just ask a quick question on the infrastructure as well? As you alluded to in the interim statement, there was a sort of fair value gain of £15m on policies you've mentioned it before, just really asking Duncan if it’s possible to sort of clarify whether you’d see a similar amount of benefit on fair value gain in the second half in the infrastructure investments?

. . . .

Duncan Magrath, Chief Financial Officer
It’s difficult for me to make any forward looking statements. In terms of the - if I can just perhaps say that the fair value gain came off a revision of the cash flows that we did in the first half, that’s something that we would be doing every year but not necessarily twice a year.

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Howard Seymour, Numis
Okay, that’s fine. Thank you.

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Telephone Operator
We now have a question from the line of Olivia Peters from Royal Bank of Canada. Please go ahead.
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Olivia Peters, Royal Bank of Canada
Morning everybody. Just three questions please. I just wanted to try and get a sense of what the underlying UK Construction margin was excluding the issues that you had in the Engineering business? Or to put it differently, maybe where do you see peer margins at, at the moment? I'm just trying to get a sense of where you're going to.

Secondly on your average net debt guidance of £375m, I mean given your working capital outflow in the first half and the fact that you're expecting a second half inflow, are you still comfortable with that guidance?

And then just lastly Nick you said that you could improve the cost base in the UK Construction business. I was just wondering if you could quantify what those future cost savings may potentially be. Thank you.

. . . .

Duncan Magrath, Chief Financial Officer
Olivia, perhaps I'll deal with all three of those. Unfortunately two of them have forward looking questions in them that I'm not going to be able to deal with, particularly around the margins and the cost base one. In terms of the average net debt I think I'm probably on safer ground in terms of the expectation there. If you look at the average net debt we were at 424 for the first half, the average net debt for Q2 was just over 500 and I would expect that to remain around about that level for Q3 and Q4. We will see a working capital inflow in the second half. We do have two dividend payments that go out in the second half.

The other thing that I probably should have highlighted is that £55m of our disposal proceeds wasn't received until the day after the half year cut off, so that fell into the second half cash flow. So if you put all that together then the average net debt will be higher than the 375 which is where we were I think towards the beginning of the year. It will be closer to around about 450 for the year as a whole.

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Nick Pollard, CEO, Construction Services UK
Yeah, Olivia we can't give you any numbers on it but I mean if you look on page eight of the presentation, it talks about areas you know like procurement and shared service efficiencies and ERP platforms that I think give you some idea of where some of those savings come from. And on the earlier slides we've indicated we're moving away from the smaller jobs you know to stuff above £5m. And obviously that affects, as I said in my talk, you know that affects supervisory and enabling function overheads behind that. I think you've got to draw your own conclusions from that I'm afraid.

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Telephone Operator
I have a question from the line of Mark Howson from Canaccord in London. Please go ahead Mark.

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Mark Howson, Canaccord
Good morning chaps. Can I just ask on Support Services, obviously the working capital became a bit of an issue, larger than expected in the first half. Can you just about what's going on there, particularly with National Grid? I mean a number of your peers that have been working with National Grid say some of the terms are getting paid. I mean it's one thing recognising profits, when actually it's another thing getting the cash in against that are quite onerous. Can you just say - you mentioned earlier I think in the slide pack what you were doing - you were doing things to try and improve things with the client. Can you just say what that's involving please?

. . . .

Duncan Magrath, Chief Financial Officer
Yes. So this is the contract that we signed in the middle of last year Howard, sorry Mark. We highlighted at the time that there was going to be a significant level of positive working capital associated with the project which was priced into our bid. So there's nothing - you know it was contractual, we agreed to those terms and so it was agreed on both sides. What actually happened was that actually a lot more work came through in bigger packages last year, and the way the mechanism worked is we ended up having more working capital than we anticipated. National Grid understood that and helped us which is why towards the end of the year the negative working capital came down again, because effectively it wasn't operating as both sides intended.

Where we are at the start of this year is we're sort of back in the same process again, and I'm sure we can continue to have a constructive dialogue to make sure that we get back into a good space by the end of the year.

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Telephone Operator
The next question is from the line of Kevin Cammack from Cenkos in London. Please go ahead Kevin.

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Kevin Cammack, Cenkos
Good morning. I've got three but I suspect two of them probably fall foul of what you're allowed to say. But I'd be pleased to know if even in the round there was anything stopping you maintaining the forecast that you made for the full year, in terms of the range of profitability, firstly?

Secondly, again I guess this is probably difficult, but I mean given the underlying movement that you've seen in the cash, sorry the net debt, in a post Parsons Brinckerhoff, and assuming the ballpark proceeds are the right amount give or take even £100m, going forward and with the repayment of some of that cash to the banks, is there any sense that the banks are seeking a further reduction in the ongoing level of debt that a post Parsons Balfour Beatty would be, you know, they would be tolerant of in that structure?

And my last question in a way is if I was a shareholder in Balfour, one of the things going forward that might perhaps disturb me is the commitment, in a sense, of the executive, given the arrangements that were agreed and detailed in your merger discussions that effectively Chairman, CEO and FD would all be nominated by Carillion, I just would feel - what can you comfort people by saying in terms of an independent Balfour going forward? Obviously I understand the CEO role, that speaks for itself, but what generally can you - how can you comfort shareholders that there is an absolute commitment by the Board to see through a successful recovery of the Group?

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Duncan Magrath, Chief Financial Officer
Okay Kevin, perhaps I'll pick up the first two of your questions. You're absolutely right; I'm going to struggle to answer your first question. I'll just point you to the statement which basically says that trading in the first half was in line with our recent trading update.

In terms of the second point about underlying cash, I think the question from my perspective is how we wish to run the Group's balance sheet and what is a sensible arrangement for that, and effectively what we've talked about earlier was very much looking at how we would see the world. I've not had any conversations with banks that are for them seeking to put any question mark or pressure on us at all, so it's very much what I'm talking about today is how I think we should be running the Group's balance sheet going forwards. Perhaps I'll hand the question over to Steve in terms of the third one.

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Steve Marshall, Executive Chairman
Yes, I mean I think it's a very sensible and reasonable question. And I think in responding to it the first thing to do is to go back to the approach that the Board took during the month and more that we had discussions with Carillion before actually agreeing to engage. And as you've seen we've published the general terms that were agreed between the two boards before we agreed to engage.

And, you know, if you look at the key elements of that, the view that the Board took, and I come back to the commitment to restoring value that I talked about in my remarks, the view the Board took was that this was somewhat of an approach with takeover characteristics attached to it, but frankly without a chequebook to match. So the view that the Board took was that negotiating very firmly indeed in terms of the share of a combined company that our shareholders would own was an absolutely key priority. Negotiating a clear understanding on the disposal of Parsons Brinckerhoff, and at Carillion's request the retention of those proceeds in the combined group was something we spent a lot of time on. And it was clear as we engaged in those discussions that there was a very strong priority within Carillion to occupy those top Board slots.

And in the round, given as you've mentioned we don't have a continuing Chief Executive at this point, we took as a Board a very pragmatic decision that if we focused the discussion around value and all of the other things that would be needed to do to preserve value such as the PB disposal, then as a balanced package it could well be in shareholders' interests. The issue however, you know clearly, is that in a merger combination you have to be very mindful of an obligation to be able to recommend the entire package to your shareholders. And we've talked about that piece elsewhere.

But the reason I go through that is that the agreement to those top three slots in Carillion's favour was part of that package of discussions. It does not, in any way, reflect a lack of ongoing commitment from the current Balfour Beatty team or the Board to take this Group forward, quite the reverse. Having got to where we've got to, there is a vigorous sense that we want to now take the Group forward. Clearly recruiting a top flight Chief Executive is important. But although the likes of Duncan and myself are principally visible to investors, what you don't see, but Nick is with us today, is a very strong top team of divisional heads in the executive committee that currently reports to me who are totally committed, totally running their businesses and each with plans to take those businesses forward. So it's actually a strong bench that is committed.

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Nick Pollard, CEO, Construction Services UK
Completely.

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Steve Marshall, Executive Chairman
And we need to get our Chief Executive recruited, which we are very focused on, and there are plenty of top flight people who want to come along and talk to Balfour Beatty, that is clear. So that's the context if that helps.

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Kevin Cammack, Cenkos
Okay, thank you very much.

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Telephone Operator
We now have a question from the line of Andrew Gibb from Investec in London. Please go ahead Andrew.

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Andrew Gibb, Investec
Yeah, morning gents. Just a couple from me. Just wanted to check on dealing with the Italy Rail business putting discontinued because you think you'll get it sold within the next 12 months, and clearly where you are in the process on Parsons Brinckerhoff, could

you just talk to me about thinking about not putting Parsons through the discontinued line at this stage please?

. . . .

Duncan Magrath, Chief Financial Officer
Yeah. Andrew it's Duncan, I mean it is a judgement call. I think the fundamental difference between the two is that the PB disposal is subject to shareholder consent, and the Italy disposal isn't. And fundamentally that was what changed our - you know made our view that it would keep it in continuing. Clearly we'd like to carry on, so hopefully very quickly it will be in discontinued.

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Andrew Gibb, Investec
On the point really going back to Kevin's point around the sort of balance sheet, and you know you mention in terms of the update and sales of Parsons about the satisfying the interest of shareholders' pension funds and debt providers, on the debt provider point is it very much that's just the Board's view on how the balance sheet needs to look, rather than you know banks or surety providers putting some pressure on how the balance sheet needs to look?

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Duncan Magrath, Chief Financial Officer
I'll repeat what I said last time. It's absolutely the Board's view of how we should run a sensible balance sheet.

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Andrew Gibb, Investec
Okay, that's brilliant. And just finally maybe one for Nick. Just looking at the mix in terms of the sort of Construction business UK as it stands, I mean I appreciate it's got sort of go forwards comments of where you're at, at the moment, but in terms of split is that how you sort of see the mix going forwards, or do you think there will be some sort of variances around that?

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Nick Pollard, CEO, Construction Services UK
Andrew, I think it depends entirely as the market shapes up. If a new government after an election came forwards with a huge package of infrastructure investments, our Major Projects business would leap forwards into the breach because that's where they're predominantly focused. You know, if nuclear power suddenly advanced quickly, equally they'd be straight in there. On the other hand, if it turns out that the UK invests in local infrastructure through local authorities and you know schools and small roads and things of that nature, it will be the Regional business that addresses it.

So it's a question of playing to our strengths and we value that. Although we talk about them on calls like this as if they are two separate businesses, I mean they're not. They sit underneath my command and that's why we changed the branding so that everyone smelt, felt and looked like Balfour Beatty. So you know, we'll move our resources, as we said in the presentation, to where customers, people and supply chains align. Those have always been, all my career, the three tenets of good, profitable, stable construction, and that's the method we'll adopt. So it will depend on the market is the answer.

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Andrew Gibb, Investec
Okay brilliant, that's great. Thanks.

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Telephone Operator
I have a question now from Alastair Stewart from Westhouse Securities in London.

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Alastair Stewart, Westhouse Securities
Two questions. One on the PPP disposals, and then the second on average net debt. On slide 16 you've got progressively better overshoots in terms of the Director's Valuation, 25% for the 2012 disposals, 54% for last year and 82% for this year. Apart from the roads ones in the 2013 they all seem to be similar, sort of schools and UK schools and hospitals. Is that progression the result of an improvement in the underlying market and discount rates dropping, or is it the latest ones have been better in terms of maturity or quality of assets? That's the first question.

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Duncan Magrath, Chief Financial Officer
Yeah. I think inevitably it will be a combination of things. I don't think there's a significant difference in the quality of assets, I think there are - it remains a strong market. And I think people - as the market has matured people have a better sense of what things are worth and what they're prepared to pay for things as it's gone forwards. So I think it's more a function of that than it is anything else.

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Alastair Stewart, Westhouse Securities
Thanks. And the second question, a couple of - well one question and a couple of clarifications on the average net debt. Does the £424m average net debt in the first half include the cash from the discontinuing, I presume it's Rail businesses, as is the case on the front page of the actual release? And looking at note nine, I think it's the cash is net of debt - say net of borrowings is £23m, does £23m equate with the sort of average net debt for those businesses? Basically does that - will the average net debt position be worse once the Rail businesses go?

And then it's just a couple of clarifications. I've got a crackly line but if you could deal with that first?

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Duncan Magrath, Chief Financial Officer
I don't think it's going to make a huge difference because obviously when they go we'll receive cash for them, so I think it's broadly a neutral answer.

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Alastair Stewart, Westhouse Securities
Oh, so basically the disposal price will be basically the cash in the business?

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Duncan Magrath, Chief Financial Officer
Broadly, I mean without going into the details on the individual ones, but I don't think it's going to make a dramatic difference to our net debt position.

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Alastair Stewart, Westhouse Securities
Sure. And finally just clarifications, I've got a bit of a crackly line; I didn't hear how much disposal proceeds had been picked up just after the half year end. And then, did you say that the average net debt for Q3 and Q4, or was it Q2 and Q3, would be just over £500m?

. . . .

Duncan Magrath, Chief Financial Officer
So it's £55m is the proceeds that was received one day after the half year. And in terms of the average net debt, it was just over £500m in Q2 and I'm expecting a similar level for Q3 and Q4, i.e. basically staying at roughly the same level as it was in Q2.

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Alastair Stewart, Westhouse Securities
Great. All right, thanks very much.

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Peter Young, Investor Relations
The next question is coming from Stephen Rawlinson from Whitman Howard. Firstly, have you consulted the debt providers regarding the use of proceeds from the sale?

Secondly, how much is the payment to the pension funds expected to be if £200m is to be given back to shareholders?

And thirdly, Nick mentioned on one of his slides that designing major projects is an activity, why is this mentioned if Parsons Brinckerhoff is being sold?

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Duncan Magrath, Chief Financial Officer
Okay, well I'll deal with the first two. I mean in terms of we've had no formal discussions with banks but clearly we have conversations with banks all the time in terms of how we might utilise proceeds. In terms of the pension fund there's an automatic mechanism which essentially works out that they would broadly get about 42% of any return of capital to shareholders would, and 42% would be the automatic payment into the pension fund.

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Nick Pollard, CEO, Construction Services UK
Yeah, and in relation to designing and constructing major projects, I think that's typically how customers buy it, they buy it as a package; it's not one or the other. Sometimes the customer has appointed their own designer and we pick them up in the course of taking on the work at bid, and at other times we team with the most relevant designer, and that's not necessarily PB. We've got JVs running in this country with Mott Macdonald, with Atkins and with others, and we select the most appropriate partner that will make us most competitive at bid. So it is as simple as that, it's just a factual statement and you know we're quite agnostic as to who we use, as long as they're the best.

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Telephone Operator
Ladies and gentleman, as a reminder if you have a question or comment please press *1 now on your telephone keypad. Thank you.

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Steve Marshall, Executive Chairman
Okay. Well if there are no further questions can I just thank everybody for participating. And just to underline the fact, we'll be available and very happy to interact later on and during the course of the week. Thank you very much.

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