2011 Full-year results
8 March 2012
Ian Tyler
Chief Executive

OVERVIEW PRESENTATION

Good morning ladies and gentlemen. Welcome to our 2011 full-year results presentation.

A strong performance

2011 was a year of strong performance. Strong performance in its own right with a steady order book and 9% growth in earnings, but also a very good demonstration of the diversity, flexibility and resilience of our business in markets that were difficult, albeit predictably so.

This reflects the successful creation of a business that is able to operate across the entire infrastructure lifecycle, generating half of its income outside its home market. We have seen growth in revenue and earnings in Professional Services, Support Services and Infrastructure Investments – which has protected us from the cyclical downturn in construction activity, particularly in the UK and the US.

We maintained our order book at £15bn throughout the year and increased revenue by 5%. Profit before tax and earnings per share was up by 9%. Based on this financial result and the healthy net cash position of £340m, our Board is recommending a final dividend of 8.5p that will raise the full-year dividend by 9% on last year.

In order to underpin the profits of the business in the near-term, we are working on expanding the cost efficiency programme we launched in 2010. To this end, we are also planning to double our target of PPP asset disposal gains to £40m in 2012.

While we are cognisant of the near-term challenges, we see opportunities for our business in growth sectors such as power, rail, transportation and mining, particularly in growth markets like Australia, Canada, and, looking slightly further out, in India and Brazil, all of which are at the heart of our strategy and our optimism for the future.

So I'll hand over to Duncan to tell you more about our performance in 2011. Duncan.

Thank you, Ian, and good morning everyone.

2011 Full-year results
8 March 2012
Duncan Magrath
Chief Financial Officer

Agenda

Despite the continuing challenging markets Balfour Beatty achieved a strong performance in 2011. Over the next few minutes I will run through the key financial highlights, then cover the segment performance. I'll also spend some time describing the key components of the balance sheet and how these have moved in the year.

Headline underlying numbers

Revenue increased by 5% to £11.0bn for the period. At constant currency but excluding acquisitions the underlying increase was 4%. Revenue grew in each of our segments.

Profit from continuing operations, before non-underlying items, increased by 2% to £331m. The impacts of business acquisitions and disposals broadly offset each other in the period.

Pre-tax profits from continuing operations, before non-underlying items, rose to £334m – a 9% increase.

Underlying earnings per share from continuing operations were also up 9% on last year at 35.5 pence. The effective tax rate of 35% was in line with last year and as forecast in August. The tax rate is sensitive to profit mix, but I expect a slightly lower rate for 2012.

We are proposing an 11% increase in the final dividend to 8.5 pence, which would give a total dividend of 13.8p, an increase for the year of 9%. This matches the growth in continuing operations EPS.

Cash generated from operations was £35m. This was due to a reduced level of negative working capital plus an increase in pension deficit payments. I will return to both of these in a moment.

Average cash for the year was £200m, with period end cash of £340m.

Despite the disposals in the year, the Directors' valuation of our PPP portfolio increased by £72m to £743m at the year-end.

The order book remained steady in the year at £15.2bn. While it did benefit to the tune of £0.4bn from acquisitions, overall we believe that this was a **good** performance.

Turning to the phasing of the order book.

Order book

The 2011 order book is shown in bold, which totals the £15.2bn shown in the top right corner.

The equivalent £15.2bn for a year ago is shown lighter.

Of our £15.2bn order book we expect £7.5bn to convert into revenue in 2012, compared with the £7.2bn we expected a year ago.

There are two key points to note from this slide. Firstly the growth in the Support Services order book, which I will discuss in more detail later.

Secondly, the Construction order book is larger for the next 12 months but reduces thereafter. The reason is a migration away from complex larger construction projects to less complex projects with shorter lead times. However, while the 'booked unexecuted' orders have come down for the 12 to 24 month period, our 'awarded but not contracted' orders for construction have increased from £3.1bn to £3.9bn, which when converted into orders will support principally 2013 and beyond.

So let's now turn to the segmental analysis, starting with Professional Services.

Professional Services by geography

The left hand side shows the order book and the right hand side shows revenue.

The US accounts for half of the order book, and of this about 80% is related to transportation. Despite stalemate over federal funding for the Transportation Bill, transportation orders remained steady for the year. There were some reductions in the US building market order book.

Order backlog in the UK was down 8% in the year, although the second half was boosted by a five year extension to a power transmission project.

The Rest of the World saw good order book growth particularly in Asia, and also significantly in Qatar where we were awarded the programme management for a £5bn roads and drainage project.

Revenue performance was consistent with previous periods, with the US stable, growth in Australia and Asia, but with reductions in the UK.

Professional Services summary

In Professional Services, I should remind you that we benefited from an unusually high level of incentive income in the first half of 2010, totalling £8m. We highlighted this last year, saying we did not expect it to be repeated in 2011.

Without it, the 2010 margin would have been 4.8%. In 2011, even without the benefit of that additional incentive income, we grew profits and delivered a margin of 5.3%. This was due to a tight control of costs and also from a good performance from the US power business and a successful integration of Halsall, to give an overall encouraging performance.

Looking to 2012, we expect to make further progress.

Now moving on to Construction Services…

Construction Services by geography

Here on the left you can see the order book was down 7% against the half year and 8% against the year-end position in 2010, including the net benefits of £0.4bn from acquisitions and disposals.

The UK order book reduced by 25% in the year; this was fairly broadly spread across our UK business, although London and the South-East tended to hold up better than elsewhere. The UK now accounts for just a third of our construction order book.

Across the Atlantic, following the strong order intake in 2010, the US business rather paused for breath. While it was up 12% in the year, this was due to the acquisitions of HSW and Fru-con.

Much like the US, Hong Kong followed a strong 2010 order intake with a stable performance in 2011.

The Rest of the World, however, was down 9% – with continuing reductions in our Dubai-based construction business and reduced workload in our German and Scandinavian rail businesses. However, since the year-end, the picture has improved somewhat with the signing in January 2012 of a major rail signalling contract in Denmark.

On the right hand side, revenue is up 5% on last year, or 2% excluding the impact of acquisitions and disposals. In the US the acquisitions we made gave us a revenue uplift of 12%.

Revenue in the Rest of the World was up 8% – again benefiting from the 2010 order intake, particularly in Hong Kong.

UK revenue was broadly stable, as increases in our regional building businesses were offset by reductions in our regional civils business.

Construction Services summary

Here's the summary for Construction Services. Profit was down by 16%to £169m. As I mentioned, the most significant factor was a very challenging comparative figure from the prior year, when our US construction business delivered a particularly strong first-half profit performance. Our lower margins in 2011 reflected the changing mix of business and the continuing competitive environment. Elsewhere profitability held up well – except for the European rail business, which saw some decline in Germany and Scandinavia.

As previously stated we will continue to see a reduction in the US margin in 2012 to a more normal level of 1 to 1.5%. Because we earn an increasing proportion of our business in the US, this will reduce the overall margin for Construction Services. However, the UK should remain reasonably steady – benefiting from the cost reduction plans we announced in 2010, and a further programme of efficiency measures that Ian will talk about in a moment.

While both geographic mix and project mix will continue to influence margins significantly, we expect to be able to maintain our overall margin at around 2% over a full year. As the market recovers, we expect to bring this back closer to 3%. We anticipate that profitability and margins will continue to be weighted towards the second half.

Turning now to Support Services…

Support Services by market

The order book overall grew steadily during the year, up 6% in the second half and 13% over the full year.

As we predicted, growth in the power sector has begun to come through, with a strong second half performance. We also had a good performance in transport, where we won new local authority work. We succeeded in renewing our contracts for rail renewals, albeit at a lower level – but not our Highways Area 2 contract. The order book in the water sector reduced as we continued to work through the AMP cycle.

The strong order intake in 2010 and 2011 has fed through into a 10% increase in revenue for the year. All areas performed well, with the strongest growth coming in the water sector, recovering from the slow start to AMP5.

Support Services summary

Here's the Support Services summary. Profit of £67m was up 8% on last year, driven by improved profits in the water and power sectors. Contract start-up costs in the building and local authorities markets impacted mainly in the first half.

In 2012 the lower profitability in major highways and rail renewals should be offset by continuing growth in the power and buildings sector, and good margin performance in the water sector.

Finally in the segmental review, we come to Infrastructure Investments.

Infrastructure Investments financials

We sharply increased our PPP concession profits. Net of bid costs but before disposals, they rose from £12m in 2010 to £23m last year. This was principally due to increased profits in the UK as we continued to grow our portfolio of both operational assets and assets under construction.

We reduced our bid costs and overheads in the year. This resulted from less complicated and therefore less costly bidding, along with the crystallisation of some bid cost recoveries.

In addition, further down the slide you can see that subordinated debt income also rose from £19m in 2010 to £25m last year due to increased subordinated debt invested into the concessions during 2010 and 2011. As this is the mechanism we invest into concessions, it is a significant element of the overall return.

In November 2010 we announced our intention to manage our portfolio more actively. In line with this policy we generated gains on disposals of £20m last year. These came from selling down our stake in the A50 road concession from 85% to 25% and selling our 50% stake in Blackburn Hospital.

Overall, therefore, the total pre-tax result from investments rose from £30m to £71m.

Looking ahead, the success of our disposal programme so far and the active secondary market, have led us to decide to accelerate our disposal programme with a target of £40m of disposal gains in 2012. This should ensure that our pre-tax return from the Investments business continues to make progress, despite bid costs returning to their previous level.

Infrastructure Investments highlights

These are our Investments highlights for the year:

- We reached financial close on four projects
- We were appointed preferred bidder on six projects including our first two waste projects
- We generated £28m of disposal proceeds in the year, and another £18m after the year-end
- And we disposed of Barking Power to the pension fund for £55m.

I will come back to the increase in the Directors' valuation to £743m in a moment. But first I'll discuss net interest income for the Group as a whole, of which an important component is the sub debt interest income generated from the investments business.

Slide – Net interest income

In 2011 we generated net investment income of £3m, compared with a net finance cost of £19m in 2010. There are two main reasons for this improvement.

Firstly, as noted earlier, subordinated debt interest receivable has continued to increase, up from £19m in 2010 to £25m.

Secondly, the net interest cost in the pension funds reduced from £21m to £3m. The asset performance and the measures we have taken to limit liabilities have helped with this. But the principal factor in reducing the net liability and interest cost has been the deficit contributions, which have totalled just under £200m over the past two years. I will talk about the changing mix of assets and liabilities in our balance sheet later.

We replaced most of our existing bank facilities with a new £850m five-year syndicated facility in November 2011. The incremental cost of the new facilities is just under £2m a year.

A few moments ago, I mentioned our cost efficiency programmes in the context of our UK Construction business. Here's an update on how those programmes are going.

Cost Efficiency

In October 2010 we announced the formation of a shared service centre in Newcastle to consolidate our accounting, payroll and procurement activities. We have made good progress and are delivering against the targets we set.

From scratch, in under 18 months, we have created a management structure, a physical location, and the transition expertise which allows us to maintain the momentum towards ever greater efficiency while supporting a more collaborative approach. Cost savings have an important part to play in delivering our 2012 results, and Ian will be updating you on how we can build on these achievements.

But first, let's take a closer look at the balance sheet at the end of 2011. Here are the key tangible elements.

Balance sheet elements

Let me point out that I am mixing our actual balance sheet position in the case of working capital, cash and pensions, with a Directors' valuation of our PPP portfolio. So there's a little bit of apples and pears going on here. But bear with me, because I think this is a very useful way of thinking about the key elements of the liabilities that the Group has, and the assets it has to satisfy those liabilities.

There is no precise formula that can be applied here, but we continue to ensure that we maintain an appropriate balance between these different elements.

The liquid cash of £340m and semi-liquid PPP investments of £743m are a balance to the current working capital liabilities of £1.1bn and the longer term pension liabilities of £275m. A matching reduction in both liabilities and assets does not necessarily fundamentally change that balance.

Over the next few slides I'll go through each element in turn. But before I do, it's worth noting that both categories of liabilities have reduced in the year, partly funded through cash payments, and this has impacted our net cash balance. The support provided to the balance sheet from the investments portfolio has on the other hand increased in the year.

Given the elements above, and also noting that the actual total book net assets increased during the year I believe we have ended the year in at least as strong a position as we began.

With that in mind, let's go into a little more detail – starting with the PPP portfolio.

PPP portfolio valuation

If you're looking for the slide that you are familiar with, you'll find it in the appendix to your pack. To make things simpler this morning I have summarised the key components on this slide.

We have marginally increased the discount rates used to value the portfolio to 9.5% for the UK, and 12.0% for the US, but in reality this is simply to focus more on the pre-tax discount rate, which is the rate that seems to be most often quoted in the market. The net effect is to reduce the opening value by £8m. The rate continues to be a conservative discount rate – as evidenced by our gains on disposals in 2010, 2011 and 2012, where we realised significantly more than the Directors' valuation.

The important point to note is that disposals and distributions totalled £98m in the year, which means that after investing £52m we received net cash of £46m from the portfolio. That's a good distribution.

But this distribution was more than offset by the increase in value of £69m from the unwind of the discount and £49m from new project wins and operational gains. It is worth noting that the combination of PPP profits and disposal gains that do appear in the P&L is numerically less than the increase in value generated in the year.

So despite the disposals the valuation actually increased to £743m at the end of the year and shows that we have the capacity to increase the pace of disposals.

Now to working capital which is a key area to discuss, and therefore worth spending some time on it, so please bear with me.

Working capital – Key points

One of the features of our balance sheet is the significant negative working capital that we carry. It is largely to offset this that we carry equal amount of PPP investments and cash. If, for instance, we had a lower level of working capital, we could run with a lower level of investments and cash.

What I would like to show you over the next few slides is that

- Management controls over working capital remain strong
- Working capital will vary through the business cycle
- Working capital is impacted by mix of business and varies by geography, segment and project size

- Given the scale of the Group, cash movements can be significant
- Working capital remains within normal cyclical bounds

Working capital - Group

During changes in the business environment it is natural to see the working capital and cash fluctuate. This graph runs from December 2007 to the 2011 year-end. As you can see, our total negative working capital, represented by the blue bars, peaked in absolute terms at the end of 2009, at just under £1.3bn.

The graph shows two other measures. The dark blue line represents working capital as a percentage of revenue measured at the end of each six-month period; and the red line shows average working capital during those six-month periods.

You are probably familiar with the period-end cash and average cash graphs which we have shown for three years now, and as you would expect the average working capital as a percentage of revenue on the red line is generally lower than the blue line.

From December 2007 to June 2011, the average working capital as a percentage of revenue remained roughly between 11% and 13% and the period-end working capital percentage some one percent higher. Each percent broadly equates to about £100m of working capital at Group level.

Looking at the blue and red lines there are two points worth noting.

Firstly, the period-end working capital at June 2011 was slightly lower than the average working capital, for the first time. This was due to changes in Professional Services and Support Services working capital, which I will demonstrate in a minute. Secondly, there was quite a reduction in both percentage measures over the second half of 2011, which you will see was due to anticipated underlying change in Professional Services, and changes in Construction Services.

Before going into the individual segments, it is worth pointing out that over the last five year ends, our net payable days, i.e. receivables less payables, has remained between a negative 47 days to a negative 54 days. We were at 49 days at the end of 2011. So our management of the payment cycle has remained very consistent. Having said that, given the scale of our business, one day represents just under £30m of cash, or £40m per working day, so small changes can result in fairly sizeable cash movements. What has changed, however, is our mix of business, which can have different cash profiles.

With that in mind, let’s look at the working capital movements by segment.

Working capital – Professional Services

So starting with Professional Services…

When we acquired PB in October 2009 we highlighted that all of the $180m of cash in the balance sheet would be used up due to a number of factors. One of these was that PB was running with negative working capital, largely due to some very favourable contract positions in Asia.

You can see that through 2010 there was relatively little movement and indeed this unwinding has only really started to happen in 2011. The swing from the negative working capital position to the positive position happened towards the end of the first half of 2011.

At the end of 2011 the positive working capital was just under 2% of revenue. Given the nature of the business, and as we reduce the amount of work that PB subcontracts, we will see this positive working capital increase over time, to somewhere around a positive 5%.

Working Capital – Support Services

Support Services also has reasonably small levels of negative working capital. Period end working capital has tended to move in the negative 2% to negative 5% range. At the half-year in June we saw a significant drop in the negative working capital as we invested in the large number of contract start-ups that we experienced at that time. This all happened towards the end of the half and therefore resulted in the June position being less negative than the average. While we saw some recovery by the year-end, I would anticipate some reversal again in the first half of 2012 due to some more contract start-ups.

Working Capital – Construction Services

Finally, let's look at Construction Services. This has the highest absolute level of negative working capital, along with the highest negative percentage. These percentages vary by type of business and also by geography. For instance the UK has generally been in a more negative position than the US.

You can see that total construction negative working capital also peaked at the end of 2009 at the point at which the construction market peaked in revenue and order intake, and when the UK accounted for about half of the order book.

In percentage terms it continued to rise during 2010 – which negated some of the impact of the falling revenue on the absolute working capital balances. As you can see, the working capital percentage is now getting back towards 2007/2008 levels.

I expect we will see a continuation of this trend over the next 12 to 24 months, so that the percentage negative working capital could reduce by a further 1 to 2%. However, the absolute level of negative working capital will start to increase again once the cyclical recovery in construction revenues occurs.

So, looking at cash.

Net cash balances

There are many factors driving our absolute cash level. But you can see that the profile of our cash is not dissimilar to the profile of our working capital: it peaks in December 2009, although this was inflated by the $180m of net cash we acquired with PB.

The average for the second half of 2011 was £104m – which is around the level we would expect to operate at in 2012 ignoring one-off events.

Cash from operations

Cash from operations, before the one-off pension deficit payment, was £35m. This compares with £209m in the previous year, the difference being largely due to the working capital movements I have just discussed.

After the one-off deficit payments and capex there was a cash outflow of £40m compared with an inflow of £83m in the previous year.

And here is how the overall balance sheet position on pensions changed over the year.

Pensions – balance sheet movement

Firstly, it is worth saying that the net pension deficit has changed quite significantly over the last two years – not least because of the nearly £200m of deficit funding that we have contributed into the scheme over that period.

During the year real discount rates declined further from 2.05% to 1.9%, driving up the value of the liabilities. Against this, asset performance was better, giving an actuarial gain of £131m.

As in the past we have shown the figure net of assets in the deferred compensation plan, which gives a net after-tax liability of £150m.

And finally, before I wrap up and hand over to Ian, a quick look at dividends…

Dividends per share

We realise the importance of dividends to shareholders. We have increased dividends every year since 1999, and we aim to maintain that policy.

As I mentioned earlier, this year we are proposing a final dividend of 8.5p, to give a total dividend of 13.8p, a 9% increase in the total dividend.

Just to put some more recent perspective on this achievement: since 2007, the year before the financial crisis started, to this year's proposed dividend we have increased the payout by almost 40%.

Summary of 2011

So let me summarise our performance in 2011.

We have continued to perform well, despite difficult markets, helped by the resilience and diversity of our business, and by continuing progress on ongoing efficiency measures.

The order book has remained stable at £15.2bn.

We achieved good margin performance delivering good profit growth in Professional Services. Along with profit growth in Support Services and the Investments business, this offset reductions in Construction Services.

And we are proposing a 9% increase in dividends for the year. This reflects not only the strength of the Group's performance over the past year – but also, more importantly, our confidence in its medium-term growth prospects.

So at this point I'm going to hand you back to Ian, who will tell you more about those prospects – what they are, where we expect to find them, and how we intend to achieve them.

2011 Full-year results
8 March 2012
Ian Tyler
Chief Executive

STRATEGY AND OUTLOOK PRESENTATION

Introduction

Thank you Duncan.

A year of strong performance

You have now heard from Duncan that 2011 was a year of strong operational and financial performance in some very difficult markets. But 2011 was also a year of progress towards the delivery of our strategy.

A year of progress towards the delivery of strategy

I'll come back to the wider strategic objectives for the Group in a minute. But first I'd like to highlight a few key achievements.

In particular, we made the progress that we'd planned in the operating performance of Parsons Brinckerhoff. You will remember that we set ourselves a Group margin target of 3.5 to 4%, and that this assumes a professional services margin target of 6-7%. The achievement of 5.3% margin in the business, up from around 4.5% when we bought it, is encouraging.

In 2010 we said we would complete our target footprint in US construction by adding a business in the Northwest. We accomplished that with the acquisition of Howard S Wright. With our significant national presence in the US we can now leverage customer relationships and capabilities across most of the country. This year, we'll be able to demonstrate the synergistic benefits of this move.

In 2010 we also launched our asset disposal programme. Our stated aim was to progressively realise value from our PPP assets at the point that they reach maturity. This will make the Investments business self-sufficient for capital. It will also deliver an on-going stream of earnings which would go through trading profit. We aimed to deliver £20m of gain in 2011 and we achieved exactly that.

Our cost efficiency programme to deliver £30m of cost savings by 2013 was launched in August of 2010. Well, the programme is well under way and we are now halfway to our 2013 target. Having already achieved a run rate of £15m, we're confident that we are on track to achieve our goal. We now plan to expand this cost efficiency programme significantly, which I will come to.

So, we are pleased with our progress in 2011. But what next?

Agenda

Today I'm going to look at the future through two lenses. First, I'm going to talk about our plans to tackle the near-term challenges. That will give you some context for the expanded cost efficiency plan that you may have read about in our press release today. But after that, I want to spend most of the time on the development of our strategy for the longer term.

Near-term challenges and actions

Increasing operational performance

Duncan has summarised the benefits of the cost efficiency programme that we announced back in August 2010. Let me remind you of the background.

In the UK, our rapid expansion by acquisition created an opportunity to gain some back-office synergies in our operating companies. We opened our Shared Service Centre to deliver services more effectively across these businesses. It is already delivering the £15m of savings I just mentioned. And based on our experience to date, we're looking to expand the programme.

So far, we've combined elements of our back office processing, and rationalised part of our indirect procurement. Now that the divisional structure we put in place in 2011 has bedded in, we expect to be able to go further.

We are planning to move the programme deeper into our operations, taking advantage of the increasing integration of our activities. Some of the potential savings will go to our customers – making us more competitive – and some will benefit the bottom line directly.

How far can we go? On the basis of what we've delivered so far, we believe we can achieve a further £50m a year. We aim to see some modest savings this year, with a major portion coming through in 2013 and the residual element in 2014.

Of course, this level of cost reduction requires investment of both management focus and cash. In respect of the latter, based on previous experiences, we anticipate that the cost of delivering these savings would be between 1 and 1.5 times the potential annual savings.

Accelerating the PPP asset disposal programme

A similar theme applies to the PPP asset disposal programme. The success of the programme so far and the activity level in the secondary markets are encouraging. During 2012 we expect to be in a position to double the gains we achieved in 2011 through the sale of some mature assets. That means we are targeting £40m of gains in 2012.

The cash proceeds from these disposals will support further investment into new and exciting PPP opportunities both in the UK and in international markets where we are bidding for projects. And the gains on disposal will contribute to our profit and our dividend.

Near-term challenges - Conclusion

So, where does that leave us over the next couple of years? Going back to Duncan's earlier message, there are headwinds in our construction markets. These will impact construction margins for a couple of years.

Our plans to drive operational efficiency and to recycle capital in our investments business are long-term programmes. However, these programmes will have a beneficial effect in 2012 and collectively, we believe they will ensure we make progress in 2012, and provide momentum for 2013 and beyond.

Development of strategy

So now let's look to the longer term.

Developing our business model to deliver the strategy

We're continuing to develop our business model to deliver the strategy we set out in 2009 with the acquisition of Parsons Brinckerhoff, or PB.

When we acquired Parsons Brinckerhoff, our rationale was threefold:

- PB would make us one of the world's major players in professional services in infrastructure. This would enable us to deliver greater knowledge and capability to our key customers than any of our competition
- It would create a leading position in US civil infrastructure, especially in transportation, and
- It would enhance our global reach, as well as strengthening our position in existing geographical markets.

After two years with PB on board, we're pleased to see that our rationale is delivering as planned.

By adding design and management capability to our lifecycle asset knowledge, PB gives us a more valuable offering to customers – particularly in industry verticals where this collaborative model is increasingly valued by customers.

PB is also becoming our route of access to new growth markets that we couldn't reach as a construction company. PB's presence in around 80 countries gives us local knowledge and takes us into countries with attractive infrastructure markets.

And as we capture the opportunities that our move into Professional Services brings, two distinct elements of the Group emerge. One is the element that serves our single-capability markets; the other is our growing business in industry verticals, which has been opening up new opportunities for us to leverage our asset knowledge.

Meeting customer demand in single-capability markets

I'll start with single-capability markets.

Across a significant part of our FM and construction businesses for instance, we provide world class capability to a wide range of customers. These businesses have several characteristics:

- They are market leaders
- They are strongly cash generative when in growth mode, but they are also cyclical
- They operate with lower margins, carry lower risk, and deliver very attractive returns on the resources committed.

Take our building business as an example. It is a leader in the UK, the US and Hong Kong. This is a genuinely world-class business. It's mature, which means it's characterised by lower growth and lower risk. It's cyclical, but is normally highly cash-generative. Our customers tend to buy one capability at a time. And the focus is normally on a single project or asset.

In these markets, we will continue to invest to ensure we remain a market leader, take advantage of niche opportunities as they emerge and focus on efficiency to take full advantage of our local and global scale. Our efficiency programme announced today supports this.

Seizing opportunity in industry verticals

Increasingly, however, we provide both breadth of service and depth of asset knowledge in industry verticals – particularly in the power, rail, mining, water and transport sectors. We're putting teams together from all parts of the business – be it design, construction or maintenance – to offer customers the complete range of capabilities across the Group to provide solutions to their infrastructure challenges.

The projects are often complex and valuable, and the customers more strategic in their thinking. These markets are not only characterised by customers with specific market needs – they are also more global, and take us into new territories where local resource is scarce.

Directing our resources to where we see value

On a day-to-day basis these two elements of our business sit alongside each other and both are critical to the value we create.

However, given the long term growth characteristics of these industry verticals, and our ability to leverage our specific asset knowledge, it is logical that we should direct both our management focus and our capital to developing our businesses in these areas.

Growing prospects in industry verticals

This is indeed what we have been doing since 2009.

With the addition of PB – and by allocating the resources of the organisation in a more targeted manner – we have increased the proportion of our business focused on those industry verticals – power, rail, water, mining and transportation – from 43% of our order book at the start of 2009 to 59% today..

So let's take a look at some of these markets.

Rail - Demand for rail systems is growing

I'll start with rail.

In many developing markets there's a surge in demand for urban transit systems, driven by rapid urbanisation. But we're also seeing growth in demand to support industrial growth, particularly in emerging markets and in sectors such as mining.

In some developed markets we're seeing pressure to reduce public spending on rail investments because of constraints on public finances. But although rail projects are seen as costly, they're also seen as socially and environmentally desirable – so there are potential opportunities for new and innovative financing structures.

Overall, worldwide rail infrastructure spend is forecast to grow, reaching around £100bn by 2015.

This market is increasingly global, which creates opportunity for international players like us to participate in emerging markets.

Rail - Opportunity in multi-disciplinary projects

The opportunity for Balfour Beatty is the trend towards multidisciplinary projects encompassing elements from design, track and electrification to signalling and even knowledge of rolling stock integration. These are increasing in proportion and they tend to offer higher margins.

We have had considerable success in this area, particularly since we set up a small business unit to focus on international integrated rail opportunities. We are now a joint venture partner in two very large rail infrastructure projects – one in Melbourne and the other in Denmark. In both cases, what won us a seat on the JV was our integrated proposition. We're finding that Parsons Brinckerhoff's design and systems integration capability combined with the Rail division's signalling and electrification solution makes a winning combination.

Another big rail win for us in 2011 came from Qatar Rail. They selected us as strategic programme manager for their multi-billion dollar Qatar Integrated Rail Programme. This of course builds on the success we are having with the Denver Eagle P3 project.

Power - Considerable strength across the lifecycle

Power is another sector where we already have considerable strength right across the lifecycle – from design of power generation plants to energy consultancy services to FM clients.

Power - Demand is increasing

Starting with generation, investment is driven by growing demand in developing markets, replacement of ageing infrastructure in developed markets, and environmental pressures to increase the role of lowcarbon and renewable sources in the mix. The market opportunity is huge: between now and 2035, the world is forecast to invest $9trn in new capacity, with developing countries accounting for about 60% of this. That's around $350bn dollars a year. The technology mix is expected to see a growing proportion of renewables and nuclear, while coal's share reduces.

Our activities across the world have gained momentum in recent years. We are now preferred bidder for two offshore wind assets and a waste-to-energy PPP project. We are one of three bidders for EDF's Hinkley Point C nuclear new-build project in the UK and one of two for Horizon's Wylfa project. We expect EDF and Horizon to choose their partners shortly.

Power - Transmission and distribution vital

Once the power is generated, it needs to be distributed. In addition to our leadership position in the UK, we are working in the US, with asset owners National Grid. We also have joint ventures in Australia with UGL, are developing relationships in Canada – and we intend to develop our position further in these markets.

Mining - Integrated demand for mining infrastructure

Mining is a relatively new sector for us but offers tremendous potential. It's particularly interesting to us because it not only requires expertise in plant design, but also builds on our strengths in rail and power. In resource-rich countries, increased extraction activity requires power to mine the resources and rail to transport them. We are well-placed to meet this integrated demand – particularly since the customers are typically multinationals who favour suppliers who can work with them in multiple territories.

Mining - Expanding the addressable mining market

The mining construction market is large, and it's growing fast. Most projects are procured via umbrella engineering, procurement, construction management contracts, or EPCMs. Only a few large players are capable of providing these services, and they dominate the market.

So where do we stand in this market? Parsons Brinckerhoff currently provides infrastructure design and project management services in Australia and Africa to clients on smaller projects, or as a subcontractor to EPCMs.

But it's clear to us that the market PB is currently addressing could be a springboard to a far greater opportunity as we develop our mining capability and furthermore, our related power and rail capabilities.

Industry verticals – conclusion

We are a natural player in these vertical markets as well as in highways, airports and water. They allow us to create value from our depth of assets knowledge. This was the promise of the PB acquisition and, as we implement our strategy, we expect to devote more of our capital and people resources to these verticals, making them more significant value generators in their own right.

Growth in resource-rich economies

Our intent to expand in the industry verticals also draws us towards resource-rich countries such as Australia and Canada. These present clear opportunities for us, boosted by rising demand for commodities. And their scale, economic growth rates and market structures suit our model.

Australia is a significant market, with a steady economy weighted towards infrastructure. There is a strong pipeline of work with hotspots in mining, power and transportation. It's not *all* rosy, because these projects are reliant on commodity markets and some are impacted by delays in the associated public sector investment. But overall prospects are good, and Australia has a sophisticated procurement model including lifecycle contracts providing PPP and services opportunities.

Australia is a market where we already have a substantial presence, not only with PB but also in rail and utilities. Last year we generated around £300m of revenue there.

Compared with our presence in Australia, our Canadian business is at a relatively early stage. We acquired Halsall, a Canadian professional services firm, in 2010 as a base for developing a transportation, power and PPP businesses, and we have been successful. However, opportunities go well beyond this with the huge ongoing mineral extraction and power generation programmes which naturally play to our core capabilities.

Growth in emerging markets

In addition to these more established markets, our focus on industry verticals naturally brings us into emerging markets with favourable growth dynamics. These are typically driven by strong economic growth fuelled by high infrastructure spend and changing demographics, and also by government-led market reforms. We are focusing on those with sufficient scale, but above all, a good competitive environment and appropriate ethical standards.

I should add two perspectives at this point. Firstly, our position in these markets will grow very much hand in hand with our strength in the vertical markets we have been talking about. And secondly, entry into these markets will not be quick, or easy. We do not underestimate the challenges, but the prospects are very attractive.

Emerging markets progress to date

In 2011 we began making inroads into India and Brazil, our priority emerging markets. We now have an office in Brazil; and in India we've recently opened a Balfour Beatty office to complement Parsons Brinckerhoff's presence and are working on a strategic partnership with Tata Projects. Both countries have larger infrastructure markets than the UK, are welcoming private capital into infrastructure provision, and are making efforts to reduce corruption.

There are two other growth regions that I should mention: Southern Africa, and the Middle East.

In Southern Africa we are building out from the bridgehead we already have there, with Parsons Brinckerhoff. We are also expecting new opportunities to emerge from our relationship with Tata in India – which will focus on sub-Saharan Africa as well as India.

In the Middle East, we had two key successes this year as we move business beyond our traditional construction markets in the Emirates. I've already mentioned the Qatar Rail contract. And in November last year we were awarded the programme management consultancy contract on a £5bn roads and drainage scheme with Ashghal, Qatar's public works authority.

Conclusion

So let me summarise.

Firstly, whilst three out of our four sectors continue to grow, the challenges in our core UK and US construction markets will impact us over the next couple of years, no doubt about it.

But secondly, we're underpinning our financial performance with significant further cost efficiency measures and accelerating our PPP disposal programme. Together, we expect these measures to offset the short term headwinds and provide momentum.

However, more significantly, as we focus on industry verticals, we will be less impacted by short term cyclicality and more exposed to higher growth sectors and geographies. Whilst this is a long term change in our business, it is worth remembering that our revenue outside North America and Europe grew 12 % last year and that nearly 60% of our order book is now directed to these verticals.

Long-term strategy

So, our strategy remains:

- To drive performance in key industry verticals
- To develop new geographies, deploying our collective capabilities across the Group
- And to operate ever more efficiently in our core capability based markets – so that we gain maximum benefit from the cyclical recovery as it comes.

The underlying theme behind this strategy – and behind our optimism for the future – is that we're in a global growth market, we're targeting the strongest growth sectors of that market, and we're competitively advantaged in those sectors. The development of infrastructure is an increasingly central imperative for economic policy in both mature and emerging markets. We have unparalleled knowledge and capability across the infrastructure market. And I don't think anybody's better placed to benefit from this long-term global trend.

Balfour Beatty

That brings me to the end of my presentation. Duncan and I will now take your questions.