Company: Balfour Beatty

Conference Title: Trading Update 2014 Q1 IMS & Strategic Review Conference Call

Moderator: Steve Marshall

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Operator: Good day and welcome to the Trading Update 2014 Q1 IMS and Strategic Review Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Steve Marshall, Executive Chairman. Please go ahead.

Steve Marshall: Good morning everyone. With me today are Duncan Magrath, our CFO; and Nick Pollard who runs our UK Construction Services Business. This morning as you would have seen we have issued two important announcements concerning our trading: the departure of CEO Andrew McNaughton and the possible sale of Parsons Brinckerhoff, our professional services business. In a few minutes the most important thing will be where we prepare to take your questions but before we do that I think each of us just want to make some short initial remarks.

To state the obvious today's trading statement is deeply disappointing. It's centred on the Engineering Services business within Construction Services UK. We'd signalled some issues here as part of our year end results only in March. These mask and offset very real progress we've made in other parts of the group so far this year and indeed elsewhere within CS UK, but it's clear that the downgrades we've issued to the market recently are unacceptable. The Board is determined to take early steps to strengthen Balfour Beatty's credibility and its reputation for sound operational delivery. In arriving at the pre-tax profit range of £145-£160 million the Board has taken into account these issues, the risks identified and the likely outcomes from these. This is our best estimate of the likely range of outcome. It is going to take time to resolve some of these operational issues. My own view, which we can come onto, is that it will take a further 12-18 months to set our entire Construction Services UK business on a firm recovery path, however we intend to demonstrate progress to you well before that. With the departure of Andrew I am going to be devoting significant time to the Group while we conduct a process to appoint his successor. Our priority must be to restore and improve shareholder value and improve the management of risk. It's fair to say that operational delivery in UK Construction has fallen well below the standards that the Group has come to expect. We do intend to make Balfour Beatty a simpler, more focused business centred on its international construction and that's largely Anglo-American presence and an overarching infrastructure investment business on the top.

We've also announced related to that that we've undertaken a strategic review of the Group and that has led to a possible sale of Parsons Brinckerhoff, our professional services business. We've concluded that although PB is a strong and valuable business, when you look hard at it and we have, the Group-wide synergies and revenue opportunities have been more modest than we would have hoped for when we acquired it five years ago. That said any sale would of course have to deliver attractive shareholder value and we will certainly update you on that as the process continues.

With that I'm going to hand over to Duncan.

Duncan Magrath: Thank you Steve. First of all it's worth starting with the fact that both Professional Services and Support Services have performed well in the period, are ahead of last year and remain on track for our full year expectations. The investments business is in excellent shape. There has been some delay on the projects we are targeting to close this year and a timing effect on interest that has a small reduction in income in the investment segment and also reduces our interest income. Given this and the continuing favourable secondary market for infrastructure assets, we are now targeting total PPP disposal gains of £50 million in 2014, 10 million higher than previously estimated.

Turning now to UK Construction Business. The actions we took last year in the regional business have been effective and the performance of this business has improved. The major infrastructure business also continues to operate well, however we are downgrading our expectations for our subcontract mechanical and electrical services business and our major building projects by £30 million. We noted in March that the market for the M&E business deteriorated towards the end of 2013 and we expected it to be difficult in 2014. In the first quarter order intake was below expectations and in addition we have seen poor operational performance on a number of projects. We also noted in March that we had seen deterioration in some major building projects and in the first quarter this year we have seen further forecast increases on these projects. Nick will go into more detail in a minute.

We are also updating our guidance on interest costs. These will be higher than previously anticipated by £5 million. The pension interest cost for the year is now expected to be £17 million as opposed to the £15 million previous guidance and in addition there is a decrease of £3 million in the net finance income largely due to the delays in closing some PPP projects on which we were expecting to earn interest income. Having given the above guidance it's worth at this point echoing Steve's comments that we continue to face a number of uncertainties particularly in the UK Construction Business hence the reason for giving a range for our PBT guidance.

The final point from me is that we continue to operate a strong balance sheet. I have however upped my average net debt estimate for the year by £25 million to £375 million to reflect the changes noted above.

I will now hand over to Nick.

Nick Pollard: Thank you very much Duncan. Just picking up from Steve's and Duncan's remarks. In the last ten months we've focused initially on rectifying the difficulties in Balfour Beatty Regional and the £1.5 billion part of CS UK's £2.8 billion revenue, the largest chunk and the one that was in most difficulty. We have also concentrated on making sure that the infrastructure projects business is well run and in good shape. Along the way difficulties in the major projects business were also identified and reported on and for those businesses we made substantial changes in leadership with new MDs and significantly strengthened senior teams as well as with tightening up and improving the processes that cover bidding and project controls alike, improvements in the performance in regional and major infrastructure projects has followed and start to show. However it recently became apparent through a business review of Balfour Beatty Engineering Services trading results that some of the projects in that business had become increasingly unlikely to deliver their forecast margin and when you couple that with a poorer workload than budgeted for the year there likely will be a significant deterioration in the profits delivered during 2014. In turn all of that triggered deep, intrusive reviews of the engineering services projects. Through the last ten days and with a lot of work over this last weekend the work has honed in on some key contracts revealing judgements in commercial reporting which frankly appear overambitious and fail to adequately recognise risks. Those contracts are not new contracts. They were bid in late 2012-early 2013. So these then were the events that lead up to the shortfall in forecast profit reported today. It's a deeply disappointing and unacceptable shift.

Turning now to what we've done to address these issues. With immediate effect the business processes have been further tightened in the US business with all tenders and all project adjustments to project reviews requiring sign-off from the CS UK Chief Commercial Officer or myself. There's a number of personnel changes which have already been made to the operational and commercial leadership of the business and many of the senior team have been replaced or are in the throes of being replaced including the Commercial Director and three of the five Regional Directors. A new role of Chief Operating Officer had also been created earlier with an external appointment made into that post just after Easter. The business development team has also been strengthened in order to improve work winning capabilities and address the market conditions. Lastly the Managing Director has stepped down and I will be taking the direct responsibilities of that role in the interim just as I did during the interregnum for the regional business until the new MD there arrived earlier this year.

Thank you very much.

Steve Marshall: Thank you Nick. Can we turn over to questions from everybody please? If you could identify yourself obviously and who you represent and we will do our very best to respond.

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

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

Howard Seymour: Thank you. Good morning gents.

Steve Marshall: Good morning Howard.

Howard Seymour: I was wondering in the first place if you could quantify the size of the M&E business now? I take your point Nick in terms of the losses but can you talk us through what the size of the revenue is and how much of the profit shortfall is due to M&E?

Nick Pollard: Sure. It's Nick, Howard, hi. The business revenue is approximately £300 million. In terms of this morning's announcement it comprises roughly two thirds of the profit shortfall, roughly £20 million.

Howard Seymour: Ok. Thank you. The expectation going forward, aside from the £30 million we talked about, would you assume that in the rest of the UK construction businesses they would be running to plan in the context of the regional and the infrastructure programmes?

Duncan Magrath: Howard, yes. Really as I said to you this morning I think there are only two issues in relation to that: one is the engineering services and the other one is the major projects. The rest of the division is performing exactly as we expected. Nick, do you want to add to that?

Nick Pollard: If I was to look inside the regional business which was the one which had all the attention last year, the mood is pretty constructive and the majority of our delivery units there looking at this year are forecasting on or above budget.

Howard Seymour: Ok, thank you. The second question really is just a bigger question, just a clarification because the one thing that I think is the surprise is the timing of the announcement in the context of Parsons, because obviously what we see here is the UK construction worse, the Chief Executive goes and yet one point in this is that there's a strategic review being implemented now, there was no conversation about this at the time of the full year results that potentially a business you know which is US focused obviously at a time when P3 is starting to feed through, is potentially up for sale – can you talk us through that a bit more because as I say I just find the timing of that particularly strange?

Steve Marshall: Yeah, look, we realise that people are going to put all those together and puzzle over the sort of composite timing of the three things. The fact is that the Board has been conscious in recent months of the need to look at the Group with a view to whether the synergies from Parsons Brinckerhoff were compelling, because our suspicion was that they were not; and certainly with a background desire to achieve greater focus and simplicity in our structures if they were not. So that process had come to a conclusion, supported by Andrew McNaughton I should add in case there's any suspicion that wasn't the case. We are now commencing, exploring the marketing of the Parsons Brinckerhoff business. That was going to happen anyway, however we now have this trading downgrade that we're talking about this morning on us as well and a decision to change our CEO, but we would have proceeded with the marketing of Parsons Brinckerhoff and would have informed the market in any event. Given the events of this weekend and the need to make the announcement it seemed crazy not to update the markets on the Board's thinking on PB at the same time.

Howard Seymour: Ok, thank you. Last and I think probably the most obvious question: any update in terms of what you'd say on the dividend? Obviously historically you've said that the dividend is an important factor but clearly you are now in a situation this year where cover is going to be very tight?

Steve Marshall: Yes, sure. This sounds corporate bland but it is the case: the Board understands clearly the priority that investors put on the dividend, indeed we held it at last year end but the current context is that we are seeking buyers for an important division of the Group, so we are going to have to come back later in the year in the light of whether that follows through which is certainly what we hope or not if we don't get a price that is absolutely clearly in shareholders' interests, so further down the track we'll have to review it, but I reiterate we absolutely understand the importance of the dividend to shareholders.

Howard Seymour: Ok. Thank you.

Operator: Our next question comes from Joe Brent of Liberum. Please go ahead.

Joe Brent: Good morning, several questions if I may. Could you just on Parsons Brinckerhoff explain whether it's purely a question of synergies and if there's any financial need to sell that business at all? Then secondly could you just give us a little bit more detail about the nature of the engineering services problems? Is it pricing of old contracts? Is it delivery? Is it commercial evaluation of those projects or a combination of the above? Maybe I could start with those two questions.

Duncan Magrath: Sure. I will take the first one. There's absolutely no need to dispose of Parsons Brinckerhoff as Steve said if we don't get good value for it, we will retain it. That's the issue. In terms of engineering services I think Nick is probably in the best position to answer that. I suspect the answer is all of the above, but I will let him speak.

Nick Pollard: Thank you Duncan, morning Joe. It is all of the above. Look, part of it is simply market related. This business is a subcontractor not only to our own works on occasions but also to many of our competitors and we are the tail end Charlie as a subcontractor in the industry, so recovery hits the M&E boys later than it does the building boys later than it does the housing boys in the current situation, so it is still struggling with market and we've recognised that. The second reason is simply it has not performed operationally or commercially as we would have hoped on some of these contracts. We can see our own customers having a tough time and in turn that means we get a tough time and frankly I think there were some assessments of commerciality and risk which were over-optimistic in the cold light of dawn and that's exactly the findings of the review we've undertaken in this last week or so.

Joe Brent: Finally from me could you tell us a little bit about the major projects, what issues that was facing? Is it the same sort of issues as engineering services?

Nick Pollard: The major buildings business was a small handful of contracts which we recognised before as having commercial difficulties and operational difficulties in relation to some bids and awards that came through in the back end of 2012 or the first part of 2013. Most of those jobs are now concluding. There's only one that runs over out of that batch into next year and we are simply now getting into the short strokes at the end of the jobs and recognising the reality of where they will now likely land.

Joe Brent: Thank you.

Operator: Our next question comes from Gregor Kuglitsch from UBS.

Gregor Kuglitsch: Hi, good morning. I've got a few questions. Can we just maybe take a step back and look at the UK construction business. You have given the revenues for M&E. Can you just give us regional then the major works, building infrastructure, where those margins ultimately end up this year on the three or four business lines you've got in the UK? Then I guess from a strategic standpoint obviously you're looking at PB, is it maybe time or does it make sense for you to keep this subcontracting business because it's obviously not particularly strong within the value chain as can be seen, so is that something that you have been thinking about potentially getting rid of that? On the disposal of PB my spreadsheet suggests you paid 270 million odd in 2009. Can you just remind us what the book value of the business is as it stands today, if you were to sell it, what sort of tax would come due based on that book value obviously? Then finally and this may be a little bit of a broader question but I'm just looking at the company as a whole and you are effectively unwinding what you've done for the last five or six years, right, which is going into the sort of integrated value chain. You've sold your FM business. You're about to sell your professional services business subject obviously to value. Is there maybe a question for the Board whether you break up the entire company because obviously you've now got the UK-US construction businesses, you've got separate businesses in Hong Kong, Dubai, then you've got a PFI portfolio which is relatively easy to liquidate. The question mark that I've got is what is the synergy between all those different assets? At this point I thought the strategy was obviously to go global based on value-added professional services which obviously you are now stepping back from, so isn't there a question to be had whether you sort of go a step further and say actually you carve up the company and sell the individual businesses or indeed put the entire asset up for sale? Thank you.

Steve Marshall: Shall I take the latter question and then my colleagues will eagerly hit the various earlier elements of the question. It's a perfectly sensible question. The starting point so far as I and the rest of the Board are concerned is we can't go on like this. We haven't created shareholder value and we keep slipping up on operational delivery, so that was the background behind why we've conducted a strategic review and there's no point in talking about focus if you don't actually live it yourself, so our absolute current priority is the sale of the Parsons Brinckerhoff business if we can achieve good value. Clearly if we didn't think there was a decent prospect of good trade buyer and financial buyer interest we wouldn't have embarked on this process and be prepared to announce it, but time will tell. That is a major de-cluttering of the complexity of this business and the number of countries it's operating in and all of the rest of it; and we're perfectly straightforward about it I think in our observations in the release. We tested whether the synergies in terms of the Group being able to win more business by having all these skills under one umbrella – they're modest actually, as are most of the other ones and go back to the point we purchased that business, we were very clear then that possible synergies were one of the great attractions of having PB in the portfolio but we were equally clear in what we paid for the business that at most we were paying for what that business was worth as it was. Since then it has grown, it has become more profitable, it is successful in its own right and our judgement is that the multiples that are going to be paid for a relatively scarce business of that nature are likely to be higher than at the point we acquired it. Time will tell but the important thing is realism and recognition of the situation as it is and therefore the focus at this point is de-cluttering that piece of Balfour Beatty. Further down the track if we're successful in selling Parsons Brinckerhoff we'll have to see, but it is clear that the viable access of Balfour Beatty post PB is basically an Anglo-American construction business with strength in both countries and an overarching investments business which has the ability to travel slightly beyond that reach, but let's take it step by step. The critical thing is starting to demonstrate some shareholder value and we haven't done that yet.

Gregor Kuglitsch: Thank you.

Duncan Magrath: Ok Gregor, I will have to take these in slightly a different order touching on that in terms of the PB disposal. The book value at the end of last year, if you can effectively look at the accounts and it's the net assets from the segment is around £334 million. In terms of your question on tax there is likely to be some tax to pay. It obviously will depend on the proceeds. I don't particularly want to get drawn on a number at the moment because it will depend on a number of factors. There will be some tax to pay. In terms of your UK construction question, in terms of how the revenue breaks down Nick mentioned that of the 2.8 billion of revenue 1.5 sits in the regional business. There's about 0.7 in major infrastructure, about 0.3 in M&E, there's 0.2 in the Rail UK Projects business and then the building projects there's about 0.3 and then there's some work between those, so there's like an inter-company elimination of about 0.2 and all that adds up to 2.8. You asked a question on margins, I'm not going to get into margins by each of those individual segments, just to re-emphasise what we said earlier, current performance and margins in the regional and infrastructure and indeed the rail business are exactly as we expected and the write-down is only in relation to the M&E and the building projects. Collectively I talked about there being broadly around a 1% margin across the UK construction compared with the -1% at the end of last year with this downgrade will probably be just the wrong side of break even in the UK construction as a whole after overhead allocation etc. I will hand on to Nick for the M&E question which I can't remember so I hope he can.

Nick Pollard: The question you asked Gregor was had we thought about selling the business off, the M&E business? The answer very straightforward is when I joined the business we did look at all of the businesses and understand how they work. This particular business is a sector where a lot of key competitors have died on the vine or pulled out during the course of the recession in the last few years. It is instrumental to the return of the building sector in the UK and therefore the prospects should be bright downstream. We should be well positioned. The business has a very strong brand established over years as the leader in its sector through the previous brands of Haden Young and Balfour Kilpatrick, recognised as leaders in their sector it has strong capabilities technically. It has an off-site manufacturing state of the art facility, good design and BIM capabilities and those things are right at the forefront of the drive from UK government and private developers in the UK for a slicker, more efficient construction industry. So notwithstanding the recent local difficulties on some of its contracts and the poor judgement exercised in some of its commercial assessments, this is a business that should be well positioned for the future and historically as a sector has attracted gross margins and profits that are higher than the building sector on an average as a whole.

Gregor Kuglitsch: The cash proceeds, you've given us the book value, there are going to be some taxes. Maybe this is also a question in relation to the dividend. Once the business on a pro forma basis once we look at it, is it still sensible to pay the level of dividend that you are…I guess I know that you don't want to comment on it specifically today but if you were to raise a significant amount of money from the PB disposal, what would you do with it? Would you give a special dividend to shareholders and then sort of rebase the ordinary dividend going forward? I guess I'm just questioning…I understand dividends are important but at the same time paying a dividend that is oversized relative to the new business size, is that something that you've thought about, to get a little bit of a view on that? Thank you.

Steve Marshall: Yes, we can talk about our attitude to it. Clearly the most important thing is to seek buyers for the business and get a great price and at that point yes, certainly the Board's general attitude once you've obviously made allowances for whatever tax and pension fund contributions and what have you flow out from those gross proceeds, in terms of net proceeds we've obviously got to have regard to continuing to have a strong balance sheet beyond that. We would countenance a return of value to shareholders. It's pointless at this point to speculate on the quantum unless and until we've got a firm deal on the table and clearly dividend and all of that is part of that overall assessment about the best way of satisfying shareholders' expectations at the point we've got a sale of the business on the table.

Gregor Kuglitsch: Thank you.

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

Olivia Peters: Good morning everybody, it's Olivia from RBC. A few questions please. Firstly Nick, I wanted to get a sense…it seems that you have taken steps to sort of tighten bidding control and who signs off projects and things like that in the construction business. I sort of wanted to get a sense of what that has changed from, so you're saying what you're doing which is great but what was it like before? Secondly if you could update us on potentially the pipeline, I mean obviously you're saying that Q1 the order intake was a lot lower than you expected. Is that an ongoing issue? Is there basically a lot less work than you initially expected in the pipeline or is it just a timing issue? Then on the synergies at Parsons Brinckerhoff I wanted to get a sense also of what you thought…you obviously provided a synergy forecast when you bought the business. Why hasn't that played out to your expectations? What sort of changed there? Thank you.

Duncan Magrath: I will deal with the synergy one just quickly. At the time of the acquisition we said there would be about $8 million of cost synergies which was delivered which was reasonably straightforward. We didn't pay or include the value of any incremental synergies over and above that. That was always something that we expected to come down the track but we did not pay for it and we didn't forecast it. In terms of the pipeline I will hand over to Nick but essentially what we did flag up in here is a very low order intake in the engineering services in actually not only Q1 but also April. Also just flagging up on the infrastructure business, we've been saying for some time that there is not a huge amount of activity in that sector on the major infrastructure piece which I'm sure Nick can talk to. On the regional side I think the pipeline looks reasonably positive going forwards but I will let Nick touch on that.

Nick Pollard: Thanks Duncan. Olivia, hi, good morning. Just picking up on the synergies thing with PB, I would make one point since we do do work with PB. That's not going to change in any way. The close trading relationships we have between our technical people and things of that nature, that's not going to change because the ownership changes. We routinely partner very closely with PB and with others of its ilk in the marketplace, some as JV partners, some simply in business together. So I don't know how that's going to change. I don't see that in any way this will diminish that. In fact in some ways if the business was in other hands of ownership it would ease up some of that because it would remove the issue of conflict in potential customers' minds when they buy construction, so there's some good stuff there.

Look, what's changed in terms of process, in terms of bidding and things like that is the degree of wisdom that can be brought to bear at the point of the bid. It was quite a devolved structure originally with local business units able to determine the price at which they bid, their view on risk, their view on inflation and their view on the contract terms they were willing to accept. By changing the process we have been able to get more eyes, perhaps more experienced eyes and I mean that in terms of age and scars as much as anything else in looking at those bids and making sure that we have positioned them appropriately for the marketplace and that no-one is going to accidentally trip up and self-harm by putting in a bid that's inappropriate, so it's that kind of risk mitigation and the quality of the submissions themselves being improved.

In terms of market and pipeline, Duncan is already indicating we do see an improving pipeline of work in the UK. It would be fair to say that it's the big, heavy, chunky infrastructure schemes and whilst there is a pipeline of those we'd always like to see more but as we go through an election that will be one thing that colours that because that kind of work is let from government and things like HS2, you know as much about that as I'm sure as the rest of the marketplace, what's the timing of that etc, but in terms of the immediate pipeline we've had some very significant bids and tenders submitted over the course of the first quarter. We will keep our fingers crossed on those, I believe we're competitive and I believe we've got a good quality of thoughtfulness behind those submissions too.

In terms of regional pipeline, yes, we see that strengthening and although the pipeline as I said for engineering services, we have not had a lot of orders in the first quarter, that pipeline will pick up on the back of the rest of the industry as the last man on the train comes out of the recession and starts to gently pick up with the rest of the market. Does that help?

Olivia Peters: Yes, that's great. Thank you.

Nick Pollard: Cheers.

Operator: Our next question comes from Mark Howson from Canaccord. Please go ahead.

Mark Howson: Good morning gentlemen, a range of questions if I may. Can you just say whether firstly whether the sale of Parsons Brinckerhoff releases you from any bonding requirements in the US particularly or anywhere else?

Duncan Magrath: Not very much frankly Mark, they do a small amount of EPC power contracting which attracts some bonding and there's also some bonding in the Middle East. Off the top of my head it's less than a couple of hundred million dollars so it's small compared with the scale of our bonding scheme.

Mark Howson: Right. What was the total bonding scheme, just remind me?

Duncan Magrath: Across the world it will be around about £6 billion.

Mark Howson: Just to clarify, you're pretty much saying that the dividend is dependent on the price that Parsons goes at, it could be literally a price you may accept but clearly you have to re-base the dividend going forward. Is that fair?

Duncan Magrath: Yes. Post sale we just have to look at the earnings power of the Group and then look at the dividend appropriately.

Steve Marshall: There's obviously an inter-relationship between return of value and so on at that point, so it's one assessment isn't it that I repeat the important thing is to get the deal on the table and then we'll be able to, in discussion with shareholders, determine what makes sense.

Mark Howson: Mmm. Can you just remind us as well, your personal borrowing facilities, I think we've got a view that obviously you should be ok on all of this but can you just give us a reminder of where we are?

Duncan Magrath: The simple answer is we're very comfortably within our facilities. There is no covenant or facility issues. At the year end we had 950 million of facilities and they were all undrawn. Committed facilities I should say.

Mark Howson: Finally, I didn't quite get my head around the answer as to why you didn't think about putting the whole business up for sale? Can you just repeat what you said please?

Steve Marshall: Being the Group?

Mark Howson: The Group, yeah, why is that not considered something that could be put on the table?

Steve Marshall: You don't put groups up for sale but I will sort of keep saying until I'm blue in the face: shareholder value is the key objective of the Board. De-cluttering the Group by the sale of Parsons Brinckerhoff is an important first step and you know, beyond that the important thing is to get the recovery in the businesses particularly the UK which is what we're talking about this morning, but no-one is ruling any options out. You never can do as a Board because you have a fiduciary responsibility to your shareholders, but the most important thing you can do is make the Group in its post PB form, if we can achieve that, as attractive and as profitable as possible. I do think it's reasonable to say that the Board's general approach is that the more focused our structure is, the better that is going to be. For anybody assessing the attraction of the Group to anybody else, clearly a simpler de-cluttered Group is easier to assess but our principal objective is to get the management delivering operationally and the more focused we can get them and the less clutter the better in that respect.

Mark Howson: Just finally if I may, what percentage of the PB business is related to the rest of the company these days?

Duncan Magrath: I'm not sure I could give you a figure which probably answers the question…it's small Mark, less than 5% probably.

Mark Howson: Ok, thank you.

Operator: Our next question comes from Szilvia Bor from Goldman Sachs.

Szilvia Bor: Good morning gentlemen, thank you for taking my question. It's just more of a medium term/strategic question. Despite the near term issues, does any of the strategic review change of your view of the mid-cycle profitability potential of the business, even though getting there or achieving it might be more challenging than first thought?

Duncan Magrath: I think in relation to margin targets there isn't any change. Clearly the recovery in the UK towards what we believe is a central margin is going to take longer than we might have thought, but beyond that there's no other change in our long and medium term views of margins.

Steve Marshall: Just adding to Duncan's accurate assessment I do reiterate what I said in my introduction. My personal assessment is that to get full recovery coming through firing on all cylinders for the UK, realistically with all of the new people coming in in senior management roles and all the action that Nick is taking, we're talking about a 12-18 month period. Realism is key in Balfour Beatty at this point and that is I think a reasonable, balanced assessment.

Szilvia Bor: Ok, thank you.

Operator: As a reminder if you'd like to ask a question at this time lease press *1 on your telephone keypad. Our next question comes from Stephen Rawlinson from Whitman Howard. Please go ahead.

Stephen Rawlinson: Good morning chaps. Just like everybody else I've got a few questions. I guess I'm puzzled by the whole timing and thought process around the strategic review which wasn't mentioned on 6th March but now seems to have taken place in a very short space of time. Can you just talk us through the extent of that, what you've looked into and did you look into possibly hiving off the investment arm from the operational arm of Balfour Beatty in the way that Bilfinger Berger did three or four years ago? The second question, in terms of that strategic review you must have put something in front of the Board to say what it will look like at the end of the 12-18 months transition period. Now aside from selling Parsons Brinckerhoff there doesn't seem to be much else going on, so what is the picture that you painted for the Board of what Balfour Beatty might look like in two years' time in terms of revenue and in terms of where…you've talked about the US and UK, you've talked a little bit about margins but just give us the extent of the size and feel for the business that you've put in front of the Board?

Steve Marshall: We've looked in recent months, and yes, you don't necessarily announce a strategic review at the first point that the Board embarks on the work, it's rather more helpful in the round to announce conclusions to the market that they're in a position to evaluate. But yes, we've looked at all the obvious options for the Group. An overriding priority from the Board, as I've described, is what are we going to do to start to generate some shareholder value because we clearly haven't been. We looked at a range of configurations from, you know, would it even be viable to back-flip into becoming a global professional services business, for example. On inspection, that wasn't particularly credible. We looked at all other permutations inbetween. We evaluated synergies between our different businesses and what – to cut a very long set of scenarios and stories short – we concluded was that the axis of our Anglo-American construction strength and our investments business, where there are genuine synergies between the two, was a pretty powerful way of defining Balfour Beatty as a core. And as I think was highlighted in an earlier question, yes, sure, we have a range of joint venture interests around the world and we've got our UK support services business and so on. But the obvious core of Balfour Beatty is what I've described, but you know, the key conclusion was that if we couldn't demonstrate clear synergies with having the Parsons Brinckerhoff business in the Group then in shareholders' interests, both from a possible value realisation point of view and because it de-clutters and focuses the Group, that was the logical key building block to explore. As I said earlier, that's not ruling out, you know, other options going further. We've got to take this step by step. But we're clear what the logical core and synergy of the Group is and it's as I've described.

Stephen Rawlinson: Okay, can I just ask a follow-up then with regard to that strategic review and the data on which you've worked on? I mean some of the problems in the UK seem to be that some of the data systems that were making you, enabling you to understand the risk and profitability weren't necessarily operating properly. Are you satisfied for the rest of the Group you've got those in place at the minute and that we won't have some other problems appearing elsewhere because of similar issues?

Steve Marshall: It's always the deadly question to answer, isn't it? But you know, one has to say that in the round, you know if we look at our big US construction business, it has been able to restructure, take a lot of cost out and all of the rest of it, reduce the number of regions and – I touch wood as I say it – has shown no sign of slipping up in its risk management and in the quality of its processes.

Stephen Rawlinson: And can I just ask a – sorry, go on.

Nick Pollard: Steve, it's Nick. If I could just add on to that, I'd hate you to wander away thinking that this was all about data and systems that weren't functioning in some way. It's not. you know, as I said earlier, part of the issue has been around just market conditions, the volume hasn't come through to that M&E business yet this year. Part of it is around straight operational issues actually in sites not achieving perhaps the degree of performance that we would have liked, and part of it is around the commercial judgement of some of the leaders that were sat within that business on the degree of risk they held. That's not a data and system issue so much as operational and people and performance and capability issues. Sorry, am I clear about that?

Stephen Rawlinson: I think I understand that but I just wanted to be sure for the rest of the business that we're not going to be faced with similar sorts of issues that are as yet undiscovered, and just wanted your thoughts on that at this stage, which may or may not have been part of that strategic review, and I was trying to explore that. Just finally on the UK regional position, I mean you've talked about workloads improved but you've also said that your order book is declining in regional. Is that just you trying to obtain better margins in a generally improving environment or are there other things at work there?

Nick Pollard: Sorry Steve, just ask me that again?

Stephen Rawlinson: The regional business in the UK, you said the order intake has been lower than expected. Is that you seeking better margins? I mean are you trying to get margins that are above where the market level might be? Delays to contract awards are mentioned for example, you see.

Duncan Magrath: Yes, so Steve, Duncan. The order book intake in the first quarter was down in the regional business but actually, as we've put in the statement, I believe that's a timing issue.

Stephen Rawlinson: Right, okay.

Duncan Magrath: We've not actually reduced our win rate, but Nick can go into that.

Nick Pollard: No, indeed and in fact part of that timing issue isn't just stuff that came backwards or went backwards. It was also some stuff that came earlier in the year into 2013 so we took the order there rather than in 2014. So no, I'm quietly confident that there is a very strong pipeline of opportunities in the regional business ahead and yes, you're right to surmise that we not only are taking the opportunity to be selective about what we price and for whom we price it, but the quality of margin and also our view on risk inside those bids too. What's been pleasing is we've had a strong repeat order book coming from some of our customers, people like the MoD for instance where we've won big projects and frameworks, and repeat business with customers we know and love is deeply important to us and hopefully to them as well. We were appointed to the Q6 framework on Heathrow.

Stephen Rawlinson: Yes.

Nick Pollard: You saw their announcement some time back, and I think all of that is indicative of the rigour and the strengths of that business.

Steve Marshall: I just want to add one comment, coming back to the earlier question on just sort of strategic review conclusions and the Board’s attitude to it. Let me just come back to this core construction axis and the investments business overarching. Another thing that the Board was very clear on, certainly for the foreseeable future over the next few years, is come back to focus and priorities. Recovery in our two major markets, in the UK recovery of operation delivery as well, in the US it’s about recovery of the marketplace itself and margins from it. Those are our absolute priorities, drive earnings in those two areas. The thoughts of any expansion plans into new markets from a construction viewpoint are not on the agenda and we don’t believe it’s in shareholders’ interests that they should be.

Stephen Rawlinson: Thanks, chaps.

Operator: Our next question comes from Marcin Wojtal from Bank of America Merrill Lynch.

Marcin Wojtal: Yes, good morning. I just have one question. In your presentation, you stated repeatedly that the Group going forward would be focused primarily on the UK and US but I want to know what is your position on your construction subsidiaries in the Middle East and Hong Kong. Have you looked at them as a part of your strategic review? Are there any synergies that they generate with the rest of the Group? Is there scope to unlock some value for shareholders at these subsidiaries? Looking at the new Group, I mean they would be quite, quite, quite sizable I would say. So if you could share some thoughts.

Steve Marshall: Yes, as I was saying earlier, phase one is to be focused. So the principal current focus is to explore the marketing of the PB business. If one defines the core as the Anglo American construction axis then clearly, you know, there are other possibilities in terms of realising value. But, and the synergies – in direct answer to your question – from the JVs and the rest of Balfour Beatty are modest. It's as simple as that. But you know, let's be focused. So the PB process is going to take up our agenda for the balance of this year and all other options are on the table.

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

Manu Rimpela: Yes, morning, gentlemen, can you hear me?

Steve Marshall: Yes.

Duncan Magrath: Yes.

Manu Rimpela: Okay, it's Manu Rimpela from Deutsche Bank, just two questions. One, in terms of the new CEO for the Group, so would you be considering more external hires this time compared to the previous change? And then in terms of all the projects you have now in the UK construction business, so can you say that you have gone through the whole portfolio and we should not expect in twelve months' time that we will be in the same situation as now. It seems like it was the UK regional business which was the problem twelve months ago. You did a good job in addressing, going through all the projects. It ended up being slightly higher, the eventual write down, then you said at the beginning, it was only a small difference and now twelve months later, it's a different part of the UK construction business. So are there still parts in the UK construction business where you haven't gone through more or less all the projects, at least the sizeable projects, which could end up in surprises? And then also if you think about the write downs in the UK mechanical engineering business and the building business today seem to be related to the end of '12/early '13 taken projects. So how confident are you that the projects you've taken on during the later part of 2013 are projects with good margins? Thank you.

Steve Marshall: Okay, I'll take the CEO recruitment process first off. Yes, we will be defining and commencing a process shortly and we will certainly be scanning outside and looking for the very best available talent that's on the market and you know, looking back for a second, we did have a look outside at the point that we made Andrew McNaughton's appointment, but we did conclude that Andrew's long periods of success in the Group and his great knowledge of the businesses in the end argued very much in favour of an internal appointment. I'm not ruling out internal candidates at this point but there will clearly be a very strong effort to see the very best talent, particularly with construction and related expertise, that's available on the market and it will be a rigorous process.

Nick Pollard: Okay, Manu, good morning. Nick. If I pick up the other part of your question. Have we gone through all the projects in CS UK? Yes is the straightforward answer, and I've got processes in place which routinely, every month, review those projects with my management team and with the businesses and of course it was one of those reviews which flushed through the trading issues in ES (Engineering Services). Having said that, look, construction inevitably has risk and I'd be a fool to sit here and say that we'll never have another loss-making job. The issue is to manage those risks and make sure that as a business we're trading successfully and steadily and profitably. Can I be confident that we're heading in the right direction on that? All I can tell you is that the volatility that we're seeing or saw previously inside the regional business and inside major infrastructure projects has diminished considerably. We can see that in our results, and we need to keep pedalling really hard in that direction as we drive the business forwards. Refer my previous comments about customer relationships, repeat business and rigour of bidding reviews. And dealing with that rigour of bidding reviews, can I have confidence that the later bids in 2013 or indeed 2014 are on a better footing than they were previously? Yes I can. Having said that, of course, having the right bid doesn't in some way obviate a construction company from design and operational construction risks or indeed the commercial risks that sit beyond that. So it may provide a great platform to trade from but they're not a total guarantee of getting to the end of every job, you know, on time with the right amount of money in the bucket. That's about operational excellence, something that we're working really hard on and we'll continue to drive. And as Steve said, you know, we think there's a journey ahead of 12-18 months to really get this business where we want it. Does that help?

Manu Rimpela: Yes, thank you.

Nick Pollard: Tickety-boo.

Operator: Our next question comes from Kevin Cammack from Cenkos. Please go ahead.

Kevin Cammack: Good morning, gents.

Steve Marshall: Good morning.

Duncan Magrath: Good morning.

Kevin Cammack: I fear this could become like twenty questions, but I really, I guess, can hone it down to two or three really. Firstly, I wonder if you could confirm whether the appointment of a new CEO would inherit the strategic review as it stands or whether if – you know, in other words, if in the appraisal process they actually disagreed with a decision that had been made, you know how – is his appointment purely contingent on accepting what the strategic review is? That's the first point. Secondly, I guess there are going to be some shareholders who, rightly or wrongly, look at this as a sort of panic response to what might be construed as a longer-term deterioration in the UK business – some of it cyclical, some of it self-inflicted – and that the sacrifices to that are arguably the most valuable asset you hold, i.e. Parsons Brinckerhoff. And I suppose without going to innumerable questions around that, I suppose the one I'd be most interested in the response to is whether, if the business is sold, would the priority be with those proceeds to de-gear the business or to actually return some of that cash to shareholders, given the previous answer you gave about not seeing the PFI portfolio as contingent to the core of what you remain to keep. And my last question actually just goes back to the balance sheet really and the increase, Duncan, in your average debt position in essence is less than the decline in EBIT from the UK construction business that you're now forecasting, which suggests that underneath all this, there's been remarkable stability. Can you just confirm that, in effect, the increase in assumed debt is no more than the loss or the shortfall that you're now anticipating in the UK and that looking back over the last five years, what has been the net balance in terms of cash contribution in or out of Parsons Brinckerhoff please?

Duncan Magrath: Sure, let me deal with the last one while it's fresh in my mind. I think in relation to the cash point, I mean I've upped the estimate by £25 million which, as you say, is the moving parts obviously are principally a change in the forecast estimate for UK, which obviously doesn't all happen at the start of the year and therefore is somewhat less than that. There is also, I have mentioned, we mentioned in the statement a bit of timing changes in some investments in the portfolio which has an income effect on the sort of fee income, interest income we have that then has an improvement on the net cash position. So rounding them all together, there's roughly a £25 million adjustment. But in terms of any other movements, you're right, it's stable underneath.

In terms of the return on PB over the last five years, if you remember at the time of the acquisition PB came with about $120 million of cash so when we quote an acquisition price of 626, actually that came with $120 million of cash. A lot of that has unwound, which you can see. We warned people that would happen, and some of that was things like tax and pension, but a lot of that related to working capital. And so when you look at the graphs that I gave you in March and you see over that period of time that Parsons Brinckerhoff has moved from a negative working capital position through to a positive working capital position, effectively that was what we predicted, which was the unwinding of the working capital. So without doing the maths precisely for you, my gut feel would be that the cash that we had in the balance sheet has offset the change in working capital and therefore it's delivered profit in line with cash.

Kevin Cammack: Okay, thank you.

Steve Marshall: I'll pick up a couple. Congratulations on weaving seven or eight very good questions and portraying them as one or two, by the way.

Kevin Cammack: A practiced art.

Steve Marshall: And they are good questions. Look, let me come back to the strategy review and the interrelation of that with UK's performance and competitiveness and all of that, just a statement of simple fact. I realise that all this coming out on the same day feels like my god, they've been panicked into selling the crown jewel of PB and all of that. I repeat what I said earlier: the Board has been clear that we did need to look, and have looked at, all of the different parts of the Group, where there was logical synergy, where there were good arguments for releasing value and de-cluttering at the same time. And you know, you don't have an M&A process ready to go, you know, and all of the paraphernalia around it just over a weekend. So we've been thinking about Parsons Brinckerhoff and that's what we've announced today. The events that we've been talking about with respect to the UK have crystallised over this Bank Holiday weekend and so on. So they are unrelated other than that we have announced them over the same time on the same day.

I agree with what – something I think I heard you say during your weaved question, which is that the issues that Nick is now looking to address in the UK, they're not just as a result of the reorganisation at the beginning of last year. I personally, having looked at it quite hard, think that in some areas of that business we've been losing competitiveness over a bit of a longer timeframe than that, and the work winning challenges and our place in the market are, you know, equally important things to focus on alongside simplifying the business. It's not either/or; we've got to do both.

Duncan Magrath: Yes. There was a question around the strategic review and the new CEO.

Steve Marshall: Yes, thank you. Yes, I mean the Board is clear and committed in its attitude, in the marketing of the PB business and the priorities we're attaching to the sort of post-PB Balfour Beatty if we can get it to that stage, as I was describing earlier. That doesn't mean you set every parameter in a box and tell an incoming CEO: terribly sorry, everything you do has got to be within that box. But the reality is the Board is clear on why it wants to move forward and we're not going to suddenly turn 180 degrees during the CEO interview process. That's just not how the real world works.

Kevin Cammack: Yes, okay. And sorry, there was another one, which I will just repeat because it's probably lost in the morass of me groaning on. The proceeds – I mean, just theoretically assume that you got back $630 million, what you paid, but obviously, there's a big – it won't be full of the cash it was then. But let's just assume the figure's that. Would your – would the Board's priority be to reduce the debt of the ongoing business, or would it be to try and return some cash to shareholders?

Steve Marshall: We would firmly expect that we would be returning cash to shareholders as part of that mix. As one of us said earlier, I can't remember whether it was Duncan or I, obviously we've got a strong balance sheet and we need to retain a strong balance sheet but you know, beyond that, certainly our expectation would be that we would be returning value to shareholders.

Duncan Magrath: The scenario you just gave, Kevin, actually wouldn't – wouldn't actually exist because when we talk about increasing shareholder value, we would be expecting considerably in excess of what we paid for PB.

Steve Marshall: For sure.

Kevin Cammack: Yes. And no, I appreciate that, but I didn't want to flag a figure which you would then say, well I can't comment on what we're going to get. I was simply using the original $626 but if you want me to suggest $900 I will.

Duncan Magrath: I think we'd better move to one of your other 52 questions or somebody else.

Kevin Cammack: No, I think that was all mine.

Steve Marshall: Thank you.

Duncan Magrath: Thanks.

Kevin Cammack: Thank you.

Operator: As a reminder, if you would like to ask a question at this time please press *1 on your telephone keypad. Our next question comes from Howard Seymour of Numis. Please go ahead.

Howard Seymour: Hi gents. Sorry, I don't mean to start everything again, but it was just a follow-up to Duncan and really it was on the seasonality of how you'd see the debt profile this year because obviously now you have this bigger outflow in the second half. Would you expect – last year was sort of weaker first half/better second half. Would you expect the same sort of profile again, Duncan?

Duncan Magrath: Yes, I'm expecting the net debt at the half year to be higher than at the full year.

Howard Seymour: Okay, and would you just revise your expectations on a pro forma basis relative to what you've said today, i.e. no other changes other than the UK construction first half/second half?

Duncan Magrath: Sorry, in terms of cash or profit was that, sorry?

Howard Seymour: In terms of the cash. In terms of the cash.

Duncan Magrath: Yes, I think, as I said earlier, it's always seasonal. I suspect, I don't think there's a huge change in my expectation.

Howard Seymour: Because the other aspect was just the property disposals. From what you're saying obviously they're going to be higher, but I'm assuming that's going to be second half-weighted.

Duncan Magrath: Yes. Yes, at the moment my best guess is a rough 50/50 split between first half/second half but the first half will be very much towards the end of the first half and so if you're thinking about a sort of net cash calculation, there won't be any proceeds till really the first half and then second half should be towards the end of the year, so they have obviously dampened their effect on the average net cash.

Howard Seymour: Okay, right, thank you.

Steve Marshall: Just sort of conscious of everyone’s time, could I suggest maybe a couple more questions but I don’t want to constrain anyone either that's bursting with questions.

Operator: Okay, our next question comes from Alastair Stewart from Westhouse Securities.

Alastair Stewart: Morning, gents, a couple of questions, the first is quite specific. Will this shift in profitability this year – or what appears to be a shift in profitability – from the UK to the US result in a higher tax rate than you were guiding fairly recently? And the second question's broader. You talked about Parsons Brinckerhoff not really producing the synergies down the years, which I think comes as a surprise to most people. Can the same be said for the UK support services business? You didn't mention it really so far and you seemed to studiously focus on UK/US construction with the investments overlaid. What sort of crossover is there between the services business this time, at this point? Did you consider it as part of a disposal as part of the strategic review and if so, what decided you to keep it on board?

Duncan Magrath: I’ll start and then let Nick, let Steve carry on. In terms of tax rates, you're right. I think it’s roughly an extra 2 percentage points on the tax rate, on the effective tax rate with the shift, as you said. I think in terms of…

Alastair Stewart: Are we talking about 42, just to, not to be…

Duncan Magrath: Yes, that's absolutely correct.

Alastair Stewart: Yes.

Duncan Magrath: In relation to support services, just to point out things like, you know, we do work for the Highways Agency that sits in our support services business when it’s maintenance work and sits in our construction when it’s construction, people like Network Rail as well, so there are a number of clients which we operate across both of those divisions. And obviously that's key. But I don't know if, Steve, you want to add anything to that.

Alastair Stewart: Sure. But I mean there had been similar arguments down the years for Parsons Brinckerhoff. Are you saying that you wouldn't get construction work for the Highways Agency for instance, without doing the support services work and vice versa. Are the – is two and two more than four?

Steve Marshall: Go on, Nick.

Nick Pollard: Okay, my – sorry, it's Nick, Alastair.

Alastair Stewart: Yes, hi Nick.

Nick Pollard: My comment to that would be for some clients it's increasingly important that when we are designing and constructing, we understand, you know, the maintenance implications of that, how that asset operates and actually that asset operational maintenance knowledge that we gain through the support services side informs some of the design and the point of renewal form. And that will certainly be true of the Highways Agency where they're focused very much on us delivering outcomes for their business rather than dealing with recipes of inputs. You understand the difference I'm sure.

Alastair Stewart: Sure, absolutely. But was a disposal considered as part of the review?

Steve Marshall: I won't get into all of the scenarios we went through in the review but we explored everything, as you would imagine, and I reiterate again what I've said during this call. The current focus is to explore the sale of Parsons Brinckerhoff.

Alastair Stewart: Sure.

Steve Marshall: And we'll see, you know, once we get to that point where we go.

Alastair Stewart: Yes.

Steve Marshall: But you know, we're going to be focused.

Alastair Stewart: Sure, all right. Thank you.

Steve Marshall: Okay.

Duncan Magrath: I think Alastair used up the last two questions, so.

Alastair Stewart: There were only two questions.

Duncan Magrath: There was the tax and there was…

Alastair Stewart: Unlike everybody else.

Steve Marshall: Okay. All right, well let's in that case conclude this and thank you for all the questions. Obviously we'll keep everyone informed but to major shareholders on the line I just wanted to firstly apologise for some of the surprises that we've inflicted on you today. We fully intend to move forward from this and become more predictable. And also that certainly I would be very keen to have the opportunity to talk a bit more in meetings and calls to assist you sort of evaluating all of this. So with that, thank you very much.

Nick Pollard: Thank you.

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

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