Balfour Beatty Plc

Balfour Beatty Plc Trading Update

Presenters: **Andrew McNaughton, Duncan Magrath**

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Operator: Good day and welcome to the Balfour Beatty Plc Update conference call hosted by Andrew McNaughton, Chief Executive Officer, and Duncan Magrath, Chief Financial Officer. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Andrew McNaughton. Please go ahead, sir.

Andrew McNaughton: Good morning and thank you for joining our conference call for the trading update which we released this morning. The trigger for this trading update was the need to inform the markets that our UK construction business is now expected to deliver significantly lower profits from its operations than the management expectations at the time of our full year results we announced in March. Now if you'll allow me a few minutes, I'd like to summarise the developments that led to this trading update, before I hand over to Duncan – before Duncan and I take your questions.

As part of our normal business process, we review the performance of each operational division on a monthly basis. At the end of March, the run rate performance was showing signs of a worsening trend and was combined with a select number of contract reports that were highlighting specific issues such as delays to progress or completion, subcontractor failings or changes to forecast commercial outcome. At this point, we concluded at our regular review that an in-depth, detailed review across the construction business was necessary in order to understand whether our concerns were founded. This was initiated and we focused initially on the regional business, led by a senior manager independent from the regional operation. This was a process of engagement with the local management in delivery units and reviewing the book of work on a project-by-project basis. 950 projects were reviewed, 100 of those in great detail and what has emerged from this review is a material change to the forecast outturn performance across the portfolio of the regional business. Now this is not uniform; indeed, while there are some variances, our businesses in the traditional heartland of the Group – in Scotland and the North of England – continue to perform close to our previously forecast position. However, the regional businesses across the South of England have emerged as demonstrating a significant deterioration, and there are several key causes of this. Firstly, the importation of additional contract risks, particularly driven through tighter schedules in a constrained margin environment. Secondly, poor subcontractor selection or failure during delivery. Thirdly, the low standard operational productivity or performance. And finally, poor commercial strategy.

Let's now focus on the background for a moment. In 2012, the UK construction business embarked on a significant organisational change. The new operating model which merged six operating companies into one company with three business streams was established and fully operational by January 2013. It's now clear that during the transition phase, the new management teams were slow to assimilate the complete project portfolio in their delivery units. This has led to inadequate review of schedule risks and subcontractor selection at the bid stage, and some failures to address progress deficiencies at an early stage. These factors have led to the trend of downgrade of outturn position on projects as the regional management teams took stock across their individual book of work. There is no doubt that the prevailing economic environment, including increased competition, subcontractor strain and customer procurement trends have exacerbated the issue. However, most of the issues can only rest with individual projects and the management of our regional business.

As soon as this was apparent to us, we instigated the detailed review. The results of this was presented on Friday 26th April. We are confident that we have identified the scale of the issue through the review process that has been undertaken. Not only have we scrutinised the forward forecast and the progress position of the existing book of work but also the key prospects, what we call "awarded but not contracted" and the target bids in hand.

There have been clear failings in the oversight of the regional business and I have committed to addressing them. Since being presented with the results of the review, I have developed a plan to address the issues that have been identified. There will be management change in the leadership of the business. In addition, there will be changes to specific regions where there remains inadequate assimilation of the project portfolio. The incoming leadership will be tasked with the rigorous enforcement of bidding criteria and enhancing the quality of operational delivery and commercial support. In addition, the nature of operational reviews will be changed to provide more intensive, intrusive scrutiny and early action triggers.

Whilst the operational issues have been particularly prevalent in the regional business, we have detected through the review process similar factors relating to a small number of individual major projects. These have been confined to building projects where margins are traditionally lower and a higher reliance on the performance of trade contractors. Whilst limited in number, the size of the project exacerbates the cost impact of specific issues and their resolution. This has impacted the business at a time when there has been a runoff from high-value infrastructure projects.

Whilst each building project has a specific action plan to address its individual issues, we are assessing the risk of continuing to acquire new work in each building sector whilst current market conditions prevail. We are confident that we've got to the bottom of this issue in the UK construction business and have quantified the impact on 2013 profits as £50 million.

In our trading update this morning, we have indicated that trading in the rest of the business is developing broadly in line with our expectations. We see a £10 million deterioration in rail operations in Germany and some weakness in the professional services in Australia due to the slowdown in their economy. These are offset by outperformance in investments and also in professional services specifically in US transportation, Asia and the Middle East.

So in aggregate, Balfour Beatty's businesses outside UK construction are on track to deliver on management expectations for 2013 and continue to support the Group's medium-term strategy. Let me conclude on that note, and Duncan and I will now take your questions. Operator, over to you.

Operator: Ladies and gentlemen, if you would like to ask a question please press *1. 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. And we will take our first question from Olivia Peters of RBC. Please go ahead.

Olivia Peters: Good morning, everybody. Good morning, Andrew and Duncan. I just wanted to get some more sense on basically, I mean you obviously talk about you restructured the construction business and all the measures you've taken to look into each project. I mean, given what you've done in the last few months, what timing can we expect on any sort of turnaround in the business? Do you have any visibility on that? That's just my first and only question. Thank you.

Andrew McNaughton: Okay, sorry, there was a number of pieces in your question there but specifically taking your point around the turnaround, we've … I've been developing a plan over the weekend to implement into that business. As far as the whole of the UK business is concerned, I will be stepping in to take control, closer control on CS UK, the construction business in the UK. From there, we will be making changes in the leadership of the business and changes in the management, as I indicated in my note.

The one thing where we've identified is that these, the business where this relates to is pretty much a short-cycle business and therefore it is projects with a shorter award-to-completion period. We're currently in the process of bidding work for 2014 and therefore, to give you an indication of the timescale for that, the indication of that, the position and the impact is for 2013. The process of management change that we'll be implementing will place closer rigour on our bidding process, as I mentioned in my note there, and that therefore we anticipate will be feeding through into 2014.

Olivia Peters: Thank you.

Operator: And we will take our next question from Gregor Kuglitsch of UBS. Please go ahead.

Gregor Kuglitsch: Hi, morning. I have a few questions and maybe the first one was just maybe following on on that, from Olivia's question which is basically I mean, basically you're saying £50 million shortfall in the UK construction business. Is it right in thinking that that business is now pretty significantly in loss because I would have thought US, I'm just looking at sort of the numbers that you'd previously published, sort of stripping out Middle East, Hong Kong and then I guess you still have the US which I presume is profitable. So is it right in thinking that that business is roughly £50 million therefore in loss and as a result, if you're telling me today you are bidding new business, presumably at a margin which you believe is going to be flat or positive for 2014, so that that falls away in 2014, is that the right way to think about it? First question. Second question is maybe just on the £50 million shortfall. To what extent are you effectively writing off previously recognised profits or any other type of provision within that, just so we're clear in terms of how much of this is sort of related to previously booked profitability? Third question is I don't think you mentioned a dividend anywhere in the statement but obviously earnings are going to come down significantly. Obviously you're talking a 20% pretax cut to consensus I believe. Are you still committed to a flat dividend or is it too early to say? And then finally I think you also mentioned that you are talking about sort of the balance sheet can fully absorb the £50 million profit shortfall. Can I just have an update maybe where you see average debt after this? I would have thought at somewhere around 300, maybe slightly below 300 million euros – pounds. Is there, at what point do you become concerned about the debt levels? Is there anything we should think about in terms of covenants or cash requirements maybe for your bonding lines in the US? Any colour there would be helpful. Thank you.

Duncan Magrath: Hi Gregor, it's Duncan.

Gregor Kuglitsch: Hi.

Duncan Magrath: I'll deal with most of your questions I think. In terms of the shortfall in UK construction, in terms of any of it relating to previous years, no, none of it relates to previous years. This is all to do with looking at existing contracts where costs have escalated above tender expectations and obviously subcontractor failures, all of these things are events that are happening in the current year and, as Andrew pointed out, these are very short-cycle contracts. So this is a current year issue.

Secondly, just in terms of the balance sheet comments, yes, I think at the March results I talked about effectively average net debt for the current year being round about £100 million more than the second half of last year so that put it just around 226 for the current year. In terms of this, because this is effectively, as I said, it's completion of existing projects, the simplest thing is to take £50 million off that in terms of increasing that average net debt figure.

The third I think you asked about was just in relation to the dividend. I mean, as you know, we've clearly got a policy of trying to have a progressive dividend policy and we understand the importance of that to people. Obviously we need to make a decision on the dividend at any point in time looking at the outlook for the business as a whole and trading at that point, and we'd have to make that decision at that point in time.

You had four questions; I think I've answered three of them. Was there…?

Gregor Kuglitsch: Yes, I guess the first one was sort of whether you are – I think you sort of answered it but obviously you're saying a £50 million loss essentially in the UK. I mean first of all, is the UK actually in loss?

Duncan Magrath: I'm sorry, yes. Sorry…

Gregor Kuglitsch: And then finally, does that sort of, do you really believe that that is a one-off.

Duncan Magrath: Yes, sorry, what – again at the results presentation I think I talked about the overall UK construction business being around about a 2% business, and this is a £2.5 billion business. So, and that's before some allocated corporate costs, etc. but if you look at the profitability of the underlying business units across the divisions, that's, it was about a 2% business. So this effectively makes it broadly a breakeven business with this reduction, for 2013. But clearly, as Andrew said, obviously it's a quick cycle on the regional construction side and obviously we'll be looking to improve on that next year.

Gregor Kuglitsch: Okay, thank you.

Operator: And we will take our next question from Howard Seymour of Numis. Please go ahead.

Howard Seymour: Thank you. Morning, gents.

Andrew McNaughton: Morning.

Duncan Magrath: Morning, Howard.

Howard Seymour: A couple from me please, just start again on UK construction. Can you outline if the 50 includes any additional restructuring costs and whether, Andrew, you sort of mentioned the regional side of things, whether you would consider closing down any of the regional businesses that you've got?

Andrew McNaughton: Yes, I mean the £50 million is actually trading. We've already looked at the restructuring costs that – we've taken those separately. The information that we're giving today is about, is the trading performance. To take your second point around would we consider closing elements down, clearly we've got to examine all elements of the business as to where we see future profitability is going to be. That's something that, as you know very well about the business, that we do all the time. What I would say, and I'll go back to what I said a moment ago, is that the issue on this business and particularly around our regional business is not uniform. We've got elements of the business that are performing, in difficult environments, very well and very strongly. There are elements in the business that we are going to have to look quite hard at as to whether those are viable going forward, and we'll do that as we go forward from here.

Howard Seymour: Okay, so Andrew, from that point of view, the cost restructuring that you've got in, you wouldn't be looking to increase the cost of the programme in place then; this is part and parcel of that and you'd accelerate it?

Andrew McNaughton: We actually have a plan – as you know, we've got the phases of the cost reductions that we've been implementing. We're still ongoing with that right now. Part of that was envisaged looking at various pieces of the business. It's a bit too early for us to say, am I going to have to implement additional measures on that. It really depends on the market conditions that are operating in those units that we're concerned about. If we need to then we'll keep you advised as to what we're doing.

Howard Seymour: Okay, thank you. The second question was really on the rail side of things. You mentioned the £10 million deterioration in rail operations in Germany.

Andrew McNaughton: Yes.

Howard Seymour: Can you talk a bit more about that because if it's down £10 million now, would you expect to sort of stem the decline there or do you think it will get worse from here over this year?

Andrew McNaughton: That's our – it's a forecast from the information that's coming through to us now. If I just give you a little bit of background to that, clearly the reason that this is emerging in Germany is in part linked to the position that we took at the full year in March. You'll recall we signalled that we would be exiting our activities in the European rail business. We have seen a couple of issues that have gone on as a result of that and there are some changes in attitude in the business. I guess, so the indicators, what we're doing is forecasting over the full year the impact of the closeout of contracts, change in attitudes and also economic environments that are still going on in Germany, and let's not forget, we signalled one of the reasons that we were doing this was because of the difficult economic environment in Germany. Therefore, what's emerging over the – as we see right now, that there are going to be some impacts for us. If anything, it's hastening our resolve to actually make the change that we have to in Germany in order that we don't see future impact.

Howard Seymour: Okay, great. Thank you very much.

Operator: And we will take our next question from David Phillips of Citi. Please go ahead.

David Phillips: Hi, good morning, everybody. Could I just ask about the 2014 situation with the UK regional? I mean reading between the lines, you're saying look, pricing was wrong, subbies have gone down. You've also got a reasonable market share in some of those areas. In '14, would you be looking to defend that market share or will it become a much more selective bidding pricing environment do you think, and is there a chance that you actually may downgrade the volume expectations again by trying to shore up that margin? Was it a case that maybe there was a bit of market share hustle this year that has led to some pricing that is now looking too competitive?

Andrew McNaughton: That's a very good question, thank you. Your assessment of where we believe that the issues that we've seen, one of those is that those are absolutely true. You've summarised the points I was making well. In terms of will we see some change in nature of the book of work going forward, it's a regional business and that, those regions fluctuate and change with the market conditions. I think it's a bit difficult to forecast as to what the volumes will be around there. What I can assure you is the actions we are taking to ensure the discipline around margins through the bidding process, and not just margins as well but actually scrutinising carefully our ability to perform and deliver on schedule and other project risks, means that there will be fluctuations in the volume. We will be – will we be more selective in the projects that we bid? There's a high possibility that will be so. But I come back to the fact that let's remember, in the heartland of where we do have strong market share, those businesses are performing well. When we look forward at the book of work that we're bidding at the moment, we do see some fluctuations but it's fluctuations rather than a wholesale reduction.

David Phillips: Understood, understood. And yes, I guess that is what I was saying about further restructuring. If there is a downsizing, there may be some leverage effect of these bid teams, etc. but I guess you'd be maybe thinking about some bid teams more as a variable cost going forward. Is that fair?

Andrew McNaughton: Sorry, can I just clarify the question? Would you just, would you mind repeating the question, sorry?

David Phillips: Yes, I was just sort of saying if you do decide to be more selective on a regional basis, presumably that means that there is some bidding team resource that may become surplus to the core – or is it because it's a regional business, you have to maintain that presence in each market? I guess I'm getting, is there some cost that can come out of the bidding side if you do decide to downsize?

Andrew McNaughton: Yes, there's a long answer to that question and it goes to the heart of the operating model that we've been developing. I talked about the bringing together of six units in the three business streams. We've already been taking action through the restructuring of the business to focus on, if you like, we call them hubs but they are four major regions, if you like, and from that we spin off operating units. So we've already been taking some action, through the cost structuring exercise that we've been doing, to bring together our bidding resource. So if you like, it's now faced – as I say, based on four macroregional hubs and we have delivery units spinning off those. So we have been taking actions on those. Is there more we can do? There probably will be some but I wouldn't anticipate it's major because we've already anticipated that through the restructure we did.

David Phillips: Yes. No, understood, understood. And sorry, there was a question earlier on on the dividend. I got distracted by another call offline. Could you just repeat what the answer was on the dividend situation? It will likely be on, it will be sub two times cover this year on the revised guide. Could you just repeat that answer please?

Andrew McNaughton: Yes, I'll take that one just to demonstrate to everybody on the call that Duncan and I can be consistent. I mean, clearly we've set out that we intend to have a progressive dividend policy and it's absolutely clear to us that that's vitally important to our shareholders. You know, what we need to do is to take the decision on that at the point in time when we're able to do that. We said at the results, it's too early to give a prediction on that, and we will come back to that later in the year. Our policy and our philosophy on it remains absolutely true. We need to take those as the situation, as we see it at the point in time when we're ready to make that decision.

David Phillips: Yes, okay, fine. Just one final one. On the carried goodwill in some of the regional businesses that were purchased 2004 to 2006-7, I mean does this call into question some of the goodwill values or is it way too early? If this is viewed as a one-year hit then that's not a question at the moment, or is that something you're going to be discussing with the auditors do you think?

Duncan Magrath: Well, I think clearly this significant reduction in our expectations does actually trigger us to review the goodwill. Frankly, I haven't had a chance to do that over the weekend. Certainly we obviously do the impairment exercise every year. We'll obviously have to look at this at the half year given this announcement. We had a lot of headroom when we tested it at the end of last year, so I don't think it will be a problem but I do need to go through the exercise before I can be definitive on that.

David Phillips: Great, thank you very much.

Operator: And we will take our next question from Hector Forsythe of Oriel Securities. Please go ahead.

Mark Howson: Actually Mark Howson from Oriel here. Can you hear me?

Andrew McNaughton: Yes, morning Mark.

Mark Howson: Morning. Just three questions. Just can you talk about the timing of when this was known? Could you just go over that again? Because you know, I'm starting to get investors here looking at the timing of share sales by directors and former directors and they're asking the question, when was this known? That's the first question. Secondly, is any of this related to the delays in the power market or in PF2? And thirdly, are you now going to be moving towards sort of step three of your cost savings programme?

Andrew McNaughton: Okay, thanks, Mark. If we just take the timing for that then, these issues came to light sort of at the end of March when we were looking at our regular business review. At that point in time, that's when we instigated the detailed review across the whole of the business. The report to that came back to me on Friday morning and the outcome of that, so we made our assessment as to what the feedback for that was on Friday 26th April, and that's why we're sitting here this morning. So that was question number one.

Duncan Magrath: Delays in the power market…

Andrew McNaughton: Delays in the power market. Inevitably we've been disappointed in terms of the progress that's being made in the power market. We had anticipated from our major projects side that – and I guess this question I'd probably put in the context of the ability over the book of work to take that into the major projects side. There has been a slow-up in that. PF2, again, there have been delays in implementation so inevitably all of those delays do have an impact on us. The issue we're highlighting specifically on the regional business clearly is difficult to blame on those elements of it. But yes, it has an impact overall. Those things have an impact overall on our business.

As far as your point on Phase 3 of the cost implementation, clearly, as we set out earlier this year, we're in the middle of Phase 2 of that. Is there more that we can do and would those three then be implemented? I think it links back to the conversation, the question that Howard had is that as we go forward from here, we will be looking now at each part of the business to ensure that we're operating in the most cost-efficient way. There may well be more that we can and we should be doing and we'll come back to you as soon as we've bottomed that out.

Mark Howson: Okay, thank you.

Operator: And we will take our next question from Stephen Rawlinson of Whitman Howard. Please go ahead.

Stephen Rawlinson: Morning, chaps. I think a lot of the ground has already been covered but just two questions from me. I think firstly with regard to your signals as to what you believe to be going on in the UK market, it's not clear from what you – the way you've written it, at least to me anyway, whether you see conditions actually bottoming out now or whether you see them getting worse. You refer to "increasingly stringent conditions" and I'm not sure whether it's still increasing or whether it's actually bottomed out. And the second question is just with regard to your role, Andrew, going forward. I mean, quite clearly this does require some intervention. But if you've got a pretty big group to run and if you're actually running the UK as well, that actually sort of raises alarm bells to me as to what might happen in the rest of the business if you're focusing purely just on the UK. Could you comment on that please?

Andrew McNaughton: Stephen, thank you. Thanks for those. First of all taking the market point, has the UK market bottomed? I think there's a couple of questions there. Has the UK market bottomed in terms of volume and has the UK market bottomed in terms of bidding conditions? I think it's evident from the review that we've seen, I have to say the first one is difficult to call as to whether the volume is there, and I'm not really best placed to be able to say whether the volume is likely to decrease any further. We're currently, all I would add is that we're currently not seeing that in terms of the bidding pipeline, particularly in the regional business, is remaining pretty robust. What I would say is that our observation across the business is that the bidding environment is different in different regions of the business and there's no doubt about that. And, we are now having to look carefully at the actions we have to take, and those actions are pretty focused in different parts of the country. I've given observations previously about the United States not being a single market. I think what's becoming evident, more so, is that when you look at the regional business, we don't have a single market either. I mean, there are large variations in those areas. If I take your second point…

Duncan Magrath: Andrew, it just might be worth adding, I mean I think this is the market, Stephen, that would benefit quickest obviously with a recovery in the housing sector so that would be the – that would be a positive if that happened because I think that would improve conditions in the regional markets going forwards.

Andrew McNaughton: If I take your second point, having stated, if I go back to a couple of months ago when we were at the results and since then, I've stated what our strategic direction is and particularly our focus on a more international basis outside of our home markets. Since we did that and also in the first couple of months of the year, I've been freeing up senior management capacity around the Group in order for us to drive forward with that. Clearly, whilst we remain committed to the international development and the focus on economic infrastructure, some elements of what we want to do, given the nature of what we're advising today, are going to have to be put on hold. I particularly refer to, when we look at our country model, I'm focusing particularly in answering this to the organisational change in the UK towards a single-country model. In addition, I'm going to need to take a short while to assess the actions that we've currently planned for the USA to make sure that those remain appropriate and that we're pushing forward at the right pace. But I would come back to that point that says I've already created additional capacity, both in the USA and to focus on those emerging markets and I'm going to be utilising that capacity in the short term whilst I get on with what we need to do in the UK as well.

Stephen Rawlinson: Yes, thanks, chaps.

Operator: And we will take our next question from Andy Brown of Panmure Gordon. Please go ahead.

Andy Brown: Morning, guys, it's Andy at Panmure's here. Two from me as well. Could you just remind me of the split in the UK between regional and major projects, either by revenue or profit?

Duncan Magrath: Yes, so if you take the £2.5 billion revenue then 50% is in the regional business, about 40% is in the major projects business and about 10% sits in our mechanical and electrical engineering business. And that sort of is broadly in line I think with the splits that I gave at the full year where I said that the order book was, about half of it was in the regional construction.

Andy Brown: Okay. No, that's useful, thanks for that. And the second thing, when you talked about the other businesses, you suggested that the investments division has outperformed. Does that suggest – I'm guessing that's through disposals.

Duncan Magrath: Basically I guess that was a comment, a) its trading has been good in terms of from the underlying concessions and the costs that we've incurred so far year to date in terms of bid costs, but secondly also the outlook for that market looks strong. We are, as you would expect, in negotiation on selling some assets and certainly the prices that we are seeing for those are better than we expected.

Andy Brown: Okay, okay, so just to make sure I understood the answer, so the comment you put today isn't on the basis of disposals achieved so far?

Duncan Magrath: No, it's based on year-to-date trading plus there is also an expectation, well, in our minds, it will be better probably by the end of the year than we expect.

Andy Brown: Yes, okay. Okay, cheers, Duncan, thank you.

Operator: And we will take our next question from Joe Brent of Liberum. Please go ahead.

Joe Brent: Good morning, gentlemen.

Duncan Magrath: Morning.

Andrew McNaughton: Morning, Joe.

Joe Brent: A few questions from me if I may. I mean firstly I just wanted to dig into the £50 million number. Is that a large number of small contracts or are there some large contracts in there? Could you give us a sense of how that £50 million shortfall is made up?

Duncan Magrath: Sure, so of the £50 million, effectively roughly 75% of it is in the regional business and 25% is in the building part of the major projects. Across all of the £50 million, there's only one contract that's had more than a £3 million impact. If you look at the regional market, they're all, the vast majority of them are below £1 million each. There is probably about five that are somewhere between £1 million and £3 million.

Joe Brent: Thank you. And you said that there's different pressures in different regions, and the North and Scotland are performing better. Are we to take that to mean they are better bidding environments as well or is it more of a management issue there?

Andrew McNaughton: Sorry Joe, I lost in the middle, right at the end when you were – is it better?

Joe Brent: That the North and Scotland are trading better than the South. Is that difference due to the sort of bidding levels or is it due to the management difference of the two areas?

Andrew McNaughton: I would say that the impact of the issues are more prevalent in the South. When you look at a) the management, b) the environment, c) the market conditions and also the pipeline, the trading conditions are better in Scotland and the North. The ones further south are exhibiting a much more prevalent view of all of those conditions that we've talked about.

Joe Brent: Fine, and it sounds like you initiated the review about a month ago, and you say that you feel that you've bottomed out the issues. That is quite an achievement in a month to get comfort on a business your size. Could you give us some comfort that the trading issues really are bottomed out, putting aside the market which I don't expect you to add on?

Andrew McNaughton: Yes, I mean we have carried out a detailed review of the book of work of the regional business. I mean, as Duncan's described the sort of nature of it, there is over 1,000 projects that are ongoing in the regional business. Those split down into some very small contracts also because they're live contracts. Some are accounts that are being closed down, and some haven't started up yet. So the process we've done is looked at the key book of work, and when I mentioned in my note, my notice earlier, we looked in detail at 100 contracts. Those 100 contracts were the ones that were really flagging up the issues and were of scale. So whilst we've – you're right, the book of work not only in hand, in the order book but also the forward order book is quite substantial but we were able to home in very quickly, through the process and the reporting process and the data that we have in the business, to actually figure out the ones that were at risk. So we are confident that in that period of time, and the team that we've had on this has been very focused going round with each of the regional management teams. So we've been, we've not been looking at this from here in Central London. We've been out with the businesses, looking at their individual books of work. So we are confident that we've got to the bottom of that.

We've flagged the issues in the building projects in the major projects part. Clearly their portfolio of work is smaller in terms of the number of projects that are running at any one time, and the ability for us to look at those quickly has been much better.

Joe Brent: So a final one from me. I mean, does that – what percentage of total is the 100? And I appreciate 10% by number but what is it by value?

Andrew McNaughton: Oh, it's significantly more than that. Putting me on the spot, it would be 65% probably.

Joe Brent: Thanks very much.

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

Mark Howson: Hello, it is me this time, so I think I had some technical problems with the phones earlier on. Just to go back to the timing, you said the issues became known at the end of March but the full report wasn't written and landed on your desk until Friday. What do you mean, the issues were sort of known and identified at the end of March? Could you have taken a view at the end of March that there were some problems and this is going to cause a cost and therefore there's likely to be some expectations missed or was it just impossible to say at that stage? Can you just, I just can't understand why it's taken from March till the end of April, nearly beginning of May to actually, to get to the bottom of it.

Andrew McNaughton: Okay Mark, I'll kind of flip that back to Joe's question as well in terms of it's a large portfolio to look over. We have a monthly review process that we carry out. At the end of March, what was flagged to us was a position in the business that just seemed out – the performance of the business overall seemed outside of our seasonal norm. And actually from here, what we saw was we therefore flagged some concerns that we needed to go and investigate. So as far as being definitive about what the number was going to be for this year, that wasn't presented to us in March but what we were actually looking at was the run rate performance as to where we were at the end of March when we did our business review raised some significant concerns in our mind. As a result of that, we instigated the process which we've just run through and talked about in the scale of the number of projects we looked at with Joe. That process has taken us time to actually get round to the management teams because we wanted to be definitive and as accurate as we possibly can be to the information that we give to the market. And that's what's taken us until the report landed on my desk and we actually reviewed that on Friday.

Mark Howson: Okay, can I just ask, if I'm still on then, just the UK order book for 2013, is it still down 20% or it's just the cost of the execution of these contracts is obviously worse than you thought because the pricing is not as good as you would have hoped, or has the order book slipped from being down 20% to down something else?

Duncan Magrath: Mark, it's Duncan. Our revenue guidance is completely unchanged, which is sticking with the down 20% that we said. So this is around execution than market volume.

Mark Howson: Yes. Okay, thank you.

Andrew McNaughton: Thanks, Mark.

Operator: And we will take our next question from Edward Donoghue of One Investment. Please go ahead.

Edward Donoghue: Morning, gentlemen, a couple of questions if I may. Just one with regard to the German rail business, I mean that's where you had your largest impairment on the rail impairment last year. Is there a risk that you will see another charge taken this year on that? The other one is the ability to close that out I'd have thought is diminished on the basis of the losses, the way they're moving. You haven't talked about the US construction business, bearing in mind the comments you made about you put a new structure in place and unfortunately certain parts of your UK organisation haven't followed it through, and what are the implications for having a more centralised structure in the US there? And the other one is just to get an idea of – you talked about the UK business being a 2% profitability. If you look at the conditions now and you look to 2014, is the UK business still a 2% business?

Duncan Magrath: Okay, perhaps I'll deal with the German rail business. When we took the impairment hit last year, we had about £65 million of goodwill remaining. Clearly, a bit like the comment earlier, I think if we've got a downgrade in our expectations in Germany, we'll have to go through an impairment review at the half year and look at that, and we will see. I mean, there was no headroom at the end of the year because obviously we had to come up with an accurate number in Germany. So there is a chance of an impairment because of the downgrade in our expectations.

If I perhaps touch on the last point in terms of the UK and then ask Andrew to answer on the US, I mean in terms of going to 2014, will the UK construction be a 2% business? I mean, I think clearly it is a bit early to say; clearly it's dependent on market conditions. But most of the impact – the impact that we've taken on the £50 million is certainly an impact in the current year and we will be looking to get a business of a reasonable profitability next year. And so I don't see any particular reasons why the business can't go back to that level of profitability but we do have to work through the impact of, as Andrew talked about earlier, the impact of looking at different parts of the market. There are bits of the UK regional market that may not be able to support an overall 2% business, but that's certainly not all of it.

Andrew McNaughton: And I think I'll pick up the US piece in a moment. I think the only thing that I would add to Duncan as well, in terms of we've talked about the regionals and we've talked about the major projects business as well. If I reflect back on the strategy that we presented to everybody in March, we were absolutely signalling the fact that we are going to move this business more focused towards economic infrastructure. And clearly we are focused on that and our experience shows that that gives us the ability to deliver an increased profitability from that. We've also signalled that the issues are in the building side of the major projects element and our infrastructure projects, we can see a line of sight that that, the comment around a 2% business overall for the UK, the delivery from that would support that.

So if I come onto the US side, we have carried out a reorganisation in the US business. We implemented that last year in taking it from five regions down to three regions, in the same way as we've been, we carry out our business reviews around the business. We've been monitoring that, and the completion of that and the performance of projects, whilst the concerns were raised to us at the end of March, we have no indication at all that there is anything that we should be concerned about in the business in the US, and that's why we've not signalled that – and highlighted that today as something that would contribute to our position that we're putting forward.

In terms of the – I certainly would hold back, if you were going to follow up on that in terms of what does the market look like, I'd guess the comments we've made in the last few weeks around where the two markets are, they probably still stand, and again the line of sight we've got on the pipeline in the US is probably more positive than the UK. That's what I would hold at that point.

Edward Donoghue: Okay, and if I can just come back to, you kindly gave the information on sort of the regional split in the UK. Can you give an idea just, you know, is this a volume decline in the South East or is this very much just the pricing of the projects?

Duncan Magrath: When we gave our 20% estimate of a volume decline at the March results, that was across the UK business. I think in terms of volume decline, I think we've talked for some time now that in terms of if you look at the shape of our business, where we've seen bigger volume decline actually is in the major projects business. We've seen an absence of the bigger projects coming into our order book. So there's an overall trend in terms of an increasing proportion of the business and the 50% I gave you is up from probably 40% a year ago in terms of the proportion of our UK business in regional construction. So there is a trend ongoing but actually that's, none of that actually is related to what we announced today.

Andrew McNaughton: Perhaps I can add to that. You're suggesting, the two are connected, it has to be said. If you take – when we make the observation around our businesses in the South of England, there has been volume decline. I mean it's, if you look at any of the indices for regional activity, you could actually look to the South West and see there has been a major decline in volume with the South West, and with that major decline in volume and as I've already said, in the last few weeks, one of the features of the current economic situation is there is, there has not been a consolidation in the market in terms of the number of main players, and so therefore that drives harder competition in the market at this moment in time. So that leads to these kinds of features.

Edward Donoghue: And if I may, just one last question, I apologise, but if I look last year, you had a major subcontractor failure in the UK business. Bearing in mind that that was not a new phenomenon and it's flagged by everybody, also across a number of other markets in Europe, that that is a difficult part of the chain and therefore I would have thought the focus would have been on that specifically, bearing in mind the impact it had last year on your figures. Why has that become such an issue again in 2013 and how are you going to actually be able to improve that significantly, i.e. reduce that risk?

Andrew McNaughton: Yes, it's a good question. The subcontractor market, I mean clearly we engage subcontractors on many, many of our projects and particularly focused in the building market. We are dependent on many of the trade contractors and I think whilst it is an element that's going on in the market at the moment in terms of the strain that's being experienced by those particular trade contractors and materials specialists, it's prevailing through the downturn. We have implemented strong actions over the last twelve months to ensure that we are much more closely aligned to the performance of key subcontractors for us and the main subcontractors. But it is evident that the whole of the market is suffering concerns. What we can do, all we can do is in putting forward our bids, is to increase the level of rigour and scrutiny on the a) the financial position of subcontractors and b) to scrutinise the onsite performance of them, and protect ourselves in selection of those subcontractors. Could I give you a prediction that there is not going to be any more subcontractor failures across the whole of the construction industry in the UK?

Edward Donoghue: No, I wasn't asking that. Don't worry.

Andrew McNaughton: I can't, I cannot do – I cannot do that, and therefore we are having to take decisions and therefore allocate risk contingencies in our bids accordingly. And that's the element that we're going to have to, we are going to have to ever be focused on those points.

Edward Donoghue: Great, thank you very much for the answer.

Operator: And we will take our next question from Kevin Cammack of Cenkos. Please go ahead.

Kevin Cammack: Morning, chaps, just I think two from me. I think people have been pretty thorough in what they've asked. The one thing I'm still struggling to understand is – and I accept that there are obviously shorter duration contracts that dominate the regional business, but presumably there has to be a reasonable chunk of revenue that is due relating to the contracts and the £50 million profit, there has to be a chunk of revenue which would have been running into 2014 and due to be booked in 2014 on which I presume there will now be no profit. Not saying there'll be any further shortfalls but there'll certainly be no contribution. So I'm sort of struggling to cope with the, you know, the context that there could – you know, that the business could still be a 2% one in the next, you know, in 2014. Structurally I accept it could be in any given year but surely there will be a decent slug of revenue in next year that is related to completing the contracts you've now provided against? That's firstly. The second thing in, again and it's been touched on a number of times I think but just to be clear, are your monthly procedures that you adopt in markets like the US for example, the same as those that you're now challenging in the UK? Or do you, are you sort of suggesting that really the crux of this issue has been about, has been compounded by the restructuring of the regional businesses and the sort of, you know, mayhem I guess that may have been caused around that, which sort of comes back to the earlier question about, you know, is the next step to sort of check what's happening in the US along the same grounds? And the very final thing I had was just a point of clarification. I may have well missed the answer on the average net debt steer, but I think if my – my hearing's probably going but I mean did you, were you suggesting actually the net debt will actually come down as a result of this?

Duncan Magrath: Kevin, I'll deal with the first one and third one and perhaps let Andrew deal with the second one. Basically I said, in March I gave a – I said that basically I expected the net debt to be £100 million higher than the 126 of net debt which was the average for the second half of last year.

Kevin Cammack: Yes.

Duncan Magrath: So that would be 226, and I'm suggesting to add 50 to that to make 276.

Kevin Cammack: Yes, yes, okay. That's fine. Sorry, I thought – I'd misheard you. I thought you said it would actually be down.

Duncan Magrath: You may have heard me correctly but I may have said it the wrong way round, but that's the answer I meant, if I didn't say that the first time.

Kevin Cammack: Yes, okay. No, that's fine, that's fine.

Duncan Magrath: In terms of your shorter duration, your point about contracts and revenue running into 2014, I mean I guess just to repeat again that the average life of the contracts is nine months but clearly you're right, therefore there will be some contracts in the regional business that will be longer than that and that will be going into next year. I think it's probably important just to highlight that effectively the £50 million isn't £50 million necessarily of contracts making losses, it's a £50 million adjustment on our expectation for the year and…

Kevin Cammack: Yes, yes, I understand. Yes, but similarly, I suppose is there – well, what surprises me is that there isn't a tail of that, you know, by the same token, in 2014 that would have come off your expectation as well because you're still completing that work.

Duncan Magrath: Well, I think it is inevitable that there will be some contracts, and actually saying how much of the £50 million will repeat next year is a very difficult question to answer. It's clearly not all of it, and hopefully not a substantial part of it. But you're right, there could be an element that carries on which is related, and bearing in mind that the 50 million a combination of poor execution, which hopefully we will rectify, as well as the margin at which it was – and the rates at which it was bid at. So the rates which we've bid at on those contracts we're obviously stuck with now but in terms of improving onsite performance, we will fix that.

Andrew McNaughton: Kevin, perhaps if I just give you a couple of numbers just so that you can understand that in terms of how much hits…

Kevin Cammack: Yes.

Andrew McNaughton: The nature of the business. We've said, our regional business is 50% of the construction business in the UK.

Kevin Cammack: It's about half, yes.

Andrew McNaughton: So you know, if we go roughly it's about £1.25 billion.

Kevin Cammack: Yes.

Andrew McNaughton: We're actually bidding, adding into that portfolio roughly £100 million a month. So interestingly, so as you get the – so with a nine-month duration, and we usually get to the end of the year, the normal metrics for that business, and it hasn't changed dramatically, the normal metrics of that business is that by the end of the year, for in-year performance we're somewhere between 70 and 80% of the book established. So we can see the kind of nature of turnover. So to give you some confidence, as I said in my note earlier, we're actually currently bidding the work for 2014 now. So the volume in that regional business that was acquired in the period of time of that transition, so I'm going to come onto your other part of your question for 2014 is very modest.

Kevin Cammack: Yes, but I suppose in a way though, Andrew, I mean if you've got to fill 50%+ of your order book of next year through the rest of the year, then in the light of this, I mean unless you can click your fingers and bring in an instantaneous level of new procedure, surely your instructions will be, well hang on, let's hold back till we've got, till we fully recognise we've got an appropriate bidding process in place. So filling the order book at £100 million a month is going to be, I would have thought, risky over the next couple of months, isn't it?

Andrew McNaughton: Don’t get me wrong, I mean – and I’ll go back to Mark Howson’s point around timing. These issues were raised to us a month ago at the end of March, or when we flagged, when we identified the issue we had to go and look into. So we have already made changes to this business. We’re not wait – I’ve not waited till today to actually put the business on notice that what's been emerging through the review process over the last couple of weeks – what we didn’t have was the full review of that, and the actual changes that I’m implementing now are immediate.

So the other thing I would say is that don’t forget of the businesses, the business units that we’re talking about here, I’ve told you that it’s not uniform. Over the past few weeks when we’ve been scrutinising that business, we have a large number of our regional businesses that are operating absolutely in line with what we expect, and if I give you a sense of that, we’ve got about – we’ve got 21 operating businesses in our regional business. And my concerns are particularly for six of them. So let’s not feel that…

Kevin Cammack: Okay.

Andrew McNaughton: That, you know, wholesale. I mean I’ve said a couple of times this morning, it’s not uniform across our business. I’m going to be scrutinising and focusing on those areas where we’ve got particular issues and I have absolute confidence in the management in those regions where they're operating exactly to the procedures we have.

And going to those procedures, I’ll tackle your question about the United States. The procedures we have, what I’m actually driving and I will be driving as we go forward in this is a return to the operating principles that we have had in this business. Your question around has this been a position in transition that's gone on through the process of organisational change, my concerns that have been raised is that in particular areas – I’m flagging those six areas that have the management teams assimilated their project portfolio and have they been focused on those kind of controls that we require. And I have already looked at and been in communication and review of the business in the US and as I say, they are, there is absolutely nothing that gives me concern that there is anything that's changed in their attitude or process.

Kevin Cammack: Okay. All right, thanks very much.

Andrew McNaughton: Thanks, Kevin.

Operator: And we will take our next question from Eugene Klerk of Credit Suisse. Please go ahead.

Eugene Klerk: Yes, good morning, I have a few questions. You talked about the fact that poor execution has resulted to a significant degree in today's announcement rather than materially weaker end market. Now to what degree has this been more ignorance on the side of your local management or is this something more serious than that? And if that's the case, would you be potentially insured against this? And then second question is you talked about your monthly review showing that some of the results were out of seasonal norms. These results, were those cash flow concerns, cash proceeds in particular, and if so, can you give us an update on your working capital performance year to date and how that relates to previous guidance? Thirdly, can you give us an estimate for after tax, the after tax impact of today's announcement? Is there anything to be gained in that sense from the taxman? And then finally, can you just remind us again on the US construction margins, what they typically are and what you expect them to be for 2013? Thanks.

Duncan Magrath: Okay, Eugene, perhaps I'll deal with some of those. I mean, in terms of your first question around the execution, I mean basically we believe this is poor execution. There isn't anything deliberate going on here in the sense of people misleading, so there's definitely no recovery to come from any insurance.

Secondly, in terms of the monthly results and seasonal norms in terms of impact to cash flow, yes, I mean there were a couple of things. I mean there's a number of things that we would review but within that process, the performance of the projects both from a profitability and a cash perspective were things that we were questioning. I'll go back to what I said earlier though in terms of the guidance around working capital as a whole, that's broadly, that stays the same but the reality is that this profit impact will affect cash.

And thirdly in terms of after tax guidance, this is obviously clearly all of it in the UK. I think you can probably use a 25% tax rate on these figures to calculate the after tax effect.

And just in relation to US construction margins, I'd remind you that it's like, you know, it's just over 80% of the business is the building business, which tends to operate on lower margins than the UK, and that's around about 1% type margin at the moment, perhaps slightly lower than that. And then there's the infrastructure business as well which tends to operate on slightly better margins than that but it's obviously only 15% of the business.

Eugene Klerk: Thank you.

Andrew McNaughton: Can I just, I'd just like, before we go to the next question I'd just like to come back on that first point because from my perspective, I want to make it absolutely clear to everybody on the call that, to take over on Duncan's point around the regional management teams, I'm absolutely confident that the regions and the projects have been striving to deliver results for this company. The key for me here is that during the transition period, in those small number of regions that we've talked about, and identified projects, we've fallen short on our normal standards of operational delivery and some of our management rigour. There is no question that the regions would not have been working in the best interests of the company and have that at their heart.

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

Mark Howson: Hi, just a follow-on from me. Just you mentioned in the statement that you're taking direct control of the UK construction business itself. I mean who or what have gone as a result of that action and the changes?

Andrew McNaughton: Okay. There are things, there will be people leaving the business. Our head of regional delivery at the regional business has, as of today, left the business. As a result of that, Mike

Peasland, who's the CEO of the UK business, will be stepping down into the regional business. I mean, he's a man who's got extensive experience of running a regional business and therefore he will be focusing his time and attention on delivering the business for the next few months. He and I will be working on a succession plan and Mike will then be leaving the business at the end of the year.

Mark Howson: Thank you.

Operator: And we will take our next question from Olivia Peters of RBC. Please go ahead.

Olivia Peters: Hi guys, just one more from me, a sort of bigger picture question. Given what you said around economic, you'll focus on economic infrastructure, at the full year you mentioned that you were potentially looking to dispose of WorkPlace. Can you just give us an update on that strategy – given the nature of the business, it seems to be relatively more stable – whether that still remains the case? Thank you.

Andrew McNaughton: Okay, number of a comments, first to take your last one, it seems to be stable and therefore is it the case. Yes. It's absolutely stable. I mean, there's been some – we've indicated that we are currently running a process, and it was part of our strategic review, considering that business. We still have a process running. We've nothing further at this moment in time to add to that. As and when that process concludes or we get to a point where is something to advise, we will do.

Olivia Peters: Okay, thanks.

Operator: And there are no further questions in the queue.

Andrew McNaughton: Can I just thank everybody for all your questions; very helpful questions in order for us to make clarity on that. I guess we've made several comments about where we see the issues in the business and how we're addressing them. I've made it quite clear that, of my commitment to get on top of this and personally get involved in it.

I want one thing to be absolutely clear about this. We've come forward this morning to make these statements as a result of information that was made – that was made to us on Friday morning. As a part of our business review at the end of March, we had significant concerns which forced us to take a detailed review of our business. We've looked at that in detail over March and we are confident in the position that we've got to that led us on Friday to the position that we have to come forward and speak to you today. And we will be taking actions from now going forward to drive the business forward as we deem appropriate. And I'll hand it back to you now, the operator, to close off.

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