Balfour Beatty
2015 Half Year Results Presentation
12th August 2015

Summary and Operational Overview

Leo Quinn, Chief Executive Officer
Good morning everybody, I'm Leo Quinn, Balfour Beatty's Chief Executive Officer. I'm joined today by Phil Harrison our new Finance Director who has now been in the job some eight weeks. So you'll be pleased to know he's got everything under control.

Obviously the forward looking statement. I'm going to start off with a brief summary and introduction and then some of my observations in terms of the financial numbers in the first half. Phil will then take us through a review of the finances in more detail and then I'll give you an update in terms of the Build to Last programme. And remember - just to remind everybody this is a cultural transformation that we're looking to put in place here, we're six months into our 24 month self-help plan and we all know that culture in effect eats strategy for breakfast and it will take us a good five years to embed everything we're doing. But we're starting off with vigour.

Let me try and sort of frame these results for you and the way I think about it in terms of the progress we're making and what you should look at in terms of the company. The first six months we've seen the order book and the revenue stabilise, so year over year we're about flat in both of those areas. And we've seen a number of landmark wins, both in the US and in the UK, whether it be the new nuclear in the places like Hinkley or the motorways with the Highways Agency.

So what this really says to me is that you know our customers still have confidence in Balfour Beatty and our engineering capability and the things that we deliver. So this is an exciting company to be part of that does really, really great things and our customers recognise and respect that.

The first half losses I think as updated in July really sort of - they're part of the history of the company and they are something that we have to live with and we have to work through. The good news is that most of our projects have a lifecycle of 24 to 36 months and that most of these will actually be completed in the next 18 months. So I think it's something we have to live with and we're going to work through.

If I look at our Build to Last programme, I was encouraged last night by some of the feedback, we're doing a lot of things in Build to Last and as you read through the statement the one thing it's characterised with - there's a lot going on in the company at this moment in time. But people pointed to delivery, they pointed to the fact that we've generated substantial cash in the first six months and that we've taken cost out. So our balance sheet is at a net cash of £260m. So Build to Last has real momentum and real deliverables.

In terms of the sector I'm often asked when customers are placing business with us, you know, what's Balfour Beatty's financial strength? It is interesting having just run a comparison we're still one of the strongest balance sheets in the sector, of course underpinned by a £1.25bn worth of investment assets and the net cash at the end of the year.

The other thing that's worth thinking about is if you look at all of the infrastructure spend that is actually on the table at the moment that's going to happen over the next few years, whether it be in the areas of Water, Rail, HS2, you know we are heading into what I think is a favourable market. And you know on a rising tide all ships rise and Balfour Beatty is still the largest ship in the UK market. So I think it's an encouraging market outlook for the company.

So fundamentally we're into our 24 month self-help plan and I think this is the backdrop and this is the way you should look at the company going forward.

In terms of the numbers I'm not going to talk about the specifics because most of it is actually better said in the results report. But what I want to do is I want to take you through some of my observations over the last six months and sort of add a little bit of colour to this. I'm going to actually spend a lot of time talking about the UK because the UK is where we're leading and where we have the biggest problems. But as we actually roll through the company all that we're doing in the UK is already rolling out in other regions and actually will get more traction with time.

So my first priority is that you know in order to transform Balfour Beatty it's about clear leadership and holding people accountable. And interestingly enough about two to three weeks ago we had a senior management leaders' meeting in the UK, we had the top 40 leaders come in for a meeting; we're going to do the same in the US. And of the top 40 people who are all fiercely independent and federated in terms of the way the company used to be structured, I asked three simple questions. I asked the question that says - what have you actually done in the last six months? I then asked - what are you going to do in the next six months? And then I asked in light of the fact that we're centralising and optimising all of our back office services what support and help to do you need to deliver on those goals?

Now when I first laid this out I thought - oh god this is going to be a really turgid meeting, interestingly enough it was quite inspirational. Because people actually came along and they put up what they were doing and what they were going to do. And when their colleagues all 40 of them realised that there's 40 people in this room driving this business forward it was quite uplifting and it was really the formation of a team that's now starting to run Balfour Beatty. So I was really, really encouraged by the output of that particular meeting. And if you think about how you transform a company it does actually start with that leadership, really, really important.

My second observation is around the bookings challenge. As you look now at the order book it is strong. In the first quarter of this year when we sort of decided to actually raise the standards within the company and that is in terms of the margins that we were booking business at and the terms and conditions and the risks that we were taking on we found our first quarter very, very challenging, bookings were not what we wanted them to be. Interestingly enough we actually held the course and we maintained those standards into the second quarter. And now what we're seeing is, is that our bookings are at better margin, there is less risk, the terms and conditions are better.

And as we look at the backlog of quotes that we have out there and places that we know we've been selected as the preferred bidder we see ourselves in a position where we're quite confident and that margins are improving and that the risk is actually starting to reduce. And I think that bodes very, very well and is important for the next few years.

We're not without our problems and as we sought to work through the portfolio you know we're still seeing and picking up issues which I associate with forced growth. And last time I went into great length to talk to you about the symptoms of forced growth.

But I'll give you an example; in a recent review of the US we were looking at an area called multi-family housing. This is an area that historically in the business we've actually done very well at. About two to three years ago there was an initiative to roll that out right across the United States. So what we did is we actually moved this into the East area and whereas historically we've actually done concrete frame we were doing timber frame or stick work.

What we've actually found in that particular area we aggressively pursued multi-family housing, took on a couple of projects which were in the order of about $100m, and what we found in order to cope with that growth we were actually taking on new customers, people that we'd never actually dealt with before. Because we didn't actually have the capacity in house to deliver it we went out and hired in a new project management. Given the capacity was used up with our existing customers we then had to energise a new supply chain. So we went through a competitive tender process, we backed off all of the contracts and we brought in new suppliers. All these suppliers were all bonded.

Anyway as a result what happened was the project management themselves didn't know the Balfour Beatty way of doing things, the supply chain was new, they'd bid over aggressively and even though they were bonded they did end up going bankrupt and we actually called in their bonds.

So there's $100m of work, so that error around venturing into a new market where we had no experience, where we take on new people and a new supply chain has probably cost us about $10m as a single event.

So it's really interesting to see that growth isn't something that comes without pain. It's something that effectively if you don't manage it correctly will actually work against you. So I'm quite clear with the organisation that I'm not driving this business for growth, what I want to do is drive it for returns and good cash flow. And you know we can learn from the experiences of the past, but those challenges that we've got are in the portfolio, they do have to be worked through remember the good news is, is that by the end of 2016 the majority of those will actually be finished and completed.

Finally just in terms of my last observation, you know we are focused on simplifying this business and this is really, really important. We're simplifying it around leadership and structure and I think I'll talk to the fact that we're stripping out layers of senior management and actually taking those people who really run the businesses and have them report directly to me.

We've looking at putting in new processes, which I'll talk to in the second half of the presentation in order to ensure the quality of the business that we're actually booking actually gets delivered at the right margins and at the right cash flow. And then finally we're looking to back that up with systems and I'll talk about our R12 implementation which went live yesterday, which is the UK's new ERP system.

So really important to see there's an awful lot of progress behind the results that you see here and I wouldn't be distracted by the profit number, I'd be distracted by the fact that we're stable and that we're improving the quality of the underlying business.

Let me talk about Support Services for a few minutes and again in this area what I want to talk about is you know perhaps some of the more strategic nature of this business. In the first instance we've taken the same actions in Support Services that we've taken in the Construction business, we've upgraded leadership and we've actually taken out the entire top layer of management. And what we've focused on now is around three business units and I'll show you that later on in the presentation. So we're taking out overhead costs and we're simplifying this organisation.

The thing to realise in this area here is that of the businesses, whether it be Gas, Power or Rail we're actually the number one or two supplier in those markets to our customers. And that's actually a really great place to be, that's the good news. On the counter to that is most of our customers are dominant customers, it can be people like Network Rail, people like National Grid, so effectively they are dominant in terms of the fact that they are the only person that we supply to.

These are customers that actually operate in what I call very challenging regulatory markets. And in that capacity there is a great pressure for them to be more efficient and to drive down more cost. And that sort of leads us to two branches, in the area of places like Rail we see a business there where very, very challenging as an organisation, very, very difficult to work with - that's Network Rail by the way, not London Underground, very difficult to work with and very, very difficult to make a return. And in that area what we've announced is the fact that you know we are actually divesting ourselves of those businesses in Signalling which we've sold SSL, we're looking at withdrawing from contracts that we've historically made losses on because if we can't engage in business profitably there's no point in being a busy fool.

However on the other hand if I take the other extreme which is Power and people like National Grid and other people, they are under grave pressure for efficiencies, but given our, actually unique, capability - especially in areas like extra high voltage and things like that we can bring innovative cost solutions to the table. And in doing that we can add real value to those customers and I see Power for example and Gas as areas that will grow for us and will, by virtue of our innovation, turn to very profitable business.

We have one or two contracts in this area where we make reasonable returns, but they actually come with awful working capital in terms of the fact that it just takes so long to get the WIP processed and then the WIP turned into receivables and then get paid. So the challenge here is, is to look at our business in terms of how are we making an EVA from it, not just a profit from it.

So again we really are looking at bearing down on some of these businesses to make sure that we're actually making a real return as opposed to, you know, we're making it on the profit side, but we're actually wasting it on the financing side. And that will require in some cases that we're going to need to renegotiate some of our contacts with our customers.

Also in the Power area I think it's worth remembering that in the regulated market if you look at the spend of some of these companies it's actually starting to reduce and it's reduced quite dramatically over the last 12/24 months. However in terms of the private operators there's a lot more investment going into things like interconnectors, which is effectively tying electricity supply out of Europe through the Channel Tunnel, or Ireland, or Belgium back into the UK. Those interconnector projects are hundreds of millions of pounds apiece and we can actually play a role in either project management and consultancy or all the way through to delivery. So there's an exciting area, a new area opening up in that region.

So fundamentally I think Services is one of these businesses that will operate on a sustainable 3 to 5% return basis when normalised, but we do have unique engineering capability which gives us some real advantages. So we're looking to capitalise on that in conjunction with our customer and the pressures that they're under.

My final slide before I hand over to Phil is just a quick whiz around Infrastructure Investments. First and foremost a fabulous business, another very, very strong performance; the balance sheet of Balfour Beatty is underpinned by the £1.25bn we have here within Investments.

We've had a strong performance both in terms of we're continuing to invest in new assets and we have a very, very healthy pipeline of activities. In the first half I think we invested about £64m, we're talking about circa £50m in the second half. But the good thing about that is we're actually offsetting that with assets that we're selling which we are selling at the Directors' valuation which I think is very encouraging, because I know a year ago we thought that that valuation was high, but we are achieving that in the marketplace. We sold £112m worth of assets, the Edinburgh Royal Infirmary and the Thanet Offshore Transmission Line; so all encouraging.

Going forward in this area we're going to continue to actually divest ourselves of assets which we believe are mature. We want to make sure that we're self-funding in terms of our investment in new assets and of course we want to make sure that there's a residual or a dividend that comes out of that as well; so again a very strong performance. And remember that it's this balance sheet that underpins Balfour's transformation.

So on that note I'm going to hand over to Phil, I would remind you to go easy on him, it is only his ninth week, so I'm sure there isn't a question he can't answer.

Financial Review

Phil Harrison, Chief Financial Officer
Thank you, Leo, and good morning everybody, just a couple of quick observations on my first eight weeks in the company. We have great people in Balfour Beatty and they are dedicated to driving the business forward. However, we have inherited an overly complicated structure. My first task from a finance perspective is to simplify the structures, processes, and systems to deliver better transparency and control within the businesses.

What I'd like to do today is take you through four things. Firstly, an overview of the half year results by operating segment. Second, set out the key contract write downs and risk based judgements that have been made against the project portfolio in the first half. Thirdly, take you through the improved cash performance that the Group demonstrated at the half year. And finally, comment on the strength of our balance sheet. And that gives me confidence that we have the financial flexibility to underpin our Build to Last transformation over phase one of the programme.

Let's now look at the headline numbers for the first half. As I go through my presentation my comments will be on the underlying continuing results of the Group unless stated otherwise.

Order book has remained stable since the start of the year at £11.3bn. I will make some further comments on the order book on my next slide.

The revenue including joint ventures and associates of £4.1bn was broadly in line with the first half of 2014. At constant exchange rates revenue was down 4%.

The loss from operations was £120m compared to a £29m profit in the prior year.

Net finance costs of £10m fell by £5m on the prior half year predominantly due to lower pension net interest expense, as well as lower borrowings.

The reported loss before tax was £130m, and including non-underlying items the total pre-tax loss for the period was £150m.

The Directors' valuation post half year disposals at £1.25bn was broadly in line with the beginning of the year valuation, and net cash at £260m was £41m higher than year end 2014.

If we now go to the next slide, I will pick up on the split of the order book by segment.

In Construction Services the order book at £7.7bn was 2% lower than year end 2014. A reduction in the UK of 13% was offset by improvements in the rest of the world. The US order book increased by 3%, as order intake remained strong.

The UK order book as expected declined by 13%, as both regional and major projects order books fell. In London and South East, higher bid margin thresholds and an active decision to withdraw from certain types of work resulted in lower order intake. The major projects order book declined as the business continued to execute on long-term contracts.

However the order book is expected to increase in the second half as portions of landmark contracts Smart Motorways, Thames Tideway tunnel and Hinkley Point nuclear new build at preferred bidder stage enter the order book.

The Support Services order book increased by 2% since the end of the year to £3.6bn. Order book growth in the Water business was partially offset by a reduction in the Transport and Power businesses.

We will now cover the operating segments over the next couple of slides, firstly Construction Services. In Construction Services, revenue from continuing operations were stable compared to the prior year and down 5% at constant exchange rates. Revenue declines of 2% in the UK and 1% in the US were offset by a strong 37% increase in Hong Kong.

The loss from continuing operations was £209m. This was largely due to historic contract issues in the UK, US and Middle East. The net impact, on the first half results was £152m; with two thirds of the shortfall impacting the UK. I will cover these historic issues in a future slide.

In the UK and US profit from operations also showed declines due to the completion of large building projects in the prior year.

In our joint venture in Hong Kong profit from operations benefited from new project awards in 2014, which began to trade in the first half.

In non-underlying results, our legacy contracts within Engineering Services performed in line with our expectations.

If we now turn to the next slide and look at the results for our Support Services business. Revenue for the division was flat on the first half of 2014 at £615m. Growth in the Power sector was offset by an expected decline in the Water sector as the business transitions into the AMP6 regulatory cycle.

Power revenues increased by 9% as volumes in the gas distribution strategic partnership contracts with National Grid returned to more normalised levels from the lower comparatives in 2014.

Profit from operations for the first half was £4m versus £22m last year. Profits had been expected to be lower than the prior year, due to lower volumes on the Beauly Denny project - a power project in Scotland, as it nears completion, and due to prior year profits being boosted by positive contract settlements and a very strong performance in the Transportation business last year.

Profits in the first half of 2015 were also impacted by an increase in future loss provisions on a small number of contracts in the normal course of business.

Moving to our Investments business, pre-tax profits increased to £114m from £88m in the prior period last year, driven by an increase in gains on disposal. The pre-disposals operating profit declined by £7m to £14m. The previous period included a gain of £15m, resulting from movements in the fair value of PPP financial assets, and recognition of bid costs income. This was partially offset this year by good performance in the US and a small decrease in bidding costs in the period.

The sale of Royal Infirmary of Edinburgh and a partial sale of Thanet OFTO generated £112m of proceeds, with disposal gains increasing to £84m from £51m last year. The secondary market continues to show strong demand for quality assets.

Net interest income, a significant element of total income, was flat on the prior year at £16m.

If we go to the next slide this shows the detailed movements in the Directors' valuation of the portfolio. The Directors' valuation showed a small decrease since the year end to £1.25bn as at June 2015 from £1.3bn, after realising £112m of disposal proceeds, £37m of distributions and £64m of new investments. It was pleasing to see the disposal price was in line with our valuation for those assets.

The number of investments within the portfolio increased to 71 versus 66 in prior year, as the business continues to find attractive investment opportunities. As we go forward we will continue to invest in the business, and we currently estimate approximately £50m of equity investments will be made in the second half.

If we now look at non-underlying impacts for the period on the next slide. Non-underlying items for continuing operations comprise pre-tax losses of £20m. These include £1m of losses on certain legacy contracts and £2m of trading losses in Rail Germany. Non-underlying items also comprise amortisation of acquired intangible assets of £5m.

In addition to this, the Group incurred £12m of costs relating to the Build to Last transformation programme. The Group also incurred £4m of restructuring costs relating to our sale of Parsons Brinckerhoff and £7m of other prior restructuring actions within the Group.

These costs are offset by a £15m gain on disposal as a result of the Group's sale of its 50% interest in Signalling Solutions Limited.

If we move to the next slide I will discuss the profit impacts of our contract reviews in the period.

Most of my first eight weeks has been spent on understanding and assessing where we stand on our historic project base. I think we now have a sensible and balanced risk position on our cost contingencies and traded positions. We now need to ensure we embed into our culture and processes a disciplined approach to project management.

On UK Construction as a result of schedule slippages and operational deterioration on a number of historic contracts, write downs were taken to maintain a sensible level of cover against the likely end contract positions. Further risk based provisions across the entire UK portfolio were also included. The net impact on the first-half results was approximately £100m.

US Construction - a number of multi-family housing unit projects on the East Coast, bid between 2012 and 2013, suffered sub-contractor failures. The business is not pursuing any new contracts of this type in the East region.

Two projects in the federal healthcare sector, which had been bid pre 2011, have suffered programme over-runs and subcontractor performance issues. In addition, provisions against a small number of other contracts, awarded in 2013 or earlier, and risk based provisions across the US portfolio were also included. The net impact on the first-half results was approximately £32m.

Middle East Construction - a review of the Middle East historic contracts has resulted in an increase in project specific provisions, predominantly in the mechanical and electrical engineering business, for additional cost overruns and claim recovery shortfalls. The net impact on the first-half results was approximately £20m.

The risk based portfolio provisions accounted for approximately a third of the profit impact.

Before I leave this slide a comment on our Far East business, I have reviewed the more significant projects that incorporate large judgments on future contractual outcomes. At present we trade those on a prudent basis to break even, which is unchanged from our year end position. I will be visiting the operation in the coming months. As with all project positions we need to have a continuous process of review as the projects move through their life cycle and Leo will pick that up later.

If we move to the next slide, this is the UK historic problem contracts. As an outcome of our half year process I am now tracking 89 UK problem contracts that the business is focused on managing through to completion. As at June 2015, 31% of the historic projects are already at practical or financial completion. By the end of 2016 the number of projects at practical or financial completion is expected to be greater than 90%.

Moving now to the performance of the company on cash in the period as you can see on the next slide. We ended the half year with a net cash balance of £260m driven from a strong focus across the business on cash generation and working capital management, despite the typical seasonal outflow trend in the first half for the business.

The losses in the first half resulted in a large operating cash outflow, before taking account of the movements in working capital. This was largely offset by a very strong working capital performance; including the impact of foreign exchange, negative operating working capital increased by £211m. The increase is mainly driven by Construction Services, where an increase in negative working capital of £202m was recorded.

The Group generated a working capital inflow of £42m from its trade and other receivables. The Group also generated a more favourable working capital inflow from inventories, non-construction work in progress, and the IAS 11 construction contract balances, giving a £168m working capital inflow in the first half. These movements reflect the Group's improvements in its billing and WIP management, converting debtors and WIP into cash at a quicker rate.

Offsetting this is a working capital outflow in trade and other payables, of £30m at the half-year versus an £85m inflow in the same period last year.

Further to the right you will see cash flows associated with the Investments portfolio. The net of disposals and new equity investment generated a net £48m inflow. There were other cash inflows of £29m. The aggregate of all these movements explain the overall net cash inflow of £41m in the first half.

Now comparing the first half cash performance versus the prior year. The cash inflow of £41m in the first half of 2015 compares to a cash outflow of £321m in the first half of 2014; therefore a £362m improvement year on year. The Group finished the first half of 2014 with a net debt balance of £387m compared to the net cash position at June 2015 of £260m. This is a strong performance from the business driven by early engagement throughout the company on focusing on cash.

If I turn to my final slide, Group balance sheet I will finish with a few comments on the Balance sheet. In addition to the high quality assets which made up the Investments portfolio, worth £1.25bn, the business had net cash of £260m at the half year on a much improved prior year position.

With this base we have one of the strongest balance sheets in the industry which gives me confidence that we have the financial flexibility to support our Build to Last programme over its initial 24 month phase of self-help.

I will now hand you back to Leo.

. . . .

Build to Last Update

Leo Quinn, Chief Executive Officer
Thank you Phil. Right let's just have a quick fly through in terms of Build to Last, what it means and what it will deliver. This is really the foundation for the transformation of the

company. Build to Last is - you know, we've been around for a hundred odd years; it's my intention that we're going to be around for another hundred so we're putting in the right foundation and building on it.

There are four major planks to the programme; it's about Lean, Expert, Trusted and Safe. Lean is about not only how we lean out the company and make sure that we're cost effective, but about how do we lean out our supply chain, ensuring that we're cost effective in that area too.

Expert is fundamentally about retaining and maintaining the capability that actually makes Balfour Beatty great. So how are we investing in our employees developing them and retaining them.

Trusted is about doing what we say we will do and a culture of no surprises, that will be novel won't it.

And then Safe is about ensuring that it's zero harm, but safety is a license to operate and is something that you should take very seriously, it is a foundation stone for any business, but especially when you've got a business like construction which is dangerous.

We're going to measure our performance over time and we'll display those statistics when we have a history and trend. But we will be looking at obviously cash and profit and we started there with this set of results, employee engagement, customer satisfaction and then of course the safety statistics.

So let's start with Lean. We set out a very clear goal, remember I said accountable leadership is something we're driving towards; we talk about 200 in 100 out. In terms of the progress on the 200 cash in we launched Cash is our Compass, I do think that the cash performance has been stellar when you look at first half last year and first half this year, £362m of cash generated; it just shows how inefficient the system is.

Our goal of £200m is about how do we retain and capture that through to the end of the next year and the year after. So it's not a question that £362m means we beat the 200, it's about ensuring that we keep that in our bank account over the whole period, not just an event at the period end.

Clearly management incentives are aligned behind cash in the organisation. And once we've actually got that in place we want to make sure we've got the systems to track and monitor that. We launched R12 across the entire UK Construction operation as of yesterday. This was a programme that was due to be launched in March, we reshaped it, we de-risked it, we pushed it out to launching in August, I think it's probably one of the most belt and braces rollouts that I've seen in a long time and I've done a few of these. So really happy about where we are on this. As of yesterday morning we had 1800 users signed on to the system, if you think about it 1800 is a large organisation by any standard.

I've never known an ERP system transform a company and usually the teething problems are painful in the early years. But over time we will systematically half on half use that to drive efficiency and productivity and have a better dashboard and better control on the company. It's something which is desperately needed in the UK organisation. So I'm very keen to make sure that we now put a lot of time and effort into making that work and making it productive.

In terms of the cost out we've already started with a £25m cost out on an annualised basis within the organisation. We've got plenty of opportunity in terms of leaning out all of the back office areas. Remember in this programme we are really focused on maintaining front line capability here. We're not looking to actually lose any of our people that are customer facing, we're looking at just driving efficiency out of the £500m back office spend.

We've already aligned all of our organisations in terms of finance, IT and Legal and we're bedding that down. We have a strong focus around procurement, we have now a procurement accrued both in the US, the UK and we're analysing that in order to actually optimise savings. We had a very interesting win recently on insurance where we've taken out virtually 30% of the brokerage costs for actually delivering that service to us, just by rolling up our global spend and putting it through a procurement process.

We also have a programme to make sure that we track what's going out of the organisation doesn't come back in via another route.

In terms of Expert what we're looking to do is ensure that we're upgrading the top leadership. We've made improvements in the Board and also in the executive management. What we're also doing is actually investing in our people and actually engaging them to be part of the programme Build to Last, but also to be part of a sustainable future. We want Balfour Beatty to remain an exciting place for people to work where they can make a difference. And we've put in place what are effectively CEO recognition awards where we're recognising those people who do a great job and that we want to give them a message that we want them to stay around for a long time.

Remember on a rising tide and the market is improving there's lots of opportunities, people have choices. So our number one priority is to make sure people choose to work for Balfour Beatty. And it starts here. It's about having the right leadership because people work for people.

Organisationally we're looking to continually upgrade the top management of the company but this is an evolution not a revolution. And it gives me comfort that we're moving through this in a very sensible, pragmatic way. You can see in the case of the investments, international rail, US Infrastructure and buildings that we have the same leaders in charge today that we had in charge of the business a year ago.

In the case of the UK we've stripped out for the major projects power, gas and water the top leadership in those areas and we've got those people reporting directly to me. And these are very industry hardened, seasoned leaders who are quite capable of running these businesses and don't require the benefit of an overhead structure just to consolidate their numbers. So what we're doing is we've got strong leaders in place and we're holding them accountable to run and deliver on their business.

In the case of the UK regions and services we've got a strong organisation in the regions now. We've got new leadership which brings more process, more systemisation, more accountability to the organisation so this is a very, very necessary upgrade and I think you'll start to see results come through in that area.

When I take the support functions which are these areas here, we've effectively out of six we've got five new people. The reason we've brought these people in is that these are all experts in driving process efficiency and solutions in those areas. So if I take the IT leader for example, Chris, he's actually done this three times before for me personally in terms of driving a better IT organisation, one which actually delivers to our users but at the same time takes cost out of the organisation. So we're doing that in house and we're very confident about the delivery.

These new leaders in this area are really around driving process, efficiency and making sure we've got the right services to the organisation so that these people can do what they're paid to do and that's two things, sell and deliver flawlessly.

In terms of trusted, think about it, we've got one of the strongest balance sheets in the sector; we've got a world leading brand. You know this is a fantastic place to start from. Our customers are still engaging with us. I mean I've met more CEOs in this job of other FTSE companies, than I have in my two previous jobs. The fact is what Balfour Beatty does for them is really important and I think we need to remember that.

We have to have robust financial processes and systems and that's Phil's number one priority. Coupled with that we have to also ensure that we drive a culture of what I call no surprises. The number one process that we put in place in order to deliver this is really around a disciplined, business-like contracting process. And this is our, I won't call it new because it's probably 30, 40 years old, but this is our eight stage gate process whereby we will actually review every single job that comes into the company in order to actually sign it off and to make sure that in the first instance at Stage Gate 1 that we actually are interested in doing that. There's no point in actually going through all the costs and expense, and in some cases it's hundreds of thousands of pounds to deliver a bid, and then decide you don't like the risk in it and you don't want to do it.

So in stage one we just ask three very simple questions, you know is it real, is the customer actually going to spend the money? Secondly, can we win and beat the competition? And if we've gone through all of that pain are we going to make any money out of it at the end? And on that basis we decide to actually then proceed.

On Stage Gate 3 we look at appointing the project manager. And the reason for that is we want to make sure that the person that actually knows and puts the bid together and the schedule lives with that throughout the cycle of the job. At Stage 4 we're looking at the contract award and the handover from sales to delivery. And at Stage 5 we're looking at the project mobilisation plan. But what's key is we also want to make sure we take it all the way through to Stage 8 after the defect liability period. You know we have seen some situations in the last six months whereby we're going back and having to fix and repair defects, and that costs real money especially when a building is occupied and people are working in it.

So effectively now every job that comes through is reviewed via this 8 gate process. We're looking to embed it in every part of the organisation at different levels. All big jobs over the last six months have been reviewed by myself or one of the top team personally so this is actually something which is an absolute and there's no deviation from.

In terms of Safety you know I can't emphasise this enough. We talk about a licence to operate, you know if you are not safe, apart from the moral ground of the fact of people should actually come to work and go home safely, this is going to actually have a real impact on people's ability to do business. In some countries there's a case that fatalities can actually damage your ability to tender in the future and you can have a suspension period, a little bit like a red card. I'm sure with time that that's going to come in in all countries and therefore it's something that you've got to get right.

We do a good job today, we need to do a better job but we also have some world class capability in terms of Power and Rail where those industries are inherently dangerous, you know far more dangerous than anything else that we do within Construction. So it's really important that we actually do work and transfer best practice from those areas into the rest of the business. So this is an area where it's a licence to operate. You know if you don't have your licence you know you can't drive your car. If you're not safe you won't be able to practice construction. So it's a really important area for all construction companies.

Finally I want to just touch on this point which is we've talked about reviewing the business but it's interesting of all the things I looked at it doesn't matter to me whether it's actually the UK, the US, the Middle East, you know the business model in Construction is a simple model. What we do is extraordinary in terms of some of the things we build and deliver but the model itself is really, really simple. And the one thing that I've seen that underpins all of the root causes of all the problems we have can all be corrected by what I call short interval control. And that is a regular drumbeat of actually looking at, inspecting and understanding what's going on. You need transparency to do that, you need systems to do that, but it's really, really important that this is something we embed in the organisation. And this really becomes our drumbeat.

So we've set up a process which is really around on a weekly basis we review our Build to Last progress whether it be cash or whether it be cost out. We have a Pulse call every week for an hour with all the leadership to understand what's going on in the business and to get real time feedback and hold people accountable for what they've said. We have tender committees such as the eight stage gate process which goes on all the time. Monthly we're looking at the financials and the contract review. And this is something where we need to apply more rigour on the contract review because we should not be getting surprises at this point in time.

Quarterly we're looking at our joint venture boards. I think in the case of Asia it's three times a year. My Contribution in terms of how we're engaging with our employees is about innovative ways of driving change. Some people might think of it as Six Sigma and things like that. Then we've got our Build to Last deep dive and review. And on a half yearly basis we're looking at a leadership conference. We've had two of those in the UK already; we've had one in the US. We're looking at our IT strategy, our talent review.

So what I'm saying here is that the fix for this company is not complicated. It's about short interval control, systematic review, creating accountability and transparency in the organisation.

So, really in summary I think to say there is clear momentum within Balfour Beatty around building a company that's capable of having a strong foundation and growing into the future. I think you can read positively into the fact that the order book and the revenue is stable, and that we have the confidence of our customers. I think the first half reflects what effectively are a lot of the historical practices and challenges which will just have to be worked through.

In terms of Build to Last, look it's clearly starting to deliver. We're not there until it's over but the fact of the matter is the cash generation is very, very impressive by any standards. We still have the strongest balance sheet in the sector and as I've said before having started a business in a barn and been the first person into it, starting with £260m in the bank and £1.25bn of assets is a pretty impressive place to start.

And the other thing is we're doing this transformation with a tailwind not a headwind, and that we're making sure that we're capitalising on that but making sure our gated process delivers to us what I think are lower risk better margin contracts.

And on that note I think we will hand over and take questions. Thank you.

. . . .

Questions and Answers

Joe Brent, Liberum Capital
Good morning. Two questions if I may. Firstly you talk about historic projects. Could you just define what a historic project is exactly?

And secondly you give target margins in Support Services but I'm not sure if I saw one for Construction. Could you give us what your target margin is on Construction and ideally some timeframe on that as well?

. . . .

Leo Quinn, Chief Executive Officer
Right let's do the second one first. Target margins I think for Construction as I said last time should be in the range of - industry standard is about 2% to 3%. Remember our portfolio is slightly skewed by the large US business where the business model is of less risk because most of the risk should be offset against subcontractor commitments. So 2% to 3% is the right sort of order of magnitude.

What I mean by historic is fundamentally projects that were booked I suppose before I arrived given that I hadn't signed off or approved on them, so that would be the way I'd think about it.

. . . .

Joe Brent, Liberum Capital
And could you give us some sort of timeframe on the 2% to 3%? Would you say sort of three years or medium term or three to five years?

. . . .

Leo Quinn, Chief Executive Officer
I think at the end of the Build to Last we should be starting to operate on a run rate of that level. And of course you know the historic ones will be sort of burnt off in the main by the end of 2016.

. . . .

Joe Brent, Liberum Capital
Thank you.

. . . .

Gregor Kuglitsch, UBS
Thanks. I've got a question on the legacy sort of provisions that you booked and I think on your slide you sort of give the working capital numbers which I think is as you point out significantly more negative than in the first half last year. So I think you're negative £1bn roughly, last year you were negative 400. So it's obviously a £600m position there. I guess the question really is how do you see that delta unwinding because I think that delta is maybe the provisions that you booked over the last 18 months? And over what timeframe that unwinds? And then ultimately where you sort of see the balance sheet settling down on that basis if you take that into account?

And then the second question is perhaps for Leo on the portfolio. I think you're in the job now what eight months, I'm not sure to what extent you've reviewed the portfolio of businesses Balfour Beatty has got. And you've always talked about the US and the UK being the core, obviously that excludes some of the joint ventures that are sort of rather far away. Where we are in that process and the thinking on perhaps disposing some of the parts of the business?

. . . .

Leo Quinn, Chief Executive Officer
Phil do you want to try the …?

. . . .

Phil Harrison, Chief Financial Officer
Yeah I can do the first one. You're quite right, the write downs are held in our IAS 11 balance. There will have been - clearly some of that coming out at this half because from previous write downs that we did in 2014, but if you look at the new situation, the 150 that we've announced today, that will flow out all the way through '15 and '16 as we close off the contracts. So 90% of those numbers will be gone by yearend 2016.

. . . .

Gregor Kuglitsch, UBS
Is there some left from the ones before?

. . . .

Phil Harrison, Chief Financial Officer
There is some left from the ones before as well.

. . . .

Gregor Kuglitsch, UBS
Are you prepared to say how much?

. . . .

Phil Harrison, Chief Financial Officer
I haven't got a precise figure on them.

. . . .

Gregor Kuglitsch, UBS
Okay thank you.

. . . .

Leo Quinn, Chief Executive Officer
In terms of your other one about the portfolio, what's interesting is, and it's very interesting and I haven't announced a sort of a strategic review or anything like that because this isn't a question of strategy in terms of the challenges that we're looking at and resolving, this is really around operational effectiveness. And the big challenge is when you do actually announce things like operational reviews and strategy reviews, what you find is all of a sudden is your employees make their problem your problem and you end up with more write offs. So we've effectively suspended the idea of having a review. We're now operationalising our review. So we're into short interval control. We're into looking at all of the projects. We're looking at seeing what the returns from

those are. So from our point of view I think we've gone past the point of allowing people to make their problems our problems, we're sort of holding leaders to account and we're driving returns.

In terms of the portfolio per se, given the sort of different nature and construction of Balfours we are divesting parts of the business at premium value within investments to generate the cash. So there is a process of divestment that's going on. We've got one or two small businesses which were earmarked to be sold from the past which like SSL in Rail that we actually sold and we'll continue with those.

But I think what I see here is there's an organisation and a company here where there's substantial opportunity to create value just by actually restoring businesses to their normal credible margins. And so we're really focused on Build to Last and actually making sure that the value that we have within the company is declared before we make any decisions around what the future of the portfolio might or might not look like. So I think at the moment it's about making sure that we deliver the value we have today to the current shareholders.

. . . .

Stephen Rawlinson, Whitman Howard
Three unrelated questions if you don't mind. I mean just firstly with regard to the US, the level of bonding has always been quite high, can you tell us where that is now and whether the transformed balance sheet that you now have has made any difference to that that would have a material impact on the numbers?

Secondly just with regard to support services, could you give us if you don't mind a better timescale on when you feel you might get to the sorts of margins you've talked about, and in particular you've mentioned the National Grid contract getting back to more normalised levels. Could you just explain that a little bit more please as to whether that actually is now profitable?

And finally and it's a bit of a different type of question, but you've now got 15 direct reports Leo. That's an unusually large number for a Chief Exec. I wonder if you could just help us a little bit with the thinking behind that?

. . . .

Leo Quinn, Chief Executive Officer
Sure it would be a pleasure. Right the first one in terms of the US bonding, historically the US bonding had been extremely high because there was an awful lot of federal work. I can't remember the exact number, it's somewhere between 1 and 2 billion now, but it has reduced dramatically over the last couple of years as the Fed has actually put less money and investment out there, and as the portfolio has moved into different areas. So there was a real reduction in bonding there. And as a result of that reduction the market is getting tighter and of course we've taken the opportunity to capitalise on the bonding rates that we are charged because it would appear that we've been charged

better than the average in the past and so we're looking to actually normalise that back in our favour.

In terms of National Grid, I was only referring to the volume of business that National Grid have been doing given they're one of our largest customers, and that their revenues or their expenditures have lowered. We've been able to offset that with other utilities and the offshore and onshore operators. So I see that as operating in the same sort of range volume wise as it has in the past so I'm not concerned about that. But National Grid expenditure itself with us will reduce, but the Power sector I think will continue to grow. I think Power is actually a very exciting area for the next ten years or so.

And your third question about the number of reports -

. . . .

Stephen Rawlinson, Whitman Howard
I asked about the timescale to get support services to the 3% to 5%. And the final question was in and around 15 direct reports to a Chief Exec being a rather unusually large number and how that might be sort of managed if you could give us some idea on that?

. . . .

Leo Quinn, Chief Executive Officer
Yeah. The timeframe I'd say is that yeah I do think this first half is actually a bit of an anomaly in terms of the financial performance. I'm not uncomfortable with the fact that our Support Services business should be operating in those ranges in the next 12 to 18 months as I look at it.

In terms of was it 15 reports you said? Well first and foremost whereas we all love strategy I think I prefer operations, so the fact of the matter is if I've got 15 people a little bit like the Italian Job all driving minis and I can see their dashboards and their speed gauges and their petrol tanks, I've got a very good insight into their controls. So it doesn't really worry me. And if I think about it that was three less than I had at QinetiQ so I'm obviously slowing down.

Laughter

. . . .

Howard Seymour, Numis
Couple from me please. Firstly Leo you mentioned the annualised cost savings that you have seen to date, is it possible to give us one, an indication of where they have come from to date and if you perceive those as sort of low hanging fruit? And related to that do you see the sort of £100m out as a relatively linear process in terms of the cost savings?

And the second question was just on the Rail business.

. . . .

Leo Quinn, Chief Executive Officer
And the second question was on?

. . . .

Howard Seymour, Numis
Well the second question I was just going to ask in terms of the Rail business, you mentioned obviously Network Rail are pretty difficult to work for. It's how you see scale of that business and also historically margins would have been higher in that business as capital intense.

. . . .

Leo Quinn, Chief Executive Officer
Not only can I actually tell you where the cost has come out from, I can tell you by person, by supplier and everything else because we track it religiously. You know first and foremost there's clearly been a headcount reduction out of it. I can't remember is it 300, 400 people, something in that range, have left the organisation. Department budgets have effectively been halved. You can't do that overnight if you're being fair but we are trending down in terms of all of our expenditure.

As I said last time I spoke, I think we had 28 IT directors. You know what we're doing is we're looking to how do we lean out that organisation. We've got some fantastic people who work for us and how do we actually put them in the right jobs doing the right things so they're adding value across the whole organisation. Our IT spend is £120m or something like that which is to me a crazy ludicrous amount of money for what we do.

You know funny enough I popped in to see the - we've now got a dedicated procurement office for IT that are negotiating global licences, global hardware agreements and things like that. I popped in their office yesterday and they have got a pipeline of opportunities that they're systematically working through. So we're leaving no stones unturned there and I actually think that those sorts of savings are low hanging fruit.

You know we are also looking at strategic partnerships with one or two really key suppliers at the moment. If you think and look ahead over the next few years at the industry it's not going to be about whether or not you can get something at the cheapest price or the best working capital, it's about whether or not you'll be able to get the materials and the supplies. So what we're now doing is setting up long term relationships where we're reserving capacity going forward in the future, not just looking at short term gains. So a much more strategic approach in those areas.

In terms of Rail, you know Rail is an interesting portfolio because we've got some good customers with LU that control and operate both the lines and the trains. We have a very successful Rail plant business out there and we actually have a very successful Rail technology business. Interestingly enough all of those have made money but if we take a view over the last five years our engagement with Network Rail and delivering projects has actually lost money. And funny enough most of the losses have offset most of the profits.

So strategically what we're looking at is how do we engage with Network Rail? Obviously it's a challenged customer in its own right, but we have to find a way that we make a return there or we won't operate in those markets, it's as simple as that. Does that help?

. . . .

Howard Seymour, Numis
Just on cost savings, would you expect to see cumulatively more for the full year?

. . . .

Leo Quinn, Chief Executive Officer
I think the idea is that - shall we just stick with linear? So let's think of it in that way rather than sort of getting ahead of ourselves too fast.

. . . .

Howard Seymour, Numis
Fair enough, thank you.

. . . .

Leo Quinn, Chief Executive Officer
Obviously love to over deliver if we can.

. . . .

Kevin Cammack, Cenkos
Two questions really which are just to clear up confusion in my own mind. Just going back to this swing in the working - in the cash flows. You've had year on year £360m of cash in. You commented on an earlier question that in effect the provisioning is still sitting in that number which is expected to unwind, but if you unwind 150 you're still effectively at the 200 cash in which is your 18 month target and effectively you're there now. Is there something else you're anticipating going out or should we realistically expect a fair bit more than £200m by the end of December '16? I suppose what I'm saying is if you do the simple maths you're there today aren't you?

. . . .

Leo Quinn, Chief Executive Officer
Yeah but I obviously wouldn't want to do that simple maths for you, would I now. But I'd have to say that, look, the progress on cash has been fabulous. It's around keeping it every week, every day, every month and not event driven. So the way I look at it is

I'd like to be at the same sort of number at the end of the year and at the end of 24 months. I think it's too early to sort of declare victory and increase the target so I just like to leave it as it is at the moment and if we do better then we're all happy aren't we.

. . . .

Kevin Cammack, Cenkos
Yeah so I suppose my point is there's nothing, inverted commas, exceptional that you're expecting to additionally unwind?

. . . .

Leo Quinn, Chief Executive Officer
I don't think so.

. . . .

Phil Harrison, Chief Financial Officer
No I'm not anticipating any - there's nothing - other exceptionals. It will be normal course of business in terms of the ebb and sway of mobilisation of contracts, contracts unwinding. Remember we do have on these things; we still have negative working capital on projects. So in some projects we were cash positive on those but they will unwind to a loss. So that has to unwind as well as we go forward. But that's just the normal mechanics of the projects so there's nothing exceptional.

. . . .

Kevin Cammack, Cenkos
And the second thing, I'm slightly - I'm not sure how to interpret your comments around the Gammon JV. Were you telling us that actually as things stand at the moment everything is fine in terms of the run rate of cash in and out, receipts against creditors? Or were you saying that actually until you do the full review in - I can't remember on your chart when it was the next one round, the next quarter, are you saying until you do that you're not sure whether there is sufficient provision?

. . . .

Leo Quinn, Chief Executive Officer
There's two things. First of all my recent visit to Gammon. You know Gammon is probably one of the more professional, more structured businesses that we've got within the portfolio. So you have a high degree of confidence around that. I think the key thing with Gammon is there's the midfield air terminal and there's the A10A which is actually the terminal for the platforms to connecting Hong Kong to China, and those have some very, very large judgements with them that you know if we get everything in our favour to which we have really good advice that we've got an extremely strong case, there's an upside over the traded position both in terms of - well certainly in terms of profit. In the case of the A10A terminal it wouldn't be cash because we're already paid ahead on that, but in case of the midfield airport there would be an upside in profit and an upside in cash. But those have to trade through to completion. So the fact of the

matter is that you could have an upside or a downside depending whether it's found in favour of you or against you. We've got very strong opinion and a reasonably good level of confidence that it will trade favourably, but it's a risk that sits in the portfolio and one of those things it's just impossible to forecast because you just don't know what the adjudicator will finally say.

Anything?

. . . .

Phil Harrison, Chief Financial Officer
No I wouldn't add anything. It's a sensible position that we have. It's a balance of risk and reward that we're going to and we're trading it at breakeven.

. . . .

Alastair Stewart, Westhouse Securities
Two or three questions. First you started the period with £219m net cash and ended at 260, but you had an average net borrowings in the period of £16m. Can you talk us through that? That's the first question.

. . . .

Phil Harrison, Chief Financial Officer
So yeah we had average net borrowings of £16m. Prior year we were average round about £300m. So as you can see the differences around the flow in terms of this year versus last year. What I would say is that I think with Leo's arrival in January I think the organisation very quickly got behind the Cash is our Compass. There was a lot of activities particularly in driving WIP, so taking - getting our stuff converted out of WIP, into invoicing, into the hands of customers and turning that around into cash. And I think that gained momentum in the second quarter.

So we went cash positive I think in - I think it was late April, early May, but clearly we were in net debt before then. So from that position that's how you get to the kind of £16m average. I think it's a very good start. I think what we've got to make it is more permanent and sustainable as Leo said. And I think that's the actions that we're going to do over the next 18 months is to make it more permanent.

. . . .

Alastair Stewart, Westhouse Securities
And in H2 do you see yourself going into average net cash?

. . . .

Phil Harrison, Chief Financial Officer
I would see us being - I think my view on that is we'll probably be net cash positive at the yearend.

. . . .

Alastair Stewart, Westhouse Securities
That's different from average.

. . . .

Phil Harrison, Chief Financial Officer
Yeah I don't know where we're going to be on the average. We're either going to be £16m or just negative. We're not going to go back to a £300m average net debt for the period.

. . . .

Leo Quinn, Chief Executive Officer
I think something has changed in the company because I look at cash daily, I get a cash email so to speak, and I think I'm correct in saying that we've traded cash positive every day since the half year. So I mean that is a change from historical practices. So our emphasis at the moment is always to try and stay on the cash positive side, not only at the end of the period but during the period. That's our goal.

. . . .

Alastair Stewart, Westhouse Securities
And then in terms of the contract reviews, to what extent do they recognise liquidated damages and legal settlements rather than if you like the physical cost to complete? Because it's one thing forecasting physical costs, it's another and it's pretty much finger in the air stuff with liquidated damages and legal settlements.

. . . .

Leo Quinn, Chief Executive Officer
Like all these things we take a sensible view on that. We look at what our case is; you know whether or not LDs will apply, whether we deserve an extension of time which is why practical completion is important because some of those liabilities actually disappear at practical completion. But we take a balanced risk adjusted assessment on all contracts on all parameters.

. . . .

Alastair Stewart, Westhouse Securities
And finally how long do you think the review of problem contracts will last? Do you see another six months and there really will be a line drawn under them?

. . . .

Phil Harrison, Chief Financial Officer
Well I think this is continuous. So from these, the historic projects we will continue to review them on a monthly basis in our cycle. We'll review new contracts that come in.

For us it's a matter of completing and getting off these contracts and that's what draws a line under them. I don't want to give anybody the impression that we just do one review and we're done, it's a continuous process now.

And by the way the other thing about this continuous process is not just to accept these numbers are going to happen. So where we have a contractual obligation - right and we can go back and if we have to use the law we'll use that to net money back to this company, so we will chase all claims that were due as we believe.

. . . .

Mark Howson, Canaccord
I'm conscious I need to get off to Interserve but just finally from me just on the UK, you very kindly gave a position of how far the projects were complete etc. in terms of the problem ones. Can you give us a feel for how those completion figures would be for the Middle East in terms of how far you are into completing sort of more difficult projects and stuff like that?

. . . .

Leo Quinn, Chief Executive Officer
I'll let Phil take that one.

. . . .

Phil Harrison, Chief Financial Officer
On the Middle East we'll finish in the first half of '16, so end of first half of '16. I'm trafficking round about ten contracts on the Middle East.

. . . .

Phil Harrison, Chief Financial Officer
And just for completeness, you haven't asked me but I'll tell you, round about 20 contracts on the US.

They'll complete in same as the UK, end of '16.

. . . .

Marcin Wojtal, Bank of America Merrill Lynch
Just one question, do you see any impact on your business from the increase in the minimum wage in the UK?

. . . .

Leo Quinn, Chief Executive Officer
No.

. . . .

Marcin Wojtal, Bank of America Merrill Lynch
Could you perhaps elaborate a little bit?

Laughter

Do you expect to pass the increased cost to your clients or it's just …?

. . . .

Leo Quinn, Chief Executive Officer
First of all our policy is that we pay the minimum wage but in most cases you know you can't see all the way down the supply chain to know that that's honoured. But in those cases our prices are effectively fixed. In the London area we pay sort of the living wage, so I don't see that having an impact on us. If I'm wrong or it changes I'll let you know straight away but I think you're thinking about Interserve announcing their £15m problem this morning, but no it's not something that we're looking at.

Well if there are no more questions - oh we've got one more at the back. Right, last question because I know you're all probably dying for your summer holidays.

. . . .

James Davis, ANZ
At the full year you had £3bn of performance and financial guarantees on issue. Naturally one of the things they indicate is consumer confidence and - sorry customer confidence, and I note that creditors have come in a little. Can you talk to what that number is at the half year and whether it's tracking positively or negatively?

. . . .

Leo Quinn, Chief Executive Officer
I think the question you're saying that we have lower sureties overall and therefore that's contracted and is that a sign of a lack of confidence. Is that what you're saying?

. . . .

James Davis, ANZ
No, at the full year the Group had around £3bn of performance guarantees and financial guarantees that were issued. Just wondering whether that number has changed in the half year because there's no reference to it in the half year accounts?

. . . .

Phil Harrison, Chief Financial Officer
I don't know exactly but my treasury guy is saying no we haven't - that's not changed.

. . . .

James Davis, ANZ
Okay thank you.

. . . .

Leo Quinn, Chief Executive Officer
Great well look thank you all for taking the time coming in and I look forward to the next update. Thank you.

. . . .

END

DISCLAIMER