Balfour Beatty

2018 Full Year Results Presentation

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Balfour Beatty

Leo Quinn, Group Chief Executive

Phil Harrison, Chief Financial Officer

Questions From

Howard Seymour, Numis Securities

Stephen Rawlinson, Applied Value

Andrew Nussey, Peel Hunt

Gregor Kuglitsch, UBS

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Introduction & Highlights

Leo Quinn, Group Chief Executive

We'll get started if that's okay with everybody.

Obviously when we announce our results we sort of talk to the press very early on and we get the various headlines. And one of the comments that was made is that this is a fantastic transformation of an internationally diversified engineering company, which happens to be based in the UK and is 110 years old. And I thought that was a nice summary. The quote was mine by the way.

But if we actually look at the benefits that are still being accrued through our Build to Last programme, this is a cracking set of results.

First and foremost we've delivered on our phase two promise of industry standard margins across the entire portfolio. If I remind you and wind you back two years we had our phase one which was £200 cash in, £100m cost out. We delivered on that as well.

Our order book is up double digit at 11%. And what's more important about that is improved margin. But even more important is the terms and conditions in which we're contracting mean that we're not accruing a long term liability in the portfolio, so much more strength in terms of the quality of that order book.

Cash has always been our compass. We paid down 40% of our debt and we paid down the convertible at £253m in total so that was concluded in that period of time.

Again Construction Services margin's up 32%, you only have to go back to those days of KPMG and it was 89 distress projects. That really is a thing of the past, there will always be challenges in our industry and there will always be challenges on projects. But I mean there has been a complete transformation of the underlying quality of the business which is a really accolade to 26,000 employees in our Build to Last programme.

We always said that we would measure our progress and performance in Build to Last through Lean, Expert, Trusted and Safe. If I remind you that Lean was about £200m cash in, £100m cost out and also investing in the infrastructure for the future. We've invested over the last four years, £450m in the portfolio and I'll touch on that later. But you can see from a cash point of view, if you look at '14 versus '18, £500m at its peak is the improvement in cash flow.

If I look at Expert, we're looking at employee engagement and you can see the trend there. The key thing around employee engagement is that in the future our issues are not going to be around market growth, they are going to be around having the talent and the capability to deliver on the projects, which is going to demand that we're more selective. But it means that we have to hire, train and retain the best people. So making it a great place to work and being the UK Google of the Infrastructure industry is really our goal.

If I look at Trusted, we do it through customer satisfaction and again the trend has improved there. And this is backed up by our risk review process in terms of our G Ticks, our Project on the Page and all of those things are trending in the right direction. And of course the thing about Trusted, which is most important, is that we deliver on our promises.

And then finally in terms of Safety, you know, Safety is really our licence to operate and if you're not safe in this industry you're not going to be in this industry for long. We've effectively halved our LTIs or AFRs, that I have to tell you is a phenomenal achievement. If you actually look around sites that are clean and tidy and safe, usually they perform better than sites that aren't. So this really is a leading indicator in terms of future performance and behaviours across the company. These are all the benefits that are actually being delivered through our Build to Last programme.

And then if you want to look at some numbers that you can actually tie back to our annual report and our balance sheet. Here is our average net cash and the way I think about it is we used to be on average overdrawn by about £400m four years ago. On average we've got £200m in the bank today.

If I look at our earnings from our Earnings based businesses, we were running at £150m loss, today we're running at £150m profit.

This year to me is a phenomenal achievement in terms of, think of it as overhead, we've gone from £450m, and you tie this back to the balance sheet, down to £280m which is about £170m. I think the number is actually much bigger than that. But what's fascinating about that number is I can't tell you anything that's missing. Stuff that somehow or other we used to do in the past that we're not doing today, and if we're doing it today we're doing it actually better.

And this all comes around our consolidation of our systems, our processes and everything else. That's a great achievement and the good news is we haven't stopped there; we're going to look to improve that number more in the future.

And then finally if I go back to employee engagement and talent and retaining expertise, our attrition rate was running at about 16%. We're now down at about 12 and we're heading towards 10. So keeping the best and brightest is a reality for us and it actually positions us very well for the future growth market. And on that note I'm now going to pass over to Phil to talk about our financials.

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Financial Review

Phil Harrison, Chief Financial Officer

Thanks Leo. Good morning everyone. Let's look at the headline numbers.

As Leo said these results demonstrate the value being created through Build to Last. I'm particularly pleased with the average net cash up at £194m. In this industry you need to run with average net cash and this result underpins the strong financial position we've built.

Another highlight is the order book which not only increased, but as we'll come to later, is also of a higher quality as we've continued to win work through our gated lifecycle process.

Profit from operations increased 5%, profit before tax by 10% and following the recognition of deferred tax assets for some of the Group's UK historical tax losses, EPS increased 26%.

Given this performance the Board has recommended a final dividend of 3.2p, taking the recommended full year dividend up to 4.8p per share, a 33% increase on prior year.

Balfour Beatty is now operating from a position of strength, with the financial flexibility to take advantage of the market opportunities we see ahead of us.

Let's now look at the results in detail. Turning to underlying profit from operations. In the Earnings based businesses there was an increase of 25% to £141m, which contributed to the overall 5% increase in the Group's underlying profit to £205m.

Looking at the constituent parts, Construction Services improved by 32% to £95m, with increases in all three geographies.

Support Services improved 12% with underlying profit from operations of £46m.

And following significant disposals in 2017 Infrastructure Investments profit from operations decreased to £97m.

If we move to the order book, as you can see the order book has increased £1.2bn from year end 2017 an 11% increase in the period, 8% at constant exchange rate. Importantly the quality is also increasing with the gross margin of work won in 2018 higher than the previous year, consistent with the higher margin thresholds.

The Construction order book increased by 18%, 14% at constant currency, primarily due to increased orders in the US. In the first half we booked our share of the LAX people mover, circa $600m. And in the full year we booked over $1bn of new school and higher education projects, mainly in California and North Carolina.

The UK order book increased 11% to £3bn, this does not include our share of the HS2 £2.5bn civils work, or the £1bn Old Oak Common station in London. Work is underway to deliver detailed plans and costs for the civil works for Lots 1 N1 & N2 under an early contractor involvement scheme now expected to conclude by the end of the year.

At Support Services the order book decreased 10% to £2.8bn as growth in the transportation sector was offset by an expected decline in utilities. In an environment of rising infrastructure spend in the UK, US and Hong Kong; the Group continues to focus on the disciplined bidding to generate a high quality order book capable of delivering profitable growth.

Now let’s look in more detail at each segment starting with Construction.

Importantly the Group achieved its Build to Last industry standard margin targets for the UK and US construction in the second half of 2018. Whilst revenue was down, the underlying profit from operations continued to improve as all geographies had an increase in profit and margin percentage.

In the UK profit from operations was £28m with a material increase in the second half as the Group moves on from its Legacy projects.

In the US revenue was 5% lower at constant currency following the managed reduction in order book during 2017 as we focus on higher quality work. Importantly both profit and margin percentage continued to improve.

At Gammon profits increased to £23m as the business moved back towards a more normalised financial performance.

In conclusion all our Construction business are now delivering industry standard margins.

Now turning to Support Services. As you can see on the slide, profit from operations and margins increased year on year. The 5.2% profit margin in the second half was actually above our Build to Last industry standard margin target range of 3 to 5%. For the full year the profit margin was 4.2%.

Breaking down the constituent parts into a bit more detail. In Power the business continues to undergo restructuring cost removal. The business is now focused on core clients and markets. Recent contract wins demonstrate this focus which will contribute in the medium term.

Gas and Water the business is moving towards the end of its current regulatory cycles. In Water the Group has started to engage on the AMP7 planning cycle including negotiating the renewal of current contracts.

At Transportation, the underlying Highways market is good with multiple local authority contracts coming to market. Whilst at Rail, our track partnership contract with London Underground was reordered at the start of 2019.

These comments with regard to the market relate to the medium term. In 2019 the Group expects a revenue decline in Support Services, following the conclusion of the Area 10 Highways maintenance contract and a reduction in power transmission and distribution.

Although we expect Support Services underlying profit from operations to be broadly in line with 2018, the PFO margin is expected to increase.

Moving to Infrastructure Investments. This business delivered another strong performance having continued its strategy of optimising value through the disposal of operational assets, while also continuing to invest in new opportunities.

Following significant disposals in 2017, underlying profit from operations decreased to £97m. With both pre-disposal operating profit and profit from disposals lower than the prior year. Pre-disposals underlined operating profit decreased to £17m as a result of the prior year disposals, refinancing costs on the Connect Plus M25 asset and write-downs on two investment assets, partially offset by overhead savings. Profit on disposals were at £80m after material sales during the year.

The Group continues to see opportunities to invest in high quality projects with good returns and we will continue to look to time asset sales to realise optimum value to the shareholders.

Turning to the Director's Valuation, looking at the moving parts.   We invested £58m in new and existing projects whilst cash yield from distributions amounted to £89m as the portfolio continues to generate cash flow to the Group net of investment.

In 2019 we expect to invest around £50m in new and existing projects. The sale proceeds of £187m are predominantly from the partial disposals of our M25 Connect Plus assets and student accommodation projects in the UK and US.

The Group also made a full disposal of its interests in Fife Hospital, such that we now only own one UK PFI healthcare project. The unwind of discount was circa £100m with the year end valuation again rounding to £1.2bn.

If we move to cash flow. We saw a good average net cash performance for the Group, as I said earlier, with an average net cash of £194m for the full year. This is substantially higher than last year. We expect 2019 to improve and range between £220m to £260m.

The total cash movement in the year resulted in a £2m increase to the Group's net cash position of £337m with proceeds from Infrastructure Investments disposals largely offset by cash used in operations and investment in new infrastructure assets.

Cash used in operations was impacted by the reduction in working capital which was caused by significant out flows on the AWR project, the expected decline in revenues in US Construction and improve supply chain payment processes.

Going forward as operations have normalised, we expect the Group to continue to operate at a low double digit working capital percentage.

Now turning to financing and tax. Normally for the balance sheet slide we show the condensed set of numbers. This can still be found in the appendix but today I want to take the opportunity to demonstrate the strength of our balance sheet.

Most importantly as Leo has already mentioned, we have reduced our gross debt by over 40% in the year. In fact over 45% since we started to pay down the convertible bonds early in November 2017. In 2018 we repaid the remaining £231m.

The debt repayments mean that the Group's interest charge in 2019 is expected to be lower than 2018 at approximately £20m, net of any interest income lost on Investment disposals.

Balfour Beatty has not needed to use its £400m revolving credit facility. In fact this facility has remained unused since January 2017. In 2018 we officially closed our supply chain financing scheme which had never been material to the Group.

On taxation, please also note that going forward we expect effective tax rate on US profits to be around 26%. And in the UK as we've said previously in the short term, the Group expects the effective tax rate on UK profits to be around half of the UK statutory rate.

In summary the strength of the balance sheet not only reduces the costs of doing business. For instance we have reduced the collateral to support our US bonding programme. But also provides the financial flexibility to make the right value decisions for all stakeholders.

So finally our capital priorities. We've ordered our priorities to provide greater clarity on cash use for the Group. Our number one priority is to continue to invest in the business, to drive and support our managed growth, whether that be via equity investments, as stated earlier around £50m this year. New plant and equipment to be used for our growing backlog and the market opportunity that we see ahead, digital innovation and increasing the capability of our employees.

We will continue to pay down borrowings, over 40% repaid this year. And although there's nothing due in 2019, in 2020 there is approximately £35m of US private placement followed by the next significant repayments, £112m of preference shares in July 2020.

The recommended dividend has increased 33% this year and shareholders can expect a continuation of this progressive dividend policy going forward.

And finally we will return surplus capital to shareholders, consistent with Leo's comments back in August, we remain open to this in the medium term.

So that concludes my remarks and I'll now hand you back to Leo.

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Business Review

Leo Quinn, Group Chief Executive

Just a quick summary. If I can bring you back to Build to Last just for a few moments. Build to Last has always been focussed on how we build a sustainable platform and we've said for the next 100 years.

I think it's really important to realise that this is not a sprint, this is a marathon so year in, year out it might seem relentlessly boring but what we're doing is we're building up our strength in terms of entrepreneurialism, innovation, governance and control. And that's all about building a company for the future.

I think I said a couple of presentations back that I'd like to think of Balfour Beatty as a share that you buy, you put it in your bottom drawer, you come back ten years later and think - oh I haven't done well.

So there's no quick fixes in this type of business because the types of projects we engage in are very long cycle. They go on for five to ten years. And although we're four years into this transformation we're only now just finishing up projects which were actually sold back in 2013/2014. So you can see how long some of these things actually run for.

The key point about this slide, and I've used this before, is that this market is very large, it is growing and my forecast is that that is probably the largest infrastructure growth market we've seen in 25/30 years.

And Balfour Beatty is uniquely positioned in this international market to take advantage of it. We're not going to be constrained by market growth and I think that's the key thing.

So if we actually think about what does that mean, it really means that we have choices. And the idea is those choices are that we're going to be very much selective. And in being selective that coins our approach to risk. And we start by thinking about risk in terms of our circles of risk, in terms of what capability and what team do we have and what types of projects do they want to engage in. This all seems very obvious but these are quite strategic choices.

The second thing we look at is our customer. And I can't tell you how important this is because at the end of the day in the future, we are only going to do business with customers that actually have the same value set as us. And what do I mean by that - is that it's very interesting, you're going to have great customer relationships when things are going well but when things are going badly you sort of really do understand what you've entered into and the relationship that you've got.

And if you think about the fact that there's a large growing infrastructure market where we have choices, then we're going to actually work with those customers that we've worked with for 10 or 15 years that we know how they behave in bad times.

So for example customers like Heathrow, customers like Highways England, people that we have a long track record with and this is really, really important. It means that there are places and parts of the country and internationally where there are large infrastructure spends that we won't be participating in. Because the behaviours of those clients means that you can't make a sensible return. So therefore in the future we'll be very restrictive in those areas.

The next area we look at is the type of contract we enter in to. It's a little bit like you make your money at the beginning of the contract, not by sort of killing yourself to get the schedule finished at the end. So the terms you sign up to early on in terms of your liquidated damages, your NEC option, C contract, whether it's a pay and gain or whether it's a fixed cost. All of these things are where we actually put all of our effort at the front end. And if we get these things right, 5, 10 years from now you're going to have very, very good outcomes.

Then in terms of the geographies that we play in we'll be very selective about those regions of the world that we play in where we know we can get a return. As you know our geographical strategy's very clear, we're about £1bn in Hong Kong, we're under £4bn in the US and we're about £3.5bn in the UK. Those are the three geographies that we're going to continue to play in.

As you know our order book is up double digit this year and I think we can forecast that growth will continue in this market over the next three to five years.

In terms of our engineering capability, I want to go back to this and we're going to show you a very short movie at the end so don't leave your seats, the best is yet to come. The kind of things we do are truly amazing and truly extraordinary.

Some of the projects we've engaged in in the last year in the Dorenell Wind Farm whereby we've applied our new composite poles which are plastic. The terrain was so difficult to traverse, the pylons had to be bought in by helicopter.

We're in the process of actually delivering a 50km cable through the Channel Tunnel. And if you actually go down and have a look at that, we've actually built an entire train set to pull that cable through the tunnel and to fasten brackets to the wall. We've assembled a helix which actually takes 2.5km of high voltage cable which is to be installed in the tunnel. Because the area of the site is so restrictive you can't lay the cable out on the ground.

In the case of Hinkley we've got a factory which is pre-casting units, part of our 25 by 2025 where 25% of our work is actually done off site, which is currently done on site. Those panels are then used to build a shaft and the tunnel and the tunnel actually goes out into the Bristol Channel and takes the cooling water back in. You'll see a picture of the tunnel boring machine in the video in a few minutes.

We're also well positioned in terms of all the M&E contract that will go on with Hinkley for the mechanical and electrical controls of the nuclear power station when it's up and running.

And then on AWPR. I know this has been a challenged project which has got lots of negative press. But if you actually go up to Aberdeen and you drive this, this is a truly remarkable feat of engineering. It's a 58km highway, it has 72 structures on it, it sculpts the entire landscape and it's a brilliant project.

The fact of the matter is it was sold at a time, and it's run over on cost and we have a large entitlement and claim there, shouldn't detract from the fact that this is a brilliant piece of engineering.

When you hold this capability and you hold all these skills, you then have the choices as to where you want to apply them. And this actually is the actual pipeline that we're working on at this moment in time in terms of large jobs. Rather than quote a particular size, is that something of this diameter is actually a billion plus and something of this is under a billion.

But you can actually look at the UK, you've got HS2 and N2, you've got Old Oak Common, you've got Network Rail in terms of CP6. You've got the AMP projects that Phil referred to; you've got the A303 which is the Salisbury Road. By the way we may not actually decide to bid some of these but the fact is we have the opportunity at this moment in time. You've got Heathrow and the list goes on.

If I look at the US, we're currently working on bidding I35 which is an interstate which adjoins the Southern Gateway, which adjoins Horseshoe, both projects that we've delivered and are in the process of delivering, both over £500m a piece. We're working with Microsoft; we're working on the I45 which is in Houston, another billion plus highway. You've got the high speed Texas and somewhere up here we've got High Speed Rail.

Again, you've got a large emerging infrastructure market in the UK; you've got the same in the US. And if you go to Hong Kong we've recently bid the third runway, we're bidding the Kowloon Tunnel somewhere along here. Even in Hong Kong now we're seeing the infrastructure market starting to take off.

So it really is around the fact that with our capability - and remember people is the limiting factor, not market, we can choose where we deploy those resources.

In terms of the other part of our portfolio which is a really important store of value and that's our Investment portfolio and this is still valued at about £1.2bn. Over the last four years we've yielded over £600m of cash from the portfolio. And whereas we will sell assets at the peak of their value, we're also investing strategically in those assets so that we've got future value that accrues to us.

This is the one area where we're able to capitalise on the true value added of our expertise combined with our project financing in order to deliver an optimal out turn.

So this is an area that we want to concentrate on and make sure that we're continuing to grow. An exciting part of our portfolio and again lots of choices there. Our biggest success last year was winning the LAX people mover and Phil talked about that in his presentation.

If I look also at the risk in that portfolio, there's been a real transformation over the last four years we've effectively switched the distribution from the UK into the US where nearly 60% of the portfolio is now in the US and 40% in the UK.

As I said the portfolio's valued at about £1.2bn and we see this as a unique area to continue to invest in, in order to capitalise on the returns from our project financing and from our engineering capability and expertise.

Moving on, all of this business in terms of our construction business and our infrastructure business, is actually founded on what I think is our entire corporate overhead and infrastructure. And I see this as a real source of competitive advantage for us.

Between the investments and investing back in the capability of the company, we invested some £440m over the last four years. And some of the returns that we're now seeing, you can see on this slide here. In terms of our systems integration, we're driving towards an instant single country enterprise system. So in the case of the UK we've got R12, in the case of the US we've got JD Edwards.

We're effectively - in 2015 we were 6,000 employees on the system, we've now doubled that. This week we've added another 1,500 in terms of moving the rail business on to it. Back in 2014 in the UK we were zero people on R12 so this is an incredible movement of resource on to a scalable platform.

The important thing is as I've seen more companies fail through implementing these types of systems, for us it absolutely works and it's a source of competitive advantage.

In terms of just back office processing, and I'm only picking out one example, but we've now integrated the back office payroll and everything else on to R12. In the UK our payslips for example used to cost £6 a payslip, they're now £2. Again it's all of those things which service our contracts and actually resource a competitive advantage. We're getting leverage out of, where in the past they've been an overhead.

If I look at our supply chain, 2015 we had 37,000 suppliers, we're now down to 9,500. All of those 9,500 suppliers were actually certified or accredited to work with Balfour Beatty. So again we're ingraining more quality through our systems and processes.

And from an IT point of view back in 2014 our hardware didn't work and our software didn't work. Today, 2018 everything works which is quite a statement when you're referring to IT, but our expenditure is effectively in that area halved. Now why is this important, why is it a source of competitive advantage? If you look at the large growing Infrastructure market as we go forward, what we're going to find is that the incremental contribution of growth through to the bottom line is going to be far greater for us because of the ability to actually scale this platform. As we actually grow our revenue we don't have to incrementally increase our costs at the same level.

So in summary our proposition, not only have we managed to actually take out costs at our corporate overhead, we are now moving to the point where we're looking to actually take the incremental gains.

I'm a great believer, in my last two companies, both De La Rue and QinetiQ, we launched something called My Contribution. And My Contribution is about how do we actually deliver the marginal gains that exist in the business. The best innovations and the best ideas come from your employees. And my contribution is about how do we capture those ideas, how do we make the individual responsible for delivering them and then how do we track them through to a conclusion. And I'm comfortable that the benefits of this will actually derive directly to the P&L and further reduce our overheads over the next three years.

So in respect and in summary I think our value proposition going forward is very, very simple. First and foremost we're positioned extremely well in a large international growing infrastructure market. So growth is not the constraining factor for us, it's about people and capability.

We're in a market where we can afford to be selective, where we can choose projects with the right risk profile and the right engineering capability where we can be confident that we deliver.

We have an overhead structure which is uniquely scalable. So as we add revenue we don't have to add incremental overhead cost to make that work.

And then finally we have a strong balance sheet which at the current time is a source of competitive advantage because customers want to do business with a company that's going to be around for the next 10, 20 years. And we've seen by virtue of the consolidation that's happening in the industry, is that we're getting much more favourable terms and that our customers actually value the balance sheet that we have.

And on that note I'm going to let you see a very quick video which just emphasises the scope and scale of our engineering capability and what differentiates Balfour Beatty I think from many of its competitors.

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Video Played

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Leo Quinn, Group Chief Executive

So we'll hand over for questions. Phil can answer anything you might wish.

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Questions and Answers

Howard Seymour, Numis Securities

Thank you. Two for Phil and probably one for Leo, I think, if that's okay.

The first one, quite specific I'm afraid, on the investments, I just note that in the UK, on the GOVs in the infrastructure businesses, they're actually in loss. Is that the write-down assiduity that you alluded to? Can you just clarify that for us a bit, please?

Secondly, on the supply chain, you alluded to sort of supply chain terms changing. You, helpfully, gave us a sort of feel on overall working capital but, in the UK, do you perceive that sort of supply chain issues continue to become more onerous, you continue to see pressure in the UK?

And then, thirdly, on a general basis, in terms of rightsizing the business, two areas; one, because obviously the US went down a bit last year, is that now rightsized as far as you're concerned? And, secondly, UK regional, because, clearly, I suspect Aberdeen would have been regarded as that, do you perceive that that business going forward is at its right level? Thank you.

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Leo Quinn, Group Chief Executive

After you, Phil.

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Phil Harrison, Chief Financial Officer

Okay, yeah, we had two write-downs in the UK that put the UK business into loss, but, as we go into '19, we expect that to come back into profit. So, that's a one-off in nature.

Supply chain, we have varied levels of payment terms that we operate in. I would say that, actually, what we've seen is actually, as Leo alluded to, we've been improving our own internal processes. So, actually, to some extent, this is ourselves actually driving better payment processes to our supply chain as we get ours slicker internally.

I don't actually see - there will be some shift. There's project bank accounts coming in on government work, so we do see that, but I still believe we're going to operate in the low double-digits on working cap, certainly for the next couple of years.

Again, it's dependent upon how the model may change, but one thing I will say is that there's two ends to a model. People concentrate on the pay terms but, if the model changes significantly, we'll have to look at margins. And, so, you know, that's going to be a debate with the clients.

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Leo Quinn, Group Chief Executive

Yeah. In terms of size of the business, we've sort of contracted over the last year by about £400m. I think, over the last couple of years, we've also contracted. I think that's really around being selective, and it's about, you know, the right terms and the right pricing.

In terms of the UK and the US, if I look at the order book and look at the future, I would see that, in the UK Construction Services, is that you are going to see some growth, but it will be managed growth. We're not interested in driving the top line for the sake of it. So, it's really around being very, very selective in terms of where we take the growth.

That should accord with improving returns, both at the GM level, but also on our scalable platform. We should get incremental fall-through to the bottom line.

Remember, it all doesn't happen in the first year, given project recognition, but, you know, 2020, 2021 should look very bright.

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Howard Seymour, Numis Securities

Thank you.

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Stephen Rawlinson, Applied Value

Morning. Three, if I may, and all on Support Services. Firstly, you spoke quite glowingly about your relationship with Highways England, but you came out of Area 10, so could you just talk us through how that happened.

Secondly, you alluded to higher margins in Support Services this year. Is there some sort of release of provision in that because we're getting into the end of AMP7 and other regulatory periods? And what do you expect to be the ongoing margin in that area?

And, thirdly, just in terms, again, of support services with the UK utilities - there's quite a lot going on there in terms of the supply base with three players in some form of transition, Morrison, AME and McNicholas. Could you just sort of talk a little bit about the competitive environment in that as we approach AMP7, please?

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Leo Quinn, Group Chief Executive

I'll take the first one. Yeah, it's very easy. Area 10 came to its natural end in terms of lifecycle. It was a challenged contract. It was booked five, six years ago. It did lose money. So it would be a bit stupid to sort of carry on continuing to lose money despite the good relationship. And the fact of the matter is we delivered on our responsibilities and the client is now looking to place that contract in the future.

You know, it might be that we look at it again if we think we can make a return on it. If we don't, we'd look to look elsewhere to apply our engineering expertise.

There is no shortage of road capability required in the UK at this moment in time.

Over to you.

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Phil Harrison, Chief Financial Officer

On margins, no, there weren't any particular one-off items at end of cycle. I see that we're going to operate pretty much in the kind of three to five range and work our way up that range in Support Services.

There are opportunities, as we alluded to, in Power. That's had a period of consolidation, recovery, but it has recently won a couple of large projects around Hinkley. So, we announced that in January. A high voltage line - very core area of our business. We've always made good margins in that area.

So, I can see that we're going to continue to operate in the industry standard ranges and work our way up. That’s that one.

Do you want to handle the Balfour and AME?

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Leo Quinn, Group Chief Executive

Up to you.

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Phil Harrison, Chief Financial Officer

I don't mind.

I think, for us, in the sectors that we meet those individuals, I think, again, we're selective in our Power business. We've been selective in Rail where they also operate. We're, again, selective in Water. We don't come up against them particularly to be honest with you.

So, I think, where we operate, we are going to maintain our discipline and bid looking at margins rather than revenue first. And you've seen that because we've actually made sure that we're not - we don't want to bid non-profitable work in Support Services.

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Leo Quinn, Group Chief Executive

I think, just in that tone, if you look at competition, and you take all the players you've just named, I mean, they are in total disarray, so it does give us a source of competitive margin when talking to the customer because, at the end of the day, they like the solidity and comfort that Balfour Beatty brings. That does allow us to ensure that we strike a sensible contract with sensible terms and conditions at a sensible price.

So, I think, you know, the market is moving favourably in our direction at this time.

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Andrew Nussey, Peel Hunt

A couple of questions as well from me. First of all, there's obviously five of the legacy projects still to reach financial completion. There's obviously one very big obvious one. I just wonder, in terms of the other four, what the timeline might be on those.

And, secondly, in the sort of regional UK Construction business, by virtue of the overall margin performance, I'm assuming that's now firmly in the black, but have you got any comments around particular regional performances, or if there's any areas for further improvement in that business?

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Leo Quinn, Group Chief Executive

Do you want to do the five legacy? I don't think the one that you refer to is the obvious one, but do you want to…?

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Phil Harrison, Chief Financial Officer

On the five legacy we have, of the five, there's two that are associated with Crossrail. Crossrail, I think, the current stance is indeterminate when actually Crossrail's going to finish from actually Crossrail itself, but we're well ahead of where we need to be. We have supplementary agreements in place, so we don't see any exposure on Crossrail.

We've got one road in –

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Leo Quinn, Group Chief Executive
Essex.

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Phil Harrison, Chief Financial Officer

… Essex due to complete the first half of '19. We have a retirement village and we have a student accommodation, and that's it.

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Leo Quinn, Group Chief Executive

Well, I think the output of those large remaining five is quite managed and controlled. We don't anticipate surprises in that area at all.

You might have been referring to examples for Aberdeen. That will be resolved in the fullness of time. As far as we're concerned, the cash has gone out and so, therefore, you know, the cash return is the important thing to the balance sheet, which will strengthen the balance sheet further.

In terms of the performance of the regional business, the regional business continues to make good progress. London was a particular area there was huge losses historically. That's now back into profit. It's a business which was half the size that it used to be but, again, that's well-managed. You know, our Scottish business is well-managed and we have some big projects in The Midlands, which are all performing in terms of their outputs to forecast.

So, I see our regional business having made good progress, but I think there's still a long way to go in terms of delivering, you know, solid, sustainable market returns.

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Andrew Nussey, Peel Hunt

Okay, thanks.

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Gregor Kuglitsch, UBS

A few questions as well. So, the first one is on excess capital. Could you give us some kind of idea how you define that and how you look at it? Obviously, you mentioned you think the business should be running with an average net cash position? So, that's question number one.

Question number two is, there's been some media noise on the military housing in the US. If you could just give us your perspective on what's going on there and to what extent that has any impact, if any?

And then, finally, in terms of just to be clear, perhaps tying back into the capital allocation, M&A clearly doesn't feature at all. Obviously, it's not something you've done before, and now that the business is stable, is it something you'll consider, or is it basically off the table and you'll just focus on organic?

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Leo Quinn, Group Chief Executive

I'll better take the balance sheet question otherwise Phil will be giving away our money.

Our definition of excess capital is money we don't need within the business. If you look at the calls on capital over the next 24 months, we've got a pref in June next year, not pref, yes, preference shares, £110m. That would be our first priority along with investing in the business.

We still continue to look at an attractive portfolio of opportunities in terms of investing capital in our Infrastructure business.

Those are the first calls. And, if we have some cash which is truly surplus, then we would look to how do you return that to all stakeholders, and, particularly, it could be share buyback, it could be return on capital, whatever is the most tax efficient economic way to do those sorts of things.

So, there's nothing really new there. It's the same old same old.

Military housing, as you know, we operate about 47,000 homes in the United States. We're one of four major suppliers. There's no doubt there's been some adverse PR around that particular subject. It is only in a small, very small minority of cases.

It's very disappointing that we haven't delivered the accommodation to the standards that we would normally deliver to, but, as I say, it is an industry-wide challenge. We're working to make sure that those issues that have been pointed out to us have been rectified and restore the portfolio to normal.

We have about an 85%, 84% customer satisfaction. We measure it regularly. We're putting new systems and processes in place where we can get real-time data back in terms of any issues that arise.

We had one particular problem around a plumbing application where the plumbing fitments didn't work, and so we've actually had to refit, I think, it was about 350 homes in terms of their water plumbing systems. But that's something we're 80% the way through, and we've been working at for the last 18 months to get it all rectified and fixed.

So, we will remain diligent and focused on that to make sure we achieve the high standards that we've delivered in the past.

And then capital allocation. Remind me what the question was again.

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Gregor Kuglitsch, UBS

Acquisitions.

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Leo Quinn, Group Chief Executive

Right. Look, I'm on record as having said that, you know, if I want to lose money in this business I can bid a project directly. I don't need to buy an intermediary. So, on that note is we're not out to acquire, but, at the end of the day, you know, if there's a really good deal that comes up and it's a contract that we know and that we want to take it on board, you know, we wouldn't sort of turn a blind eye to it, but we're not really in the acquisitive mode. I mean, there's enough growth out there that we can manage and acquire under our own auspices, with our own capabilities, and apply our risk assessment to it.

So, no, we're in a business, and we've turned into an era of managed growth. We're going to manage the revenue we take in order to deliver our returns. We're not in a business of forced growth, which I think the service industry, the construction industry have managed through over the last 10 years, and it's now all coming to roost with an awful lot of noise and fanfare around it.

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Gregor Kuglitsch, UBS

Thank you.

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Marcin Wojtal, Bank of America Merrill Lynch

So, the first one is on your PPP portfolio and future divestments. I mean, in the last few years, pretty much divestments have been in the UK. And, going forward, the UK is a much smaller part of the portfolio. So, could we see some disposals in the US? Is it actually easy and practical to sell some of those US military housing projects?

And question number two, it's on your profitability targets. You used to include all those margin ranges for UK Construction, US Construction, etc, in the release, and, if I'm not mistaken, this is not included this time. So, I just wanted to double-check if there is any change, and why is that not included?

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Leo Quinn, Group Chief Executive

Okay. I'm just going to pull out some facts. Our strategy around the investment portfolio is to sell assets when at the optimum of their pricing and return for us. We are indiscriminate, whether it's Singapore, US or the UK. I think you'll find the US market is slightly less mature than the UK, so, therefore, you know, UK gives us a more optimal return.

The military housing in the US, although we categorise it as one large asset, it is actually multiple bases. And, if you wanted to break it down, you could. We don't choose to because there are economies of scale of managing it as a whole.

So, we'll dispose of assets irrespective of geography under the same principle when we feel they're optimal in value.

In terms of margin ranges -?

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Phil Harrison, Chief Financial Officer

This year, or 2018, we did make our first sales of US assets. So we did sell US student accommodation. So, the team does look at the right optimal time in all markets.

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Leo Quinn, Group Chief Executive

And, in terms of margin ranges, I'll let you Phil give the answer and then I'll make sure he says it right [Laughter].

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Phil Harrison, Chief Financial Officer

Well, clearly, when we took on the business in 2015, I think we needed to be very clear about where we needed to get the business back to.

I think we're much, much more confident now about the business going forward, and I think we're looking at, as Leo said, it's all around about this profitable managed growth as we go forward now. So, I don't think we need a necessity of those targets.

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Leo Quinn, Group Chief Executive

Yeah, I think that's fair. You know, early on, I mean, there were lots of question marks over the capability and competence of the company. You know, we delivered on Phase One Build to Last; we've just delivered on Phase Two. I think it does - sort of we've earned the right to be thought of as just a normal Infrastructure Construction company that, you know, is within the normal bounds of reasonable and is forecastable. So, I think we're sort of at that point going forward in the future.

Well, if there are no more questions, I'll just summarise by saying, again, I mean, this is a market that we're not constrained by opportunity. It's a large growing international market. We are in the advantageous position that we can be selective and, therefore, our future strategy is really around managed growth.

We've put a great deal of money, time and investment into building a scalable infrastructure behind this business which will allow us to incrementally drive more profits to the bottom line than without it. And then we are uniquely positioned with a strong balance sheet, cash in the bank, and a £1.2bn infrastructure portfolio, which the customers are looking to because, you know, it is clear that we're going to be around for the next 10 years, and they want to make sure that they've got relationships with people who are here for the long-term.

It does help us that the competition is in disarray at this moment in time. And so, therefore, I think we're uniquely well-positioned as I speak.

Thank you.

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Phil Harrison, Chief Financial Officer

Thank you.

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