Costain Group – Half Year Results 2022

Wednesday 24th August 2022

Transcript

Alex Vaughan: Good morning, and thank you for joining Costain's 2022 half year results presentation. I'm Alex Vaughan, Costain's Chief Executive. And I'll start by taking you through a summary of our operational highlights. Helen Willis, our group CFO will then present the financial results before I return to provide a strategic update and outlook.

The high level summary is that our performance in the first half of 2022 has been strong across our performance measures. Both revenue and operating profits have grown as we expected, and our free cash flow has been strong with a period end net cash of £95.9 million.

The forward momentum right across the business is very good. Our differentiated business model, one, focused on our customers and in meeting their changing needs, continues to build both our resilience, competitive advantage, and is delivering growth. There has been a high level of bidding activity throughout the first half of the year, and we secured some more work right across construction, consultancy, and digital services. And we expect a good volume of winds in the second half of this year and in early 2023. Our order book represents a broad range of market positions and is of a high quality and of a low risk.

Now, we have a very clear roadmap and have made progress in our margin progression towards our targeted range of 5% to 6% margins. We have also successfully worked with our customers to address and best mitigate the impacts of inflation, and believe that we will remain resilient throughout this current economic environment. Looking at transportation, we have seen growth in the volume of our activities and increases in revenue as inflationary impacts are absorbed. Our adjusted operating margin is in line with last year, but it's worth noting that this includes the impact of investment in significant bids in the first half of the year, and we expect the full year numbers to benefit from a more normalized spend across the year.

Our roads team are industry leading experts in highway design, delivery, and operational improvements. We are continuing with our programs of work as one of the strategic partners to National Highways, with four large schemes under delivery, including the A30, which is pictured on this slide, and two major schemes that are currently being developed ahead of delivery. We've also supported our customer with the launch of their Digital Roads strategy, and we continue to support the development of their digital technology needs through our positions on key frameworks.

In rail, our expertise has positioned us as one of the major partners on HS2, now delivering our fourth contract for HS2, which is progressing well. The scope of work is highly complex and a real engineering challenge, and that unlocks the very best of our teams, as can be seen on the Euston Throat picture.

Now, we've recently achieved an industry milestone with one of our sites being totally diesel free, as we drive progress towards our net zero target. In May, we celebrated the queen opening the Elizabeth line at our Paddington station, and we're continuing to support transport for London with the final optimising of operations for this new line. We are continuing to deliver the Gatwick Airport station project and other consultancy work for Network Rail and TfL, developing other rail infrastructure plans, including design work on the Piccadilly line.

Now, very sadly in July, we had a fatality on our Gatwick station contract. We and our subcontractor are working with Network Rail and the authorities in the investigation to fully understand its cause. We're focused on supporting the family and on the wellbeing of our colleagues and partners.

And coming back to our team in integrated transport, they continue to support local authorities and devolved bodies, including Transport for London. And we are delivering a number of construction projects, as well as providing a growing range of consultancy services through frameworks we've already secured. We are also continuing to grow our management consultancy activities with central government and have this year been delivering data led services to the Department for Transport to help reduce carbon right across their asset portfolio.

Now, both revenue and profits have grown in natural resources division as a result of stability in the water business and volume increases in energy and defense consultancy activities. Our adjusted operating margin has improved in line with our roadmap of targeted margins, driven by those stable activities in water and the consultancy growth. However, they have been impacted by investments made in developing our consultancy and digital expertise to support our growth aspirations.

With our water process and engineering expertise, we're working with six water companies, delivering their AMP 7 business plans, all of which are operating well. And our Tideway contract in London continues to be delivered to plan, with the tunnel breakthrough in the first half as pictured. As well as working with our clients to deliver their investment programs, we have stepped up as one of the partners working to shape a more sustainable and better performing water sector. We have secured Ofwat funding for two innovation projects, working with the regulator and customers. Firstly, to develop solutions that will generate hydrogen from wastewater, a build on our expertise in this area. And the other, an open data program to drive productivity and performance improvements, building on our digital expertise and industry insight.

Now, the backdrop in energy is very positive and the government having published their British energy security strategy as a result of the position we have built in shaping the energy transition and our energy process expertise, our energy activities, which are predominantly consultancy, have grown by 30%. We're seeing increased demand for our services, both in the production improvements and in the energy transition marketplace.

One notable award was the BP Teesside Net Zero project, where we are completing the front-end engineering design for their carbon capture scheme.

We have also continued to build our position across four major industrial clusters and in securing further framework contracts with energy majors.

In defense, we have built a very strong position right across the continuous at sea defense program. And our consultancy service proposition continues to grow in line with our plan.

As pictured, our role at Devonport as the customer's delivery partner has grown in the year. Our expertise in program management, project controls, risk management, and delivery implementation is providing further opportunities, and we expect our activities associated with the new submarine program continuing to expand. We have a clear roadmap to deliver our margin improvements, linked to better performance in water and continued growth in our energy and defense consultancy activities.

Helen, over to you.

Helen Willis: Thank you, Alex. I'll start by taking you through the headline financial performance for the first half of 2022.

You'll remember from previous results announcements, that in order to provide clarity on the performance of the group and the divisions, we've reported revenue, operating profit, and earnings per share on an adjusted basis, as well as on a statutory basis. I'll speak through the differences between these statutory reported and adjusted metrics as we progress through the slides.

For now, I'll focus on the adjusted metrics, which were in line with how management monitors and manages the business on a day to day basis. Adjusted revenue is up 19% on the first half of last year, primarily reflecting volume growth and inflation protection mechanisms in contracts. Adjusted operating profit was £14 million pounds for the first half, in line with expectations and up 22% on the same period last year. We returned an adjusted operating margin of 2.1% for the half, at a consistent level with the first half last year.

As volume increases, an improved mix and operational improvements were offset by upfront investment in our digital and consultancy capability, and the timing of additional cost of increased bid activity on a series of major opportunities during the period.

In fact, our adjusted operating margin absorbed around 80bps of margin dilution in the first half of this year, due to the unusually high level of bid activity costs and investment in consultancy and digital, that I mentioned. Adjusted earnings per share was 3.9p compared to 2.8p in the first half of last year. And growth of 40%, due mainly to the improved profitability.

And we returned a strong free cash flow of £34.4 million, an increase of 22% over the £28.2 million delivered in H1 of last year, where free cash flow is defined as our cash flow from operating activities, excluding adjusting items and pension deficit contributions, less capital and taxation.

Now, turning to the revenue walk, focusing to start on the middle of the slide. You can see the adjusted revenue has grown by 19% to £665 million. This was driven by transportation, where divisional adjusted revenue growth was 23%, a result of volume increases and inflation protection mechanisms in contracts. This growth in transportation was complimented by 12% adjusted revenue growth in natural resources, primarily driven by strong growth in energy.

As the bars at either end of the chart show, there were no contract adjustments made. And therefore, no impact on reported revenue in the first half of either this or last year. A demonstration that there have been no further contract issues identified in the half.

Moving now to the operating profit walk. Again, focusing on the middle of the slide to start with. You can see the adjusted operating profit has grown by 22% to £14 million, in line with expectations.

As Alex talked through earlier, we saw growth in both divisions. £0.4 million of growth came in transportation, where the benefit of increased volumes was partially offset by upfront investment in our digital and consultancy capability, and the timing and additional cost of increased bid activity on a series of major opportunities during the period. £2.2 million of growth was delivered in natural resources, due mainly to revenue growth, improve mix on and the addition of new higher margin contracts within energy, as well as operational improvements, partially offset by upfront investment in our digital and consultancy capabilities.

Central costs were unchanged, with just a £0.1 million difference, first half on first half. Looking then at the bars either side of the chart, these represent the adjustments made to our reported operating profit. In the first half of this year, we recognise 2.6 million of costs relating to the ongoing transformation and restructuring of our business. This is partially offset by a profit of £0.5 million, recognised on the sale of a non-core asset.

In the first half of last year, we incurred £0.2 million in the last of the amortisation of acquired intangible assets. The balance sheet has strengthened with the net assets increasing from £199 million at the end of last year to £218.1 million at the end of the first half this year. This strengthening was driven part by our strong underlying cash flows, and more of these on the next slide, as well as recognizing an increased pension surplus of £86.2 million, representing an increase of £19.1 million in the accounting valuation, from £67.1 million last year, and this was primarily due to the re-measurement of financial assumptions.

The next triennial valuation of the Costain pension scheme has an effective date of the 31st of March 2022, and issue results are expected from the trustees actually imminently. And discussions on these are expected to take place over the second half of 2022. And we have until the 30th of June '23 to finalize the valuation.

Other movements of note include a decrease in trade payables and other liabilities, driven by the settlement of the Peterborough and Huntingdon provision earlier this year. Partially offset by an increase in contract liabilities, with trade receivables and other assets largely flat on year end. Underlying this represents a strong improvement in our working capital position.

I'd like to draw your attention to the green bar on this chart, representing adjusted cashflow from operating activities of £34.5 million over the half. This is a result of a continued focus on strong execution and continued cash collection. To the left of this are our cashflows on adjusting items of £48.4 million, which represent payments in the half on contracts against which we'd previously taken a significant...

Helen Willis: Payments in the half on contracts against which we'd previously taken a significant contract adjustment. Most notably the payment of £43.4 million settlement provision on Peterborough and Huntingdon, as well as the other final costs in relation to this contract and on the A465. We incurred capital expenditure of £0.1 million and taking these together with our adjusted cash flow from operations, results in free cash flow for the half of £34.4 million up 22% on the same period, last year. It's worth noting that our operating lease expenditure, which is really a cost of us doing business is shown outside of cash from operations under IFRS16, where these costs shown within cash from operations are free cash flow growth in the half, would've been 43%. We made cash contribution payments to the pension scheme of £5.2 million over the course of the half. And after lease payments of £3.7 million, repayment of borrowings of £4 million, payment of interest costs of £1.1 million and recognizing sale proceeds of half a million pounds on the sale of a non-core asset.

We've ended the first half of 2022 at a net cash position of £95.9 million. Prompt payment code continues to be a focus for us and we've consistently achieved the target of 95% of invoices paid within 60 days, with 97% of invoices paid within 60 days throughout the half. As I just mentioned, cash at the end of the half was strong with net cash at £95.9 million, compared to full year 2021 at £119.4 million. It's worth emphasising again, that half year net cash was after the payment of the Peterborough and Huntingdon settlement provision of £43.4 million. The net cash position comprised Costain cash balances of £76.5 million at the end of June, compared to a £101.3 million at the end of 2021. Cash held by joint operations, which has continued to decrease was £55.4 million compared to £58.1 million at the end of the year. On borrowings of £36 million compared to £40 million at the end of December and this is dated before arrangement fees.

During the period, the group's average month end net cash balance was a consistent £91.9 million as compared to £107 million over FY21. Of course impacted by the provision payment at the very start of the year. The group continues to maintain sufficient committed facilities to meet its normal funding requirements over the medium term. And as at the 30th of June 2022, these committed facilities totaled £310 million in contract bonding and bank facilities. The banking facilities of £175 million include a revolving credit facility of £131 million and the term loan. These current banking facilities expire in September 2023. A management is in negotiations with the respective facility providers to secure a one year amend and extend of these facilities. The board considers an amend and extend to be in the best interest of shareholders, given the current state of the debt market. The objective of our strategy is to deliver long term value to shareholders while maintaining a strong balance sheet that underpins our financial position and supports our growth prospects.

The board recognises the importance of dividends for investors and is committed to returning to dividend payments at the appropriate time. For now, we're focused on investment for growth, maintaining discipline in contract selection, increasing our cash balances and strengthening our balance sheet. Our targeted dividend policy is a dividend cover of around three times adjusted earnings, while also considering the free cash flow generated in the period. Moving now to the slide on order book, to remind you our order book includes revenue from contracts, which are partially or fully unsatisfied and probable revenue from Water Frameworks included at allocated volume. Our secured revenue for the second half of FY22 at the end of the first half was £0.6 billion. Our order book stood at £2.7 billion at the end of June against a prior year end position of £3.7 billion. Reflecting timing of major contract bids with award results expected in H2 of this year and H1 next year.

The order book evolves as contracts wind down and new contracts are added. Therefore, it does not provide a complete picture of potential future revenue. In addition to the contracted order book, we have a further £0.8 billion of contracts, where we are preferred bidder and around 50 further secured frameworks from higher margin consulting and digital services that we yield meaningful revenue each year.

And finally, a summary of our continued focus on risk management demonstrating our robust contract governance through the first half of the year. We're seeing changes in the quality of new work secured and the culture of raising any issues and dealing with them promptly through the life of a contract. In our contract selection, we are shaping our contracts to better reflect the balance of risk and reward, working with our clients and using the government's construction playbook to guide us. We've strengthened our legal function and aligned the team with our divisions to be an integrated part of our work winning.

The operational excellence model gives us a grounding of brilliant basics and we're focused on continued improvement across operations in the delivery of our contracts. This is important to drive resilience in those contracts and certainty of outcome for our clients, responding to the challenge to improve productivity, drive better ESG outcomes and deliver on plan. We're continuing to invest in our risk and assurance activities throughout the contract life cycle, through our bidding activity, across the delivery of contracts and of course, planning the contract completion. And with that, I'll hand you back to Alex, thank you.

Alex Vaughan: Thank you, Helen. When thinking about the future direction of the company, it's important to us to understand the operating environment and trends affecting our customers. As I've outlined previously, our nation's infrastructure is facing enormous change. To best take advantage of this change and to build a differentiated business built on value added to our clients and investors, we've purposely positioned ourselves in those key markets where committed strategic investment is being made to meet critical national needs. The UK's infrastructure is being shaped by the need to address the realities of climate change. To ensure, we maintain security of our natural resources, a sustainable energy supply, improving the performance of our infrastructure networks and enabling our communities and businesses to thrive. Positively, the UK government in their national infrastructure pipeline announced over £650 billion worth of investment in the UK's infrastructure, to meet these national needs. This is before we consider the further investment to deliver energy resilience, including increased nuclear power generation.

Now, that's quite a big number and this slide gives you an understanding of the breadth and scale of our opportunity, building on the position we've already built to benefit from this continuing investment over the next 10 years, at least. Firstly, the customers in our chosen markets predominantly operate through underwritten and committed five year business plans. For example, national highways are delivering their RIS2 business plan, investing £27 billion upgrading and future proofing our strategic road network. HS2 is currently focused on the delivery of section one and we're now procuring for the later phases, including the power installation and mechanical fit-out the tunnels. The procurement of Phase 2a and beyond will then progress.

Likewise, the investment plans for network rail, local government, Water companies and defense organisations is against their long term plans. In addition, there's the significant committed investment to delivering the UK's integrated rail plan and significant investment arising from the energy security and decarbonization commitments with the level of planned investment being enormous. Whether that be nuclear, hydrogen or carbon capture, our leading energy expertise and established position across the major industrial clusters positioned us well to take full advantage of this opportunity.

As I've said before, our opportunity is built on being strategic partners to these clients. Our teams being engineering experts with a reputation of adding great value and our focus being on how we can help our clients best meet their strategic objectives. For me, being able to fully support our customers to meet their business plan commitments requires a new kind of company. We're focused on their whole ecosystem and we bring together a unique mix of experts that act as construction, consultancy and digital partners. This is a clear and important point of differentiation in our marketplace and is supporting our growth. We are a business that influences and shapes the solutions to meet today's and tomorrow's challenges. That's why Ofwat have appointed us to work with the Water companies to explore how we can generate hydrogen from waste water and how we can then transform the industry's operating performance through using open data systems, two areas where our cross sector and broader expertise positions us perfectly for this role.

We've also secured the BP net zero carbon capture contract in Teesside, as well as supporting national highways, launch their digital road strategy. We're also a business that creates capital investment solutions. Whereas our customers design consultancy, we work through long term consultancy frameworks in designing new infrastructure assets. We are doing this for transport for London, including the new Piccadilly line, also, for energy companies and Water companies. We're also a business that delivers complex engineering capital investment programs, primarily as a leading contractor on programs, such as HS2, national highway programs, Water Frameworks, Tideway, rail infrastructure etc. But also, as one of the leading delivery partner or program manager organisations, where through our growing consultancy role, leveraging our delivery expertise, we oversee capital investment programs, including those for AWE, Cadent and Babcock.

Now we are a business that helps our customers to optimise the performance of their operations, where for example, we're helping United utilities transform through a five year program, their asset maintenance programs. Supporting EDF to extend the life of their existing nuclear generation fleet. Helping Water companies to optimise their network performance and avoid regulatory failures and where our digital infrastructure capability improves highway safety and our data systems enhance the delivery of carbon commitments.

Now by being this strategic partner, focused on our customer's whole business system, leveraging our engineering expertise and supporting where the best improvements can be made. We will continue to grow our business through the increased addressable market and increase our profits and margins through growing our higher margin services. I'm very pleased with our first half performance and in particular, our cash generation. We've continued to build key positions in growing markets and continue to see plenty of opportunity in our market and are very active in our bidding activities, with new awards expected in the second half and into next year. Whilst our mindful of the economic backdrop, our contracts offer inflationary protection and our clients are committed to meeting the key challenges facing their businesses and society. Therefore, the outlook remains positive with clear actions in place to deliver on our medium term margin targets. Thank you and I wonder if we can open up the lines for questions and answers.

Call Moderator: Thank you. If you would like to ask a question, please press *1 on your telephone keypad. If you find that your question has already been answered, you may remove yourself in the queue by pressing *2, again, please press *1 to ask a question over the phone. As there are no questions from the phone, I'll hand over for any webcast questions.

Jack - BRR Media: Thank you. We've had a number of questions coming through over the webcast. The first one is from Terry Sweeney, a private investor. Regarding the banking facilities, would the extend and amend plan be at similar rates and is their scope to eliminate the borrowing with the cash at the end of the one year extension rather than incur additional fees. And as such, are there considerations a part of the decision on dividend payments?

Helen Willis: Thank you for the question, Helen Willis here. First of all, we put in the RNS that the board considers that the amend and extend is in the best interests of the company, as we move through renegotiations on our facilities with our banking group, and those discussions are underway. So absolutely right, we will be looking at the facilities and citing that to what suits the business's needs.

And whilst we're in the midst of those conversations, it's really too early to give an answer on those outcomes and costs. And you're absolutely right. This is all part of our balance sheet strengths, making sure we are strong enough for the work we want to win. And dividend is a key element for us to consider as well. As we said in our RNS, our real focus is on cash generation and continuing strengths in our balance sheets. And those will be in our minds as we consider when it's appropriate to reestablish any dividend. I hope that answers your question.

Jack - BRR Media.: Thank you. A follow-up question from Terry Sweeney. Can we expect operating margin for H2 to show progress on H2 2021? And looking forward to 2023 and beyond, is there a timeline where we can expect the strategic targets of 5% to 6% operating margins being achieved?

Helen Willis: Terry, thank you. I'll take that one and Alex may build on it. So the target for the second half of HY '22 is for further improvement on our margin percent of 2.1 that we achieved in the first half. The targets of 5% to 6%, we've stated are medium term targets. We haven't put a precise timeline on that. How we're going to get to that target is multilayered. So there's the real focus on our construction contracts, looking to improve those margins and really looking at the brilliant basics from our operational excellence model.

Then of course, there's the mixed impact as we continue to grow our consultancy and digital business. There is the transformation program that we've referenced as well, where we're looking to further simplify the business and build further resilience into our margin. So, a multilayered approach driving us towards those targets. I don't know, Alex, if you want to add anything.

Alex Vaughan: Terry, thanks very much for your question. Alex Vaughan, chief executive. Just building on what Helen's said, as you can see from our results this morning, our energy business has grown by 30% and that is consultancy work that's driven that growth, and the defense business is growing as well. And an underpin within transportation is a growing volume of our consultancy services.

So, to deliver our medium term targets, we're continuing to build that momentum in growing our consultancy services, which have a higher margin than our construction margins, which is positive. I think also you can see what I pulled out is digital is beginning to play a bigger part in our clients' thinking. I'd made reference to the work that we've secured with Ofwat, which is to develop an open data system to really drive operational performance, reduce leakage, et cetera, in the water sector. And our digital services would be higher margins.

So in the first half, we've won a number of frameworks for digital services for our clients and we're growing that position. So the combination, as Helen has said, of increasing the margins in our construction projects, together with growing the volume of our consultancy and digital work is how we'll achieve those medium term objectives.

Jack - BRR Media: Thank you. We've had a number of questions coming in from Chris Millington at Numis. The first of which is, "Please can you comment on your expectations for average net cash for FY '22 and FY '23? And what proportion of this sits in joint ventures?"

Helen Willis: I'll take that. Good morning, Chris. So you will see on slide 12, you can see the progression on average, month end cash on the blue line on that chart. Of course, that level's impacted by the payment on Peterborough and Huntington at the beginning of the year, but you can see a nice upward trend there, as we drive working capital really tightly.

I'd expect that to continue to increase. As we go through the second half of the year, we are predicting that we'll be cash generative still through the second half and into '23. I hope that answers your question.

Jack - BRR Media: A follow-up from Chris. And that's, "What percentage of revenue/EBIT comes from your consultancy and digital business?"

Helen Willis: Chris, I'm afraid we don't actually share that information. So you'll see in the segmental that we talked to the two divisions and the subsets within the division. So you can see, for example, in natural resources, our energy sector values and so on. I think as Alex has said in his presentation, energy as a sector is entirely consultancy. For example, defense as well. So you can start to see the scale of those services within our overall.

Jack - BRR Media: Thank you. The third question is, "Do you foresee any danger in a pullback in the infrastructure spend, in the light of increasing cost pressures the government is currently facing?"

Alex Vaughan: Well, look, thanks so much, Chris. It's Alex again. Look, we're obviously mindful of the pressures that the government's under, but I think I want to come back to the decision that we made. We have chosen to focus on those markets where we believe long-term strategic investment is being made, and really where it's not discretionary to make that investment. So if you look at energy, the challenges around resilience and decarbonization are a priority. In the water sector, very topical at the moment. Again, a priority to drive that investment.

I think in transportation, you can see that in terms of strategically helping support growth and investment in the UK, by connecting the UK and driving productivity and efficiency. We believe that it's a priority to invest in the markets that we are in, which is why we've chosen those markets. I'd expect us to be resilient as we move forward, but we're obviously very mindful of the challenges and pressures that the government is facing in dealing with the inflation challenges and energy prices at the moment.

Helen Willis: I'm just going to add on, I realised Chris that I didn't fully answer your question on joint venture cash. So if I could just finish off that answer. So, cash held in joint ventures at the end of this half is 55 million. I would expect that to stay at a reasonably steady level as we go towards the end of this year and beyond.

Jack - BRR Media: Thank you. We've had a number of questions from Andrew Nussey at Peel Hunt. The first of which is, "Please can you provide some insight to the potential second half FY '22 margin drag from investment in bidding, consultancy and digital? And might this continue into FY '23?"

Helen Willis: Morning, Andrew. So the margin expectations for the second half is, as I mentioned earlier, there'll be a slight improvement on the first half. So, really significant expenditure on the bidding activity in the first half that will lessen to some extent in the second, along with a number of other positive impacts, means that we will see an improvement into the second half and then on into '23.

Jack - BRR Media: A follow-up question from Andrew and that's, "Please could you provide some insight to how you've seen the competitive dynamics evolve in the traditional construction activities division, as well as digital and consultancy?"

Alex Vaughan: Well, I'll take that. Good morning, Andrew. It Alex. So look, I think one of the positive elements of the markets that we've targeted is the barriers to entry to those markets. The people we compete against, people are behaving responsibly, continuing to behave responsibly and are bidding in a strong way. So look, like any market, it's competitive, but the way our clients procure is we're able to compete on value, not just on price and that's important. We're able to continue to win our market share.

I'm not seeing a big change in the dynamic. It is all about how you can differentiate yourself on the value you're going to enter the client. That's what we're very focused on. And as we've said in our statement, we've had some successes and we look forward to being able to make announcements in this second half of the year around the contracts that we've been winning. And as Helen has said, we've been incredibly busy in the first half, tendering work.

But I think just to answer your question, I think the competitive dynamics are driven by the value our clients are looking for, which gives us the ability to compete well and to differentiate ourselves.

Jack - BRR Media: Thank you. We have a question from Alex O'Hanlon at Liberum and that's, "Could we get a split of the H1 '22 order book between the two divisions?"

Helen Willis: I'm afraid we don't provide that level of detail. You'll see the order book shown year on year in the presentation, giving you a feeling for how that progresses.

Alex Vaughan: Sorry, Jack, can I build on that? Sorry. I think one of the things to note in helping Alex's question is in natural resources, certainly in the energy space and the defense space, what you'll see is a lot of our revenue comes from the frameworks that we have secured. We've got 52 consultancy and digital frameworks. A lot of the consultancy work comes through and is generated through those frameworks. They are zero value in our order book and we generate reasonable and good levels of revenue that come through that.

There's more of a bias to the framework benefits for revenue coming through in natural resources than there is in transportation, but I hope that helps, a bit of extra flavor.

Jack - BRR Media: Thank you. We have a question from Andrew Blain at Investec and that's, "FY guidance indicates an improvement in H2 margins. Please can you give a feel for what these key drivers are?"

Helen Willis: Morning, Andy. As I mentioned, there's a shift in the balance between H1 and H2 on the spend on the work winning activity, the bidding that we've been talking about. Further operational improvements as we continue to drive our brilliant basics and that will start to improve. And you'll see, for example, natural resources has really started to turn the corner with the margin that it's delivered in H1. So it's multilayered, through a number of our activities to just gradually drive that improvement level up across all the different layers that we've spoken about.

So, the OEM and brilliant basics on construction, the diluted impact of bidding, continuing to drive the mix impact. And obviously the transformation impacts are more likely to impact into, benefit into '23. So multilayered, but that's certainly our expectation.

Jack - BRR Media: Thank you. We have a couple of questions from Massimo Antonello at Credo Wealth. "Helen, can you kindly provide some more details on the cost of sales? What are the main components and what is their relative percentage?"

Helen Willis: The cost of delivering our contracts are, obviously materials and people costs. That split will be different for the different types of service we deliver.

So in construction, clearly materials will be much more impactful. In consultancy and digital programs, the labor costs will be a bigger percentage. I don't think I can give you much more detail than that, other than to say, I suppose construction is by volume, very much the larger part of the business. Hence, materials are going to be much more significant in that area than consultancy and digital.

We don't give much flavor on gross profit at the moment. You'll see segmental disclosures for the two divisions. As Alex and I've mentioned, if you look at the natural resources division, that has a heavier bias towards consultancy contracts, transportation, a heavier bias towards construction. So you can imply there that there're different mix of materials and people crossing those two divisions. I hope that helps, but I just don't think I can give you very much more detail.

Jack - BRR Media: And a follow-up to that, are there any elements of the cost of sales where you are feeling the impact of inflation?

Alex Vaughan: Yeah. Massimo, it's Alex. Yeah, look, obviously, there are a number of elements. So certainly labor costs have been increasing. I think that's a mixture of one, inflation impact, but I think secondly, it's also around the availability of labor, which is available in the market.

And then from a materials point of view in our sector, it's predominantly concrete and steel, which are obviously affected both by commodity prices and energy costs. So, those have been the two. And what we're doing is working really hard with our clients to best mitigate those. So we are obviously looking at alternative materials and that ties into a lot of the work we're doing on getting to net zero. So that is driving a look at alternative and designing alternative materials into new infrastructure.

And obviously, the productivity gains that we can make and how we can forward plan the use of labor enables us to mitigate some of those costs as well. So, looking at the input costs, those are probably the three primary drivers on cost at the moment.

Jack - BRR Media: Thank you. We have a question from Stephen Rawlinson at Applied Value. And that's, "The pension scheme and the dividend have been linked for many years, but at present, the pension fund seems to be getting its funding, but shareholders are still not getting a reward. Is reinstating the dividend a priority?"

Helen Willis: Morning, Steven. So the pension deficit payments upset is a commitment that was made a number of years ago. So the circuit term and in pound contributions is a commitment that is in place and we can't step away from. We are in the midst of the next triennial valuation. And it's important to note, I know you will know this, but so it's important to note that the accounting surplus doesn't necessarily reflect in the actuarial valuation and that's the negotiation that we're going through at the moment.

Clearly we would like to be able to return to dividend. We've made it clear there is some dividend matching to the pension contribution. That's again, that's a further commitment that has been made a number of years ago. So all of those considerations we need to think about in when is the right time to return to dividends. We do have those commitments in place.

As I said earlier, we are really focused on cash generation, the business, and continuing to strengthen the balance sheet. And all of those elements we will be thinking about and considering when the right time is to return to dividend. But we take our commitments to the pension fund very seriously. And so that's an important stakeholder that we need to have in mind as well.

Jack - BRR Media: Thank you, Helen. We've had a number of follow-up questions. The first of which is from Chris Millington at Numis, "Are we likely to see any material change in financing costs in the light of the extended amend debt negotiations? Is your decision to go down this route driven by banks' reluctance to lend, or the cost of debt?"

Helen Willis: So, Chris, too early to say what the likely outcome will be on pricing. As you'll know, those conversations are lengthy. This is not driven by any concern about our facilities. As I think I mentioned, the board's consideration is that with the macro climate around us, actually conversations with banks are... I think, yeah, there's concerns about inflation as we've been talking about on this call, concerns about what's happening in Ukraine and so on and that brings a volatility to the markets.

And so the board's consideration along with our advisors is that an amending extend for a year is a pragmatic step to take. And our hope is that the environment around us in which we have to operate, will stabilize and therefore be a better environment for the refinancing. But that's not born of a concern. We have a supportive banking group. This is a sensible, phased approach, I think. And you'll be aware of the pressures in the banking environment on... Sorry, someone was just writing something down. You'll be aware that the pressures on pricing and the nervousness in all markets. And so this, we felt was the best approach for us in the interim period.

Jack - BRR Media: Thank you, Helen. We have a follow-up from Andrew Blain at Investec. And that's, "You've done a lot of work to improve the risk profile of the business. Is the lower order book partly a reflection of that? And should we anticipate a lower level going forward?"

Alex Vaughan: Yeah. Thanks, Andrew. It's Alex again. So, look, we have done a lot of work in making sure that we've got the right governance, we've got the right approach to contracts and in how we operate and run the business, which is paying dividends, which is great. But actually, what we found from this approach is actually being very proactive with clients and helping them understand the risk profile that we think is the responsible profile.

Our proactive efforts have helped us actually influence clients' procurement. So, we are really not being held back in being able to bid work. I think once you explain to clients what the concerns might be around early thoughts of approach, when they understand it, they're able to shape their procurement in the way that we are now comfortable with, and we can proceed with. So it's not holding us back in being able to bid for work. And as Helen has said, we've spent a lot of money and a lot of effort in bidding work and been very busy in the first half of the year.

The reduction in the order book is a consequence of our clients' procurement period. So our clients procure, as I've set out in one of my slides, the clients have business plans, they procure against those. So our order book's driven by that. I think, I'd like to also make point that the order book that we've set out is a very prudent view of what we have secured and are able to proceed with.

We also have a lot of other contracts that we have been awarded, but require another signature. In other words, they haven't been signed to start, and those are excluded from the order book. And as we've said, will be announced in the second half of the year. So, a really good volume of work. So hopefully, that gives you confidence that our approach to risk whilst doing exactly the right thing, isn't holding us back from being able to bid opportunities. We're very active in that space and we've got a very prudent and robust order book number. But we've got a significant volume of other work that we've already won that following signing of those contracts and signing to proceed, we'll be able to announce those contracts in this remainder of this year.

Jack - BRR Media: Thank you. The final follow-up question comes from Stephen Rawlinson at Applied Value. And that's, "The investment in consultancy, can you explain this? Was that people who were employed, but not fully utilized, or were people working for low slash zero rates on projects or was it something else? And will this reverse in the second half?"

Alex Vaughan: Yes, Stephen Good morning. It's Alex. So, I think it's a number of things, Steven. Let me just answer the last bit, we're not tendering or completing any work with no returns. So, we're making our expectations of a return on all of the consultancy work that we complete.

We have invested in business development activity, we've invested in thought leadership. We've invested in communications, and we have recruited quite a number of people ahead of the curve. And those are all the factors that have resulted in some dilution to the margins. So, I hope that helps you with the context of that.

Jack - BRR Media: Thank you, Alex. And we'll take our final question from Tim Mott at BlackRock, and that's, "What are the top three challenges that your business is facing and how do you intend to solve them?"

Alex Vaughan: Well, look, let me answer that. I think the top three challenges for us are to ensure that we deliver our contracts safely and well. That's a key priority for us. The second one is to make sure that we can stay close to our clients, understand what their challenges are, what their needs are, what the opportunities are, which is the second thing we need to put that time.

And then I think the third priority for me is making sure that we are working incredibly hard, that we've got a differentiated proposition that offers better value than anyone else. And that takes a huge amount of effort from us. So, I think those for me are the three priorities for me. Helen, do you want to add to that?

Helen Willis: I'd like to add one, which is to continue to focus on cash generations. So, through all of those elements that Alex has just outlined, we have a real focus on cash generations throughout the business.

Alex Vaughan: Absolutely.

Jack - BRR Media: Thank you. As that concludes this morning's Q&A, I would like to hand back to Alex and Helen for any additional or closing remarks.

Alex Vaughan: Thanks very much, Jack. Look, thank you very much all for taking your time and look, all I'd say is, I hope you have a good rest of the day and we'll see you soon. Thanks very much.