I. Executive Summary

The Group has a number of businesses capable of generating stable profits and cash flows, in particular the Infrastructure and public sector services businesses in the UK and Canada. However, as whole, the Group has been poorly managed for a considerable period, during which time significant underperformance and contract issues have been masked by aggressive accounting and working capital management. As a result, the balance sheet and liquidity position of the Group is stretched and unsustainable.

Background

- The Group is facing a financial crisis, stemming from the incurrence of major losses (and overstatement of profits) on a number of construction and support services contracts in the UK, Canada and the Middle East.
- In July 2017, the Group announced provisions of £0.8bn, principally relating to the write-off of receivables and provision for future liabilities in respect of construction projects in the UK, Canada and Middle East. Further provisions in excess of £200m were taken later in 2017, mainly relating to the support services businesses and further provisions of £60m are expected to be reported at the year end.
- The Group has not attempted to re-state its underlying revenues and historical profitability for the impact of the £1.1bn of provisions taken in 2017; however it is apparent that, for a number of years, the Group has been compensating for the failure to convert reported profits into cash through the incurrence of further debt (both on and off balance sheet) and the aggressive management of working capital.
- The historical year-end and half-year public reporting of the Group's net debt has been aggressively managed through the short term deferral of payments, acceleration of receipts and receipt of short term loans from JVs.
- Having incurred borrowings in the region of £1.5bn from a number of banks and debt investors at Plc in order to fund these losses (including £140m of emergency financing in September 2017), the Group has signalled a need for a full equitisation of Plc debt and additional financing of around £360m to underpin forecast cash outflows on loss making contracts and working capital requirements over the next 2 years.
- In addition to the £1.5bn of financial debt at Plc, the Group has amassed a further c.£250m to £300m of 'core debt' through it's off balance sheet supplier financing (EPF) arrangements, which extend payment terms on the supplier base from c.30 days to c.120 days and has received significant advance payments on construction and ICT (Wipro) supplier contracts.
- In addition, the Group is further overburdened with a number of defined benefit pension scheme liabilities, which in aggregate are estimated to have a (technical provisions) funding deficit of approximately £700m (and a Section 75 liability of c.£2.8bn).

Governance & Historical Performance

- Since the profits warning in July 2017, the Group has undertaken a number of governance and executive management changes.
- Keith Cochrane has taken on the role of Interim CEO, Emma Mercer has assumed the role of Group Finance Director (although not a board director) and Lee Watson (of EY) was appointed as Chief Transformation Officer. Andy Jones has been appointed COO and Andrew Davies has been announced as the future CEO of the Group, and will take up his role in late January.
- The Group has retained Lazard to assist with the financial restructuring and EY to support in the development of the business plan, working capital, liquidity and cost reduction.
- In addition, and at the request of the creditors, Alan Lovell was appointed as a Non-Executive Director in order to strengthen the Board's restructuring experience and THM Partners have been engaged to provide assistance in the reporting and management of short term liquidity.
- The Group announced a reorganisation of its internal structure which took effect from September 2017, with the intention of streamlining the management structure and simplifying the business.
- As a consequence of these changes in reporting structure, it has not proved possible to compare forecast projections with historical performance.
- Indeed, the detailed presentation and availability of robust historical financial information is extremely weak; in particular as it relates to the historical working capital movements of the Group (which are the principal drivers of cash flow) and business unit profitability.
- This is in part due to poor accounting information systems, a lack of senior finance resource / bandwidth at Group level and weak corporate knowledge in view of extensive management changes throughout the business.
- We have therefore been unable to provide any reliable assessment of the Group's historical financial performance at a business unit level; and have therefore focussed our attention on the Balance Sheet at 30 September 2017 and the forecast which is projected therefrom.
- Whilst we have not been provided with any analysis or board papers in support of the provisions taken in July 2017, management ultimately provided (with the support of EY on a contemporaneous basis) on 3 November 2017 a detailed contract review of the major projects. We comment on the adequacy and robustness of the contract review and the resulting provisions later in the report.

I. Executive Summary

The Group has announced a number of strategic measures in order to address the historical underperformance of the business. These include an exit from the PPP market, an exit of the construction market in Canada, the disposal of non-core assets and a major cost reduction programme. Whilst each of these initiatives would appear sensible, the unwind of losses and working capital on legacy contracts continues to be a major drain on liquidity and management bandwidth.

Current Trading

- Amidst the unsustainable levels of financial and pension debt which sit within the Group, there are a number of strong and profitable underlying businesses. In particular;
  - **Infrastructure** is one of the leading providers of road and rail maintenance and construction in the UK. Whilst it has been severely impacted by losses on 2 large lump sum contracts (Aberdeen and Taunton), the remainder of the business is robust and profitable (FY18 forecast Operating Profit of £29m)
  - **Central Government** provides FM services for Government infrastructure, in particular accommodation for the MoD, with stable profits on long term contracts. The business has suffered losses and cash outflows on the NOMS contract for the MoJ, and is currently looking to negotiate a solution to this contract (FY18 forecast Operating Profit of £19m)
  - **Corporate & Regions** provides FM services for local public bodies and private companies as well as broadband network installation and maintenance through the telent JV. The business has a core of profitable, long term contracts and is currently looking to rationalise its portfolio by exiting loss making contracts and disposing of some areas that are considered non-core (FY18 forecast Operating Profit of £49m)
  - **Canada** has recently changed focus from construction to services. The decision to exit construction has been made, legacy contracts are being worked through and the Rokstad power transmission construction business is in the midst of a sales process. This leaves a loss making road maintenance business, where the group is looking to exit loss making contracts, and a profitable services business (FY18 forecast Operating Profit of £26m)
- In addition to the problem contracts in the above businesses, the Group has experienced more fundamental issues in its Building business in the UK and construction business in the Middle East. Significant losses have been incurred, and significant cash outflows are ongoing, on a number of large contracts which the Group entered into too quickly, and on inappropriate terms, in order to secure large advance payments and report large contract wins.
- Following the July profit warning the Building business has struggled to win new contracts and some counterparties have become more cautious about supporting the Group's working capital. As a result, the negative working capital position in the Building business is forecast to unwind resulting in additional cash outflows in addition to the contract losses. Net cash outflows totalling £154m are forecast in these businesses in the next two years, although this assumes successful collection of claims and the winning of new work from Q2 2018 onwards.

Business Plan

- Following the provision of £140m emergency funding at the end of September 2017, the Group commenced a bottom up business planning process, supported by EY. This plan was presented to Lenders on 10 January 2018. Key elements of the strategy underpinning the plan are:
  - Governance changes and exit from higher risk businesses, including PPP construction, which were announced as part of the July 2017 profit warning;
  - A cost reduction programme targeting an annualised £100m of savings to be delivered by the end of 2018;
  - Disposal of non-core assets to raise liquidity;
  - Renegotiating, consensually exiting or completing problem legacy contracts and looking to recover losses through claims against insurers, suppliers and customers; and
  - Selective growth, particularly in Infrastructure and Canada.
- The Group's strategy shows a forecast increase in reported EBITDA from £187m in FY17 to £275m in FY22, with Canada, Central Government and Infrastructure all showing significant growth in EBITDA.
- Assumed cost reductions are a major factor in the improvement with an assumed £100m of savings reflected in reductions in central costs and improvements in operating margins.
- However, driven by the unwind of working capital and contract losses, the Group's forecasts indicate a funding requirement, before sensitivities, financing costs and pension contributions of £168m to £239m depending on the outcome of ongoing disposal processes.
- This includes the Group's stated requirement of £175m of headroom for intra-month cash flow swings but not management sensitivities or assumed financing costs. Taking these into account, the Group's view of it's funding requirement is £360m, of which the vast majority is required by May 2018.
- In addition to the cash funding requirement, the Group is also forecasting a requirement for bonding and LCs of up to £309m.
- The forecasts assume that a comprehensive recapitalisation of the business will restore confidence of customers and suppliers allowing for new contracts to be won and the demand for bonding (in addition to parent company guarantees) to return to normalised levels over time.

I. Executive Summary

The Group's business plan shows a funding requirement of c.£240m before disposals, sensitivities and financing costs. After management sensitivities, the Group has assessed the incremental funding need to be £360m. However, the plan assumes the Group is able to settle material claims without lengthy disputes and win new work in Building to benefit from working capital inflows. We believe the plan contains additional risk and our sensitivities increase the overall new funding requirement to £495m.

FTI View and Conclusions

- The Group's profit warning and the quantum of the provisions taken cast significant doubt on the true historic trading position and cash generation of the business. Rather than addressing the underlying challenges facing the Group in respect of problem contracts and the strength of the balance sheet, transactions were entered into, and accounting treatments and assumptions made, to enhance the reported profitability and net debt position of the Group.
- Whilst circumstances outside of the Group's control are a factor in the operational challenges faced on certain projects, a lack of management attention to (and accountability for) addressing key issues, governance failures over the amount of risk being taken on, and a focus on short term financial benefits (net debt and cash) at the expense of long term profitability and viability are significant contributing factors.
- With over £1bn provisions taken, and substantial changes made to the business, the management team has taken a significant step in recognising the issues of the past and addressing them. However, this has taken a significant amount of time, during which the Group has consumed all of its available liquidity and required an additional £140m of emergency funding. The Group now requires a further substantial funding need in the next few weeks.
- Furthermore, in view of the scale of the extensive pension liabilities across the Group, the provision of further new money (either as debt or equity) is likely to be extremely high risk, as the funding requirements of the schemes are extensive, and the schemes' relative claims in the event of insolvency would severely impact the prospects of any future recovery of new money.
- In addition to the scale of the challenges and limited time available, we are concerned that the Business Plan does not appropriately reflect the short term risks around inherently uncertain items such as claim recoveries, the lasting impact on the business of its recent challenges, or the longer term ability of the Group to grow profitably.
- Our sensitivities represent our balanced view on the risks to the forecast and in particular the funding requirement. Key sensitivities include:
  - A 6-9 month period following a restructuring where Building will struggle to win material contracts (and the working capital benefit thereof) from private sector customers;
  - Delays and some reductions in the value of claims recovered to provide time for dispute resolution pathways to be followed; and
  - Reductions in the assumed growth and margin increases in the Canadian services and Rokstad businesses.
- Our sensitivities still provide for the business to grow reported EBITDA to £226m in FY22. However they have a significant impact on the funding requirement, increasing this to £495m in August 2019 before any future financing costs.
- Management believe our sensitivities overstate the risks and are too harsh. Given the material funding requirement, risk items outside of the Group's control, weak information systems and the businesses track record, we consider that our sensitivities reflect a balanced view (and not a worst case).