Private & Confidential

Rt Hon Frank Field MP and Rachel Reeves MP

The Chairs

Work and Pensions Committee

Business, Energy and Industrial Strategy Committee

20 February 2018

Dear Mr Field and Ms Reeves

Carillion – Joint Select Committee Hearing Evidence

Thank you for your letter dated 13 February 2018. My responses to your five follow-up questions are set out below.

(1) *You told us "I think I only met two or three investors post 10 July" (Q234). Which, please, were those investors? Did other investors request a meeting? Did you offer to meet them?*

I have now been able to review a schedule of the investor meetings and calls that I had following the 10 July 2017 trading statement. The schedule suggests that I met or had calls with the following investors during the course of July 2017, as part of an investor 'roadshow' to discuss and explain the £845m provision: Kiltearn Partners, Letko, Brosseau & Associates (being the shareholder from Quebec, Canada I referred to in my answers to the committee), Standard Life, Schroders, Janus Henderson and Brewin Dolphin. I also met with Soros Fund Management and AKO Capital who were short on Carillion's shares and with Cerberus and Artemis, at their request, although they were not shareholders.

Later in the year, I had further meetings or calls with Kiltearn Partners, Legal & General and Letko, Brosseau & Associates.

The Company had an Investor Relations department which I know had meetings with other investors at this time but I did not personally attend them.

(2) *In Q240 you said that you increased the provision following your own review over a weekend.*

(a) What did you change the total provision from and to?

The detailed contract review was provided to me with the Audit Committee papers which were circulated on Saturday 8 July 2017 in advance of the Audit Committee meeting on Sunday 9 July 2017. The contract review (supported by a paper from KPMG) recommended a provision of £695m. Having considered the review carefully myself on the Saturday and having discussed it with Mr Khan on the Sunday prior to the Audit Committee meeting, I recommended to the Audit Committee (in a discussion including KPMG who were also in attendance) that the provision should be increased to £845m. The Audit Committee adopted that position and recommended a provision of £845m to the board.

(b) What elements of the provision did you increase, by how much, and why?

The contract review recommendation of the £695m provision was based on the top end of a range of financial outcomes for each contract reviewed. The ranges established were within the "likely best" and "likely worst" outcomes. The £695m provision was premised on the then-assessed "likely worst" scenario and was proposed to be split between an impairment provision against receivables of £449m and a future cost provision of £246m.

My starting point was that we needed to ensure that the provision that we made materially de-risked the contract position. In order to do this I felt that the provision should reflect a more pessimistic assessment rather than a "likely worst case" assessment. On the basis of the information drawn out in the contract review, I considered that an additional £150m provision would achieve this. I came to this figure by providing for additional headroom in relation to all the contracts which had been "red flagged" by KPMG as high risk and more generally by providing for an additional cushion against contract revenue recovery. I considered that an increase in the provision in respect of revenue recovery was necessary because the effect of the announcement itself and the fact that the group was seeking to exit from certain key markets meant that it would inevitably become more challenging to collect cash (by reason of the Company's perceived loss of leverage).

(c) What information did you see as Chief Executive that you had not previously done so as a non-executive director?

At the time of the decision relating to the provision I was still a non-executive director and had not yet taken up the role of Interim CEO (although I had offered to Philip Green, subject to board approval, to step into that role on 10 July 2017). I did not have any additional information at that point in relation to the contract review, by virtue of my position as an executive director in waiting. Nevertheless, the whole board had access to the contract review prepared by management and the report prepared by KPMG on that review, both of which were extensive.

(3) In the session, you undertook to provide cash flow data prior to March 2017 (Q252-3). We would be grateful if you could please do so.

I enclose extracted copies of the cash flow statements for January and February 2017 (each showing 2017 actuals, 2017 budgeted figures and 2016 actuals). These statements were provided to the board with a month's delay, in February and the beginning of April 2017 (as there was no March board meeting), respectively. By the start of April 2017 I would therefore have seen the January and February cash flows.

At the Select Committee I was asked by the Chair whether there had been any problems with cash flow before March 2017 (Q252). My initial response was that I recalled that cash flow was trending broadly in line with the budgeted position for the first couple of months of the year.

I have now gone back and looked at the cash flow statements and at the 2017 "RF1" which was provided to the board on 6 April 2017. The RF1 is the first of the four revised forecasts which were prepared quarterly by the CFO, in conjunction with the MDs of each of the business units. A copy of this is also enclosed.

By the end of February 2017, net borrowing was higher than budgeted (£789m or £777m before currency effects against £753m), which showed a slight deterioration in cash flow, but was still only marginally higher than for the same month in 2016 (£767m). While the change in net debt between 1 January and 31 January was higher than budgeted (£494m against £429m), the opening net debt position on 1 January was better than budget (£218m vs a budget of £250m) and the change in net debt for February itself was near in line with budget (£77m against £74m).

The RF1, which would have been prepared by Mr Khan in the course of February and March 2017, reflects my recollection that management's verbal reports to the board were that the company's finances were trending broadly on budget. It states that full year average net debt was forecast to be marginally lower (ie better) than budget and 2016 and full year spot net debt was due to be in line with budget, with net operating cash inflows of around £9m, after taking account of committed acquisition costs and dividends. Half year spot and average net debt were likewise forecast to be in line with budget. Although the RF1 was not available to the board until April 2017, a verbal update was provided by Mr Khan at the February meeting with Mr Howson and the divisional MDs of the UK business providing comfort in achieving market expectations and their RF1 targets (as was ultimately confirmed in the RF1).

(4) You said in Q391 that you had an "agreed payment profile with the pension fund". Robin Ellison, chair of the trustees, stated, however that "none of the recovery plans were agreed. They were imposed". Were these plans agreed or not with the trustees?

My belief that the payment profile for employer contributions in respect of the shortfall in funding was agreed with the Trustees reflected my understanding of the basis of the c.£50m per annum additional funding commitment made by the Company following the 2013 triennial valuation. This was before my appointment to the board and as such I was not involved in the agreement but became aware of the commitment upon joining the board in July 2015. Fresh negotiations regarding the recovery plan commenced in 2017 for the purposes of the new triennial valuation but in view of subsequent events those negotiations were not completed.

(5) *In Q398, you said that the board were "concerned at some [of] the revisions that were being made to our cash flow forecasts, which seemed to come as a surprise". Did you investigate why cash flow forecasts had been poorly reported to the board?*

I believe it will be helpful to the Committee if I set out a bit more of the background in relation to the revisions to the cash flow forecasts that I was referring to and to the reasons for Mr Khan stepping down in September 2017.

On 30 August 2017, the board held a conference call in order to discuss the proposed reorganisation of the business and supporting programme of cost reduction. Also in attendance were our advisors Lazard (the Company's bankers), HSBC (the Company's brokers), Slaughter and May and EY. At this stage EY were involved in support of the reorganisation and cost reduction programme as well as working on cash management matters.

One principal point of discussion during the call related to the preparation of a draft announcement to the market in relation to the business reorganisation and accompanying changes to the leadership team (including the appointment of a Chief Transformation Officer (CTO) to assist with that process). Also discussed on the call was the Company's liquidity position including its headroom under its existing banking facilities. Mr Khan noted to the board that, looking further ahead into October / November 2017, there was a reasonable margin to the forecasts that had already been prepared based on the facilities currently in place meaning that, at that point, there was no need for new funding.

Over the next couple of days, Mr Khan informed me that there was a deterioration in the financial position of the Company compared to what was just reported to the board. I therefore arranged an urgent board call for the Sunday evening in order to update the board. I noted to the board that based on Mr Khan's revised figures (which had been worked on in conjunction with EY) there had been a deterioration in forecast liquidity in the period since the 30 August board call. EY's view was that this was a material deterioration in the circumstances and that the company needed to consider obtaining additional liquidity from its banks.

In addition, a further revised forecast was being worked on by EY and Mr Khan which was still a work in progress. The indications from that revised forecast were that spot debt and the average net debt were going to be materially worse than had previously been forecast by Mr Khan.

Given that a final revised budget was outstanding and the debt issues that had been highlighted, it was decided on advice that it was not appropriate for the proposed announcement to be made at that time.

A pre-existing bank presentation was scheduled for 5 September 2017. At the end of this meeting, we took the opportunity to have a discussion with Carillion's four key banks on seeking a further c£150m of funding. It appeared from that meeting that there could be scope for the funding being provided. Following that meeting the board met again on 6 September 2017 and an update was given in relation to the meeting with the banks.

When I referred in my oral evidence to the Committee to the "surprise" and "concern" of the board, I was referring to the discussions on the 3 September call and the adverse change of reported position over a very short period of time, which I felt should have been picked up in the earlier report. EY at this stage were becoming closely involved in the cash management and forecasting process. Work on cash flow forecasting and solving any liquidity problems (including revising the previous forecasts) was at the centre of management and board thoughts at this time and was being closely examined.

Following the Sunday meeting, I had come to the realisation that Mr Khan was not the right person to be Finance Director and that he should be replaced. This decision was based on a view that he was not on top of the numbers to the extent that the board needed him to be given the challenges that the company faced and there was a disconnect between the group and business finance functions. It was also clear that he did not have the confidence of the banks given the likely need for raising new funding or the experience and skills to facilitate a broader financial restructuring with multiple stakeholders. Accordingly, I asked Emma Mercer to step into the CFO role to replace Mr

Khan from the following Monday 11 September. In addition, Lee Watson, an experienced EY restructuring partner, was seconded into the newly created CTO role to provide additional support in our restructuring efforts.

To be clear, Mr Khan's dismissal was not related to the contract review or its presentation to the board on 9 July 2017. Indeed, it was Mrs Mercer, and not Mr Khan, who took the lead in presenting the contract review to the board. My decision was also not a reflection on Mr Khan as a finance professional; I just did not believe he was the right man for the role at the time.

Some of the documents that I have enclosed with this letter contain information which is confidential to the Company and third parties and potentially commercially sensitive. I have provided these documents to the lawyers of the Official Receiver. I enclose a copy of the letter I have received in response and would draw the Committee's attention to the penultimate paragraph of that letter.

Please let me know if I can assist any further with the Joint Committee's investigations.

Yours sincerely

Keith Cochrane

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