Carillion plc

MINUTES OF A MEETING OF
THE BOARD OF DIRECTORS

Held at 25 Maddox Street, London, W1S 2QN
On
Wednesday 5 July 2017 at 8.00 am

Present:
Mr. P.N. Green Chairman
Mr. K.R. Cochrane
Mr. A.J.H. Dougal
Mrs. A.J. Horner
Mr. R.J. Howson
Mr. Z.I. Khan

In attendance:
Mr. R.F. Tapp Secretary
Mr. A.R. Green (in part)
Mr. N.P. Taylor (in part)
Mr. S. Carter (in part)
Mr. P. Rees (in part)
Ms. S. Wokes Slaughter and May (in part)
Mr. C.W.Y. Underhill Slaughter and May (in part) (by telephone)
Mr. D. Arch Stifel (in part)
Mr. T. Perry Morgan Stanley (in part)
Mr. P. Moorhouse Morgan Stanley (in part)
Mr. S. Barnett Morgan Stanley (in part)
Mr. V. Litchfield Lazard (in part)
Mr. P. Noel Lazard (in part)

Apologies: Baroness Morgan of Huyton

Minute No: ACTION

2161 Directorate: Baroness Sally Morgan of Huyton

The Chairman noted that the appointment of Baroness Morgan of Huyton had been announced on Friday 30 June. Due to existing commitments, she was unable to attend this meeting.

2162 Minutes

The minutes of the meeting of 8 June and notes of the Strategy Meeting held on 7 June were approved.

Matters arising –Strategy Meeting of 7 June:

a. Accounting Review. The special session of the Board to deal with lessons learnt and to receive the report of the QS on a selection of projects would now be held on the afternoon of 4 October.
b. **Chief Executive Reflections.** A note of the Chief Executive’s six points had been circulated separately.

c. **Disposal Strategy.** A commitment to £100m of disposals had been included in the Project Salmon proposals.

d. **Capital Structure.** Rationale for a potential equity raise and alternative leverage scenarios had been reviewed by the Board and advisers on 8 June.

**Matters arising – 8 June:**

a. **Disclosure.** Confirmation that no disclosure obligation had arisen as a result of the deterioration in the position during the half-year had been given, and a copy of Slaughter and May’s email on the position had been circulated to the Board.

2163 **Health and Safety**

Mr Howson briefed the Board on the health and safety performance in the month. The report was noted.

2164 **Sustainability**

The Sustainability Report had been previously circulated and was noted.

2165 **Project Salmon**

The Chairman noted that Morgan Stanley and Stifel had advised him on the previous evening that they were not able to underwrite the proposed equity issue. He noted also that a conversation had been held with HSBC with a view to the possibility that it may act as sponsor, either alone or in combination with another party, and/or may otherwise participate as an adviser to the Group.

The Secretary briefed the Board on the progress of the work streams of Project Salmon prior to the withdrawal of the Sponsors on the previous evening. It was noted that good progress had continued to be made and that there was no obvious reason why the Project could not have been announced as planned, had the Sponsors been willing to proceed.

The work which had been done towards the Project was available for other prospective should the need arise. The due diligence and verification work was housed on a platform within CAS and could be mapped across; the accounting work could be given to a new sponsor with KPMG’s consent, and it would be suggested that Davis Polk should act for any such sponsor in order to expedite the process.
Advice had been taken on the disclosure obligations now arising and it was understood that brokers had advised that an announcement should be made on Monday 10 July. Slaughter and May had confirmed that that was their view.

Subject to confirmation of that position it was agreed that the Audit Committee would meet at 4pm on Sunday 9 July, followed immediately by the Board. There would be an announcement when the market opened on Monday 10 July followed by an analysts' conference and call later in the morning.

The working assumption would be that the interim programme would revert to its original planned dates, pending investigation as to whether it should be further deferred. Absent further change, the Audit Committee would take place on Thursday 17 August and the Board on Tuesday 22 August, with the interims being announced on the morning of Wednesday 23 August as planned.

Messrs. Arch, Moorhouse, Perry, Litchfield, and Noel, and Ms. Sally Wakes joined the meeting. Mr Underhill joined the meeting by telephone.

The Chairman invited Mr Moorhouse to speak. Mr Moorhouse read from a prepared note, which he explained further expanded on the position which he had explained to the Chairman on the previous evening.

As he had explained to the Board at its last meeting, Morgan Stanley's view was that on the spectrum of transactions, Project Salmon was at the outer edge in terms of market capitalisation, pro-forma value and the very significant shareholder rotation anticipated. There was virtually no scope at all for a de-rating of the shares and to ensure that the value does not fall below the price paid. There was also pre-rights volatility with a very significant need to attract new shareholders who would examine the investment case closely.

The executive directors and advisers had worked hard to enhance the investment case; the presentation had been improved, and the investment committees of both Morgan Stanley and Stifel had been delayed, but the investment case was materially short. There had been changes to the investment case, but the expected impact to the share price from the contract review given the current market rating meant that the investment case was insufficient to support an underwriting.

The sponsors had concluded that the material risk in the market, and especially the fact that new investors would not be convinced, meant that the proposition would not get investment committee approval. They had chosen to accelerate that conclusion once it had become clear to them, and hence he had had a discussion to that effect with the Chairman on the previous evening.

He had found this hugely disappointing, both personally and professionally, and remained entirely focused on supporting the
company in whatever the Board chose to do.

The Chairman noted the position and invited questions from the Board for Morgan Stanley and Stifel. There were no questions.

The Chairman reported that in the light of the decision of Morgan Stanley and Stifel, it was proposed that the Board should endorse "Plan B" — essentially that the proposed announcement and presentation should proceed subject to amendment of detail, and obviously excluding the references to the proposed rights issue.

There was one area where further focus was required — that of "self-help." It was proposed that a greater level of disposals would be announced, together with further equity sales over the coming 18-month period to ensure that appropriate value was received. It was noted that in addition to Projects Lawrence and Salus, and the position in the Middle East previously discussed, consideration would be given to further disposals including possibly either the Defence or Canadian businesses. The Board discussed whether individual businesses should be mentioned or whether more generic wording would be used in forthcoming presentation on Monday would need to cover the issue, and noted that the drafting would be finalised in due course.

Mr Cochrane noted that one of the key issues for the Board was focusing on maximising value for shareholders. Mr Arch indicated that it was possible that one or more strategic partners may emerge, and/or the Board may anticipate an approach from potential bidders.

The Board discussed future work streams, noting the significant win-rate in the first half of the year, and that a decision on HS2 was due to be announced on 15 July. The Group's consortium had been asked to re-confirm its bid on two contracts, and market speculation was that the consortia asked to re-confirm bids were likely to be awarded the contracts in question. However, it had to be stressed that there was no certainty in that regard.

The Chairman asked for the brokers' view on the level of shareholder engagement after the forthcoming announcement. Mr Moorhouse felt that it should be extensive, with the same engagement with existing shareholders as had been proposed when the rights issue was in contemplation.

Morgan Stanley and Stifel also indicated their view on the likely behaviour of the shorts in various scenarios, and the Board discussed the timing of the interim announcement in that context, which would be kept under review. Mr Underhill reminded the Board that the timing and content of communications needed to be carefully managed and to be consistent.

Messrs Arch, Perry and Moorhouse left the meeting.

The Board returned to the discussion of possible disposals and rehearsed the merits of the various options in terms of value, deliverability and strategic fit. It was agreed that Lazard would
refresh its paper identifying possible disposal options and their related values. The wording of the announcement in relation to disposals remained to be concluded.

Mr Howson briefed the Board on the work ongoing with HSBC. He noted that the Board must be aware that there was a very low probability that HSBC could bring through an offer to underwrite prior to the proposed announcement on Monday. The possibility of funding would also be discussed with them, as well as the possibility of funding from other sources.

The Board also discussed the rationale given by Mr Moorhouse, reflecting that it was not credible given that there had been no obvious change to the market position, the position of the business or its prospects since he and Mr Arch had represented to the Board that an equity issue was viable and that the two banks would expect to underwrite it. Whilst it was necessary to continue to work with them as brokers in the short term that would clearly change in the future.

In conclusion, the Chairman noted that work continued toward a positive and upbeat announcement for Monday, focusing on the strength of the business as a compelling and attractive proposition, and mentioning the self-help and disposal position.

At the same time, discussions would continue with HSBC and Royal Bank of Canada, and with regard to alternative funding from them in the short term. An internal and external communications programme was in development to ensure that appropriate audiences were informed.

The Chairman thanked Mr Litchfield and his colleagues at Lazard for their support.

The meeting was adjourned at 9.45am and resumed at 11am.

Presentation: Business Plan 2018-2020

Mr Carter and Mr Rees joined the meeting, together with Mr Adam Green and Mr Taylor. The Chairman noted the importance of the Business Plan in the light of the forthcoming announcement to the City which had been discussed in the earlier part of the meeting.

In discussion, the following points were noted:

- The profitability points were shown as ranges in the light of the current economic uncertainty, and at the request of the Chairman, Mr Carter explained the underlying philosophy and structure of the information in the Plan
- The Plan included businesses which might now be disposed of;
- Mr Taylor noted that the Services Plan was based on a very ambitious, but deliverable, position – very stretching but achievable. Mr Adam Green confirmed that the construction
plan was similarly based. Responding to the Chairman, both they and Mr Howson confirmed that they had a c.90% level of confidence in the Plan. Mr Howson explained that the two points of tension were in relation to MENA, where the business's submitted plan had been significantly reduced, and Canada, where a further large transmission win was needed. In that regard, he explained the current position around East West Tie.

- The "sensitised" case adopted a more "prudent" set of assumptions around the base case.
- The Plan assumed that a negotiated exit of the RBS Services contract was achieved.
- Some £17m of cost savings were anticipated in each year of the Plan, but they were not included in the Plan. It was anticipated that they would broadly compensate for the loss of profit from the sale of Salus.
- Prospective receipts from the sale of Salus, Lawrence and possibly Emrill were not included in the Plan.
- Further work was required on measuring and valuing cost savings to ensure that cost savings fell directly to the bottom line. Arrangements were now in place to monitor job families against overall cost.
- Mr Taylor noted that the Services business had grown stronger in each of the previous three years, and built on that in the Plan currently before the Board.
- Work continued to manage and improve cash across the Group, with the significant outflows in H1 related to the four problem contracts and Battersea.
- In relation to Canada, the change in margin in the year related purely to volume.
- AFC's performance in the plan period related primarily to Expo 2020.

**Services**

- With regard to Defence, it was noted that Defence Infrastructure Organisation's remit was changing to that of a service provider. Mr Taylor explained that the strategy was to extend beyond accommodation work into airport and other asset management work, with improved margins.
- In Regions and Communities, the strategy was to move to a more partnership-based approach to property, bringing estate management opportunities and margin, and development management. A consulting business was being built which would have a £30m turnover at the end of the period with 15-20% margins.
- In Corporate, the core business was shrinking in over the plan, as the sector was commoditised and hard-fought, although the skills important to be retained in the business's toolkit.
Construction

- Mr Adam Green summarised the position in the construction businesses, noting the key growth areas of Highways England and telecoms work.
- There was a slight reduction in rail work across the period, reflecting the change in structure, but offset by HS2.
- In Highways, Highways England had announced a number of schemes earlier in the day: although many had been announced previously the focus was positive.
- In telecoms there were opportunities with Gigaclear and Virgin
- High-end residential had slowed following the Brexit vote in 2016

General

- In further discussion the Board reviewed the position on the Net Promoter Score, noting a deterioration in 2016 but anticipating an improvement in 2017.
- In discussing Investments, the Chairman asked if the business was core.
- Responding to Mr Cochrane, it was noted that the only one-off in the year in the Plan was Project Phil
- It was noted that the Canada and MENA overhead were too large and work was in hand to address. There were a limited number of UK expats in Canada
- The PPP pipeline was very limited -- the Plan did not envisage any investments until 2019.
- Responding to Mr Dougal, Mr Howson noted that it was important to manage cash and debt at a lower level within the business, and Mr Khan confirmed that divisional controls were being reviewed.

After discussion, the position was noted and the Plan adopted. The Chairman thanked Mr Carter and Mr Rees for their presentation and they left the room together with Messrs Adam Green and Taylor.

2167 Reporting

At the Chairman’s request, the finance and operations reports were agreed to be taken as read.

2168 Project Cameron

Mr Litchfield and Mr Noel took the Board through their presentation which outlined the Group’s Defence procedures, highlighted the Defence Manual and the duties and responsibilities of directors in the event of an approach.

They also reminded the Board that the Group’s Defence Committee was in place and comprised the Chairman, Senior Independent Director, Chief Executive and Group Finance Director.
The Board was reminded of the disclosure and related obligations which arose, including the very low threshold by which an approach had to be judged, and the Board's obligations in relation to a leak.

Mr Litchfield and Mr Noel also reminded the Board of the Put Up or Shut Up provisions and of a number of specific issues including the impact of schemes of arrangement.

The Board discussed the presentation together with a number of ancillary topics. Mr Litchfield and Mr Noel left the meeting.

2169 Directors' Dealings

It was noted that Mr Howson had acquired 8,719 shares respectively under the dividend reinvestment plan on 10 June 2016 at a price of £1.9749 pence per share.

2170 Code of Ethics

The new Carillion Code of Ethics as previously circulated was approved.

2171 Next Meeting

The next meeting would take place on Sunday 9 July, immediately following the Audit Committee which would itself commence at 4pm. The meeting would be held at Maddox Street but dial-in facilities would be made available.

As a number of dates had now changed, a summary of the current dates would be circulated.

2172 Chairman and Non-Executive's Review

The executives left the meeting and the Chairman and non-executive directors held a short review meeting.

2173 Any other business

a. Next Steps. The Chairman reviewed the next steps on Project Salmon, which were agreed.

b. Cladding. Following the tragic events at Grenfell Tower, considerable work had been carried out to review the Group's portfolio of work, and Mr Howson tabled a paper detailing the position across the Services, Construction, and former eaga businesses.
He noted that all work had been compliant with the relevant building regulations at the time and would have been signed off as such by Building Control. Some 962 buildings were in scope, and of them only some 22 were over 18m and with metal cladding with an oil-based core. Of those buildings, only 6 were not sprinklered. In the Middle East, such buildings were not sprinklered.

Eaga had had a business which manufactured insulation, but all such insulation was fibre material, which was not flammable. TPS Consult's Specialist Services business provided building control services to Carillion and to a broader customer base.

Mr Howson explained in detail the relevant building regulations, the coding of material as A2 or B, and the criticality of the overall fire control system of the building, including material specification, sprinklers, and other matters beyond the simple envelope of the structure.

Since Grenfell, DCLG had announced that all material needed to be A2, but that was not previously the case and there was no belief that any responsibility arose for retrospective change. Royal Liverpool had said that it was considering changing the cladding on the building but that if it did so, it would be at its own expense.

Mr Howson also briefed the Board on the position at Ferrara Quay, a development constructed by Carillion in Swansea a number of years previously. He noted expressly the fire control arrangements in hand.

A copy of the paper would be placed on BoardPad, together with the suite of Appendices which set out the position in detail.

c. **Reward: Management Incentive.** The Chairman noted that there was a proposed management incentive to address the current circumstances. Mrs Horner would speak to Deloitte to discuss.