



Industry perspectives and Insights
from the 2011 Ernst & Young European
Infrastructure and Construction Roundtable



Building the future:
winning in the new economy

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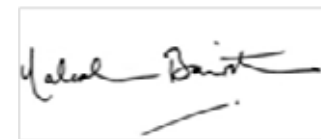
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Unprecedented challenges of the changing economy

Ernst & Young is pleased to present perspectives and insights from our 2011 European Infrastructure and Construction Roundtable held in London on 8-9th September. This unique event brought together Industry experts and Chief Financial Officers from all across Europe from many of the sectors' leading businesses.

The last three years have seen dramatic changes in the construction and infrastructure sectors. Businesses across many parts of the globe have faced unprecedented challenges arising from an unfavorable combination of circumstances. Rising raw materials prices, lack of availability of funding, corporate failures arising from the inappropriate management of risks, Government spending cuts and weak consumer spending are just some of the factors businesses have had to contend with, not to mention the pressures brought about by new accounting standards and other regulations.

In looking to the future, the emerging markets will continue to experience transformational changes in economic performance compared with the established world order, with countries such as China and Brazil in the front row. Although the developed economies are likely to make significant demands in areas such as utilities provision and infrastructure renewal, the major growth nations are likely to be those where the principal opportunities for big-ticket commercial and infrastructure development will arise. The multi-national operators in particular, must look to move with these trends through both consolidation and diversification if they are to be successful in the competition for market share in these rapidly changing times.



Malcolm Bairstow
Global Infrastructure
& Construction Leader



Ad Buisman
EMEIA Infrastructure
& Construction Leader





Opening remarks

Ad Buisman (Ernst & Young's EMEIA Head of Infrastructure and Construction) opened Ernst & Young's 10th European CFO Roundtable by commenting on the significant changes observed in the sector since the Roundtable's inception in 2002. He emphasised that, even in the apparent good times, the warning signs were there for those prepared to look closely enough, for example the impact of the increasingly burgeoning US deficit. Ad described the last 10 years as a "...sleepwalk into crisis".

Ad mused that the particular problems experienced by Portugal, Ireland, Greece and Spain (with Italy, Hungary and maybe others waiting in the wings...) mean that fiscal unity in the Eurozone area was a preferred but unlikely scenario, but of even greater concern was the prospect of the collapse of the Euro, the costs of which UBS has calculated at 50% of European GDP.

In setting out the theme for the Roundtable of competing for growth in the new economic reality, Ad stressed that the problem of the debt mountain could be overcome, granted economic growth, but there is a huge dependency on Germany in acting as the engine for that growth, with the signs of recovery in many of the other Eurozone countries far from nearby.



Peter Spencer, Chief Economic Advisor to the ITEM Club provided a vivid picture of the challenges and opportunities facing the sector

The global economy at a dangerous junction

Whilst a rare glimmer of hope in an otherwise grim global economic position was provided by Peter Spencer of the Ernst & Young ITEM club, there was an overriding message of uncertainty, with significant challenges ahead before we see a return to pre-recession levels of growth.

There remains a serious imbalance in the global economy, particularly between the US and China, the recent powerhouses of world growth, where the former is facing huge levels of debt and sluggish demand and the latter is still trying to sell to the West to boost its burgeoning economy. This amongst other influences has contributed to a highly unstable economic situation across the globe.

Highlights

- ▶ A very uncertain outlook for UK growth – companies are unwilling to invest (even at what can be negative real interest rates) and demand from the East, and particularly China, is now seen as key if the UK is to grow its way to an economic recovery.
- ▶ The Eurozone is acting as a bellweather for the world economy as a whole and remains deeply unbalanced in almost all major economic indicators – exposure to dangerously high levels of sovereign debt is acting as a barrier to new private sector lending, making refinancing of debt problematic.
- ▶ The Ernst & Young ITEM Club projects that the Euro itself will survive but the uncertainty and a lack of action will act as a brake on investment, with growth remaining sluggish until at least 2013.
- ▶ However, there was some reason to be hopeful in the midst of all the gloom. Falling commodity prices and low interest rates should combine to help the squeeze on the consumer's purse.




The Keynote address

Network Rail's new Chief Executive, David Higgins, offered enlightening perspectives on the current state of the UK Rail Network, stressing the opportunities available to the public and private sector working in tandem to deliver fundamental change, as the network embarks on its most fundamental upgrade for over 100 years.

Highlights

- ▶ There are factors to be proud of in the UK rail sector in recent years – safety, reliability and punctuality have been amongst the best in Europe, but fundamental change is required to create a culture of devolved decision-making within the industry: a culture which is fit for the modern era and responds to the needs of customers.
- ▶ Proper planning is vital – David described the “2-4-1” model (two years for planning, four years construction and one for testing) that he successfully implemented during his tenure as Head of the Olympic Delivery Authority to deliver the Olympic Park project on budget. Undergoing rigorous planning procedures upfront helps eradicate mistakes during construction and operation.
- ▶ The investment in the Crossrail line, the Thameslink Programme, the prospect of HS2 and electrification of significant portions of the network, along with tens of millions of pounds of investment in new rolling stock and signalling upgrades offer enormous opportunities to the private sector, without which Network Rail simply cannot achieve its objectives.



Running a major infrastructure provider in a challenging economy

Presenting his views on how to create and run a successful infrastructure provider in the current challenging economic conditions, Andrew Wyllie, Chief Executive of Costain Group, stressed the importance of a strong leadership team who are able to provide a clear strategy, secure customer base and innovative solutions to clients, whilst identifying, nurturing and developing talented individuals.

Highlights

- ▶ Companies must ensure that they “make the customer come back for more.” Focus on delivering high quality services that meet the needs of key customers is critical. 20% of Costain’s customers now account for 80% of their business.
- ▶ Producing innovative solutions comes from a number of actions – closer relationships with supply chain partners, making corporate acquisitions relevant to better meeting the needs of customers and investing in and developing relationships with leading Universities all underpin a commitment to innovation.
- ▶ The right leadership and creating the best team is fundamental to success. A strong and diverse management team has allowed Costain to best utilise talent within the organisation, to direct strategy and create a leadership team for the future.

Competing for growth and winning in the new economy

Malcolm Bairstow, Global Construction and Infrastructure Leader at Ernst & Young, acted as moderator for a lively and enthusiastic panel debate. The panellists included Mike Lucki, CFO of CH2M.Hill, Victor Pastor, CFO of FCC Group, Brian Field, Urban Planner and Development Advisor at the EIB, Duncan Magrath, CFO of Balfour Beatty and Andrew Wyllie.

Highlights

- ▶ Banks and funding institutions need some convincing that the risk/reward equation in funding infrastructure projects is attractive. The overriding sentiment across the panel was that funders need greater knowledge of the sector and the risks involved – cash-rich pension schemes and sovereign wealth funds might offer additional funding avenues and stimulus.
- ▶ Political drive and support to push through infrastructure development is essential in helping fuel recovery. Expenditure on such projects is calculated to have a multiplier effect of as much as 2.5 in the wider, national economy.
- ▶ Key differentiation factors for leading infrastructure and construction companies in the future will include improved product offerings through continuous innovation and appropriate consolidation, along with a concentration on so-called “gigaprojects” worldwide – expertise in sectors such as waste management, water and sustainable energy projects will be important, as will a strategy which addresses the vast potential of the emerging markets.
- ▶ A critical challenge for the sector is that of maintaining an appropriate “talent pool” – government intervention in promoting and supporting flexible working practices is seen as particularly important, as is the continued easing of restrictions around global mobility.



An analyst's perspective

Luis Prieto, an analyst at Deutsche Bank specialising in the sector, is a regular visitor to our Roundtable and offered some challenges to delegates in addressing market sentiment. The recurring theme of uncertainty loomed large again, with the adverse impact this is having on the analyst community and potential investors.

Highlights

- ▶ There is a huge degree of sensitivity in the earnings of companies in construction and related sectors to fluctuations in world demand. Calculations project that a 1% slow down in global economic growth could result in as much as a 25% decrease in the earnings of, for example, cement companies and a 15% fall in earnings by contractors.
- ▶ The impact of reductions in contract prices, caused by market contraction and increased competition is also notable with a 1% decline predicted to reduce EBITDA levels by 30%.
- ▶ The lack of appetite from the capital markets is heightening the difficulty in achieving short term funding. In a sector where financing is key, given the capital intensive nature of projects, this is only adding to the lack of attractiveness.
- ▶ Among analysts, there continues to be a perceived lack of transparency in the financial statements of construction companies. More insight, for example, into the maturity of order books or projections of margins likely to be achieved on future contracts would help to mitigate the challenges associated with making detailed projections about a company's future performance.



Corporate Governance and the Bribery Act

With the recent introduction of the UK Bribery Act and the increase focus around Europe and across the globe on governance processes and practices, Bribery and Corruption is a high-priority topic for CFOs. Kevin Hills, a Partner in Ernst and Young's Fraud Investigation and Disputes department presented his thoughts and perspectives and guided the audience through the results of Ernst & Young's fraud survey, applying its relevance to the Infrastructure and Construction sector.

Highlights

- ▶ The greatest pressures facing companies in the sector are around the ability to cut costs, ahead of driving revenue and boosting margins. Survey respondents indicated that as many as 72% believed that management were likely to cut corners to achieve satisfactory results.
- ▶ 68% of respondents Europe-wide believe that corrupt practices are prevalent in the industry – regulators are seen to be key agents for change. Although many governments are introducing new legislation, 77% of respondents in Europe to the survey either tended to agree or strongly agree that increased activity by regulators was needed. Training for employees is required to raise awareness of corruption, with up to 89% of employees in firms questioned not having received any training in the area.
- ▶ Although changing current practices will be difficult there are some important initiatives underway globally to improve transparency. Strong anti-corruption measures are gaining momentum in countries such as India and several countries in the Middle East and Africa with regulators looking to clamp down on illegal practices.
- ▶ On an individual company level, being proactive in the management of risk is essential – first and foremost the correct tone needs to be set at the top, supplemented by a thorough anti Bribery and Corruption risk analysis throughout all aspects of the business: and risk management should not end there. Thorough due diligence on all customers, suppliers and contracts is required to ensure that they comply with legislation and reflect a suitable anti-corruption stance.



2012 and beyond



Ernst & Young has an unrivalled client base across the Infrastructure and Construction sectors: we continue to help businesses of all shapes and sizes to respond to these unprecedented business and financial challenges. Whilst in the recent past the priority has been one of weathering the economic storm, we are of the opinion that there are reasons to be optimistic: we expect business focus to turn once again to growth, with high performing companies differentiating themselves in four key areas; customer reach and client relationships, operational agility and innovation, cost competitiveness and stakeholder confidence.

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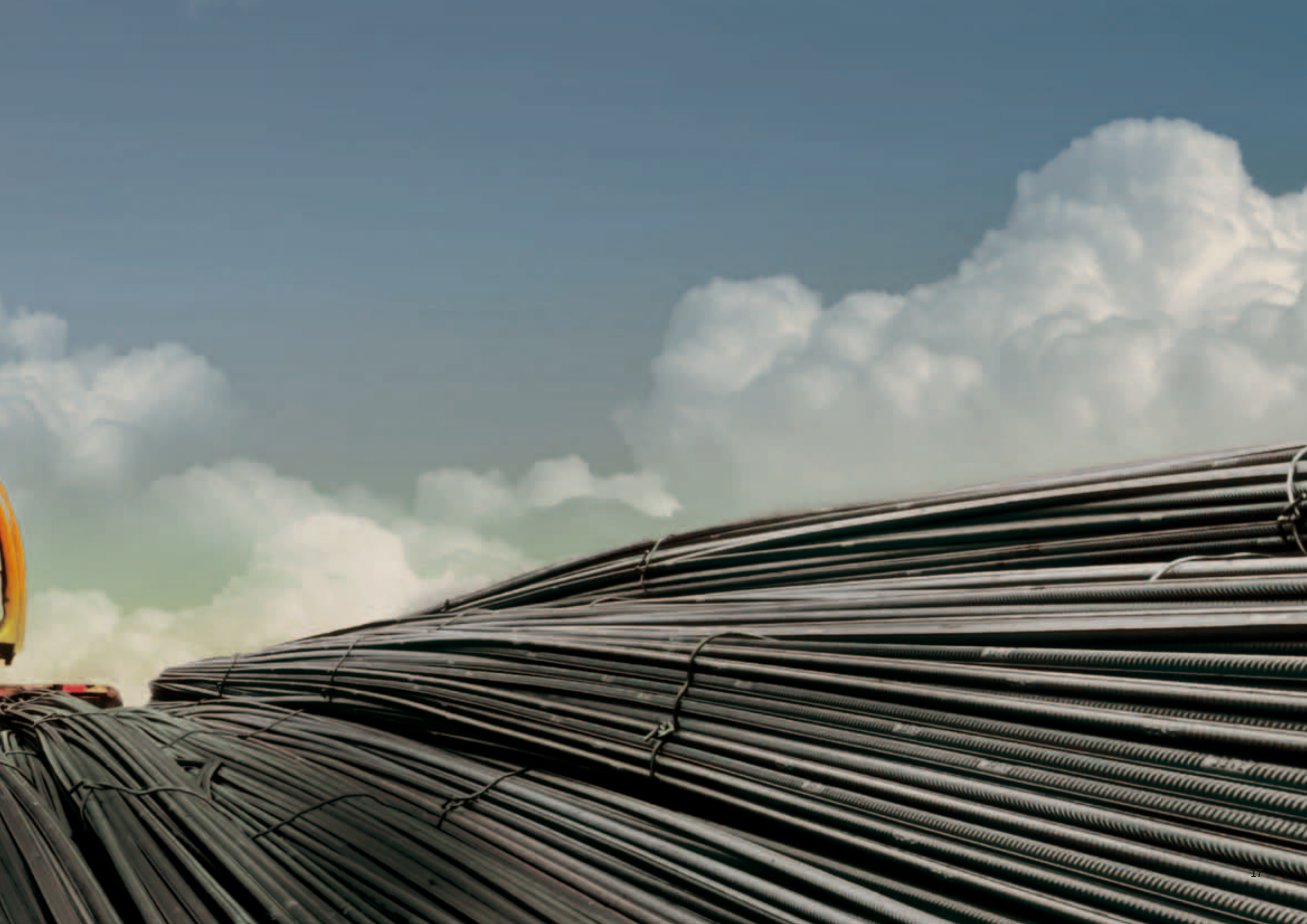
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