Galliford Try Holdings plc

Initiation Note

15th December 2020

Price
107p

TICKER
GFRD

Market Cap
£119m

Av. Month End Cash (June 2020)
£141m

Free Float
100%

3mo Av. Daily Volume
0.75m

Brokers
HSBC Bank, Peel Hunt

Index
FTSE Small Cap

Share Price Performance

Source: Bloomberg

Having exited its housebuilding and regeneration businesses in early 2020, Galliford Try is now a leading pure play construction firm with a solid balance sheet, strengthened risk management, and exciting growth prospects. Its focus is on "building, highways, and the environment"

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Old Company, New Business, Crazy Valuation

After the significant (and timely) sale of its housebuilding businesses in January 2020, Galliford Try is an old name with a newly focused business model, no debt, no pension liabilities, and significant cash on its balance sheet. It is a pure-play construction business with a large order book and highly visible revenue (90% of FY21 revenue was already secured by 30th June 2020), which is set to be profitable and cashflow positive this year. As a result, it will re-instate its dividend at the interim results.

Its future has been secured by a complete overhaul of its approach to risk management – resulting in strict discipline when bidding new contracts. This is underpinned by a confidence in its position as a high-quality construction business that will never again get dragged into high-risk trophy contracts.

Galliford Try offers a very solid platform for sustainable and profitable growth, being a prime beneficiary (80% of revenue is public sector or regulated) of the government's economic recovery spending plans. It is also on track to achieve margin expansion and increased cash generation. We therefore find it interesting that, with an EV of -£78m, it still trades below the value of the cash on the balance sheet. To us this suggests an opportunity to invest ahead of broader market recognition of its new reality.

SWOT

Strengths	Weaknesses
• No debt or pension obligations • Nationwide footprint in both building and infrastructure divisions • Dividend re-instated • Much of the (strong) pipeline is derived from repeat clients & existing frameworks: 90% of revenue was already secured for 2021 by June 2020 • Solid, high quality PPP Portfolio • Experienced management team • Disciplined approach to project selection and rigorous risk management	• Thin operating margin leaves construction businesses at risk from single project failure, but much risk mitigation now takes place to prevent this • The new risk approach and business model has only a short history • History of exceptional items linked to specific contracts procured under a different risk appetite and management team
Opportunities	**Threats**
• Strong orderbook in chosen markets with desirable risk profile • The government's economic recovery plans include significant work on infrastructure and other construction • Strategy for sustainable growth and robust risk management being implemented, market's acceptance thereof should be a catalyst • Education market tailwinds • Operating margin expansion • Trading significantly below cash value	• Several existing regulatory investment frameworks expire in 2025, though some have roll-over provisions, which limits this risk • COVID has been a big client and supplier disruptor and if future lockdowns are closer in style to the original than to lockdown 2.0, weakness could follow • Scrapping of PFI in England

At a Glance (Yr to June)	Revenue (£m)	Adj. EBIT (£m)	Adj. EPS	DPS	PER	Yield
2019 A	1,403	(20)	(10.6p)	58.0p	N/A	9%
2020 A	1,090	(64)	(47.7p)	--	N/A	0%
2021 Cons	1,225	7	7.5p	2.5p	14.1 x	2%
2022 Cons	1,278	13	12.1p	4.0p	8.7 x	4%
2023 Cons	1,339	18	16.2p	5.4p	6.5 x	5%

Background and Recent History

Galliford Try was founded in 2000 as a result of the merger of Try Group and Galliford Plc, both of which had existed since the early 1900s. It purchased Morrison Construction in 2006 and a series of housebuilders that it consolidated into Linden Homes in 2011.

In 2018 the failure of JV partner Carillion resulted in a £143m cost overrun for Galliford Try on the Aberdeen Western Peripheral Route (AWPR Bypass) project. This was a large, fixed-price contract that had already suffered from significant cost overruns, which themselves partly contributed to Carillion's failure. This led to a dividend cut and a £150m (net) rights issue. This issue was eventually settled in December 2019, resulting in a cash recovery to Galliford Try of £32m and a write off of £52m.

This settlement closed this chapter in Galliford Try's history, and in conjunction with other troublesome, large scale projects, led to a restructuring and recapitalisation plan, along with a complete overhaul of its risk appetite and its approach to risk management.

Following a rejected £950m bid for Linden Homes and the Partnerships & Regeneration businesses in mid-2019, Bovis Group (now Vistry Group) returned and bought them for £1.1bn in a mixed shares (Galliford Try shareholders were given29.2% of Bovis Group), debt (£100m 10-year bond transferred to Bovis), and cash (£300m) deal in November 2019 – this completed at the start of January 2020. There was no real benefit or synergy from owning both a housebuilder and a construction business, so we believe this transaction was a highly positive step in shoring up the balance sheet, focusing management and capital, and unlocking value with no material downsides.

The transaction extinguished all debt and pension liabilities, provided a large cash injection, and focused the group on its core Building, Infrastructure, and PPP Investment segments. Following completion, Bill Hocking (previously Chief Executive of Construction and Investments) took up the role of CEO, ushering in a new era of risk management. Interestingly, whilst at Skanska Bill had declined to participate in either the AWPR or the Queensferry/Forth Bridge contracts as he perceived them as being too risky. Safe to say he has brought strong discipline to his role as CEO of Galliford Try.

More recently, all sites remained open during the second lockdown of 2020, the pipeline has remained strong (more detail on which below) and the company is on the cusp of a return to profitability and the resumption of its dividends.

Business Model

The 'new' Galliford Try is now a pure play construction contractor that derives the majority of its revenue from the public and regulated sectors and that has 200-250 contracting jobs open across the UK at any given time.

The key thing to understand about the new business model is that it is now highly selective when taking on new contracts, emphasising quality rather than volume or pricing, and keeping a tight control on risk factors such as margin, inflation, and overruns on every single project. It no longer undertakes major, fixed-price, infrastructure projects where it alone bears all the risk – examples of that include AWPR and the Queensferry Crossing, both of which resulted in significant financial pain, though are now both fully closed off. This has been its policy for 3 years now, and as a result the current orderbook reflects the new approach to risk.

Reliable margins are the new mantra, and one that is constantly being re-iterated to managers at all levels of the business. There is a strong emphasis on "not getting one wrong", which can effectively put the contributions from many other projects in jeopardy.

Galliford Try operates under 3 types of contract:

(i) fixed price, where Galliford Try takes all the risk of cost overruns and benefit from cost underruns. It now focuses on small contracts (the median size being in the £10m-£20m range) on this basis;

(ii) cost+, where Galliford Try is repaid all costs incurred and an agreed margin on top. Galliford Try's larger infrastructure contracts are usually written on this basis to de-risk them;

(iii) target cost, where Galliford Try and the client share, on a specified basis, any cost overruns or underruns (often combined with cost+ to form a two-stage tender);

The most desirable work comes from frameworks, where Galliford Try is a pre-qualified contractor who is allocated work on individual projects within a larger plan. 90% of revenue is derived from frameworks – see appendices for a list of key frameworks. Because of the pre-qualification, these projects aren't purely price dependent. They can sometimes be contracted on a cost+ or a target cost basis, but there remains strong client demand for fixed-price contracts, so this risk can't be entirely avoided.

It can be mitigated to some degree though, for example through use of certain carve outs (for example carving out heritage works in old buildings as these are inherently unpredictable and can get very expensive, very quickly) or through focusing on work that it knows inside out, like building schools. Galliford Try has built so many that its fixed pricing is highly accurate and school build costs are, at this stage, fairly predictable.

In fact, most projects in the Building segment tend to be fixed price, whereas in Infrastructure, cost+ is more standard, particularly when building roads. Typically, Galliford Try will be paid to design a junction or other feature, following which the client owns the design. Galliford Try and the client would then agree a target price for implementation, add a margin on top, and agree a pain/gain function that facilitates the sharing of profit and cost (often 50:50) if the project comes in under or over target.

Split Pain/Gain Example	Under Budget	Over Budget
Target Cost	£100m	£100m
Actual Cost	£95m	£105m
Split Agreement	50% / 50%	50% / 50%
Extra Profit/(Cost) to Galliford Try	£2.5m	(£2.5m)
Extra Profit/(Cost) to Client	£2.5m	(£2.5m)

Galliford Try typically doesn't enter open bid situations as those tend to be purely price driven, which is more likely to result in failed projects and risk damaged reputations than a more holistically approached tender process. Galliford Try's key benefit to its clients is its consistency of deliver, quality, and ethics - not just the total project price. Its performance shows through, with a 72% net promotor score and with 90% of work won being repeat business.

Further benefits can be derived from this multi-faceted (i.e. not purely price-focused) approach to contracts. One key example is the government's introduction of the latest updates to its "Outsourcing Playbook" to formalise procurement from private sector companies. This was introduced post-Carillion (and updated in December 2020), with an emphasis on measures that drive value for money rather than achieving the lowest up-front cost. Factors taken into account include the balance sheet, employees, management and risk systems, and other work. This should reduce the incidence of lower-quality competitors under-bidding to a price at which the work couldn't be done well, and therefore favours firms, like Galliford Try, that already aim to provide the best value.

Finally, operationally management have made myriad improvements, including:

(i) Selectivity – all businesses are now highly selective when it comes to taking on new contracts. They can and do turn down work that doesn't fit within the new risk framework or is undesirable for any other reason. In February Galliford Try was the preferred bidder on a large contract in England but the price and some terms couldn't be agreed – as such it turned down the work. This confidence stems from the company knowing its strengths and weaknesses and having the cashflow and balance sheet to be *"choosy"*. It is therefore avoiding contracts where it's not well placed to execute. Where management believes Galliford Try can't work within its preferred risk parameters with a client, it avoids work from that client entirely. This has resulted in a clean order book, filled with only contracts that Galliford Try wants to and can undertake.

Selectivity also applies to contract size, which is another source of risk. Clearly in a business with thin margins (Galliford Try is aiming for a very respectable >2% operating margin in the medium term) a single large project, if it goes wrong, can easily lead to group-wide losses and write-downs. Contracts now average <£20m in building and <£30m for the group. For context we remind you that revenue is £1.1bn. The largest contract at present is £105m, which is for three Leeds-based Private Rental Sector projects to be delivered over a 3-5-year period. As such, despite being 3.5x the average size, it remains a relatively low risk contract, even more so in light of the other risk mitigation taking place at time of tender and during the construction phase.

(ii) Control – the new management team introduced a peer review process, which involves the Business Unit Director reviewing all tenders proposed by new Project Managers and for types of project in which they aren't experienced. Tenders also get challenged from other areas of the business, and expertise and experience are now often brought into the tender process from other business units to maximise group potential. This sounds easy but has required a significant cultural shift.

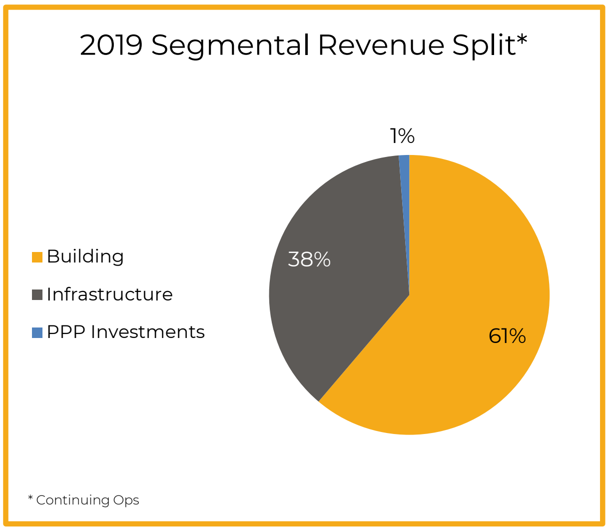
Management have also implemented a group-wide heat map: if a local area manager wants to bid on a piece of work, the bid team will investigate factors including supply chain, scale, other similar exposures, etc. and flag anything unusual to the Executive board for discussion. Additionally, any contract over £25m must be approved by the Executive board.

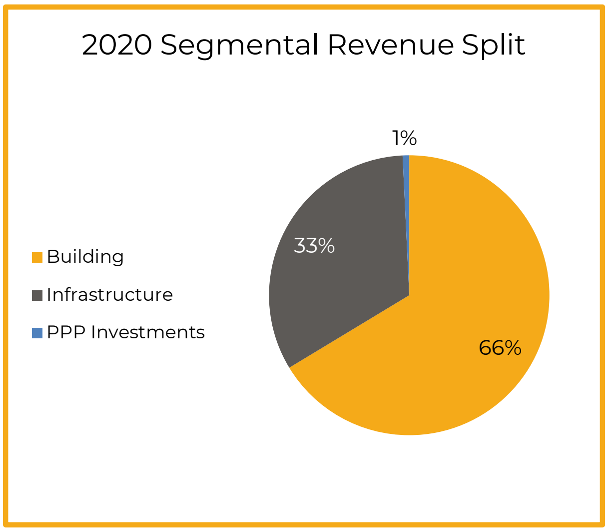
(iii) Monitoring - site managers now use digital technology to record progress, and pictures, throughout the construction phases that are archived for long-term to help with maintenance, improvement works, troubleshooting, and to ensure quality. Management also hold client reviews to ensure contracts remain on track and business development is prioritised.

(iv) Efficiency - reporting lines have been shortened and technical capability has been improved. Project efficiency and sustainability has also improved significantly, as attested to by staff and client feedback, as well as how quickly and safely work resumed post-COVID. All sites remained open during the second lockdown.

(v) Health and Safety – management have and continue to implement a new mindset across the entire group, ensuring that everything is done properly and safely. Management focus on designing safety into every aspect of the business has seen all indicators improve over the last year.

Segments





For reporting purposes Galliford Try is divided into the Building, Infrastructure, and PPP Investments segments.

Building (64% revenue, -8% FY20 operating margin, £2.2bn order book) works in the private and public sector. Its end market exposures are Education (£531m currently in the order book), Defence (£504m), Healthcare (£263m), Facilities Management £395m), and commercial buildings (£264m).

Education focuses on the building of new schools. It's a £14bn market across primary and secondary education, and represents c.£531m of the Building segment's order book. Building typically has 30 schools under construction at any given time, and this is currently Galliford Try's largest sector.

Many older school buildings currently need replacing due to changes in environmental, health and safety, and use requirements. New school projects, whilst large, are de-risked in a number of ways. New school are typically built on the playing fields of an existing school, which would then be demolished and the playing fields re-instated upon completion of the new buildings, reducing the complexity and risk of interference with the daily operation of the school.

Defence & Justice represents c.£504m of the order book, and the recent focus in this market has been on the £4.6bn earmarked for optimising existing military sites. Examples include the replacement of old garrison blocks and the consolidation of multiple regiments/sites into single garrisons.

More recently though, in November 2020 the government allocated a further £16.6bn for defence spending. Whilst this latter may be more aimed at combat capability, there will undoubtedly be a boost to spending on military infrastructure too. Galliford Try has won two significant contracts recently and the pipeline looks strong. We believe there is plenty of opportunity for growth in this market in coming years.

Healthcare work, representing c.£263m of the order book, tends to involve bolt-on additions to existing hospitals, rather than the construction of entirely new ones. Recent examples include the addition of specialist cancer wards and administrative office blocks. Health received a £7bn allocation in the government's latest capital budget, and it's difficult to imagine a decline in health sector spending in the short- or medium-term given the events of 2020. Population growth and ageing are both well-flagged drivers of growth in this sector.

Commercial represents c.£264m of the order book, and focuses on private sector commercial projects. This is clearly the area of Galliford Try's business that's most exposed to GDP. We expect client investment here to remain subdued for 2021, as not only do corporates have to recover from COVID-19, but also have to decide on the shape and size of their real estate in a future that contains an unknown *"working from home"* outlook. Offices, hotels, leisure buildings, and student accommodation have been hit hardest so far. On the other hand, private rented accommodation is likely to remain in demand due to a shortage of housing stock – and there have indeed been good opportunities through 2020 in PRS. Here and now more than the other sectors at other times, the selectiveness of Galliford Try will pay off – clearly there is increased credit risk in the private sector, which is elevated by the current economic climate.

Facilities Management (CAG estimate c.£30m revenue, £395m order book) provides ongoing operational and maintenance services for buildings built or invested in by Galliford Try. This is a long, slow order book with contracts typically lasting 20-25 years – and therefore it provides an annuity-type income for the group.

Scottish contracts operate under Morrison Construction brand; the largest construction business in Scotland, having delivered more than £1bn of projects to the Scottish public and private sectors between 2015 and 2020. It represents c.25% of Galliford Try's business. Morrison offers a full range of contracting solutions, and is well known for its *"whole-life"* contracting solution – whereby it helps with funding, design, construction, and operations & maintenance. One of its most famous, if not one of its largest, projects is the Falkirk Wheel, but it has contributed to projects as large as £790m (the Queensferry Crossing/Forth Bridge) and as small as £1.9m for a commercial property refurbishment. Scottish public infrastructure and projects at the large end of this scale no longer fall within its strategic plan.

The Building order book comprises much smaller projects than it used to, with an average size of c.£20m to reduce concentration risk. In fact, the largest Building contract contribution to revenue last year was £30m, which really caps the potential for significant, one-off contract losses.

During 2020 Building secured a place on 13 lots for the Crown Commercial Services Construction Works and Associated Services major framework. This c.£20bn framework is available to all public sector organisations to procure construction services, so Galliford Try's inclusion on it can offer a significant potential pipeline boost.

Infrastructure (35% revenue, 5.1% FY20 operating margin, £1bn order book) undertakes civil engineering works, focusing on highways and the environmental sector – this latter consisting mostly of water and waste-water processing.

Highways is the larger part of Infrastructure (£598m order book), and work is mostly contracted with Highways England. The remainder is contracted with local authorities. – However, the need for upgrades and repairs won't disappear, so this is a timing issue more than a decline issue. The UK currently has a £28.8bn budget between 2020 and 2025, through the National Roads Fund. Much of the road network is at or beyond capacity, and is in poor condition, and during FY20 £377m of work was contracted, underlining the momentum here.

Environment work is mostly contracted through frameworks with Southern, Thames, Scottish, & Yorkshire Water. It incorporates water, wastewater, and flood alleviation works. The order book (£384m) comprises work from long-term framework environments (as opposed to cold bidding for ad hoc work) with collegiate clients, most of whom are repeat business. The contracts are typically on a cost+ basis, minimising risk for Galliford Try, and the frameworks generally last for 5 years (in the UK, 7 years in Scotland), with the option to extend to 10 years in some cases. A key factor here is the renewal of the frameworks, which are generally aligned with regulatory cycles, the latest being AMP7. An asset management plan (AMP) period is a five-year window used by the water regulator (Water Services Regulation Authority) to set allowable price increases and assess water quality and customer service KPIs. AMP7 focuses on population growth and environmental impact.

Galliford Try has been awarded contractor status on both the infrastructure and non-infrastructure programmes of Thames Water, for example.

PPP Investments (1% revenue, portfolio NPV £40.7m @ 9% discount rate) uses public-private partnerships and co-development to deliver major building and infrastructure projects. This part of the business leads bid consortia, arranges finance, makes equity investments, and manages construction and operations. It often acts as a pipeline feeder for the construction and building segments – for example if it works on the fundraising for a school, the Building segment often then carries out the work, and Facilities Management might maintain it on a 25 year contract.

It's worth noting that the interest income from PPP Investments comes in below the EBIT line, so success here isn't assumed in the 2% EBIT margin target. The PPP portfolio is also valued using a 9% discount rate, which we believe is high given the prevailing rate environment. A 1pp reduction in this rate would represent an additional £3m of value on the balance sheet.

PPP Investments and Facilities Management are small parts of the business but in our view offer low risk, stable & repeating income with high margins and scope for further low risk growth, as well as providing a pipeline feeder for the rest of the business.

Strategy

There are three prongs to Galliford Try's strategy: Retain & Enhance the existing, solid business to provide a platform for sustainable growth, Improve operations to drive margin progression (towards its 2% operating margin goal), and Deliver strong and predictable cash flow and margin expansion.

In practice this looks like a huge push to improve risk management and safety, support the workforce, modernise systems and construction methods, and deepen supply chain relationships.

It's well understood that the key risk for any business in construction, an industry with thin operating margins (generally around the 2% mark) is a large project turning loss-making and offsetting the profit generated by a large number of successful projects. It only takes one: as Bill Hocking says *"To be the most successful contractor in the UK you only need to have no loss-making contracts."* This sounds easy but it is the core of the industry and its history of struggles.

Galliford Try's risk management strategy, which includes choosing counterparties carefully, limiting contract size, and encouraging or mandating internal checks for exposure or unusual risks, is all about avoiding these losses. It looks like it should set the business up well for sustainable growth. The details of this are discussed further elsewhere in this note.

The goal is to become a business with medium-term revenue of £1.2bn-£1.5bn, <£10m of central costs, a >2% operating margin, no outsized risk from large vanity projects, and positive cash flow allowing re-instated dividends.

In order to hit the 2% margin target, central costs will be kept below £10m a year. Some legacy operating costs will take time to fall following the disposal of the housing business, such as property leases – although many of these will expire within the next 5 years. At the start of 2021, for example, the head office will be moved to a smaller and cheaper (per sq. ft.) location. The same will happen with another large property at the end of 2021.

Given what has been achieved so far with the disposal of the housebuilding business, the repair of the balance sheet, and the bidding discipline that's been installed at all levels of the business, this looks like a realistic target.

Impact from external events (Brexit, COVID)

Management reacted quickly to the COVID crisis, ensuring all office-based employees could work from home before the first lockdown was implemented. For site work, when sites were re-opened in early summer staggered start and end times were implemented, along with weekend working to keep construction operating in England, although Scotland was forced to close down fully. Once Scotland was open again, the sites were at full capacity again quickly though due to lessons learned from having implemented these processes in England. By the second lockdown, Galliford Try was able to keep all sites open and operating throughout, at near normal productivity.

There was a strict cash focus early on, although management didn't shut down payments to the supply chain, in order to be fair to their suppliers. Instead they matched cash in and cash out to preserve its position. With the government continuing to pay its suppliers, this balance was made easier on both Galliford Try and its supply chain and Galliford Try actually improved its prompt payment metrics through the COVID disruption period. As a result, cash held up well and was at the high end of guidance and management's expectations by the end of the crisis.

Early in the crisis COVID had some impact on the supply chain, with some specific materials/products being hard to obtain at first, but many factories re-opened after the first month in Spring/Summer.

Furlough was used to retain c.1,200 staff at the peak of the crisis, but the company dropped out of the scheme in August, with the majority having returned to work at the end of June. No other loans or grants were taken.

Longer term we believe there will be a positive impact from COVID, with the government intent on investing in infrastructure to boost the economy, on top of its existing plans to *"level up"* the North of England and de-carbonise the economy. In fact, the orderbook has grown through the pandemic due to the ongoing policies and additionally the Economic Recovery plan. COVID has possibly accelerated government spending but growth was expected anyway under this *"no return to austerity"* government.

We don't expect Brexit to impact the business materially, although there may be some supply chain disruptions in the short term and localised staffing difficulties in the short- and medium-term. However, Galliford Try is mitigating these risks by maintaining strong and long-term relationships with suppliers and subcontractors, offering access to training programmes to encourage closer co-operation. It is also providing subcontractors with more visibility on the pipeline so they can manage their workloads better, which makes Galliford a favoured partner.

ESG

Both public and private sector clients (though there's more emphasis on this in the public sector) are ever more interested in ESG factors when it comes to allocating contracts. It's vital that procurement teams can demonstrate the ESG performance of their purchases, so it's core to the way the business operates.

Galliford Try is industry-leading in terms of ESG, and when we met management, they were clearly dedicated to doing the right thing – not only because it helps business, but also because it aligns with their beliefs.

Proof of this comes from both its proportion of public/regulated revenue in the mix (81% in FY20) and its FTSE4Good rating, which was much improved YoY at 3.3, from 2.4, out of 5. This also compares favourably with the sector, on an average rating of 1.5 out of 5. Its considerate Constructors score is also ahead of the industry average, at 41.1 in FY20 vs. 37.1 for the industry and 40.5 for FY19.

Further, between calendar year 2018 and 2019, carbon dioxide emissions fell 30%, and it won *"BIM Constructor of the year"*.

Management

Peter Ventress, Chair. Peter became Chair in 2016. He is also Chair at Bunzl and an NED at Signature Aviation. Previously he has been CEO of Berendsen, International President of Staples, and CEO at Corporate Express N.V.

Bill Hocking, CEO. Bill was appointed CEO in January 2020 after the sale of the housebuilding division. He has been with Galliford Try since 2015, and since August 2016 he was Chief Executive of Construction and Investments. Prior to this he was EVP at Skanska UK.

Andrew Duxbury, FD. Andrew was appointed FD in March 2019 having previously been FD of Linden Homes. Prior to joining Galliford Try he was at PWC.

Financials and Consensus

We now take a look at consensus forecasts for this financial year and the following 2 years. Galliford Try is covered by three analysts: HSBC, Peel Hunt, and Liberum. The last round of updates was in September 2020.

P&L – Revenue visibility in this business is very good, with 90% of 2021 revenue already secured – as such we believe consensus of just over £1.2bn is well grounded. The 4-5% consensus growth estimate from there is undemanding given the tailwinds discussed earlier in the note, but management are more focussed on quality of work than volume.

The biggest driver of margins is the level of losses and claims, so avoiding these is, as discussed elsewhere in the note, far more important than GM. That said, gross margin is also driven by the quality of the order book, and the achievable gross margin is a key decision factor in the bidding and pricing process.

Management is aiming to achieve operating margin of c.2% in the short- to medium-term, which would then be bolstered by financial income before reaching the bottom line – and an absence of financial cost due to the lack of debt. During this forecasting period consensus believes a 1.4% operating margin can be achieved, with range of estimates fairly tight at 1.2% to 1.6%.

The dividend consensus represents c.33% payout ratios against consensus EPS, with a tight range for FY21 DPS spreading by FY23 to between 5p and 6p.

£m	2019 A	2020 A	2021 Cons	2022 Cons	2023 Cons
Revenue	1,402.9	1,089.6	1,225.3	1,277.5	1,339.3
Cost of sales	(1,348.4)	(1,085.9)			
Normalised gross profit	**54.5**	**3.7**			
Margin	3.9%	0.3%			
Legacy adjustments	(44.8)	25.7			
Reported gross profit	*9.7*	*29.4*			
Administrative expenses	(74.1)	(68.0)			
Normalised operating profit	**(19.6)**	**(64.3)**	**7.2**	**13.4**	**18.6**
Margin	-1.4%	-5.9%	0.6%	1.1%	1.4%
Restructuring adjustments	(2.5)	(0.6)			
Reported operating profit	*(66.9)*	*(39.2)*			
Share of post tax (losses)/profits from JVs	0.4	(0.2)			
Normalised (Loss)/profit before finance	**(19.2)**	**(64.5)**			
Reported (Loss)/profit before finance	*(66.5)*	*(39.4)*			
Finance income	3.6	5.8			
Finance costs	(1.6)	(1.0)			
Normalised (LBT)/PBT	**(17.2)**	**(59.7)**	**9.9**	**16.1**	**21.4**
Reported (LBT)/PBT	*(64.5)*	*(34.6)*			
Income tax credit/(expense)	5.4	6.8	(1.6)	(2.5)	(3.2)
Normalised net profit from cont ops	**(11.8)**	**(52.9)**	**8.3**	**13.5**	**18.1**
Margin	-0.8%	-4.9%	0.7%	1.1%	1.4%
Reported (Loss)/profit from cont ops	*(49.5)*	*(32.6)*			
Profit from discontinued operations	136.9	353.0			
Reported Net Profit	*87.4*	*320.4*			
Number of shares out (m)	110.8	110.8			
Diluted EPS					
Normalised, continuing Ops	**(10.6p)**	**(47.7p)**	**7.5p**	**12.1p**	**16.2p**
Reported	78.9p	289.2p			
DPS	**58.0p**	**0.0p**	**2.5p**	**4.0p**	**5.4p**

Balance Sheet - A robust balance sheet is, in the post-Carillion world, a vital requirement for a construction business – not just for investors, but for clients. Galliford Try excels here, with average cash at month end since the disposal of the housebuilding business having been £141m – 13% of turnover.

The disposal also rid the business of all debt and pension liabilities, and Galliford Try doesn't use supply chain financing so gross cash is a true net cash position. Note most peers retain some bank finance and other leverage. The provisions lines in the balance sheet relate to the finalisation of the disposal accounting.

We do not expect the balance sheet or equity position to change much – certainly no debt is likely to be added and no equity raised in the near- or medium-term. The Consensus view is similar.

£m	2018 A	2019 A	2020 A
Assets			
Non-current assets			
Intangible assets	15.3	11.8	**7.8**
Goodwill	159.6	159.6	**77.2**
Property, plant and equipment	16.7	16.2	**3.8**
Right of use assets	0.0	0.0	**22.8**
Investments in subsidiaries	0.0	0.0	**0.0**
Investments in joint ventures	49.9	67.0	**0.2**
PPP and other investments	26.8	41.6	**40.7**
Trade and other receivables	148.9	238.4	**0.0**
Retirement benefit asset	7.0	7.0	**1.0**
Deferred income tax assets	0.0	1.3	**4.3**
Total non-current assets	**424.2**	**542.9**	**157.8**
Current assets			
Developments	724.9	876.7	0.0
Trade and other receivables	731.6	674.3	247.5
Current income tax assets	12.3	8.7	23.1
Cash and cash equivalents	912.4	591.2	197.2
Total current assets	**2,381.2**	**2,150.9**	**467.8**
Total assets	**2,805.4**	**2,693.8**	**625.6**
Liabilities			
Current liabilities			
Borrowings	(617.1)	(547.8)	**0.0**
Trade and other payables	(1,184.0)	(1,262.5)	**(458.8)**
Lease liabilities	0.0	0.0	**(9.5)**
Provisions for other liabilities and charges	(0.3)	(0.4)	**(13.9)**
Total current liabilities	**(1,801.4)**	**(1,810.7)**	**(482.2)**
Non-current liabilities			
Financial liabilities			
– Borrowings	(197.1)	(100.0)	**0.0**
– Derivative financial liabilities	(0.9)	(0.4)	**0.0**
Deferred income tax liabilities	(0.7)	0.0	**0.0**
Other non-current liabilities	(122.3)	(103.0)	**0.0**
Lease liabilities	0.0	0.0	**(12.8)**
Provisions for other liabilities and charges	(0.8)	(0.4)	**(10.1)**
Total non-current liabilities	**(321.8)**	**(203.8)**	**(22.9)**
Total liabilities	**(2,123.2)**	**(2,014.5)**	**(505.1)**
Net assets	**682.2**	**679.3**	**120.5**
Equity			
Ordinary shares	55.5	55.5	**55.5**
Share premium	197.6	197.7	**0.0**
Other reserves	4.8	4.8	**85.7**
Retained earnings	424.3	421.3	**(20.7)**
Total equity	**682.2**	**679.3**	**120.5**

Cash Flow - This is an intrinsically cash-generative business, with clients paying cash in tranches over the duration of the contract. As such there is minimal requirement to fund fixed assets or working capital.

Primary uses of cash include the funding of PPP projects, maintaining the strong and flexible balance sheet, and dividend payments.

There is quite a spread in cash flow estimates, with Net Cash Used in Operations for FY21 ranging from -£6.4m to +£36.9m. Our view is that with sites open and the worst of COVID behind us, not to mention that legacy loss-making projects have been settled, operating cash flow should be positive this year.

It makes more sense to focus on average month end cash as opposed to year end, as this removes some of the lumpiness from contract finish dates etc. Management updates the market regularly on this KPI.

£m	2019 A	2020 A	2021 Cons	2022 Cons	2023 Cons
Cash flows from operating activities					
Net cash used in ops pre-working cap	**(68.3)**	**(2.8)**			
Decrease in trade and other receivables	31.7	128.5			
Decrease in trade and other payables	(92.6)	(257.1)			
Net cash used in operations	**(129.2)**	**(131.4)**	**42.8**	**36.2**	**41.6**
Interest received	5.0	4.9			
Interest paid	(2.1)	(1.0)			
Income tax received	16.6	7.5			
Net cash used in operating – cont. ops	**(109.7)**	**(120.0)**	**19.2**	**19.9**	**33.5**
Net cash (used in)/generated from operating – discont. ops	50.1	(32.1)	--	--	--
Net cash used in operating activities	**(59.6)**	**(152.1)**	**19.2**	**19.9**	**33.5**
Cash flows from investing activities					
Dividends received from JVs	0.4	--	2.3	2.5	2.5
Movement in net working capital due from JVs	0.1	(2.4)	(1.7)	(3.1)	(3.4)
Acquisition of PPP and other investments	(22.7)	(6.6)	(0.8)	(0.8)	(0.8)
Proceeds from disposal of PPP & other investments	21.1	5.8			
Acquisition of P, P, &E	(2.7)	(1.4)	(4.1)	(4.1)	(4.1)
Proceeds from sale of P, P, &E	0.5	--	(4.0)	(4.0)	(4.0)
Net cash (used in)/generated from investing – cont. ops	**(3.3)**	**(4.6)**	**(6.2)**	**(4.6)**	**1.3**
Net cash generated from/(used in) investing - discont. ops	(11.0)	362.6	--	--	--
Net cash generated from/(used in) investing activities	**(14.3)**	**358.0**	**(6.2)**	**(4.6)**	**1.3**
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital	0.1	--	--	--	--
Repayment of lease liabilities	--	(10.0)	(10.0)	(10.0)	(10.0)
Decrease in borrowings	(0.1)	--	(0.5)	0.3	0.3
Net dividends paid to Company shareholders	(79.9)	(38.9)	(1.2)	(3.6)	(4.8)
Net cash used in financing – cont. ops	**(79.9)**	**(48.9)**	**(4.7)**	**(6.8)**	**(8.1)**
Net cash generated from financing – discont. ops	--	(101.4)	--	--	--
Net cash used in financing activities	**(79.9)**	**(150.3)**	**(4.7)**	**(6.8)**	**(8.1)**
Net increase/(decrease) in cash	**(153.8)**	**55.6**	**10.4**	**8.6**	**20.8**
Cash and cash equiv. at 1 July	295.4	141.6	197.2	207.6	216.2
Cash and cash equiv. at 30 June	**141.6**	**197.2**	**207.6**	**216.2**	**237.0**

November 2020 Trading Update

This was a solid update, and demonstrates that Galliford Try is very much on track to recover from the COVID crisis. All projects have been fully operational since the start of this financial year (1 July 2020) and productivity is approaching normal levels, with operations remaining normalised during the second national lockdown.

The H1 average month-end cash position was in line with management expectations, and towards the upper end of previous guidance of £125m-£145m. The business is expected to return to profitability in H1 and dividends should resume with the interim results. Consensus expects a dividend of around 2.5p in FY21, 4p in FY22, and 5.4p in FY23 – each of which representing a payout ratio of c.33%.

Management also updated on the pipeline, which remains impressive. Recent significant contract wins include:

- lots 3 and 6 of Thames Water's AMP7 £590m four-year framework in the London region. This significantly reduces the risk of falling revenue from Thames Water as its current 4-year frameworks come to an end;
- £105m commercial and PRS development at Monk Bridge for Highline Investments;
- £85m M56 junctions 6 to 8 works for Highways England;
- £60m Winchburgh Schools project in West Lothian for West Lothian Council; and
- £50m refurbishment project at 280 Bishopsgate in London for Arax Properties.

Valuation & Peers

The first thing to address about the valuation is the fact that Galliford Try is currently priced significantly below the value of the cash on the balance sheet. This implies that the market requires further evidence that the new policies are working and the new targets, such a the 2% operating margin, can be achieved. We've explained above why we believe that Galliford Try is already achieving, and as such this valuation appears to be disconnected from the likely performance of the business.

By looking at the peer group, one can see that on historic business performance, Galliford Try deserves to trade at a discount: two of the group (Morgan Sindall and Balfour Beatty) have positive FCF margins already, for example. However, markets are supposed to discount the potential performance as much as or more than past performance.

We believe that the key catalyst will be the first set of "clean" post-COVID and post-disposal numbers to be released, provided they demonstrate significant headway towards positive free cash flow. This will not only act as a market catalyst, but may also act to further improve its reputation with clients as a counterparty with a strong balance sheet.

The only other reason we can see for this low valuation is a relative one: GFRD has significantly outperformed its peers over the last 12 months:

Share Price Performances (comparative group)	Share Price	1M	3M	12M
Galliford Try Holdings	**105**	**46.7%**	**24.4%**	**32.0%**
Morgan Sindall Group	1402	14.0%	14.0%	-3.0%
Kier Group	80	74.9%	34.2%	-4.8%
Balfour Beatty	267	23.4%	14.3%	16.0%
Costain Group	55	52.1%	10.7%	-70.0%
Peer Average		**42.2%**	**19.5%**	**-6.0%**

Source: Bloomberg

However, whilst this may imply profit taking, we still think Galliford Try falls well short of its valuation potential.

Given the negative EV of this business, we can't look at any EV valuation metrics so we next look at trailing and forward P/E:

Comparative Valuation	PER Trailing	PER '21	PER '22	PER '23
Morgan Sindall Group	9.2x	12.9x	9.5x	8.5x
Kier Group	N/A	2.4x	1.8x	1.7x
Balfour Beatty	14.2x	24.3x	6.5x	4.7x
Costain Group	N/A	6.4x	4.3x	3.6x
Peer Average	**11.7x**	**11.5x**	**5.5x**	**4.6x**
Galliford Try Holdings	**N/A**	**14.9x**	**9.2x**	**6.9x**

Source: Capital Access Group & Bloomberg

Here the story is a little more muddled, as Galliford Try does trade on a premium to the peer group – however, the peer average is again dragged down by Kier, who has a net significant debt position and Costain, which is more of a pure play infrastructure business. Excluding Kier from the average would bring it into line with Galliford Try, and excluding Costain too would suggest Galliford Try trades at a significant discount to its closest peers, Morgan Sindall and Balfour Beatty.

Finally, we can take a look at the consensus valuation: the simple average target price of the analysts covering Galliford Try is 160p.

So it's clear that in almost any way you cut it, Galliford Try represents decent value, provided it can preserve its balance sheet and avoid further large losses; something it is eminently capable of doing under its new structure.

Our key framework positions

We form long-term partnerships with our clients, aligning their needs on a project-to-project basis with their long-term ambitions and requirements, and are consequently a valued partner on many key frameworks. A framework can generate tens or hundreds of millions of pounds of work for us, over its duration.

- Department for Education's school building framework (six lots).
- LHC Schools and Community Buildings Framework.
- Crown Commercial Service (CCS) Capital Works Framework.
- Ministry of Justice Strategic Alliance Framework (multiple lots).
- Defence Infrastructure Organisation Capital Works Framework.
- ProCure22 Department of Health and Social Care Framework.
- hub North Scotland, hub South East Scotland, hub South West Scotland and hub West Scotland.
- London Construction Programme.
- Manchester City Council Highways and Infrastructure Framework.
- NEUPC Universities Framework.
- Scottish Procurement Alliance.
- Southern Construction Framework.
- North West Construction Hub.
- YORbuild/YORcivil.
- University of Strathclyde.
- Procure Partnerships.
- Highways England Delivery Integration Partnership.
- Manchester Airports Group Capital Delivery Framework.
- Gatwick Airport's Capital Delivery Framework.
- AMP7 – Yorkshire Water, Southern Water and Thames Water.
- Scottish Water.
- North East Procurement Organisation.
- Smart Motorways Programme.
- Midlands Highways Alliance.
- Network Rail Control Period 5.

Source: Galliford Try 2020 annual report, p19.

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