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Wood HY22 Trading Update

Thursday, 7 July 2022

Introduction

David Kemp

CFO, Wood Group

Thank you. Good morning, and welcome to our Half Year Trading Update Call. Before we go to Q&A, I'll take you through some of the key highlights of this morning's statement and hopefully provide a bit more colour around our financial performance.

The key positives in the half that I want to highlight are, firstly, operational momentum. We're seeing top line growth in our business for the first time since COVID, and the strong order book growth, which is up 18% on last year, and up 5% year-to-date. And our order book now stands at $8.1 billion.

Within the order book, there's some key contract wins. And that includes a ten-year contract with Chevron to partner with them on a range of solutions across their whole business. Our Projects business has seen the strongest order book growth, and that's up 10% since the year end, and that's now 30% year-on-year, as we start to move away from the impact of our decision to exit large scale EPC work.

The growth in the Projects backlog is now led by engineering design and EPCm scope work, mostly across conventional energy and chemicals. So our Projects order backlog is now both significantly higher, but also less risky than last year.

Finally, as you're all aware, we announced in the period the agreement for the sale of our Built Environment consultancy business for an EV of $1.8 billion to WSP. The completion process is going well with key antitrust filings all submitted ahead of schedule and the circular due to be issued in the next couple of days. We are confident we will complete the sale in the second half of the year, and the proceeds from this sale will transform our balance sheet.

Turning to our headline financial results for the half. We've returned to revenue growth. Revenue for the half is around $3.2 billion, with strong growth in Consulting and Operations, partly offset by a decline in Projects. Consulting revenue is up 3% with growth in both the Built Environment business and the remaining business with continued growth across our energy consulting solutions, in part driven by energy transition, and that includes hydrogen and carbon capture.

Operations revenue is up 17% with higher activity across conventional energy, especially in Europe and the Middle East. Projects revenue is down 15%, reflecting the impact from our move away from large scale work and a subdued market for project awards in 2021. However, we're seeing some really positive signs in our order book growth, and we expect projects to have a much stronger second half and grow for the year as a whole.

Looking at profitability. Adjusted EBITDA will be around $250 million, with a relatively robust performance in Consulting and Projects, offset by a decline in Operations. And that will give a margin of around 7.9% lower than last year's 8.3%. Part of this relates to the previously guided lower margin in Operations, which benefit from a higher level of contract close outs last year, plus an impact from some timing delays in our Turbines joint ventures, which we expect to recover in the second half.

The Group margin was also impacted by a lower margin in our Consulting business. And this includes a lower margin in Built Environment, which saw a mixed impact from higher subcontractor volumes offsetting lower labour volumes, plus the impact in our energy consulting business from exiting some high margin work in Russia.

You will see that we will be treating the Built Environment business as a discontinued operation in our results for 2022. From now on, we'll be talking about revenue and adjusted EBITDA performance on the go-forward business. This had revenue of $2.6 billion in the first half and adjusted EBITDA of around $185 million.

Moving on to debt. We expect our net debt at 30th June to land around $1.7 billion. The increase in net debt reflects a seasonal working capital outflow, the scheduled $41 million payment to the SFO, and the costs associated with loss-making contracts, principally Aegis Poland, that have been provided for in the P&L but had the cash flowing out this year.

As we look forward dates to the sale of the Built Environment, will change our whole debt profile, resetting our balance sheet. In addition, we anticipate lower cash outflows in H2. We anticipate a seasonal working capital inflow, and there's no further $41 million payment to the SFO in H2.

So looking ahead, our outlook remains for a stronger second half supported by the strength in our order book. We firmly believe that we're nearing the completion of fixing the issues in our business and be able to look ahead positively to capture growth and return to delivering sustainable free cash flow. The sale of the Built Environment consulting business will restore the financial flexibility necessary to deliver our strategy, and we're making good progress towards completion in the second half.

As you know, Ken Gilmartin took over as CEO this month, and he will outline some of his initial thoughts at our half year results with a more detailed Capital Markets Day and what the future for Wood looks like in late Q4.

So with that, I'll move to your questions.

Q&A

Mick Pickup: Couple of things. Can you just talk about the Operations margin, the drop down in 1H and what you expect for full year?

And then secondly, on the go-forward basis margin is, I think, you just have $1.85 billion of $2.6 billion, so it’s around 7%. What do you think about that margin and where it can get to ex Built Environment going forward? So is that for the Strategy Day in September?

David Kemp: Yeah, probably in terms of the medium-term outlook and margin, we will be addressing that at the Strategy Day. The margin for the first half, excluding the Built Environment business, is 7.3%. So there is a dilutive impact of selling the Built Environment businesses, as I'm sure you expected.

In terms of the margin and the outlook for the full year. So our margin was slightly lower first half compared to last year. And we highlighted the reasons. As we expected – we expected our Operations margin to be lower and we expect that in our full year results, just from a lower level of contract close outs that we are anticipating in the first half of ‘22

compared to the first half of '21. That was exacerbated by our Turbine joint ventures business, where we had lower profitability than we had expected.

They had some supply chain issues in the first half, which meant that they didn't get many turbines through the shop as they had expected. We expect that to be timing only. And so, we do expect that to recover in the second half.

We've not given out any guidance for the full year at this point, because we're involved in the circular process. But we've tried to state out what we think are the key moving parts around the EBITDA, which will then flow through into margin as well. Firstly, we do expect a stronger activity in the second half, and that's underpinned by the backlog that we have and the revenue coverage we have. And that's going to be led by our Projects business.

So you'll pick up with – we had a very strong half in terms of order intake in the Projects business, so they added about 10% since the end of the year, but now up 30% since the same quarter last year. And our pipelines look good as we look forward. So we think that recovery in activity will be led by Projects.

And then, as you go through the P&L, the other one is just the Turbines business that I mentioned. Usually that's weighted towards the second half, and that weighting will be slightly more because of some of the supply chain issues that we have in the first half. So all in all, we usually have a weighting 45-55, something else in that order of magnitude between the first half and second half.

Mick Pickup: Okay. Got it. And you mentioned supply chain issues there. Obviously, you're a people business in a large part. Have you seen any pressure on the wages side and tightness in labour at this point?

David Kemp: Some. You're right. Really in terms of supply chain, the turbines businesses are principal area where we're exposed. We – because we've reduced greatly our EPC business, we've not really seen any impact from that side.

In terms of the labour position, I think in common with most companies, we are seeing it in a significant inflation out there. We've not done any large pay increases, but it's something that we continually monitor. We've been more looking at it on case-by-case basis to-date. So we are seeing some tightness in the market. Probably the area that's probably had the most impact is in our Built Environment consultancy business, where we have very good backlog, but we've been struggling to hire as much labour as we would like to deliver that backlog.

And you can see that coming through in the margin for our Built Environment business, where the revenue – we've had revenue growth, but it's been more led by subcontractor volumes rather than direct labour, which has a margin impact for us. And so our margin was off in Built Environment. So that's the area we've had probably the most pressure in terms of headcount, which I'm sure as in part relates to the decision to sell and some of the uncertainly that obviously creates.

If I look at maybe just to broaden out across our headcount, our headcount since the end of the year is up 4%.

Mick Pickup: Okay. Thank you very much.

Mark Wilson (Jefferies): Good morning, David. Thanks for taking the question. I'd like to ask on and just clarify. I think the comment was there'll be lower cash outflow in the second half. Is that correct, David?

David Kemp: Yes, I was referring specifically to exceptional items and to working capital, just to be clear. So maybe if I broaden out maybe that question, just to give you more colour on it. We have seen a significant outflow in the first half, which has been driven by working capital, which, in our business is seasonal. Our revenue peaked in the summer months. And then exceptional costs relating to the investigations, Aegis, and with some Built Environment sales and fees in there as well.

When we look forward to the second half, obviously, the most significant event is going to be the proceeds from the Built Environment sale, which is going to transform our balance sheet. But we also expect a working capital inflow, in line with activity, and we won't be making a payment to the SFO. We make one payment a year, and that's at the start of the year. So that's what I was referring to in terms of the lower outflows, a working capital inflow, and no payment to the SFO.

If I look forward to 2023, our focus is really around how do we use the proceeds to reduce liabilities and improve the free cash flow going forward. So when we talk around a reset – a balance sheet reset, we also focus on a cash flow reset as well. How do we get – how do we improve our 2023 sustainable free cash flow going forward, so that's a big focus for us.

Mark Wilson: Okay. Thank you.

David Kemp: Does that answers your question, Mark?

Mark Wilson: Well, it does to some degree, apart from what I'm trying to understand is that all things being equal, outside of the Built Environment sale, what you're saying is that net debt would go up into year end?

David Kemp: No, that's not what I'm saying, Mark. Completely the opposite. We would expect net debt to reduce because we'll have a working capital inflow, and we'll have less exceptional payments in the second half.

Mark Wilson: Right. Okay.

David Kemp: And we expect improved performance.

Mark Wilson: Okay, so lower cash outflow translates into there will be a cash inflow in the second half?

David Kemp: We expect that – yeah, obviously something I'm saying isn't working for you, Mark. We expect lower outflows from working capital and from exceptional items. We expect working capital to be an inflow, and we expect the exceptional items to be reduced because we don't have an SFO payment. Overall, we would expect, absent the Built Environment sale, for our net debt to reduce at the end of the year.

Mark Wilson: Good. That's actually – yes, that was what I was looking for. And that's good to hear. Thank you for that, David. The other question I'd like to ask, you mentioned about the Turbines business, which, to be honest, hasn't been spoken about very much in recent times. But I think there is an energy transition, goodness me, even possibly a hydrogen element there. Could you talk about the size and scale of the Turbine JV these days, and

where you report it? I think it's in – well, where you report it. And just remind us about that business, please.

David Kemp: Yeah, sure. So our Turbine JVs, we've two of them now. So we have RWG and EthosEnergy. In terms of their size and where they roll up to, they roll up into operations under equity accounted, and you can see the exact detail of that from the notes.

In terms of the profitability that they deliver, the roughly – last year was roughly about $60 million, just under $60 million of EBITDA. So they are quite significant in the scheme of things.

Mark Wilson: Okay, very good. All right. Thank you for that, David. I'll hand it over.

James Thompson (JP Morgan): Hi, David. Yeah, just a couple for me really. Firstly, the Projects – the margin performance in Projects, obviously improvement. I suppose the division where you have some troubles on the execution side of things over recent reporting periods. Can we think about that business a sort of a more normalised number now in terms of the performance in that division in the first half?

And then secondly, obviously, the order [book] over $8 billion. It's good to see some momentum there. You've had a couple of, I guess, pretty blue-chip wins. You mentioned Chevron, but some other wins too, with the GCC producers? Could you maybe just talk a little bit about that whole environment? Whether you expect that to continue growing through the rest of the year, some of the dynamics in the first half? Could that have been better, or to the sort of Russia situation slow things down? Just maybe put some colour on the – on what you're seeing in terms of the environment for actually continuing the backlog growth that you've seen in the first half.

David Kemp: Yeah. Yes, well, let me start with the Projects margin. So we saw our Projects margin tick up in the first half. And actually, we had – we had pretty decent performance through our Projects portfolio. The problem projects that we had are largely behind us, outside of Aegis. And as you'll have seen in the note, we expect Aegis to be operationally complete around the year end. And so, again, Aegis, the execution has been good in the first half. There's been no change to any numbers there. So quite a quiet half for our Projects business, which has been good.

In terms of the margin potential, on a full year basis, we do see further margin potential. For example, if we look forward in 2023, because some of that margin is being diluted by effectively revenue that isn't earning any profit in the first half. And so, I do think there's further margin potential in that business as we go through things.

In terms of order intake, we're very pleased with how our projects order intake has developed through the half. We've had some great wins, as we've had across the rest of the business as well. So overall, we're pleased with how that's been developing. We highlighted the Chevron contract, which we're very excited with. It's a ten-year contract with Chevron, where the intention is to build a strategic partnership. And that's right the way across their business, up midstream, downstream, and their new technologies business. So that's one we're excited about.

I think also I'd flag, across our Projects business, there's just the range of different things. So, we previously announced the ADNOC blue ammonia facility. We talked about previously a

range of projects we've won with Aramco and we're seeing a step up in their investment. And also, we've won a contract around speciality chemicals that we're solving. That's an EPCm contract. So, you're getting quite a range of contracts there.

And so, when we look at our pipeline, particularly in that Projects space, we do see good potential going forward as well across a range of things. Clearly, our minerals business is picking up largely on the back of energy transition. There's good outlook in terms of conventional energy as well and the projects we're picking up there, and across chemicals and refining as well.

So when we look across our markets, we're really quite encouraged with how they look. And I think, again, I mentioned it in my opening remarks, one of the good things from our perspective is we do see that order book in our Projects business has been significantly less risky. So it's a much lower content of EPCm lump sum or lump sum turnkey, and it's much more around design. It's much more around EPCm. So we're getting growth. We're able to grow our projects backlog significantly, but also in a less risky area. So we're really encouraged by that.

In terms of the other parts of the business. Consulting, if I just talk about the Wood Consulting portion, we've had probably almost two different things happening in our Wood Consulting business. It was the business that was most exposed to Russia. So Russia for the Group was – we talked about being about 1% of our revenues in the past. And that was largely in our technology and products business sitting within Consulting. So that was impacted.

But what we have seen is really good growth in our specialist engineering and our asset performance optimisation business. And so that has outweighed that. And so that growth is, again, largely been driven around conventional energy and energy transition. And so, we're really encouraged with how those businesses have developed.

In Consulting, we've also – our AI business has been a bit more muted. Our TCO contract in Kazakhstan rolled off. And we've not replaced that to the extent of that contract – it was clearly a very large contract for us.

In terms of operations, we've continued to build backlog there. We see good markets around conventional energy, around maintenance modifications, and particularly around the theme of decarbonisation. There's not a contract that we're signing these days that doesn't have a significant element of decarbonisation. During the half, we signed a very good contract with Equinor, and we review – renewed a number of our contracts in the North Sea as well.

So we're really quite encouraged by our markets as we look forward. When we look at our win rates, our win rates have ticked up. So again, that looks in a good place for us.

James Thompson: Super. Appreciate all the colour there, David. Thanks for that.

Mark Wilson (Jefferies): Hi. I couldn't resist coming back, because that discussion then about your order book was very helpful, David. And I'd just like to jump into one particular point of it. The ten-year award you speak about with Chevron, it sounds like that's contributed to the order book growth, but at the same time, a ten-year award almost feels like a framework agreement in a large part, where you'll be able to add work into it. So could you give us what the quantum of that particular project?

David Kemp: Yes, so it is an MSA. It's an overarching framework agreement. So the contribution in the first half was very modest. It's more around what it unlocks with Chevron going forward. So we've very high hopes over the ten-year period around what level of work that's going to deliver, because again, it's related to the intent of agreement. The intent is that it allows us to form a strategic partnership with Chevron to help them across a wide range of their business, almost all of their business, whether it's up, mid, downstream or the new technologies. And so, that's the exciting part for us.

So its future based. It's not really reflected in the order book just know. We typically wouldn't take it in until we win contracts. But we think it's a very exciting win.

Mark Wilson: Okay. Now that's – thank you for that clarity. And yeah, thanks for the call.

David Kemp: Okay. If there's no further questions, I'll just thank you for your time and wish you a good day. Thanks.

[END OF TRANSCRIPT]