From: Donna Rodger
Sent: 20 February 2009 14:00
To: Tom Aitchison
Subject: FW: Background factors

From: Graeme Bissett [redacted]
Sent: 19 February 2009 12:27
To: Dave Anderson; [redacted] 'Steven Bell'; 'Stewart McGarrity'; Donald McGougan; Marshall Poulton
Cc: Kenneth.Hogg@scotland.gsi.gov.uk; Peter Strachan; 'Brian Cox'
Subject: Background factors

Dave and colleagues, here is a note on BB AG to confirm the background factors we have discussed.

BB AG's preliminary 2008 Group results announcement indicates improved group sales, profitability and cashflow compared to 2007. Total revenues were €10.7bn (€9.2bn in 2007) and pre-tax and interest profit was €298m (€229m). They appear not to be highly geared and have no immediate bank refinance problems within their group. They have substantial non-recourse (off balance sheet debt embedded in their projects, I assume in SPVs) totalling €1.5bn, but in principle this should not threaten their solvency. The overall picture is therefore sound, in line with the picture a year ago in the run up to Financial Close and during 2007 when preferred bidder status was awarded to BSC.

Their Civils division (which is handling the Tram project) had sales of €4.2bn in 2008, up 14% on 2007. This is the second biggest division in the group. Their services division (mostly M&R, FM and related works, but including PFI or equivalent projects such as the M80 extention) grew by 27% over 2007 to sales of €4.5bn. The smaller Buildings Division grew by 3% to €2.0bn. The Civils division order intake was down by 22% on 2007 (Services up by 18%, Buildings down by 26%). Their comments on overall performance underline the direction they are taking (my underlining) :

> **Orders received and order backlog were impacted by exchange rate fluctuations, <u>and by a highly cautious approach to the acceptance of new projects.</u> EBIT in the Civil business segment fell to €17 million (2007: €58 million) due to the one-time charge on earnings of €65 million reported in the second quarter of 2008. In Building and Industrial, EBIT fell to €14 million (2007: €24 million) as a direct result of additional costs from projects in Germany.**

The full year profits of €298m are split €17m Civils, €224m Services, €14m Building and €43m from other items. If the Norwegian loss is set aside, the operating margin on their Civils business is 1.25% of sales, very thin even by industry standards. The Buildings division is generating even thinner margins.

Their 2008 Q2 report was published on August 12th 2008 and highlighted the €65m loss on a contract in Norway which was a joint venture managed by BB and which resulted in the Civils division moving into loss for the year to date. In fact the actual loss is €90m, as they had provided €25m at the end of 2007 (not disclosed at the time). The same announcement interestingly described the Tram project as a turnkey project delivered by a consortium under BB's leadership, of which their share was €190m.

Their Q3 Report was published on 10th November and the Services Division is highlighted as "the main pillar of our business development". They also report that they "intend to establish a risk provision in the construction business". It appears this covers both Civils and Building and the amount is not specified. They sold their Civils business in France in Q3. Their Q3 Report also noted that

"we will only accept new projects if they meet our risk and return criteria. This is reflected by decreasing levels of orders received."

The 2007 Report on Civils by contrast was dominated by news of growth and major contract wins by the Civils Division.

We are also aware of management changes within the division which affect the Tram project and which appear to reinforce the change in approach.

In summary,

1. BB is a group with shares listed on the German Stock Exchange and which is sensitive to short-term financial risk and results
2. The Civils business was a vibrant part of the group's activities in 2007 and early 2008
3. Market conditions and a major exceptional loss have created a much more risk-averse approach to this business since mid-2008
4. The margins generated by Civils are very precarious and the scope of the Tram project is highly material to their published results
5. Taken together, there has been a substantial change in the approach BB Group are taking to their Civils business since Financial Close and which is a strong contributing factor to the current debate.

Happy to discuss further.

Regards
Graeme

Graeme Bissett
r[redacted]