**Paul Scott interviews the CEO & CFO of Waterman Group (WTM), 15 Oct 2015**

**Key: Paul Scott (“PS”)**

**Nick Taylor (“NT”), CEO of Waterman Group (WTM)**

**Alex Steele (“AS”), CFO of Waterman Group.**

PS: Morning Nick, morning Alex. I’ll just do the introductions then. I’ve got the CEO and CFO of Waterman Group (WTM) on the line. The market cap is £26m at 85p per share.

Disclosures – I’ve held shares personally in Waterman for about a year. I consider it a long term core shareholding of mine, and I’m **not** charging a fee for this interview. OK Nick, I incorrectly described your company in my [small caps report](http://www.stockopedia.com/content/small-cap-value-report-5-oct-2015-cbuy-tni-hsp-wtm-107454/) on Stockopedia recently as “architects” and I got that *completely* wrong! So could you explain what Waterman’s activities are?

NT: Yes sure, no problem. We obviously work closely with architects, but we essentially are engineers and environmental design consultants. So we’re involved in, you could say, making architects’ dreams a reality, in that we provide the design of the structure and the building services, and the foundations that hold the building up and make it function.

So, we don’t do architectural, we’re not contractors, we’re not cost consultants or project managers, we’re just designers and advisers to our clients. Our clients tend to be developers in the private sector, large companies which you’ll know that are mainly on the main stock market, people like Hammersons, Land Securities, British Land, so major developers. We’ve worked with these companies in some instances for over 40 years, so we have longstanding relationships with those clients. In terms of simplicity for the benefit of your listeners just to explain in slightly more detail what we do, we provide five services, are you ok with that Paul?

PS: Yes, fire away, all good.

NT: We provide five services;

**Structural engineering** is where the business originated from and that’s designs, foundations, the columns, the beams the slabs, and designs of buildings so it does not fall over from wind etc, so you could say defies gravity.

**Building services**, they design the air conditioning, the lights, the plumbing, the fire protection systems within the building, work out how to get the utilities into the building. So essentially they make the building work so it’s habitable and works for the occupants.

**Environmental group**, they’re involved in assisting clients with planning applications. There’s a thing called “environmental impact assessment” for all large developments, and they will be involved in the technical writing of those chapters, and also look at whether the site’s contaminated and come up with remediation strategies for that.

We then have two similar transportation type businesses;

One is a **consulting business** and they’ll be involved in the designs of highways and transportation studies associated with planning.

Then we have, which is unique to us, an **outsourcing business** where we have highways and transportation engineers which are outsourced to highways authorities throughout the UK. We actually have 440 engineers as part of that business, outsourced. So it’s not a temporary staff agency; they are permanent employees of ours and some of these secondments can be for up to 10 years.

So there’s five fundamental areas of our business, hope that helps.

PS: That’s brilliant, thank you. So your [last set of results](http://www.investegate.co.uk/waterman-group-plc--wtm-/rns/preliminary-results/201510050700120801B/) were published on 5th October, quite recently, for the year ending 30th June 2015. That showed a dramatic improvement in profit, adjusted PBT (profit before taxation) was up 93% to £2.7m. Can you talk us through that. I think it was mainly from stemming the losses in one division, wasn’t it?

NT: Yes and no. Two years, well three years ago, we took a strategic decision to pull out of various parts of the world. So we pulled out of Russia, China, Middle East, Kazakhstan, Ukraine, and we decided to focus on the UK as a core business because we had longstanding relationships with clients. We could see that the UK was potentially going to grow, and it has actually grown more rapidly than I anticipated three years ago. So 89% of our revenue now comes from the UK, 8% from Australia and 3% from Europe.

In the latter end of our financial year 2014, our financial year ends on 30th June each year, (in the UK) we went through quite an increase in revenue, and we held back on recruitment at that stage. We weren’t quite sure whether that level of growth was going to continue, because we grew 19% in that particular year. We had a lot of people working extended hours, because we held back on recruitment. Then as we went into the financial year that we’ve just reported on, we could see that growth was continuing, and actually we grew by a bigger rate, about 25% in revenue terms last year, so we went out and recruited people. So our margins in four of our businesses *reduced* from the previous year compared to the year we’ve just finished, because we had to recruit staff, and we had to go through some recruitment agencies for that. We’ve actually invested £0.5m in recruitment costs.

In a way the advantage going forward is that we’ve paid that money out, we’ve got staff, and so we’re generating profit from those staff moving forwards. So we will see margins *increase* (in future), but if you looked at our business in great detail, you’ll see that margins over the last few years have increased, it’s just we had a blip in 2014 as we held back from recruitment, and we’re seeing growth going forward.

You’re right in that there’s one part of our business that lost money and the losses have been reduced from £2.9m to £1.2m, so that’s positive, and we’re aiming to get that business to breakeven in the very near future. That business is the civil transportation consultancy business, generally it operates outside of London and we are seeing developments and investment now going forward outside London which obviously provides revenue for that business, and we only need a 5 or 7% revenue increase for that business to breakeven, so I’m pretty positive about that now. We’ve done a restructure of that, so it’s in pretty good shape at the moment.

PS: So given that you reported £2.7m adjusted profit last time, if you can get that division to breakeven then that’s another £1.2m on top of that isn’t it, so nearly £4m.

NT: Yes, absolutely right. We’d make a margin of 4.8% if that’s the case. Our current margin for the group is 3.3%, and as you know we’ve announced that we’re aspiring over the next four years to achieve a margin of 6%.

PS: OK, which is very interesting from a shareholder point of view, because 3.2% to 6% almost doubling, I mean I’m looking through the numbers, and that tends to point to 10 to 11 pence EPS, does that sound sensible?

NT: We can’t give forecasts, as you know. Our *broker* forecast for instance in 2018 is showing an

EPS of 12.1 pence.

PS: OK, I’m in the right ballpark, so that’s good!

Let’s talk briefly about dividends as well, you doubled the dividend from 1p to 2p this year,

so the yield is getting there, it’s quite reasonable. What’s your policy on future dividends?

**Clarification note**

NB. Please note that at this point of the interview, we got our wires crossed, in that PS was

talking about dividend **yield**, but NT was talking about dividend **cover**. So what NT *intended* to say, is that the company’s dividend policy going forwards is to move towards a dividend which is **2.5 times covered** by earnings, by 2018. This transcript has been edited accordingly.

NT: We’ve doubled the dividend now for the last two years running. We believe in increasing shareholder value so obviously we’re looking to increase dividends and obviously we’re looking to increase our profits because one would like to think the share price would follow if we’re generating higher profits overall. We’ve got a good dividend growth story going forwards.

PS: OK, brilliant. Shall we talk next about cyclicality, because obviously you’re closely linked to the new build property side of things. Where are we in the cycle, and where do you see things going?

NT: Let’s just be clear for a minute, two thirds of our business is related to the design of buildings, which is either buildings in the private sector or maybe a hospital or a school in the public sector. A third of our business comes from the public sector, mainly the highway side, in terms of outsourcing.

Now I think, if we just deal with the public sector for a minute, the Government have announced recently that they’re investing £10.7 billion in new highways construction over the next six years, so you could say we’re at the beginning of that cycle. We certainly are believing that we’ll see margin growth in our outsourcing business as we go through that cycle. So I think we’re in quite an interesting space in that respect.

Obviously we’ve been through one of the greatest financial shocks to the system over the last three or four years. As a business we’ve been able to manage our way through this, and we’re in pretty good shape.

We have net cash, an expanding workload, and (in the UK) we’ve grown by 20% year on year now for the last two years. I think the construction activity in the public and private sector, you’re right, go through cycles, and we’ve experienced good trading conditions in the UK over the last three years. I think it’s also interesting just to look backwards for a minute. The last cycle between the two large recessions in ’92 and 2010 was 18 years long. So I do anticipate that we’ll continue to grow for many years.

Secondly, I think our clients, certainly in the private sector, are more cautious at present than they were 20 years ago, they’ve got stronger balance sheets, and I think that provides a steady flow of future workload. We’re not seeing that hiatus of mad development that possibly went on in late 2007 and 2008. So I think we’re sort of in the early stages of the cycle really in my view, both in the public and the private sector and I think there’s a long way to go yet.

PS: Very interesting. I was cycling in London yesterday on a boris bike, and London is just like a giant building site! It’s staggering the amount of stuff going on isn’t it?

NT: Yes, it is. I can’t remember who used to do it, but someone used to do statistics on how many tower cranes they could count every month, there was a great graph. But yes, there is a lot of construction going on in the city. I think the European referendum which is coming I think will possibly slow down some decision-making on certainly new office buildings in the city, but we’re at a point at the moment where actually there’s the lowest available space for 14 years for tenants to move into. So if anything, you could say more building needs to happen and I think it will happen.

I think the retail sector is growing strongly, and I think the residential sector, particularly outside London, has a huge amount of support from Government and from the opposition parties. Mainly it will provide great opportunities for us as a business, because in those three sectors alone, plus highways, that provides at the moment 80% of our UK revenue. We’re very, very strong and well known in all four of these sectors. We’ve got a great reputation and a great relationships with our clients, so I’m very positive about the future.

PS: Brilliant, OK. Finally, I just wanted to touch on M&A activity, are you looking at any potential bolt on acquisitions, or ultimately could Waterman itself be acquired by a larger group perhaps?

NT: It’s an interesting question. If we look back over the last couple of years, there’s been quite a lot of M&A activity, particularly with companies that are slightly larger than ourselves.

We’ve had Aecom buy URS. We’ve had Arcadis buy Hyder. As you know there was another bidder, a Japanese consultant. We’ve had WSP being bought by Genivar, a Canadian consultant who since has bought Parsons Brinckerhoff. So there’s been quite a lot of consolidation and in fact last week there was a private firm of consulting engineers called Pell Frischmann, who were acquired by a German company.

I personally think M&A will continue. I think there will be periods of time where it will be

greater, and it will be slower in other periods of time, but I think it will continue.

In terms of what we’re doing, we’ve taken the decision that we want to invest in people and teams of people. So we’ve been recruiting people from lots of our competitors, and we grew by 14% last year, so I suppose you could say we’re investing in *people*. The reason we’ve taken that decision is that buying businesses does involve a certain degree of risk, both from a financial and cultural perspective as you bolt the businesses together. Our relationships with our clients are important to us and we need to make sure we get the right people.

However, having said that, I do think that certainly in Australia, in the market there are some pretty interesting deals down there, and I am convinced the Australian economy within the next two or three years will recover. We only provide one discipline in Australia at the moment, which is building services. I think there are opportunities there.

In the UK we will always track where the money is being spent, and try to gain positions and market share in those sectors. So unless we really felt that there was a real need for us to move into a new sector that would need a separate consultant, that’s the only time really I’d consider that because I do believe that we can leverage our relationships. If we just buy another consultant in the UK, we’re just buying more of the same.

We are very focused as a business on continuing to grow revenue in Australia, UK and

Ireland - they’re our main markets, and that’s where we see our growth will come from.

You asked the question, are we a potential target for somebody? All I’d like to say is we’re not actively encouraging interest. We do have a very positive growth strategy for our shareholders. We run the business in the interest of our shareholders and obviously we will deal with events as and when they happen. We are a PLC, so you never know, there could be somebody out there who is currently running their rule over us. We are a successful company, we’re a premium company, but we think we’ve got a long way to go in terms of delivering greater rewards for our shareholders, and there’s more positivity there.

But, M&A activity in my view will continue.

PS: An interesting take-away from that I think, is that you can scale the business up or down just through internal recruitment, so you don’t need to make acquisitions to grow effectively.

NT: As long as you can still attract talent, and as I say, we grew by 14% last year in terms of numbers. What we found is that as larger companies have merged, there have been some very good engineers that have become dissatisfied, and we’ve been able to attract them.

Also we are becoming known as a very successful business, we’re growing strongly and people like to be associated with businesses that are growing. It creates opportunities for them in terms of career. But also we’ve been winning awards, we won the Stirling Prize last year for one of our projects, and we win lots of awards. So again, design excellence is important to engineers when they work for an organisation. Success breeds success, I don’t necessarily believe that we need to acquire companies to continue with that, I think there’s more we can do through recruitment of people.

PS: That all sounds very positive Nick. We had probably better wrap up with the time constraints, but are there any closing points you want to make?

NT: Yes, I think we’ve made a strategic decision to focus on the UK. I think that’s an important point. We’re a premier company and our primary focus is on the UK and I think that does provide our shareholders with visibility, and more particularly familiarity with our client base. They are companies that (investors) might have shareholdings in, or they know them and they can understand then the future prospects of our company, from the prospects of our client base.

We are growing strongly, we have delivered against our published targets - that’s very important, certainly to the team and Alex (CFO) and myself. I believe we have a very strong investment case for our shareholders both in respect of yield, and also in share price growth.

I’ve been in Waterman now for 32 years, for me it’s personally very important the company continues to succeed and becomes an even more successful business over the coming years ahead.

PS: OK, that sounds really good, I shall continue to hold my shares then for another year, at least!

NT: Well that’s good news! Thank you very much for your support Paul, it’s very much appreciated.

PS: Well thank you for the dividends, much appreciated!

NT: No problem.

PS: OK Nick and Alex, thanks ever so much for your time, much appreciated and we’ll probably speak again in maybe six months or a year.

NT: Ok look forward to it, thanks Paul.

PS: Thanks, bye.