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26 February 2019

Babcock International Group PLC (Babcock or the Group) - Trading update

Babcock, the aerospace and defence company, is issuing the following trading update.

Underlying earnings expectations for the year remain unchanged as we continue to make good progress and grow our business across our three key markets of defence, aerial emergency services and nuclear.

Group underlying margin to be ahead of last year, delivering underlying earnings in line with current market expectations and slightly higher than last year. Margin performance has been helped by a continued contribution from our continuous cost reduction programme and, as previously indicated, profit contribution from our Holdfast (RSME) joint venture.

Group underlying revenue for the year to be around £5.2 billion[1], down from £5.36 billion last year. In addition to the major QEC contract step down and the disposal and exits from small non-core businesses already reported, there have been further disposals and exits in the second half as we continue to focus the business. Our Rail business has seen lower activity as we entered the transition period to our new contract earlier than expected, while our South African business has been impacted by delayed power station outages.

Group net debt continues to reduce and we expect our net debt[2] to EBITDA[3] ratio to reduce to around 1.4 times by the end of the year.

The UK exiting the EU has resulted in additional costs as we restructure our aerial emergency services businesses to comply with European operating requirements. There is a one-off tax cost of around £10 million this year and we estimate that additional ongoing costs related to the operation of the new structures will be around £10 million per year.

Exceptional costs were outlined in our half year results and we now expect to incur two additional exceptional costs for this financial year. As explained above, restructuring the Group ahead of the UK exiting the European Union will result in a tax charge of around £10 million. As signalled in November, we expect a charge of around £30 million related to an adjustment to our pension liabilities to equalise guaranteed minimum pension benefits for men and women, following a High Court judgement on Lloyds Banking Group in October. The cash cost associated with the pension charge will be spread over the next six years and the tax charge will be paid in the next financial year.

Order book and pipeline remains strong at around £32 billion, consisting of a c.£18 billion order book and a c.£14 billion pipeline, which is c.£1 billion higher than last year end.

The 2019/20 financial year sees the completion of two of our largest contracts, QEC and Magnox, and the normalisation of the profit contribution from our Holdfast (RSME) joint venture. As highlighted at the half year results, the impact of these step downs, and continued business exits, is expected to reduce underlying revenue by around £400 million and underlying operating profit by around £40 million relative to the 2018/19 financial year. We are currently finalising our plans for next year and will provide further guidance in May alongside our full year results.

Chief Executive Archie Bethel said:
"The Group's underlying earnings and cash generation outlook for the current year is unchanged. We continue to make good operational and strategic progress and won some great new contracts in the period including an expansion into the aerial emergency services market in North America, a significant win in Australia and securing the next ten years for our Rail business. Whilst preparing for the UK exiting the EU and for our QEC and Magnox contracts coming to an end, we continue to grow our business across our three key markets of defence, aerial emergency services and nuclear."

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Operational highlights and contract wins

We continue to see strong contract performance across our businesses. Highlights in the period include:

- HMS Prince of Wales now structurally complete and in the final commissioning stages
- Continued progress on our submarine sustainment and fleet time support programmes including the latest delivery of common missile compartment components for the UK Dreadnought and US Columbia Class submarine programmes
- Progress on infrastructure design for the deep maintenance of the Royal Navy's Astute class submarines at Devonport
- Type 23 Frigate Life Extension programme continues to plan in our frigate support complex at Devonport, with multiple ships undergoing deep maintenance and structural upgrading work
- Completed a significant sustainment work package for HMS Scott, the Royal Navy's ocean survey vessel
- Completed the capability upgrade on the first of three Estonian Navy minehunter vessels
- Secured the international sale of a further eight of our patented ecoSMRT® liquid gas transportation systems, bringing the total sold to 21 systems
- MV Kairos, the world's largest liquefied natural gas (LNG) bunker supply vessel, built and owned by Babcock and Bernhard Schulte, undertook its first fuelling operation in the Baltic Sea
- Mobilisation of our Norway aerial emergency services and Canada firefighting contracts
- Completed over 22,000 aerial emergency services missions across Europe since the start of October
- The Sellafield Silo Maintenance Facility project reached practical completion in January 2019 ahead of Sellafield's milestone and was categorised as "Excellent" project delivery by the Nuclear Decommissioning Authority

The period also saw a good set of contract wins that reinforce our strategy. Highlights in the period include:

- An entry into aerial emergency services in North America with the award of a ten year contract for aerial firefighting in Manitoba, Canada. We will manage, maintain and operate Manitoba's fleet of seven firefighting amphibious aircraft and provide three of our own aircraft
- In Australia, Naval Ship Management (50% JV) was appointed Asset Steward of the largest vessels in the Royal Australian Navy: two flagship Canberra Class Landing Helicopter Docks and their 12 associated amphibious landing crafts. Work will begin to sustain and support these vessels in July 2019 as part of a 15 year contract (five years plus two extensions) worth around AU$1.5 billion
- Helidax (50% JV) was awarded a ten year contract for the maintenance of 18 Airbus AS355N ('Fennec') helicopters for the French army
- Our Rosyth facility will complete the first dry-dock maintenance of the aircraft carrier HMS Queen Elizabeth this spring, including a hull survey and maintenance of underwater systems
- Cavendish Nuclear will carry out the dismantling and demolition of Dounreay's nuclear reactor as part of the final phase of decommissioning the Dounreay Materials Test Reactor
- We were selected as preferred bidder for the North Alliance (Scotland route) to deliver Network Rail's CP6/CP7 track and rail systems contracts. This ten year contract (initial five years with an option to extend) is worth up to £1 billion over a ten year period, from August 2019 to 2029

Sector reclassification

Our FTSE Russell industry classification was changed in December 2018 from the Business Support Services to the Aerospace & Defence sector. We believe this reclassification provides a more accurate reflection of our business model and the markets we operate in.

Board succession
As announced on 17 January 2019, Mike Turner CBE will step down as Chairman and as a director at the close of the Company's Annual General Meeting in July this year. The Company's Senior Independent Director, Professor Sir David Omand GCB, is leading the Board's nominations committee in an orderly succession process and an announcement of a successor will be made in due course.

Capital Markets Day
We will hold a Capital Markets Day in London on 5 June 2019. This will set out the details of the Group's strategy, including the long term growth opportunities available to Babcock from our leadership positions in our three key markets of defence, aerial emergency services and nuclear. We will discuss our strategy in detail, including milestones and medium term financial targets, to deliver for our shareholders. The day will include presentations from our senior executive team.

Ends

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Conference call

A conference call for analysts and investors will be held at 08:00 (UK time) this morning, hosted by Archie Bethel (Chief Executive) and Franco Martinelli (Group Finance Director).

The dial in number is +44 20 3059 5868. Please state you wish to join the Babcock trading update when prompted.

A replay of this call and transcript will be made available at www.babcockinternational.com/investors.

Notes

1. Reported underlying revenue for the full year includes an expected c.£60 million impact from disposals, c.£50 million impact from exits and c.£30 million impact from exchange rates. Previous revenue guidance was for low single digit underlying organic revenue growth at constant rates
2. Net debt excludes our share of net debt in joint ventures, which was around £345 million as of 30 September 2018. Joint venture debt is non-recourse to the Group
3. EBITDA (earnings before interest, tax, depreciation and amortisation) includes our share of EBITDA from joint ventures