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# Half year results transcript for six months ended 30 September 2019

## Wednesday 20 November 2019

Archie Bethel
Chief Executive Officer

Okay, good morning. Thank you for joining us today. Earlier this morning we reported on the six months to 30 September, 2019. I'd like to use this short presentation to add a bit of colour to the numbers and to talk about how the progress underpinning these results is creating a solid base for us to build on over the next few years.

We'll take questions as usual at the end of the presentation. Our chair, Ruth Cairnie, is also here this morning. She will stay around for a short while after the presentation and will be happy to talk with some of you at that point.

Let me begin by summarising the first half of the year. As you can see from our statement this morning we've done what we said we would do. So I can confirm our guidance for the full year is unchanged.

We've delivered the first half in line with expectations with a strong performance from marine and land and in-line performance from nuclear offsetting some weaknesses in aviation. With £2.5 billion of contract wins in the first half of the year we are moving the business forward. We are making real progress in delivering the medium term strategy we took you through earlier this year.

Our combined order book and pipeline now stands at a record £34 billion. That's almost 10% higher than it was six months ago. Most notably we were delighted to be awarded the contract to design and build five new general purpose frigates for the Royal Navy. This is a significant win for us against competition from other OEMs. We really appreciate the trust that the Royal Navy and the Ministry of Defence have placed in us to deliver what I believe to be a real step change in the provision of new naval capability.

Now let me take you through what's been happening in our core markets, starting with UK defence. In September the UK Government announced an extra £2.2 billion of defence spend. That was considerably more than had been expected. Whether or not there is a change of government next month there is almost certainly going to be a strategic defence and security review next year. That could possibly give us further opportunities.

Momentum continues in our Type 23 frigate life extension program which, with the work to support the aircraft carrier's entry into full service at the end of next year is driving higher activity levels in naval support.

The program of investment in marine infrastructure to support the new submarine and surface ship programs is now moving towards implementation. We are also continuing to see more modernisation and upgrading of training programs from naval personnel providing further opportunities for external providers.

In land, as you know, the army is investing further in new armoured vehicles and in upgrading existing vehicle platforms. That provides more through-life support and training opportunities. So overall our UK defence market is showing a pretty positive picture.

In international defence our pipeline continues to expand also with increased global spend in our target markets providing new opportunities to grow our international business. Here I am thinking about areas of support and training and in the provision of specialist technical equipment.

In Canada and Australia they are continuing to make major investment in naval capability. Those investments are driving new supply opportunities in the equipment, training and engineering sustainment areas.

In France we already have a strong position. We see further opportunities to build a presence in the defence market as they develop their equipment support and pilot training programs.

We are tracking the development of a number of new submarine programs around the world. Those new build and upgrade programs give us more scope to supply our specialist equipment to new customers.

Turning to emergency services, we continue to see new opportunities in this market sector. For example, in the UK we continue to see further investment in air ambulance services. This morning we have announced that the Metropolitan Police have selected us as their learning partner in their new public private sector model for training. We will be working with them to support the training of officer recruits from the UK's largest police force.

We have been awarded a contract with a value of £309 million. It will run until at least 2028. This is a new contract announcement. It's a great contract win for us.

Across Europe, Scandinavia, Australia and Canada we continue to see new growth opportunities developing in aerial emergency services. However in Southern Europe temporary delays to the bidding and award of a number of new regional contracts has slowed things down in this division just a little.

Revised regulations are being introduced and the changes will be helpful to us in the longer term given our position as the largest player. But in the short term we are experiencing delays to the placement of new contracts. But having said that we were awarded a new regional contract in Italy a few weeks ago. That may be an indication that things are beginning to move.

In both Norway and Canada we have made a strong start on our new entry contracts. In both countries we are already pursuing additional opportunities as a result.

The civil nuclear market in the UK is a significant market. But it is sometimes difficult to predict its progress. At the end of August we completed the hand-back of our Magnox decommissioning contract to the NDA. We are now discussing future potential opportunities at the sites with Magnox Limited and the Authority.

We remain totally focused on our joint venture contract to decommission the redundant nuclear facilities at Dounreay where we are making good progress. We can also see further opportunities emerging there for the medium and longer term.

A nuclear new build, our involvement at Hinkley Point C continues to develop. We were awarded a significant new piece of work in the period through the MEH alliance. However, plans for new build projects beyond Hinkley Point remain uncertain even with the government continuing to support a larger program of new nuclear power stations to replace existing capacity.

Beyond the UK we're delivering engineering consultancy and decommissioning services in Japan and more recently in Canada. Both these countries have mature nuclear sectors and are looking to the future. So we believe there will be significant opportunities to come.

I'm now going to hand over to Franco who will take you through the numbers in detail.

Franco Martinelli

Group Finance Director

Thank you Archie. Good morning. This morning I'm going to talk through the half year results in detail. We'll also cover three other important areas - why we are confident in our second half cash generation, the refinancing we completed in the period and our approach to capital allocation. There are a few more slides than usual to talk to these points and also to go through a few areas that you've said you would like to hear more about.

In looking at these results we need to consider IFRS 16 and of course the step-downs we have talked about many times before. We have given you some additional information and hopefully you will find this helpful.

I'll start with a summary of our results. As you can see we are where we expected to be at this stage of the year. Revenue was £2.46 billion in the period and operating profit was £251 million on the new IFRS 16 basis. The adoption of this new standard benefits profits and as a result the expected operating profit of between £540 million and £560 million for this year is the same - unchanged from before on a like for like basis.

Free cash flow was £7 million in the half reflecting the expected phasing of operating cash flow this year and as I will explain later, is on track for over £250 million of free cash flow for the year. Earnings per share was £0.325 and we have increased the interim dividend to £0.072.

So, moving on to some of the detail - last year we talked about the step-downs and the impact on this financial year. The step-downs are detailed in the appendices and for the first half they totalled £119 million for revenue and £37 million for profit.

The revenue impact this year is weighted to the second half while the profit impact is weighted to the first half. This timing difference is reflected in the margin and I will come back to this shortly.

On to the impacts of the adoption of IFRS 16 which came into effect this financial year. On 1 April, 2019 just over £600 million of operating leases were brought onto our balance sheet with around 80% of these being aircraft leases in our aviation sector. These are overwhelmingly matched back to back with customer contracts.

The financial impact is as we guided. There is an uplift in operating profit of £12.7 million for the half and around £25 million for the full year and an offsetting interest impact.

Like many companies we have adopted this standard on the modified retrospective transition approach. This means only this financial year is changed so the year on year comparison to financial year 2019 reported numbers is trickier.

Turning now to our revenue bridge, this bridge clearly shows the step-downs and the small underlying growth in revenue in the half year. If we then exclude Fomedec equipment sales revenue grew by 3.6%. This 3.6% growth is important as it is the momentum within the business and is in line with our 3% to 4% medium term growth target and will continue to strengthen in the second half.

Looking now at our operating profit bridge - this bridge shows the impact of the first half weighting of the step-downs primarily as Holdfast was mostly in the first half. You can see here the underlying profit reduction was £5 million, similar to the Fomedec equipment sales profit last year.

We have created a margin bridge this time round as there are some moving parts to explain. IFRS 16 had a positive impact of 0.5 percentage points. The phasing of the step-downs had a negative impact - a 1 percentage point impact in this half. However the different weighting of revenue and profit step-downs means that there is a positive impact on margin in the second half. This is an important driver of the stronger Group margin expected in the second half.

So excluding IFRS 16 and step-downs the margin was broadly stable at around 10.2%. The nuclear and land sectors were up and marine margin was lower as we guided in May. Aviation's margin was also lower and I will cover this shortly. I will now take you through each sector.

Marine has had a strong start to the year with 8.6% revenue growth excluding step-downs. Growth was strong across the sector with increased UK warship activity, the start of the LHD contract in Australia and strong orders in our technology business. Operating profit reflects the step-downs and the 12.8% margin which is in line with our expectations last year, half year, benefiting from some contract outperformances and higher than expected margins.

We expect the strong revenue growth to continue into the second half leading to a full year ahead of our expectations for both revenue and profit.

Now on to nuclear - a good first half for nuclear when we strip out Magnox. Revenue was slightly up with higher activity across defence offsetting a small decline in civil nuclear. The underlying margin is similar to last year and if we exclude Magnox profit was up 7.9% again reflecting the strong performance in defence.

We have made no change to our full year outlook for our new nuclear sector as outlined in June. We expect slight revenue growth and a similar underlying margin.

A strong half for land ahead of our expectations. Revenue growth was up 6.3% after step-downs with higher defence procurement revenue and a pick-up in trading in South Africa. Operating profit excluding step-downs was up 19.6% with good contract performances across the sector.

We now expect revenue growth excluding step-downs for the full year and for the margin to be maintained after adjusting for the normalisation of Holdfast JV. So therefore our full year operating profit outlook is slightly ahead of expectations.

Aviation had a difficult first half. Last year it benefited from sales of equipment of our Fomedec contract as I've said previously. If we exclude this, revenue was slightly down in the period.

Excluding step-downs and IFRS 16 operating profit was down. This reduction in operating profit reflects three things. Bidding delays in Southern Europe for emergency services, contract outperformances flagged [year and] pressures in oil and gas.

Military air is well placed for the second half. For the sector as a whole we now expect lower revenue for the year and margin to be flat, including the positive impact of IFRS 16. Of course at the Group level this is offset by stronger performances in marine and land.

Moving now to cash - here is the table of operating profit to operating cash flow. This now has two new lines for IFRS 16 adding back the depreciation of the IFRS 16 assets and IFRS 16 additions which does add to net debt. There are two moving parts in cash flow to really highlight for us this half. That's working capital and CapEx.

The working capital outflow in the first half is usual for our business. Although this was not the case last year as we benefited from over £50 million of Fomedec contract inflows this time last year.

This year in addition we entered into new countries and markets which as expected have increased the weighting of cash flow to the second half. I will cover these in detail in a couple of slides' time.

On to CapEx I will talk to the pre-IFRS 16 numbers here. We guided that that number, net CapEx, will be lower this year at around 1x depreciation. Whilst net CapEx was lower at 1x it remained at 1.4x depreciation in the first half. This will unwind in the second half. Net CapEx for the full year is still expected to be around 1x depreciation.

As you know net CapEx is a key metric and in the appendices we have included a slide that shows why this is the right way to look at these numbers for our business.

So looking ahead to the second half - we expect to generate over £250 million of free cash flow this year. That means generating over £240 million in the second half. This is only £40 million higher than we generated in the second half of last year and will be helped by a few factors - a similar second half working capital inflow, more of which shortly, higher sale and lease-back of aircraft creating lower net CapEx and lowering pension and provision second half outflows compared to last year.

So these factors and continued business performance give us confidence in meeting our cash expectations for this year and in achieving a cash conversion rate at around our target of 90%.

Moving on to working capital - we have included this slide to show the make-up of working capital for this half, last year end and last half year. Firstly you can see that the phasing of working capital within our financial years.

Working capital inflows for the Group are typically weighted to the second half as contract receivables are reduced and payables are seasonally higher at the end of the year. It is usual for us to have a significant second half working capital inflow. You will see that the payables and receivable balances are broadly in line with last September.

We have continued to see an improvement in unbilled receivables and creditors today are slightly lower. There are also higher capitalised contract balances in new contracts as you would expect with our new wins. As we have outlined before factoring is part of our aviation business model in Southern Europe. The level of factoring is typically higher in September than in March reflecting the firefighting activity levels.

The level of receivables factoring is broadly in line with this time last year. In addition to this usual phasing working capital this year was impacted by higher inventory balances. These reflect the start-up of aviation operations in Norway, Canada and France military and some further Brexit preparations plus continuing good activity in South Africa.

Putting this together we get, with other cash movements leads us to our free cash flow. The free cash flow of £7 million reflects the expected phasing of working capital and new business starts combined with the expected net capital spend.

Dividends received from joint ventures was higher year on year due to the phasing of payments from Magnox while the pension contributions were also higher with a more even spread over this financial year than last financial year.

In the period we paid a dividend of £116 million and had exceptional cash costs related to charges booked last year of £31 million. This is slightly higher than expected as there were no helicopter sales in the period and we did accelerate some lease payments into the first half as assets were returned.

I will now move on to net debt. With IFRS 16 we now have two measures with and without IFRS 16 leases included. Like most companies we will primarily focus on the IFRS 16 net debt which was £1.14 billion at the end of September.

We have redefined our net debt to EBITDA measure to the covenant basis as shown at the top here. This is the measure used for our credit facilities. This gearing measure compares net debt to Group EBITDA excluding our shares of joint ventures EBITDA but plus joint venture dividends. On this basis we were at 1.9x at the end of September and we expect to be at 1.6x by the end of the year and lower still next year.

I want to spend a few minutes now talking about two areas we get a lot of questions on. Our net debt does not include pensions or JV net debt and for very good reasons. The pensions funding deficit will be paid over the next six years and is included within our free cash flow each year. JV net debt is non-recourse to the Group and about 85% of it relates to one JV - AirTanker. I shall come back to that shortly.

Firstly let's take a look at pensions. Our accounting position has moved to a small deficit compared to a small surplus last year as lower discount rates more than offset lower inflation. On a technical provisions basis we have a funding gap of around £400 million with additional contributions in the half offset by the lower discount rate.

We still expect to pay about £400 million over the next six years although this will not be evenly spread. However, any acceleration should benefit later years.

Now looking at joint ventures. On the left hand side we show the performance in the half. JVs contributed £41 million of operating profit and £22 million of profit after tax. This compares to dividends received of £37 million.

On the right hand side you can see the net debt balances across our joint ventures. You will notice a few things. Around 85% of it relates to AirTanker. There is over £.5 billion of cash in the JVs and the JVs other than AirTanker and Ascent have a net cash position.

I will now move into AirTanker in detail. AirTanker is a joint venture between five aerospace and defence companies - ourselves, Airbus, Rolls-Royce, Thales and Cobham. Our share is just over 13% and the contract runs for another 15 years.

AirTanker owns 14 aircraft and the PFI contract is structured so that the guaranteed minimum payments cover the JV financing and on the assumption of only nine of the 14 aircraft are flying. The JV is performing very well and holds over £400 million of cash so the financing risk is extremely low. Like all JVs the debt is non-recourse to Babcock. We, like our partners in the venture, do not include the debt in Group net debt.

Now to look at the refinancing we did in the period - both Standard and Poor's and DBRS held their annual credit review and reconfirmed our BBB credit rating. We renewed our revolving credit facility of up to £775 million. This matures in August 2024. We were pleased to issue an 8-year, €550 million bond in the period which we then swapped into Sterling - £500 million at an effective interest rate of around 3%.

So far we have used this cash to pay off £100 million of loans that were to expire in 2020 with the remaining cash balance reducing our use of the revolving credit facility. This has led to an increase in financing charges in the short run as we highlighted back in September.

From March 2021 we will repay £410 million of USPP loan shown in pink in the chart. This has an effective interest rate higher than the new Euro bond. So from financial year 2022 onwards the net impact of the new bond issuance will be lower net finance costs for the Group again as we set out in September.

These timings do mean that we will carry a high gross cash balance until March 2021. So this leads on to our capital allocation policy.

You will be familiar with the priorities on the right hand side as we have discussed these many times before. What we have done now is set a clear range for our gearing level. We target a net debt to EBITDA range of 1x to 1.5x on our covenant basis. This enables us to organically invest in the business, fund our pension schemes and continue our sustainable ordinary dividend.

We expect to be at 1.6x this year end and to be firmly in the range next year and then continue to de-gear. The further into the range we get the more optionality there is. So at the lower end of the range the more likely it is we will look at M&A options to add value or consider returning additional capital to shareholders. And if we were to fall below the range we would look to move back into it.

To conclude then, we have confirmed full year guidance today so I am repeating this slide from May. We expected revenue around £4.9 billion and operating profit of between £540 million and £560 million. We expect free cash flow to be over £250 million as expected. Performance is weighted to the second half especially for cash but with increasing order book, underlying revenue growth and the expected cash phasing as outlined we are confident of meeting this guidance.

I will now hand back to Archie to talk you through our progress as we look to medium and the long term.

### Archie Bethel

#### Chief Executive Officer

Thank you Franco. I thought I would take this opportunity to remind you of the strategy we set out in our capital markets day back in June and to talk about the progress we're making. Our strategy is underpinned by our solid commitment to operational excellence. That means providing our customers with products and services that are innovative and reliable and delivered to the highest standards of quality.

Operational excellence is embedded in our strategic partnering program with the MOD and the Cabinet office and it's driving program performance. Operational excellence is at the heart of our health, safety and environmental culture making sure that our employees go home safe every day no matter where they are in the world.

On this slide you can see our medium term strategic growth targets that we laid out in June on the left of the slide. And on the right hand side are examples of progress that we are making in delivering our targets. While you're reading the slide I would like to make a few points.

In the first half of the year we made good steady progress doing exactly what we said we would do. Our order book has grown by £1 billion since March and our bid pipeline has grown by £2 billion so there is no shortage of growth opportunity.

It's not just the size of the order book and pipeline that matters. It's the high quality of the opportunities coming to market. Increasingly our service offerings are led by innovation and technology. Of course the best example of this is the Type 31 frigate. We have successfully mobilised in Norway and Canada showing our ability to build new positions internationally. In our adjacent markets we have made good progress in South Africa and with UK Rail. I'm pleased to say that our contract win rates remain as strong as ever.

In June I stressed that growing our international business was a key part of our medium term strategy. I'm delighted to say that we are making real progress. Whilst the growth in the order book in the first half was dominated by the award of Type 31, over 30% of our revenue in the first half came from outside the UK. We have achieved important new wins in South Korea, Italy and Australia and in the sale of specialist components for submarines to the United States.

Nearly half of the pipeline of bids already underway which are expected to be awarded in the near term is made up of international opportunities. In the first half the order book intake was strong with around £2.5 billion of new contracts added. When we include the Type 31 contract signed last week the order book increased by £3.5 billion to over £18 billion.

As usual on this slide we have shown the order book split by Babcock sectors. About three quarters of the order book is work in our three focus markets of defence, emergency services and civil nuclear.

You can see the breakdown of our pipeline of bids in progress now sits at a very healthy £16 billion. The slide shows the pipeline by market. Over 80% of the bids are in one of our three focus markets.

The combined order book and pipeline is at a record high of £34 billion. That shows real momentum across the business and underpins our confidence in meeting the medium term guidance we gave earlier this year.

Winning the prime contract to design and deliver the UK's next new warship class was the undoubted highlight of the first half. We are supported by a very strong supply chain that includes Thales, OMT, BMT and our own technology subsidiary, Frazer Nash bringing together extensive experience from the UK and around the world and driving collaboration across the industry.

Our Type 31 general purpose frigate solution was based on our Arrowhead 140 design. This innovative platform represents a real step change in the provision of naval capability. Importantly we offered an innovative and proven in-service design reducing the risk to the customer and the risk to us.

Our Type 31 frigate solution will provide the Royal Navy with the flexible technology enabled general purpose frigate that they are looking for. These ships are designed specifically to meet the requirements at an affordable price. The slide illustrates the modular and flexible design developed around our base case fit with optional capabilities and upgrades shown around the outside.

Our approach to the build will maximise UK content and have through-life support as a key consideration. Clearly our experience of the aircraft carrier program and the design and build of the four OPVs for the Irish Naval Service means that we have a proven build strategy that will deliver the ships on time.

We are confident that the innovative Arrowhead 140 design offering flexibility, practicality and affordability, will make it attractive to a wide range of other international navies.

We signed the Type 31 contract on 15 November, 2019 and we've already begun to mobilise the project delivery team. We will deliver five frigates between 2023 and 2028 for an average production cost of £250 million per ship. 2020 and 2021 will see the construction of new and upgraded build facilities at Rosyth with revenue and profits building up slowly in the early design phase before reaching a normalised run rate through the manufacturing and build phases.

It's a really exciting project for us. I'm looking forward to seeing the first ship in the water in 2023.

This side is to remind you of the medium term targets we shared earlier in the year. We've just completed our annual strategy review process and it confirmed our belief that we are on track to deliver on each and every one of our medium term financial targets. Earnings growth of 3% to 4%, stable Group margins at around 11%, increased cash flows generating around £1.4 billion of free cash flow, continuing to reduce net debt, improving our return on capital and maintaining a sustainable dividend policy.

So to summarise the first half of the year has gone well for the Group with normalised revenue growth of 3.6% right in line with expectations. We continue to win new business and to deliver for our customers. We were particularly proud to complete the build stage of HMS Prince of Wales at Rosyth and to see her sail into her base port of Portsmouth after successfully completing the first phase of her sea trials in the North Sea.

At £34 billion our combined order book and pipeline is ahead of plan and with growing momentum we see across the business we expect new order win rates to remain in line with our expectations. As I said right at the beginning of this presentation the progress underpinning these results is creating a solid base for us to grow from over the next few years.

Our financial performance is right where we expect it to be and have previously signalled. With revenues, earnings and cash flows tracking in line we are confidently confirming no change to our guidance for the year.

So thank you. I would now like to move on to the questions. As I said at the start Ruth will be staying around for a bit and will be able to talk with some of you. But with regard to questions about the half year results and this presentation Franco and I would be delighted to take your questions. We have our sector chief executives here to help us with that.

I would also say in terms of political questions the fact that we are just a few weeks away from a general election clearly I'm going to avoid being drawn into anything there. So could I ask that before asking your question could you please give your name and the organisation you are representing.

## Q&A Session

### Charlotte Keyworth, Barclays

Good morning gents. It's Charlotte Keyworth from Barclays. I've got three questions. The first one is on cash. Thank you very much for providing the building blocks to the H2 bridge. I notice we've come in at £7 million free cash flow. Obviously there's a £30 million exceptional in there. I wondered if you could just highlight any potential exceptional items we might see in H2. I'm thinking about the triannual review and perhaps there might be a lump sum there. At your capital markets day you mentioned a potential aviation services restructure.

The second question - again on aviation services - I'm just trying to get a sense of what the longer term margin trajectory is for that division. Obviously you've held it flat with IFRS 16 this year. But Brexit costs are going to recur. Is there any change on anything like the pricing environment we should be aware of longer term?

Then finally on Type 31 - more for modelling purposes to be honest - firstly on the CapEx you've talked about £50 million investment. Will we see any recovery on that in the rates from the MOD and how are you thinking about the phasing now that you've signed.

Then just finally on - you've got a slide around the indicative time frame. Has the revenue that you're expecting to recognise next year changed - you talked about £200 million on the slide - as you start the manufacturing phase. Thank you.

### Archie Bethel

Franco, do you want to start with the cash?

### Franco Martinelli

Yeah, absolutely. Cash - we have as you quite rightly say - provided a bit more detail this year to explain. I'd point you to slide 20 just to expand a little bit. If we look at the working capital balance's movement between September and March of last year - if we move back to the March balance sheets it's over £100 million of inflow that we would get in the second half.

So for guidance to get to the £250 million we don't have to do all of that. That's part of the confidence that we've got. If we get back to last year's balance sheet we will be well ahead of where we are. So that's the first comfort.

Secondly - sorry I'll do the revenue on the Type 31 - the revenue on the Type 31 we expected that there will be no revenue this year, small revenue next year and building up to £200 million the year after.

### Archie Bethel

The second question - aviation services margins - no I don't think we're signalling any significant real change there. I mean I think we've still come under pressure in the oil and gas and we don't expect that to change. We have lost a couple of contracts there that have much lower margins than we are prepared to bid. I think that remains a problem area.

I think we've lost some ground in the first half of the year in Southern Europe with a delay to contracts being placed. I think it will be difficult to recover that fully in the second half of the year. But as I said, in the last couple of weeks we have won one of these contracts in Marche in Northern Italy. I'm hopeful that we'll really start to see some of the bidding work that we've been in the last few months starting to come through. So I don't think there's any significant sort of structural change in that market. I think overall the margins are liable to be where we had guided to.

On the Type 31 CapEx - I mean the CapEx of the £50 million, that's built into the contracts, factored into what we've bid to the MOD.

### Franco Martinelli

Some other questions there, sorry Charlotte, I'll just come back. In terms of exceptional items, we don't expect exceptional items otherwise we would be booking them now. In terms of the - we have said repeatedly that the Rosyth valuation may include some acceleration. We haven't quite got there yet. When we do we'll tell you what it is.

### Archie Bethel

Joe then Rob.

### Joe Brent, Liberum Capital

Yes, Joe Brent and Liberum. Three questions if I may. Firstly on Magnox I understand that's out of your guidance but you did say there are some opportunities there. Could you tell us about those?

Secondly I would love an update on Project Morpheus and what the opportunity there and the timing of that is likely to be.

Thirdly on the guidance slide you talk about sustaining margins. Clearly margins will benefit from IFRS 16. Could you just clarify how IFRS 16 plays into that margin guidance?

### Archie Bethel

Okay, Franco can thank you for that one. On Magnox, the contract has been handed back. There's still a long way to go in terms of the Magnox fleet being decommissioned. We are working with the NDA and the new Magnox Limited as they develop their supply chain solutions and how they're going to carry out the decommissioning work.

I think as we had said over the last year that's still probably sometime away before we'll start to see opportunities coming to market. But we'll be working towards that and I kind of hope over the next 12 months we start to get a better picture of that.

Project Morpheus for those who have maybe not picked it up - it's a contract that we are bidding for in the marine - in our technology group. It's around about the provision and operation of a wide range of communications equipment. The contract is currently running - I think we are competing with General Dynamics and Leonardo. I know more than you thought, didn't I? It's a good contract. It's probably worth a few hundred million pounds. Again it's one of the opportunities that are coming up. It's live at the moment. We would expect to develop through next year.

Franco, do you want to say about the margin?

Franco Martinelli

Yeah, just to put this into context, as you know last year we made 11.4% in terms of margin. The step-downs brought that down to around 11% which is where our guidance is. That's what we would expect it to be plus IFRS 16 adds a .5% so we're not changing our guidance.

Archie Bethel

Rob

Robert Plant, Panmure Gordon & Co

Thanks Archie. Rob Plant from Panmure. Franco you mentioned that new countries, new markets, had a working capital impact. Is that seasonal or structural?

Franco Martinelli

It's a little bit of both - sorry it's a little bit of both. There's a little bit of structure and a little bit of seasonal. Most of it - it's a start-up so it will reduce. When we start contracts we tend to start carefully so we have more stock than we require. So that will come out - that will unwind a bit as we go forward.

Suhasini Varanasi, Goldman Sachs

Good morning, Suhasini from Goldman Sachs. Just a couple from me please. There have been some contract exits and disposals in the last two or three years. Are you planning any more near term and anything material in the pipeline like disposal of one of the non-core activities that you have, for example, like power.

If you think about the FMSP - MSDF renewal, how is that progressing please? Will we get to know next year after the elections?

Archie Bethel

Okay, on the first one, yeah we have over the last couple of years exited or disposed of a few lines of business and businesses that are no longer strategic to us. We don't really have much of that to go. Most of that's been done. So the businesses in our adjacent markets are now fairly well defined. We don’t have any active plans to be making disposals there.

On FMSP - this is the last share of the MSDF contract which is the naval base support contract that will move into FMSP negotiations and that as a single source contract. The contract is being negotiated. We now expect that at the end of this year we will enter a transition contract that will take us from MSDF to FMSP which is now likely to commence from the following year.

So there will be a transition contract that just runs straight from MSDF into FMSP. I think that's the case that we're currently at.

Ed.

Ed Steele, Citi

Morning all. Ed Steele from Citi. A couple from me please. Could you - on the £31 million cash exceptionals could you give us a rough split of where that related to please and also what your guidance is for the full year and how your thoughts about the full year cash exceptionals has evolved please.

Then a second question - on the Type 31 contract what sort of cushion do you have in your contract for variations, changes of mind from the client, et cetera? I guess this is a - I know you did the QE carrier contract but in terms of building frigates it's a new experience for you guys.

So you could you just talk through what happens if things go a bit wrong? Have you got flex in the pricing? Thank you.

Archie Bethel

Do you want to talk about the exceptionals?

Franco Martinelli

Yeah. So £31 million in the first half. £10 million of it is the tax on the restructuring of the AOC structure we did last year. We did that. There was a £10 million - if you remember - a £10 million exception charge. Unfortunately that was all cash so that's gone out in the first half. The rest of it is really to do with the oil and gas reorganisation be it leases or - predominantly it's that.

In terms of full year guidance we had assumed previously that we were going to sell three aircraft. We have converted two of those to firefighting in Spain. So we would probably think that these disposals might be next year rather than this, though there is still the opportunity that they may happen this year. So that's what I would say. That's the only real change whether that £15 million moves or not.

Archie Bethel

On Type 31 it is a fixed firm priced contract. So we would be expected to deliver this contract for the contracted price unless the navy come along and make changes to either schedules or to the requirement. But at this stage the contract is planned on a no changes basis, no modifications. On that basis we have a normal fixed priced contract risk which I think we have mitigated in a number of ways, mainly around about using a proven design using tried and tested equipment and using a build strategy that we have used several times in the past.

If they do come along and they do want to make changes to the design, add equipment or change the time scale then there are clauses in the contract for us to renegotiate.

**Christopher Bamberry, Peel Hunt**

Morning Chris Bamberry, Peel Hunt. Three questions if I may. Could you elaborate a bit more on the new regulations that are causing the delays in aviation in Southern Europe and why you'll benefit from them in the longer term?

Secondly with recent strengthening of Sterling since the half year what's your latest assessment of the impact and net debt for the full year?

Finally could you give us a bit more detail on international divests opportunities, the scale of them and the timing? Thank you.

**Archie Bethel**

Okay, in the first one I mean what's happening in Southern Europe is there's a - it's not new regulations, it's revisions to existing regulations. They are aimed at tightening up the requirements to bid and operate helicopters in these sensitive areas of emergency services. Us being the biggest player with the strongest support in terms of facilities and airworthiness and air assurance, they're pretty easy for us to comply with. Some of our competitors will struggle to meet some of these requirements. We kind of hope that the big impact it will have at the moment in Italy particularly but also in Spain, it's not unusual on almost all bids for the people who haven't been successful to challenge the winning bid on the basis of these rules and regulations. I think the clarifications should smooth that process for us.

Sterling impact?

**Franco Martinelli**

Yeah, I think you're absolutely right Chris. It's moved in our favour. Therefore the negative effect in the first half is almost gone at this point in time. But that's a daily issue. The last one was international opportunities?

**Archie Bethel**

Yeah, what I'd say on the international side is that first of all on the defence side our focused countries are Canada, Australia and France. All three of these areas there are major defence programs and spend being incurred. We are benefiting from that. I think as we mentioned one of them in the statement this morning, and Australia, we recently had confirmed the Babcock weapons handling and discharge systems, i.e. the torpedo system have been selected as the product for the new Australian submarine.

That's a program of 12 submarines being built - being supplied by the French but built in Australia. Babcock weapons handling systems will be in all 12 of these submarines. That's probably the biggest single one. It's over a period of time but it's a game changer for our Australian operations and also very important for our technology business here in the UK.

It will be the first time ever that the French have built a submarine with a British torpedo system in it. So that's quite neat. But I think beyond that Canada has got a very big program of naval development going on at the moment. BA Systems have benefited from them buying the Type 26. Again we've got a lot of equipment on the Type 26 and would expect to sell into that Canadian project and the Australian project to their new Hunter classes also a derivative of the Type 26.

In Canada we'll see - we're moving forward into the next phase of the submarine support which we currently hold but will again be moving into life extension. So that naval side - in that air defence side it's very, very strong at the moment.

In France we are building quickly on the contracts that we've previously won in terms of the Fomedec. We're hopeful in the next few months to be able to talk about some other successes there.

Outside of military - again back in the aerial emergency services, we are focusing really there again in France and Scandinavia and in Canada. Particularly Canada where we just did - we've just made a new entry there. We can see some really good opportunities.

**James Beard, Numis**

Morning. James Beard from Numis. One from me on the pipeline and order book. On the order book I just wanted to get some additional colour on trends apart from Type 31 which obviously is the big number in terms of order book addition. Because the remainder of the order book addition there at the circa £1 billion is obviously quite a long way below the order book that was used in the period effectively. So I just wanted to get some additional colour around that.

On the pipeline what more material decisions are due in the relatively near term?

**Archie Bethel**

What it says - I mean I'd emphasise that in the period new order intake was £3.5 billion. So we bombed through £2.5 billion so we added a net £1 billion to that. So in the first half of the year we took in £3.5 billion of new orders.

They came from a range of things. Almost every area of the business met its order intake. We mentioned the additional one this morning of the Metropolitan Police. But I think we've seen across the piece continued strong order intake. I think that's one of the highlights I think of the first half of the year. Sorry, what was your second?

**James Beard, Numis**

Just on larger net and decisions in the pipeline.

**Archie Bethel**

Well, you know the pipeline is pretty busy. We've mentioned a couple of them here. I think we've said before the big live bids at the moment, probably the biggest is project Selborne which is the naval training program where I think it's public knowledge that we were down selected alongside Lockheed Martin and Raytheon as the three bidders. Again that's a program that will come to decision probably next year.

In Canada we're bidding in a very large - again air force pilot training contract very similar to our UK, [UKMFDS] contract. Again that's live and we're bidding against a few major international competitors there.

We mentioned Project Morpheus which again is well down that line. We expect the fleet solid support ship contract opportunity which was cancelled just a few weeks ago while they reassess the requirement - we take that as a positive step. The ships are needed to support the aircraft carriers so they have to be built. I think what we'll see early in the new year is them coming back out with a revised requirement in terms of the technical specification.

It will be interesting to see whether that gets classified as a UK supply or back to international. So there's a good range of contract - the pipeline - we added £2 billion to that. At £16 billion it's pretty healthy.

Franco Martinelli

James, Miter is a big project also that's coming up in the new year. So that's another one. So it's across the sectors. We've got - we're pretty busy. UK defence - lots of defence stuff in Australia, Canada and the UK.

Sam Bland, JP Morgan Cazenove

Morning, Sam Bland from JP Morgan. Just one question from me please. I guess looking at the operating profit in H1, £251 million, that's got to go to about £300 million in the second half. I guess roughly £10 million of that improvement from the lower step-down impact in H2. Could you just talk about the rest of the needed improvement? Is that from contracts that are already won and secured and where the revenue is visible? Or is there any uncertainty maybe from short cycle work or just basically the level of certainty on that H2 improvement? Thanks.

Franco Martinelli

I'll take that. Okay in the stat hidden in one of Archie's slides there was a 92% coverage for the revenue of this year. That is a good measure as is the one for the following year. So we're at good places compared to where we would expect to be.

In terms of short cycle - I was just discussing yesterday - South Africa is pretty well set for the rest of the year so that's good. Rail is moving through. I mean defence can change from month to month but it has little effect on profit.

So I think the activity in South Africa in the short cycle is there. The order book is there. So we feel pretty confident in the second half really.

Archie Bethel

Any more questions? Kean

Kean Marden, Jefferies International Ltd

Morning, it's Kean Marden from Jefferies. Your UK nuclear defence revenues were much better than expected in the first half. I appreciate you flagged it up but if you could provide some context around that, that would be helpful. Does that relate to the V-class work potentially?

Franco Martinelli

As you know Kean there are limited things in our nuclear defence so I think it would be a fair assumption. But I could neither confirm or deny I think is the way to put it, isn't it. So the answer is yes, isn't it.

Archie Bethel

What I would say is there's no doubt in the naval nuclear program we are seeing some additional spending moving forward. Part of it is the Vanguard life extension. Part of it is the increased support for the SSNs, the Trafalgars and Astute classes as the navy tries to up the tempo in terms of usage of that. We are moving forward seriously on the infrastructure upgrade programs both at Devonport and at Faslane. So there is money coming in for us. We're doing a lot of preparation work and design work. We are seeing a bit more money coming into the disposal program.

But if I look forward in the next 10 years there's no doubt that I think in nuclear the four big programs of life extension for Vanguard, preparing for Astute classes first dockings and mid-life refits, the infrastructure upgrades that are needed to support Astute and Vanguard transition into Dreadnought and the submarine disposal program which we're very early in, these will be big drivers of growth for us over the next five, six, 10 years.

Kean Marden, Jefferies International Ltd

It was obviously one of the main points from a short seller note that came up recently. So it suggests that actually momentum has already come back into that program. There aren't any issues there that they were suggesting. That was the angle.

Then on Type 31, I appreciate you touched on it earlier but it's quite topical at the moment, so I do have quite a few questions. One of the other questions that we've had from investors is how the cost of your platform relates to the platform that was built in Norway, whether you have any insight into that and the plausibility of basically creating this platform for £250 million. If you've got any insight into that, that would be helpful as well.

Archie Bethel

I'm maybe going to ask [John] if he would - I'm going to give him a chance here because I have to say John has been the mastermind behind Type 31. So can you maybe pass the microphone over here and let - oh you've got one - so let John talk about that.

John Howie, Chief Executive, Marine

Hi Kean. The platform that was built in Denmark which is the Iver Huitfeldt design which is effectively structurally the same - that platform was built for under £200 million fully supplied to the Danish navy in 2010. We as part of the licencing agreement for the design got a fully detailed cost model and we used that to verify all of our bottom-up estimates.

So the big thing for us is we've been able to use what was a really, really efficient build methodology the OMT developed. That's allowed us to de-risk it. So a combination of using that proven design, proven combat management system and where possible replicating equipment choices that the Danish used, have given us a really high degree of confidence that we could meet the budget price.

Archie Bethel

Any more questions? Okay, well in that case can I bring the presentation to an end. We want to thank you again for coming this morning. Thank you for your questions. We'll see you at the next event. Thank you.

Ends