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Half year results for six months ended 30 September 2020 transcript

Wednesday 25 November 2020

David Lockwood
Chief Executive Officer

Good morning, and welcome to the first and, I hope, last virtual results presentation by Babcock. My name's David Lockwood. I'm the CEO of Babcock for the last 10 weeks. I'm going to start with a brief business overview and then hand over to Franco who will take you through the numbers before we move to Q&A. So I thought I'd start with how I've seen Babcock after 10 weeks. It is - it was described to me as a complicated company when I started, but I have to say that's not what I've found.

We might not always explain ourselves terribly simply, but actually, we have three fundamental business models. The first is, we are a full-blown marine and naval business. So we develop products with some very high technology in. We build ships, the Type 31. We support ships and submarines, some of the most complicated military systems outside the US, and then, we decommission. So, a full shipyard in the UK. We have strong maritime operations in Australia, in Canada, growing in Korea, so it's not only a UK business, but it's a strong, global, maritime business.

The second is, we do high-end engineering support of platforms for a range of people. We do that mostly in the UK, but we do it across all domains. Then, finally, we have a more traditional services business that does flying as a service in medical and firefighting, and also does things like training, and that's it. That's who we are, three business models delivered into four sectors, so not complicated at all.

That business has a wide range of strengths. First and foremost, it is a resilient business. We are a strong business that delivers long-term programmes with some very capable people. It could have been hit even more badly by COVID than it has been, but we've managed to cope with adapting working practices to minimise the impact on our customers.

We have deep customer understanding. The majority of our people work on sites shared with customers, hand in glove with customers to deliver complex solutions. There is and remains strong demand for our expertise across the whole range of everything we do. There are some less good spots, civil training at the moment due to COVID, but the long-term dynamic is good, and I'll come back to that.

Then, finally, I've been really impressed with some of the areas of innovation I've spotted in the Group. One of the things we want to do is get those to travel around the Group more, so they can be applied more widely. Of course, nothing is perfect, so there are areas to address. We've operated a federated model and that has served us well for a long time, but as the customer joins up, so we need to join up.

So we need to look at our operating model to work out how expertise travels around the Group, and in particular, to get a common culture to make it easier for people to move around the Group. The federated model didn't lead to strong collaboration, and what we are seeing is bids increasingly coming through and customer demands coming through that cross our internal boundaries, so that we need to be able to collaborate more effectively to meet those demands.

Then, finally, we need to focus on free cash flow after everything. Our balance sheet is in a resilient shape, but it could be better. We have lots of strategic opportunities. To deliver all of that value, we need to have a strong, sustained free cash flow.

Every incoming CEO to any business is going to have a look at the strategy, and it would be perverse if I didn't, so there's nothing odd about having a strategic review, but there are some things that are fundamental to the old strategy that will be fundamental to the new.

So, focus on cash, I've already touched on. Being a strong, strategic partner to the UK Government, we have a position now where, for the MOD, we are the second biggest supplier by value and the biggest by the number of programs we participate in. They need us and we want to be a forward-leaning partner, not only in responding to needs, but in helping to shape them.

International growth was fundamental to the old strategy and it's difficult to see how it can't be fundamental going forward, so that will be a key priority. Against those two, I recently appointed John Howie to take a new corporate role, to look at how we best deliver that collectively.

I've already mentioned driving innovation across the Group. We do have some really strong pockets of innovation, particularly digital innovation which, to be honest, I wasn't expecting to find at the level of maturity I found. The digital twin of our customer platform so that we can do predictive, rather than responsive maintenance and support. A whole range of things. We need to get that to travel across the Group, so Jon Hall was appointed to take responsibility for making that come alive.

Then, finally, because we've run as separate entities, we don't have an integrated people strategy or an integrated ESG strategy. We want to make that come alive. We want that to be at the centre of our strategy, not via compliance activity. It's been the principal area of concern by the employees who I've communicated with. Customers talk about it, investors talk about it. This isn't a compliance issue anymore. This is fundamental to our strategy.

In general, notwithstanding the challenges of operating in a COVID world, the macro environment is probably improving beyond what we were expecting. So we have defence spending growth in Australia, a key market for us. Obviously, the recent announcement in the UK with a significant focus on shipbuilding, which is obviously very important to us. We've still got the integrated review to come through that will fill out the details, but the backdrop to that is very positive.

For our half year, revenue is resilient but we did have declining profits, as was expected. Really, four things affecting that. Disposals, obviously, part of the cash self-help, but you lose the profit contribution. The enforcing of what I might think of as thin prime, so the management primes in the nuclear industry. COVID-19, that had a big impact, as was previously announced in Q1.

We've been learning to manage it on a weekly basis, almost, improving and improving. We have a weekly COVID call so we can be responsive to all of the impacts of different governance of COVID. Then, weakness in civil aviation has been highlighted before, and Franco will look at later.

We haven't been sitting idly by, so the insourcing by the NDA, the decommissioning authority of the Tier 1, has led us to relook at our civil nuclear business, how it addresses the decommissioning and the new build market. There has been a significant restructure in there which is still ongoing. Civil aviation restructuring, we've been going through a fleet rationalisation programme and looking at how we operate to support more broadly to our fleet, so we can offer a better service for lower cost and, obviously, the cash self-help through the disposals.

So, with that thumbnail of the business as I see it, Franco will now colour in the details on the financials.

Franco Martinelli
Group Finance Director

Thank you, David, and good morning, everyone. I'm going to go straight into the financials. Revenue was substantially maintained in the half, but operating profit was down 40%, and I will cover that shortly. There was a small net charge to exceptional items recognised and a continued cash impact from prior year charges.

Free cash flow was £58 million, which was above our first half expectations. EPS was 15.7p and net debt was at £871 million, which is lower than the end of last year and significantly lower than September last year, at both period end and average for the period. With a net debt to EBITDA of 2 times, we are in a strong balance sheet position.

Moving on to some of the detail, then, revenue was £2244 million and was down 9% on last year. If we exclude FX and disposals, that's 7% down. This mainly reflects the impact of the end of Magnox last year. If you were to exclude this, the rest of the business was down 2%.

Underlying operating profit was £143 million and, as David has said, there are four main drivers of this performance. Firstly, FX and disposals. Secondly, the decline in the Nuclear JV profits of £12 million, and I will cover this in detail in the Nuclear slide. A bit related to the ending of Magnox last year and the shortened timescale of Dounreay. If we exclude these, operating profit was down 34%.

The third driver then was COVID, and I will go into detail on this shortly. Of course, the final driver was the performance in our civil aviation business. Again, I will come back to this. Free cash flow was better than expected and included £40 million VAT timing benefit across Europe. Net debt, as I said earlier, was £267 million lower than a year ago.

So, the biggest driver of performance this half was the impact of COVID-19 across the business. As David said, we are a people business and so had a particularly acute impact of COVID-19, given the necessary constraints on close proximity working. The impact varied by business and sector, but all sectors suffered from lower activity and inefficiency. On here, we are showing the main drivers of profit performance in the half, which for three sectors, was overwhelmingly COVID-related, after allowing for the disposals and Nuclear joint ventures.

In Marine, the biggest driver was lower efficiency. For example, progress on warship support was heavily impacted in the early months of the pandemic, as access to customer sites, distancing requirements, PPE restrictions, all led to earning a lower margin as we achieved fewer milestones.

It's a similar story in Nuclear. Progress on work programmes continued, but the pace was slower and additional costs were incurred, leading to a lower margin. The civil business also had an impact from customer site closures and hence reduced activity.

The main story in Land is activity levels. Work in many civil areas such as airports, training and South Africa came to a near stop, and so revenue was heavily impacted and operating profit with it, made worse by the operational gearing in these businesses.

In Aviation, COVID-19 impacted both activity levels and efficiency. These pressures combined with the existing business challenges to cause the performance in the first half, and I will expand further on each sector as I go.

So, moving to a revenue bridge, you can see here the impacts of FX and disposals, and then the movements by sector. Good growth in Marine, led by Type 31 and ventilators, and a decline in Nuclear that is all Magnox, with growth excluding Magnox. Decline in Land from lower civil activity in the COVID-19 environment and broadly flat in Aviation, though there was an adverse mix impact there which I will cover later.

Onto the operating profit bridge, you can see the impact of FX and disposals, then the movement by sector. Marine's decline reflects the COVID-19 impact on efficiency. The movement in nuclear is partly the movement in the Nuclear JVs and partly COVID-19. The movement in Land is directly linked to the revenue decline. As Aviation, there's £34 million profit shortfall. Part of this is COVID-19, but part is the ongoing challenges of the profitability of the business. In October, with COVID restrictions lower, performances improved.

Now, we move on to exceptional items. On the left, you can see a summary of the exceptional items in the half. In summary, exceptional costs were offset by the gain on business disposals. Many of these costs related to the ongoing programmes David has discussed. Going through each of them, then, exit and disposals' costs of £9 million were more than offset by the net gain on the business disposals.

We recognised £11 million of new restructuring charges, mostly in the aviation sector, as we look to move forward our programmes further forward. We started to progress our fleet rationalisation programme in the half with fleet transactions approved to reduce the fleet by seven and to reduce the number of types by two to 31. It's created a £7 million charge, but more importantly, has realised cash.

We closed our Rosyth pension scheme to future accrual, de-risking our pension position, and this non-cash charge is the curtailment accounting loss. With the associated tax credit of the above, the net impact was a £2 million charge in the period.

On the right-hand side, I laid out the exceptional cash costs, both those incurred in the first half and those incurred in prior years. These are net of tax and represent our best view as of today. They are subject to change. For example, the Rosyth pension payment has shifted to the right since we spoke in June. We have also pulled out the disposal proceedings from these numbers so you can see the two separately.

Now to the detail within the sectors. Marine saw strong revenue growth of 12%, led by Type 31 work ramping up, and helped by the continued strength of our LGE business and revenue from ventilator challenge.

Operating profit was, however, lower. COVID-19 had a significant impact on efficiency across the sector, particularly in warship support and in Oman, where in Oman, activity stopped and costs continued. The lower margin of 7.8% represents both the COVID-19 impact but also the revenue mix, with growth in lower initial margin work versus Type 31 and a decline in our consultancy activity, one of our higher margin businesses.

Revenue in Nuclear was down 17%, reflecting the loss of Magnox last year. Excluding this effect, revenue was up 4% with strong growth in defence led by increased infrastructure work, but lower revenue in civil as COVID-19 led to lower activity.

Operating profit was down 45% and the margin was at 6.5%. This reflects the swing in Nuclear JV profits, where last year included Magnox plus profit in Dounreay. This year saw a £5 million loss in Dounreay as we adjusted our assumptions around contract milestone profit achievability, given the shortened timeframe of the contact which now ends in 2021 rather than 2030.

The lower margin in Nuclear in this half also reflects the COVID-19 challenges on efficiency and cost, particularly acute when working in close proximity on nuclear submarines and the lower margin on the MSDF transition year and initial infrastructure work.

The results in Land show the impact of COVID-19 on activity with the revenue decline of 23% coming from the significant reduction in work in airports, civil training and South Africa business. FX also had a £37 million impact on revenue. Operating profit was down 43% with a flow through of the revenue fall and the operational gearing.

Moving to Aviation, despite some COVID-19 pressures, profit from joint ventures was slightly up year-on-year. However, within the Group business profits, they're down £34 million in the period. There's some inefficiency in our defence business, as experienced in other sectors, but the main weakness came in our civil aviation business.

Revenue for the sector as a whole was lower, with lower flying hours in aerial medical services and oil and gas, particularly in the early stages of the pandemic, offset by growth in firefighting at the busy end of the season. There are many drivers of this declining trading, but in simple terms, there was significant COVID-19 impact and we are only partway through fixing this business.

Looking at some of those details, the cost base and fleet are too large for aerial emergency services. Oil and gas is a tough breakeven market in normal times, but the lower flying hours that COVID-19 created led to a loss in the period.

COVID-19 had a range of impacts, from lower flying hours through to additional costs such as PPE and refitting aircraft. It also reduced efficiency, for example with reduced aircraft capacity. There was also a mix both in terms of timing and market. For example, higher firefighting activity does not contribute sufficient profit to offset the impact of limited medical flying in the early period. The most efficient and usual model is stable flying hours, rather than stop-and-start flying. We have not been able to get most additional COVID-19 costs and inefficiencies covered in our contracts.

A summary here of our joint ventures. On the left-hand side, you'll see the profit contribution of each one and, in total, JVs contributed £31 million operating profit in the half. We received £15 million in dividends, given a no gap against profits after tax of the JVs. Our share of JV net debts was £266 million in September, mostly in AirTanker, and note here that both Dounreay and ALC finish in 2021, so there will only be two big JVs left which are AirTanker and Ascent. On AirTanker, you should note that we increased our stake by 2% this month to £9 million using our pre-emption rights.

Moving to cash flow, I will pull out the big movements here. Working capital was better than expected with a £15 million outflow compared to £107 million outflow last year. This included a £40 million benefit from VAT timing across Europe, but also reflects a collection of receivables ahead of expectations and lower inventory levels.

We have limited discretionary CapEx spend during the COVID-19 pandemic to preserve cash, and net CapEx depreciation was 0.9 times, although it will edge up in the second half. There has been no sale and leasebacks during the period, as the aircraft market remains unattractive. This is before IFRS 16 leases. These were lower year-on-year, reflecting the lower new leasing activity in Aviation.

Onto free cash flow, interest was flat year-on-year with lower average debt offset by the higher interest rates incurred post-refinancing. Tax paid was lower, reflecting the lower full year profit expectations, and dividends from JVs was also lower as last year included the Magnox exit dividends.

Excess pension contributions are higher, partly as the underlying P&L charge for the DB schemes was lower in the period. All of this led to free cash flow of £58 million, and if we take the last 12 months, a free cash flow of £244 million in the last 12 months.

Pensions, two movements in pensions in the period. The accounting position went one way and technical provisions position the other. The IAS 19 position is now £104 million deficit with a reduction in corporate bond yields and higher inflation- assumptions changing position from March 20.

On the funding side, our technical provisions deficit is now around £450 million, reflecting the deficit contributions in the period. We still expect pension contributions in excess of the income statement to be around £75 million this year, and the Rosyth top ups within exceptional cash flows will be around £90 million, but the timing of this has shifted a year, as discussed before.

Here is the bridge of the movement in net debt since March. You can see the positive free cash flow and the proceeds from the sale of Holdfast more than offset by the exceptional cash costs and FX movements.

So then, looking at the net debt position and liquidity, the self-help actions and disposals, CapEx control, VAT deferral, as well as not paying the final dividends the last financial year led to a lower net debt. So, despite the fall in profits, our net debt to EBITDA in September was 2 times. This is above our target but is well within our covenant levels.

We extended our RCF by a year and our credit rating was confirmed at BBB by two agencies in the period. The bottom of this chart shows our debt maturities. You can see the £307 million USPP that we will pay off in March, and note we had around £1.4 billion of liquidity headroom on our balance sheet in September, and so we are well-covered for this and future requirements.

So, to summarise, revenue was resilient in most areas. Operating profit was impacted by disposals, Nuclear JVs, COVID-19 and the performance in civil aviation. Despite this, we reduced net debt and have significant liquidity and headroom, so we are in a strong position to manage the challenges and uncertainties ahead.

David Lockwood

Chief Executive Officer

Thank you, Franco. Two more slides from me. So, there are uncertainties ahead in the short-term, particularly around COVID-19 and the restrictions under which our global business will operate, which most governments are mapping through to the end of our financial year, and having looked carefully, that's led us to the position where we're not providing guidance for the balance of this year, although we do have the start position that Franco has just outlined.

So, what to expect looking forward? The outlined strategy review in May with the full year results. To reconfirm our priorities of free cash, strategic partner to the UK Government, driving international growth, using innovation across the Group, and transforming our ESG and people agenda to put it at the heart of our strategy. The most important factor of all is the long-term delivery of sustainable free cash flow.

So, what happens now is we're going to run a short, 90-second video, so if people can get off this system and onto the Q&A system, that will happen when I raise my hand to the guy operating the video, and then we'll reconvene for a Q&A. So thank you for listening to this presentation. The video.

VIDEO PLAYS

Q&A Session

David Lockwood

I hope you're ready for a quick Q&A now, so if we can have the first question.

Kean Marden - Jefferies

Morning, all. Thank you, morning. I have two questions for David, please. The first touches on the free cash flow point that you repeated during the presentation. I guess I'm wondering how much of the free cash flow discipline is cultural. So, I'm wondering in your view who in the organisation should take responsibility for generating sustainable free cash flow, and is that embedded in Babcock's bid processes currently?

Then also, on free cash flow, how wide is the range of free cash flow outcomes across divisions and contracts with a new organisation currently? I appreciate COVID has impacted that to some degree, but maybe if you can adjust. Then, the second question, does Babcock have the skillset and the assets to fully benefit from the recent UK defence budget increases? Thanks.

David Lockwood

Thank you for the question. I should have said in introducing the question thing, because of this environment, if we could have questions one at a time and not test mine and Franco's memories, that would be helpful. I'll take the second one first. Yes, we do, against all of the scenarios that we can see, and in fact, a lot of groundwork is going in to make sure we can step up to an even bigger position. So I feel very confident we have all the groundwork in place for that.

In terms of free cash flow, my initial view is that we could do more. There's definitely more we could do in terms of how we train people to think about cash. David Mellors said when I first met him that cash is a cultural issue for the whole business, and until that is fully embedded everywhere, you don't achieve your maximum cash flow, and I think he's right. So you can always do more.

As I said earlier, we ran in a federated way, and therefore culture is federated, therefore the cash culture is federated, so I'm sure we can do more, but a lot of your questions are about the past, so I guess Franco will probably want to comment on that.

Franco Martinelli

The question on free cash flow, yeah, I think it really is embedded in the bid process. It really is, but we definitely can improve, and I think that's driven by our relationship with customers, our relationships in markets, so it has to be all-encompassing. We can do better. I think avoiding exceptional cash flows is also a big driver, so you can avoid the mistakes, then you can certainly drive a clean free cash flow, which is what we're talking about here, and that's of key importance. So I think that's very important.

In terms of the businesses, I think they all generate good free cash flows. I think you could probably guess which ones are the most capital intensive, i.e. Aviation, and that's probably a little bit lower. That comes down to the lease versus buy model and how that works, and how - so I think we can drive improvements in free cash flows.

I think it's difficult times at the moment, but even if we take that over the last 12 months, pre the exceptional items, which as I've said before, we should not excuse, we did generate over £240 million free cash flow. So, this is a business that's capable of generating a good free cash flow.

Kean Marden - Jefferies

Thank you very much.

Joe Brent - Liberum

Good morning. I've got three questions, as well, but if I could, I'll take them one at a time to help everybody. First of all, you've talked about cash flow, but given a consensus that isn't really changing today and given that it doesn't look like you'll be paying the Italian fine this year, could you tell us what has gone worse or might have gone worse, to mean that the overall result is unchanged?

Franco Martinelli

I'll take that. In terms of the net debt, the FX has moved against us, really, so as at September, that's worth about £33 million against us. If you took it at today's FX, that would go away, so that's where - but that's the main reason, I think. That's the question answered, so that's it, Joe.

Joe Brent - Liberum

Right, so that sounds quite cautious, then. Secondly, you've talked about, David, a new vision of how you see the Group. Will that be reflected in the divisional structure going forward?

David Lockwood

My view of companies is that they comprise three elements. They comprise a strategy, an operating model, and a culture, and you can't sort out the operating model until you've worked out the strategy you're trying to deploy. So that could be or might not be an output of the strategy review. It's too early to say.

Joe Brent - Liberum

Thank you. Then, finally, a very big thing on the horizon is the FMSP. Could you give us an update on where you think we are with that?

David Lockwood

As you can imagine, in my first 10 weeks, I've had more than a few conversations with a customer on that. I think we are probably broadly heading to a sensible place.

Joe Brent - Liberum

Timing-wise, when do you think we might get some clarity?

David Lockwood

That's a bit of a forecasting question, and I think we're not forecasting.

Joe Brent - Liberum

Thank you.

Anvesh Agrawal - Morgan Stanley

Hi, good morning. I just have a couple of questions. The first is just on the slide 14 where you have the exceptional cash costs laying out for FY21-23, which is clearly helpful, but I just want to confirm, is this - are these numbers fully comparable to what you presented at the time of full year results, or the tax inflow is making much of a difference there?

The reason why I ask is the Italian fine is around £45 million, and if I look at the outflow of FY21-23 which is, like, £7 million and £16 million, it doesn't quite reconcile with that number. So I'm wondering if there are any inflows that are in your expectation there. That's the first one.

Franco Martinelli

I'll take that. No, I think it's on the same basis, but it's an update on what our thoughts are. On the Italian fine, the appeal was meant to be in November. It's now moved to February, so we might do slightly better than this if the fine gets moved into next year. We'd probably expect the fine now not to come in one lump, but to be paid over a period, and that's reflected in these cash flows. So it is there, but it's within this three-year timeframe that you've got there, so that's where we are.

Anvesh Agrawal - Morgan Stanley

Maybe just talk a little about, what's the tax benefit that you have on the exceptional charge over these three years?

Franco Martinelli

The tax benefit will be across all of the ranges, all bar the - all the charges will be liable to tax, as opposed - except for the fine, obviously, and then - so the rest of them are all taxable with the exception of the Rosyth pension scheme because of the UK pension accounting tax, as the first year of the top up is not really allowable and you get it over time. So most of it, as I say, is allowable to tax, but with some timing difference on the pensions and none at all from the fine, is what I would say. So you can work out the numbers from there.

Anvesh Agrawal - Morgan Stanley

That's clear. David, just on the announcement by the UK Government, it's obviously positive for Babcock. I was wondering if you had had a chance to have any sort of preliminary conversation with MOD in terms of when the spending can really start to come through, how that feeds into your pipeline for next year or the year after that.

David Lockwood

Yeah, so obviously, the good thing about the John Howie appointment is we have more bandwidth to engage with Government and that's already paid some benefits in the few weeks he's been in post. So we are in discussion. Clearly, the detail of that comes out of the integrated review which is early next year. We had that on our uncertainty slide because that will affect the sequencing of events, I think. So I think we'll have to wait to see that to see exactly how the money is spent.

Anvesh Agrawal - Morgan Stanley

Thanks for that, then. Thank you.

Allen Wells - Exane

Good morning, David. Good morning, Franco. Just a couple from me. First of all, it's back on the cash flow side of things. Obviously, cash flow seems a bit better than expected in the first half and part of this is due to timing. Just thinking about the things like VAT deferrals, the lower CapEx, you're pushing exceptions into the outer years, is there any - are you in a position to comment on how this potentially impacts, I guess, your overall thinking around the medium-term guidance around cash generation for the business?

Maybe just linked to that, on that CapEx side, which obviously looks lower on the first half, would we expect a decent step up in CapEx, either in the second half or into next year? I've noted in the release, you talk about additional production facilities to support Dreadnought, et cetera. So that's my first one, so cash flow, CapEx and that side.

Franco Martinelli

The answer is yeah. Look, it doesn't change my view as to what the deliverability of a good free cash flow from this business, pre-exceptional items and post-exceptional items, should be. I think that the VAT deferral is a timing difference that will flow out at some point. CapEx will edge up slightly from 0.9 as we have to build the Rosyth facilities and the Bristol thing, so both of those will edge the stuff up, CapEx up.

I think overall, this will be under tight control. I think the focus - some of those are timing differences in terms of where we are for the half year versus the full year, but we are ahead of where we need to be. So I'd rather be in that place than having to do catch-up. We always have second half waiting on cash flows. I would hope that we are a little bit ahead of the game this time.

Allen Wells - Exane

The second question, just on FMSP and the transition there, I think you guys had previously talked about an expectation that the transition from FM to FMSP wouldn't necessarily be a negative impact to your Marine margins. I noticed in the comments today you talk about a step-down MSDF which I think has moved to a one-year transition period. When we think about FMSP kicking in, I guess, from next year, will there be a step back up again then off the back of that, towards where original MSDF is, or is it the current baseline to start thinking about FMSP, please?

Franco Martinelli

I think it's quite a challenge to answer a question, to speculate on the margins of a contract we have yet to negotiate. So I think by the time we get up in May, we should be able to answer the structural questions in Marine because we'll have much more certainty.

Allen Wells - Exane

Thanks, and final question, just on Dounreay, please. The adjustment on the profit milestones, which resulted in a £5 million loss, could you maybe just talk a little bit about the background here? It sounds like to me that, obviously, the profit take was maybe a bit high in the early years and the early conclusion of that contract has meant you've had to book some losses, just to understand exactly how you've managed to take a loss this year versus where we were expecting.

David Lockwood

Dounreay is quite a unique contract and it's got a lot of profit-earning milestones that are events in themselves. Now, when you're doing a long-term contract that ends in 2033, whether that milestone is achieved on 1 April or 31 March makes no difference to the accounting, right? So you're taking the long-term contract and the accounting makes you do that. There is no question about that. Do you then suddenly make a curtailment and stop it on 31 March? You have to reassess what you could achieve by that date, and that's why it is.

So the accounting was fine before, but with the change of circumstance with the shortened timeframe, some of those milestones which we might have achieved in April in the extreme example will not be achieved in March. So, therefore, there's a difference in the profit outlook. That's why it happens.

Allen Wells - Exane

Thank you.

Ed Steele - Citi

Morning, everyone. Two questions, please. The first is on the civil aviation business. If you're talking about the central costs being too big for the emergency services part of the business, but that part of the business has grown quite well, revenue-wise, in the past few years since you've bought Avincis. Turning that around, is there a realisation going on now that perhaps some of these contracts have been priced too aggressively? Is that what's gone on, please?

Franco Martinelli

No, I wouldn't say that they'd been priced too aggressively. I think what has happened is that we've not been as disciplined in our costs structure and our fleet management as we should have been, and there is significant potential for that and that's what we're focusing on now. So I think it's that individual contracts are fine, the question is, have we got the right cost bases to support them and the right fleet base? That's what we're focused on now. That's what I'd say.

Ed Steele - Citi

That sounds like a mismanagement situation. Have you changed management, please?

Franco Martinelli

The Aviation team is not the same Aviation team as a while ago. However, I would say that it's a matter of how quickly things grow and we have to make decisions, and we had said a year ago that we were sorting this out and we're in the process of doing it, so we are in the process of doing it.

Ed Steele - Citi

My memory is more that the issue you were facing were on oil and gas a year ago, but okay. Second question, completely different, so your depreciation, if you include the IFRS 16 component, has gone up quite a lot year-on-year. Can you talk around that and perhaps what we should be thinking of as a sustainable level, please?

Franco Martinelli

Yeah, depreciation has increased a little bit and I think this is a sustainable level. I think we've focused on it. I think it's taken a little bit more cautiously on some of the periphery, on some of the numbers. So I think the current level is correct.

Ed Steele - Citi

Right. I suppose my question was really to ask why has it gone up, please?

Franco Martinelli

As I said, we focused on - across the - it's in Aviation, and we focused on the residual values and the current view of the market, and we've been a little bit more cautious on our depreciation.

Ed Steele - Citi

Thank you.

Robert Plant - Panmure Gordon

Morning, David and Franco. David, you mentioned some areas of improvement, for example, making it more of an integrated company, particularly in terms of people and ESG. Do you think the Company needs to spend more centrally on these kinds of things? Thanks.

David Lockwood

Yeah, so I don't like the word central, because that has connotations of doing, too. I think you can achieve a lot of it, for example, on some of the ESG strands by getting collaboration across the Group. You don't need a corporate central team. You need a first amongst equals who'll make sure that the best happens everywhere.

So I don't think all of it requires central. There'll be a small amount of central cost, but that should be offset by cost coming out elsewhere. Generally, corporate doing two things for business is something I try and avoid. It's much more encouraging the business to work collaboratively.

Robert Plant - Panmure Gordon

Okay, David, thanks, but if not centrally, do you think overall, the Group needs to spend more net on these costs?

David Lockwood

Too early to say. I don't think it's a guidance-moving number if we do.

Robert Plant - Panmure Gordon

Thanks.

Christopher Banbury - Peel Hunt

Good morning. I have three questions. First, for the first half, you helpfully disclosed the revenue decline ex disposals and Magnox. Could you please do the same for Q1 to give us an idea of the underlying progress in Q2? Back in the Q1 update, you said the core revenues grew, so if I could just get an idea how they performed in the second quarter? Thank you.

Franco Martinelli

The Magnox effect was similar, so we did disclose a similar one for Magnox. I think, actually, similar percentages, actually, is what I would say for Q1.

Christopher Banbury - Peel Hunt

Secondly, profits were down, obviously, 43 in the first half and for Q1, you said round about 40. I'm just trying to get a feeling, if there was a gradual improvement in efficiencies over the second quarter, and what negative factors had a greater impact on the first quarter vs the second quarter like Dounreay and anything else. Thanks.

Franco Martinelli

Dounreay was definitely a factor, no doubt. That changes the percentages, and the spread of the disposals and FX were the other bits, I would say. Overall, the underlying business is improving and, as I said, it improved again in October, so we are seeing a gradual improvement. The difficulty in giving a guidance is that we then go into lockdown 2 in November and the world is changing slightly. So I think that's the difficulty, that we were making progress month-on-month, but what's going to happen going forward is why we're not giving our guidance.

Christopher Banbury - Peel Hunt

Thanks. Finally, with regard to outcome in contract awards and decisions, so you obviously mentioned a statement in naval training is due by the end of December. Have you got any inkling on that one, and what other decisions do you expect by the time of the finals in May?

David Lockwood

Naval training is the big one. FMSP, obviously, Morpheus, MEWSIC. There's quite a - there's three or four in the 100 million, but the big ones are naval training and FMSP.

Christopher Banbury - Peel Hunt

Can you give us an idea of when roughly you're expecting those decisions?

David Lockwood

I think you're asking the wrong person. I think that's a customer decision.

Christopher Banbury - Peel Hunt

Fine, thank you very much.

David Lockwood

Thank you all for your time. There's one final thing to do, which is to thank Franco for three things, really. His 19 years in the company, his period as CFO, but from a personal point of view, his tremendous assistance in helping me transition into the Company. I said it wasn't as complicated as I thought it would be, and that is in no small part to the assistance Franco has given me bedding down, so thank you personally, Franco, and on behalf of the Company, and on behalf of everyone who's interested in Babcock. With that, thank you all for joining the call.

ENDS