babcock™

Business update

13 April 2021 *This announcement contains inside information*

Babcock International Group PLC ("Babcock" or "the Group") issues the following update for the financial year ending 31 March 2021 (FY21) including an update on reviews currently taking place and our headline unaudited results. This announcement is being made ahead of the Group's Preliminary Results announcement to provide some early transparency on key issues.

Key points

Note: these are subject to the finalisation of our reviews and the year end audit

- Babcock will focus on being an international aerospace, defence and security company with a leading naval business and providing value add services across the UK, France, Canada, Australia and South Africa
- The contract profitability and balance sheet review ("CPBS") has identified impairments and charges totalling approximately £1.7 billion
- The vast majority of the impact of the CPBS is one-off in nature and non-cash affecting
- The CPBS is expected to result in an ongoing reduction in Group underlying operating profit of approximately £30 million each year
- We are changing our operating model to simplify the business and reduce layers. The consequential restructuring will have a one off cash cost of approximately £40 million and is expected to deliver realisable annualised savings of approximately £40 million. The benefit in FY22 will be roughly half this due to timing
- We will rationalise the Group's portfolio by divesting certain businesses. We anticipate this will generate proceeds of at least £400 million over the next twelve months
- Draft unaudited management results show FY21 underlying revenue of £4,690 million (FY20: £4,872 million) with underlying operating profit of £307 million (FY20: £524 million) before CPBS impacts. These results include our share of joint ventures and associates (note 1)
- Net debt (excluding lease obligations) at 31 March 2021 was £750 million, with an estimated net debt to EBITDA ratio of 2.5 times
- We have confidence that the markets we address and our capabilities to address those markets will be favourable in the medium term. However, we will be revising our forecasts for profitability for future periods as we continue to assess the business. We are cautious about progress in FY22 profitability as it will be a year of transition
- We aim to return Babcock to strength without the need for an equity issue

We will set out further details of the above at our Preliminary Results, the publication of which is likely to be delayed as a result of COVID-19 working constraints and the large number of potential adjustments under consideration in our CPBS. We will prioritise quality of reporting over speed.

David Lockwood, CEO said:

"We announced a series of reviews in January and promised to report back on our strategic direction, a new operating model and a new financial baseline at our full year results. Today we give you an update on all of these areas. The early results from our reviews show significant write offs and a smaller ongoing reduction in the profitability of the Group.

Through self-help actions, we aim to return Babcock to strength without the need for an equity issue. We are creating a more effective and efficient company through our new operating model and, in line *with our new strategic direction, will rationalise the Group's portfolio to help strengthen our balance sheet.*

Through our new operating model, the future Babcock will be a better place to work, a better partner to our customers and will be well placed to capture the many opportunities ahead of us".

Conference call
A conference call will be held today at 8:00am with David Lockwood (CEO) and David Mellors (CFO):

Number:	+44 (0) 33 0551 0200
UK Toll Free:	0808 109 0700
Password:	Babcock International

This call will also be webcast live at www.babcockinternational.com and will be available on demand after the event.

For further information:

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The person responsible for arranging the release of this announcement on behalf of the company is Jack Borrett as Company Secretary.

Introduction

As previously communicated, we are currently undertaking a series of reviews of the Group, including refreshing our strategy and reviewing our contract profitability and balance sheet. We are also taking actions to improve the efficiency and financial strength of the Group including a programme of disposals and changes to our operating model. While this work is ongoing and not yet finalised, the initial headlines are being shared today to give early transparency.

1) Strategy review

The strategy review we announced in November 2020 is now well advanced and so, while work continues, we can share the highlights today:

- Our UK defence businesses operate in an attractive market and have strong competitive advantages
- Our Marine business has a range of platforms, systems and products that are highly competitive in international markets
- We expect to play a crucial role as a strategic partner to the UK Government across key defence programmes including the Government's 2030 vision for UK shipbuilding
- Our international defence businesses have strong niche positions that will be further developed. We will focus on France, Canada and Australia
- The other markets we operate in vary in their attractiveness, ranging from the long term opportunities of the civil nuclear market and a strong business in South Africa through to areas outside the core of what Babcock offers, for example civil training

- The Avincis acquisition in 2014 has not delivered shareholder value with low returns on high amounts of invested capital. We are selling our oil and gas aviation business and we are reviewing our options for the each of the aerial emergency services businesses
- A number of key enablers will be needed to execute our strategy including a new operating model, a new culture and people strategy, an innovation strategy and a stronger balance sheet supported by our disposal programme

We will give more details of our new strategy alongside our Preliminary Results.

2) Results for the 2021 financial year (before adjustments from CPBS)

We set out the headline financial performance for the year ending 31 March 2021 based on our draft management accounts. This information is subject to detailed reviews by management and external audit and is before the impacts of our contract profitability and balance sheet review.
In summary, based on our previous format of underlying reporting (see note 1):

- **Underlying revenue** was £4,690 million (FY20: £4,872 million), down 2% on last year excluding disposals and FX
- **Underlying operating profit** was £307 million (FY20: £524 million), down 36% excluding disposals and FX
- **Net debt (excluding lease obligations)** at 31 March 2021 was £750 million. This position benefited from a VAT timing benefit of £56 million, corporation tax repayments of £67 million and around £20 million of FX translation benefit
- **Average net debt (excluding lease obligations)** over the year was around £1.2 billion

Balance sheet

Based on draft management accounts and the early view of the recurring impact of the CPBS, the Group's net debt to EBITDA ratio at 31 March 2021 was 2.5 times. This is the measure used in the covenant in our revolving credit facility (RCF) and makes a number of adjustments from reported net debt and EBITDA.

Our net debt now includes balances related to the use of supply chain financing in the Group with extended credit terms. Such amounts were previously reported in trade payables. At 31 March 2021 the amount included was £25 million, lower than the level last year. We are phasing out the use of supply chain financing across our Group.

In addition to supply chain financing, the Group factors certain receivables in Southern Europe. These are non-recourse to the Group and so are not included in net debt. For reference, the level of receivables factoring at 31 March 2021 was £102 million (31 March 2020: £98 million).

At 31 March 2021, the Group's cash balance was £533 million. This combined with the undrawn element of our RCF gave us liquidity headroom of around £1.2 billion. We repaid the US Private Placement of $500 million, which was hedged at £307 million, in March 2021. This was funded from existing Group cash resources.

We are commencing discussions with our banks to secure protection to the potential downside risks in our scenario planning.

Capital structure

We believe that a strong balance sheet provides resilience to the Group as well as operational and strategic advantages. After the completion of our various reviews, we will determine the appropriate capital structure for the Group which we believe we can achieve within the next 24 – 36 months.

Our plans outlined in this update, including the changes to our operating model and our disposal programme, are part of our aim to return Babcock to strength without the need for an equity issue.

Dividend
As part of our focus on building a strong balance sheet, the Board will not be recommending a dividend for FY21 or FY22.

Outlook
We have confidence that the markets we address and our capabilities to address those markets will be favourable in the medium term. However, we will be revising our forecasts for profitability for future periods as we continue to assess the business. We are cautious about progress in FY22 profitability as it will be a year of transition and also given the ongoing uncertainty of when COVID-19 restrictions will be lifted in our markets.

3) Contract profitability and balance sheet review ("CPBS")

As announced in January, we have been performing a detailed review of our contract profitability and balance sheet. This review is looking at a sample of approximately 100 contracts, representing around £2.6 billion of revenue each year across all four sectors. The selected contracts received differing levels of review depending on their perceived risk. We have also performed a review of the balance sheet covering all of the balance sheet captions. Again, these reviews were performed on a risk basis across all four sectors.

While the work is not yet complete and is subject to further review by our Audit Committee, our Board and our auditors prior to the publication of audited results for the year, the early conclusions indicate a material impact on the Group's financial statements. This update is accordingly being provided to provide early transparency on key areas with the caveat that the finalisation of the exercise well may change the results set out below.

The impacts of the CPBS on our financial results may be categorised into two types:

1. **One-off write offs and provisions** – the large majority of adjustments totalling c.£1.7 billion are one-off in nature. The technical accounting analysis has not been finalised and therefore the allocation of the adjustments between exceptional items, underlying profit and prior year adjustments is not yet decided

2. **Recurring income statement impacts** – these items will reduce underlying operating profit in both FY21 and future years. **The early estimate of this impact is approximately £30 million per annum for future periods and approximately £20 million for FY21**

There are over 100 potential adjustments identified within the review. A summary of these by balance sheet caption is as follows:

Impairment of goodwill and acquired intangibles of approximately £1 billion. Despite the fact that we have not finalised our ongoing budgets and forecasts, our current analysis indicates an impairment of the goodwill for the Land and Aviation sectors relating to a decrease in our forecasts for future cash generation and changes in our impairment test methodology.

Impairment of property, plant and equipment (PPE) and right of use assets of approximately £300 million. These adjustments primarily relate to fleet valuation – where certain aircraft carrying values are no longer expected to be recovered through use or sale – and the standardisation of our accounting policies covering aircraft maintenance and airframe parts and rotables.

Other non-current assets will be impacted by approximately £100 million relating to lower deferred tax assets, the impairment and amortisation of some intangible assets (e.g. software) and the revision of investment balances in joint ventures and associates.

Adjustments to current assets of approximately £250 million following the assessment of certain contract profitability margins, the recoverability of trade and other receivables, an increase in obsolescence provisions for inventory, and a reassessment of certain contract mobilisation costs.

Current liabilities will increase by approximately £50 million including the reassessment of aircraft maintenance accruals, contract liabilities and environmental provisions.

4) Operating model

We are changing our operating model to create a business that is more efficient and effective. We are reducing layers of management within the business to form a simpler, flatter structure that will simplify how we operate, improve line of sight, shorten communication lines and therefore increase business flexibility and our responsiveness to market conditions. This will reinforce a one company culture and remove the duplication and lower quality delivery that a siloed approach delivered. This, unfortunately, will result in headcount reductions. We are also reducing the Group's property portfolio, especially in the UK.

The changes will result in approximately 1,000 employees leaving the Group within the next twelve months with an approximate restructuring cost of £40 million, most of which are cash costs.

This will reduce our overall operating cost base. Some of the savings will be recognised across long term projects, for example where they form part of existing contract efficiency assumptions, and some savings will benefit our customers via the contract structure.

As such, the expected realisable annualised savings are approximately £40 million. The benefit in FY22 will be roughly half this due to timing.

5) Portfolio rationalisation

One of the strands of our strategic review is to consider which businesses Babcock is the best owner of and on which we could earn a sufficient return on capital. We will be looking to rationalise the portfolio to reduce complexity, increase focus and increase the effective use of the Group's capital by disposing of the businesses that are nearer the perimeter of our strategy.

We are targeting net proceeds of at least £400 million over the next twelve months from these disposals. Several businesses are currently being reviewed as disposal candidates and three processes are currently underway to test the market.

Additionally, as announced on 11 March 2021, we have agreed the conditional sale of our oil and gas aviation business. This deal is expected to complete in the second calendar quarter of 2021 subject to the satisfaction of the relevant third party conditions.

Notes

Note 1: presentation of financial results

We will change the way we report our results for FY21 onwards. The Preliminary Results will show this new approach along with restatements for the prior year and a full reconciliation from the old to the new approach.

We will be updating the definition and presentation of underlying results to align more closely to statutory measures. This will include changing how we show the results of joint ventures in our underlying numbers, moving to including one line in the income statement relating to Babcock's share of joint ventures' and associates' profit after tax. This will align our underlying revenue with the statutory IFRS measure. Our underlying operating profit will be consistent with the IFRS measure except for the exclusion of certain defined specific adjusting items.

We will also be simplifying the method of presenting our cash flow.

The numbers cited in this release are under the previous reporting format.

Forward-looking statements

Certain statements in this announcement are forward-looking statements. Such statements may relate to Babcock's business, strategy and plans. Statements that are not historical facts, including statements about Babcock's or its management's beliefs and expectations, are forward-looking statements. Words such as 'believe', 'anticipate', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', and variations of these words and similar future or conditional expressions are intended to identify forward-looking statements but are not the exclusive means of doing so. By their nature, forward-looking statements involve a number of risks, uncertainties or assumptions, some known and some unknown, many of which are beyond Babcock's control that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. These risks, uncertainties or assumptions could adversely affect the outcome and financial effects of the plans and events described herein. Forward-looking statements contained in this announcement regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Nor are they indicative of future performance and Babcock's actual results of operations and financial condition and the development of the industry and markets in which Babcock operates may differ materially from those made in or suggested by the forward-looking statements. You should not place undue reliance on forward-looking statements because such statements relate to events and depend on circumstances that may or may not occur in the future. Except as required by law, Babcock is under no obligation to update (and will not) or keep current the forward-looking statements contained herein or to correct any inaccuracies which may become apparent in such forward-looking statements.

Forward-looking statements reflect Babcock's judgement at the time of preparation of this announcement and are not intended to give any assurance as to future results.