Full year results for the year ended 31 March 2021 transcript

Friday 30th July 2021

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Chief Executive Officer
Babcock International FY21 Results

Good morning and welcome to our full year results presentation for the year ended 31 March 2021. A couple of opening remarks. Firstly, we're obviously later than we thought. Back in April we said that we would prioritise the quality of the results over rushing to get it done in a certain time window. That has taken a long time. As David takes you through the results, you will see the sheer scale of work that he and his team have put into this, supported by Simon McGough in IR and Kate Hill in comms, they've done a tremendous job to get us here with one of the most complicated sets of report and accounts that I have ever seen. So David's task is to make the complicated understandable, I've just got to give you an overview.

I thought I'd explain this. So when we thought we were going to do it face-to-face, we had a number of pieces of work made by our apprentices as part of their qualification. So this is done by a teenage guy, a full aero engine as part of his project, as part of his apprenticeship, there's some amazing other bits. Next time we'll show you them all.

So when we talk about skills, we can talk about skills at all different levels, but our apprentices are fundamental to the future of our business and they do - when you walk around Devonport or Rosyth, or any other site, they do some astonishing things, of which we are very, very proud.

So this is the disclaimer, you all should have read this before you joined the call, so I'm not going to read it to you, you'll be pleased to know.

What we're going to cover today, introduction. So throughout the last few months we've been working on our purpose, which is to create a safe and secure world together. That is going to flow through this presentation, I hope, as we talk about how we work together as Babcock and together with our customers, our supply chain and our communities, to build a safer and more secure world and in doing so, create a valuable proposition for our shareholders.

David is going to take you through the financials and the new baseline. It's really important that we have a baseline from which to measure this company that all stakeholders understand. It's been a tremendous piece of work that's been subject to great governance and scrutiny, so we're very confident in the baseline.

I'll touch on the improvements that we're making to the business to adapt to what is actually an exciting world with some significant prospects for a company like Babcock and where we can truly start to build a great engineering company for the UK and beyond. Finally at the end I shall touch on how that turns into our strategy and the future.

I thought I ought to just do a bit about life since April here, typically David is going to go through last year to this year, that's what a set of report and accounts does. But we gave you an update in April. So what are the important messages?

The most important message is, nothing much has changed in terms of the analysis. We have been developing the operating model, we talked to you about it in April, we've now had three and a half months of implementation. I have been super impressed by how the business has responded.

This is the first group-wide reorganisation we've undertaken, that I'm aware of, looking at how we delayer for efficiency and effectiveness, how we make the functions stronger. The group has really embraced that so three and a half months in we're well on track, if not slightly ahead of track on that plan, which was quite a high risk thing to undertake, so that's really good and the engagement from the organisation is outstanding.

The portfolio change is well underway and we've started the engagement on the purpose, on the people strategy, and on the project agile, which I touched on. So life since April is actually underpinning the business case which says we definitely don't want to proceed with a rights issue. Changes in numbers since April, no economic change. David will go through it, I won't steal his thunder. So there were reporting changes and there are changes in non-cash items, but the basic economics of April remain constant.

Finally, since April, a whole bunch of opportunities have developed which I'll go through at the end, which say that we are what we thought we were, a very strong, potentially, capable business, that is operating in good markets that can deliver a good business proposition for shareholders.

So what have we completed? As I've said, a strategic review that defines us as an aerospace, defence and security company, that's led to a portfolio review and the commencement of certain divestments. An operating model to deliver that, a financial baseline and then a people

and ESG strategy to underpin it. We are a people-centric business. This business is delivered by 30,000 people doing all sorts of important things for their customer and we need to have a people strategy, an ESG strategy that underpins that people-centricity.

So with that, the most exciting part of the next 40 minutes is about to commence. Mr Mellors is going to explain the accounts to you.

David Mellors
Chief Financial Officer

Thank you, David. Good morning everyone. As there's a lot to get through, let me start with some context to explain the order I'll cover things in. when I joined, David gave me three questions on the financials. Firstly, what was the right financial baseline for profitability from which we can plan going forward? Secondly, what cash flow will we generate, and thirdly, is the balance sheet strong enough? The various reviews I've been doing since have been aimed at answering these. So the order I'll cover the topics in this morning are, the way we present numbers, the contract profitability and balance sheet review, the restatement of prior years, FY21 results, the balance sheet, and then the summary and outlook.

So to the presentational changes on underlying reporting first. Points one and two on this slide are similar. The presentation of joint ventures and the IFRIC 12 income that has been changed so that neither are now in underlying operating profit. This not only more closely aligns with our IFRS but also unclutters operating profit so that operating margins can be more easily seen, and operating cash flow can be more easily derived. We also now do not include our share of JV revenue in the revenue line.

Point three, the three column P&L allows the separation of the statutory income statement into underlying in one column and specific adjusting items in the middle column, all the way down to earnings per share. We've defined what will fall into the middle column for clarity. Exceptional items, to the extent there are any, will be in the middle column, but we'll restrict the use of exceptional items in future.

The fourth point, the cash flow statement, has some reclassifications relating to releases, which will better separate out cash flows from other changes in net debt, and I'll come on to those in a minute. Lastly, we no longer exclude exceptional items from free cash flow. These changes should not only help external stakeholders see what's happening, they've already made it clearer inside the group, where we make and lose money.

So now to the contract profitability and balance sheet review, or CPBS. This review has been an extensive piece of work and is the primary reason why the year end has taken so long. We've used an external accounting firm to help us with expertise and resource, as well as a fresh pair of eyes. The review covered over 100 contracts, representing 70% of the total long-term contract revenue group-wide and the scope was prioritised on the basis of risk.

So contracts that were deemed high risk had a full review, medium risk had specific review work, and low risk had limited procedures. But if anything was identified that changed our initial categories of risk, more work was done.

All the balance sheet items were reviewed too, again with work prioritised on the basis of risk. The output has resulted in over 140 adjustments in the financial statements. There's quite a lot of detail disclosed in the preliminary announcement this morning on the findings, so I've summarised the key findings on this slide.

First thing to note is that we now have £2 billion of adjustments compared to the approximately £1.7 billion from the early view we published in April. The delta is largely goodwill impairment, which we flagged in April and was only approximate.

So the £2 billion of adjustments fall into three categories, from which the accounting standards dictate their treatment.

Category one, changes in estimates. These are where we are now taking a different adjustment on outcomes from a year ago. Changes in estimates are all recognised in the current year, and make up the large majority of the CPBS adjustments in FY21.

Category two, correction of errors. These are where transactions were originally recorded, using logic which was incorrect at the time, from simple miscalculations, to incorrect interpretations of accounting standards. The corrections are made to the year of the error. So there are some in FY21 and some are prior year restatements, and there are about 40 errors in all.

Category three, change in accounting policy, in one example in the aviation business, we didn't have a clear policy for the treatment for certain maintenance arrangements and policy changes are treated as a prior year restatement.

The next point to cover is how much goes to underlying profit and how much doesn't. I've been asked why we didn't bucket all of the £2 billion as exceptionals and have nothing in underlying. But the regulatory convention now is to look at transactions individually, not in the aggregate. Many of the adjustments we found are reassessments of contract profitability and reassessment of current assets and liabilities.

These are individually, absolutely underlying in nature for a contract business like Babcock, and happen all the time. It's just that there are a lot of them this year.

So £274 million of adjustments do belong in underlying profit, as you can see here. The transactions that go into the middle column of the income statement, of £1.5 billion, now follow the new definitions of specific adjusting items that I referred to earlier.

So while that's all logical enough, it leaves us with an underlying loss for the year, which isn't a representative baseline of current profitability. So we have to split the £274 million within underlying operating profit, into one-off CPBS adjustments, and recurring CPBS adjustments.

For example, the write-off of an old debtor can be thought of as a one-off non-cash hit, which doesn't directly impact future periods. But a long-term contractor margin adjustment has a historical write-off element and also a recurring element, as profitability in future periods is reduced.

Very simplistically, the majority of the adjustments we found are bucketed as one-off, so historic. The estimated recurring impact on underlying profit is around £25 million, and there's roughly £5 million recurring in the JV line as well, and I'll come back to the recurring £25 million in a minute.

Now I'll cover the restatement of the FY20 underlying numbers as a result of the presentation changes and prior year restatements. I've intentionally left the next three slides as very detailed for completeness. The detail is explained in the announcement this morning, but I'll just pick out the key points on these slides here.

On the income statement first, the changes result in last year's underlying operating profit being £377.6 million and the restated underlying EPS was 58.4p. On restating the cash flow, there are two key points. Operating cash flow is now restated to £288.9 million and free cash flow is restated to £55.5 million.

Touching on the big adjustments that I've highlighted on this slide, the prior year restatement of £10.9 million is a collection of items affecting profit, working capital, and sale and lease back proceeds. As you'll see on the next slide, the net cash impact of these is quite small.

New lease commitments of £109.8 million are now shown as a change in debt lower down the cash flow statement, not as an operating cash flow, so are eliminated here. The capital element of leases, of £175 million, now is in operating cash flow, akin to capex, this will have to be taken out lower down the cash flow statement, as the full lease commitment is already included in debt. The £82.4 million of exceptional cash outflow now moves up to be within free cash flow.

So moving down the cash flow statement, all of the items which change the presentation that I mentioned before reverse out below free cash flow. Therefore there's no effect on net debt in this column. However, the review identified an error which did increase the total level of debt and that was the £113.5 million of supply chain finance balances, which have been corrected to be part of debt and not trade creditors.

So closing net debt, at 31 March '20, is restated to £1.7 billion, not £1.6 billion on an IFRS 16 basis. So all of that covered the restatement of FY20 and therefore the start point to look at the FY21 results.

Now to the results for the year. I'll cover a few summary slides at Group level first and then go to the sectors and then the cash flow and then the balance sheet. The summary Group financials are laid out here. Before I go into detail I'll just point out that these financials are very much in line with the draft post-close numbers we released in April, with two reconciling differences being the change in JV presentation and the CPBS adjustments.

So the headlines, organic revenue is down 3% as growth in Marine, and Nuclear was more than offset by decline in Land. Underlying profit is £222.4 million, excluding one-off CPBS impacts. I've highlighted this number here as this is what I see as the current profitability baseline. This number was down 40% on the prior year, excluding FX and disposal impacts.

All sectors were down as a result of the estimated impacts of COVID, lower profitability due to the recurring CPBS adjustments and a very high comparator period. Operating cash flow was flattered by a VAT deferral of £56 million, and free cash flow benefitted not just from VAT but from a £67 million corporation tax receipt in March.

Resulting net debt reduced to £1.35 billion including all leases, or £772 million on a pre-IFRS 16 basis, which is the start point for the covenant ratios. On covenants, the gearing ratio is 2.5x as the year end, versus 2.3x last year.

So, to Group revenue. If we skip over the foreign exchange translation FX and the revenue lost on disposals, the main categories of revenue variance against the last year are firstly COVID. I'll emphasise here that we've estimated the impacts of COVID as best we can to try to be helpful. It does involve quite a lot of judgement when we get into indirect impacts.

The biggest revenue impacts from COVID were the shut downs in South Africa, the cessation of activity in civil training and lower flying hours in aviation during H1. The next variance is the CPBS impact on revenue. The largest element is the fact that we no longer recognise revenue on a contract in Land for pass through materials, due to a contract change last year. Other elements in this revenue variance are the reassessments of contract progress and profitability across the group. Just to be transparent, there is an element of this £207 million which is one off, but I've not split this out, just to keep revenue simple.

Then the other trading variance of £208 million is as a result of growth in Marine, Nuclear and Aviation, partially offset by a decline in Land.

On profit, starting from the restated FY20 number of £378 million, the first big year on year variance is the £47 million of what is called here, significant credits booked in FY20. These are a collection of items booked last year which were one-offs, they consist of accrual and

provision releases, a large R&D credit and some multi-year indexation claims. Again there's some judgement required in concluding what is normal in the run rate and what is not.

The £47 million here is what we see as above the normal run rate, benefitting last year's results.

The COVID-19 impact on profit of £46 million has the same caveat as to estimation and judgment as before. We've estimated this to include revenue decreases due to lower activity from site closures or staff absences. Direct costs like testing and equipment purchases, and also the indirect impacts such as inefficiency due to social distancing on sites.

We also offset cost savings in areas like travel where we believe the reduction was pandemic related. Some additional COVID related direct costs were originally settled by customers in certain cases, so these don't affect profit.

The recurring CPBS impacts on profit in the year was £25 million, and I explained earlier how we put this together but it's largely due to the margin reductions in long-term programmes coming out of the review.

The other trading variance of £29 million is largely down to lower margins on projects in Marine and Nuclear, including the MSDF Interim Arrangement, the loss of revenue in Land, mainly the Heathrow contract and higher SG&A costs.

So as I said before, the resulting £222 million is a representative baseline for current performers, and a start point for planning and forecasting the future. The overall margin of 5.3% is something we can improve over time with the new operating model.

So now we move on to the sectors, with Marine first. Again, I'll just pick out the key points rather than go through all the detail on the slide. 9% organic revenue growth was largely due to the ramp up of the Type 31 programme and growth in the liquid gas business. Within FY21 revenue, there's approximately £250 million of low or zero margin programme revenue which, over time, we would aim to get back to sector average margins.

The profit impacts, which you can see here, result in the profit margin of 6.9% which we should be capable of increasing over time.

The main points to note for Nuclear are that the contract backlog is down mainly due to the timing of FMSP, which should be a significant increase when signed. The 9% organic revenue growth reflects a ramp up of infrastructure work and higher activity in submarine support. The significant credit in FY20 of £21 million is mainly due to last year benefitting from extra R&D tax credits that were significantly above the normal run rate. The sector margins are lower, partly as a result of the completion of the MSDF contract in FY20 as flagged at the half year.

Moving to Land, which also includes South Africa, the key points here are the contract backlog reduced year on year due to the utilisation of an extra year's revenue on long-term contracts such as DSG and a small element due to losses such as the Heathrow contract.

COVID had a very material impact on this sector in the year, with the South African business and civil training, as well as the airports contracts, affected. The CPBS review identified around £80 million of pass through revenue, which should no longer be recognised after a contract change in February '20. The other material CPBS adjustment in this variance here was the reduced profitability on programmes, the largest of which was DSG, and the resulting sector margin is only 4.7%, but note there's around £200 million of pass through revenue in the FY21 number. A further £150 million of low or zero margin revenue on programmes.

Onto Aviation. The year on year comparison is impacted by £17 million of credits benefitting the FY20 year, including accrual and provision releases. These were a one-time benefit. The COVID pandemic had a large adverse impact on the sector, with reduced flying hours and additional costs required to maintain services that couldn't be recovered from customers.

With these impacts, and now excluding JVs from the financials, Aviation is a break-even business at present and we expect, with the various fleet rationalisation and other efficiency programmes, to improve this significantly.

Moving to the cash flow, headline cash conversion was 134%, but this was driven by the working capital inflow of £128 million, which benefited from £56 million of VAT deferral into FY22 that I mentioned earlier.

Advanced customer receipts drove the rest of the working capital inflow. The high capex was due to investment in Type 31 and other infrastructure investment and a much lower level of aircraft disposals in Aviation. Below operating cash flow, the pensions and interest amounts were largely as expected. Tax cash flow benefitted from corporation tax repayments of £67 million in Q4. The exceptional cash flows relate to prior year restructuring charges resulting in a free cash flow of £169 million.

I've given some guidance for FY22 on this slide. These numbers are obviously approximate at this stage. Regarding exceptionals, I said earlier we're going to restrict this category significantly in the future and of the amounts due this year, there's the £40 million of operating

model restructuring costs, £10 million of Aviation restructuring from previously announced programmes and potentially the settlement of the Italian fine, which is estimated now at £20 million.

Below free cash flow you can see the impacts of disposals and dividends. Foreign exchange also moved favourably in the year and the resulting net debt was £1.35 billion, compared to £1.7 billion last year. The gearing ratio which was based on net debt pre-IFRS 16 as I said before, is 2.5x.

Again, I've included some FY22 guidance on here. We expect at least £400 million of disposal proceeds in the next 12 months, which will be used to pay down debt. We announced earlier this year that there will be no dividend payment in FY22 and our near-term priority is to strengthen the balance sheet and get the gearing ratio below 2x.

This slide shows the gap between the average and closing net debt for the last three periods, and as you can see, there's a sizeable gap between the two. I'll just focus on the FY21 position. The difference between the average and closing position in FY21 is due to the items I've listed on the slide.

The first three items, the tax receipts, the reduction in supply chain financing and the FX difference all happen late in the year, so they explain about £160 million of the gap. The balance of £370 million is working capital. Of this £370 million, roughly £50 million is a real reduction in working capital late in the year, such as collecting old debts. This leaves around £320 million, which is down to the year-end push.

This as a result is a huge effort for cash at the period end, with much less focus throughout the rest of the year, and whilst there'll always be some pick up around period ends, this is exaggerated here by roughly £200 to £250 million by the phasing of debtor and creditor cash flows period end.

The problem it causes is a large cash outflow in April and October, and then the business spends several months making that back and then preparing to do it again for the next period end.

As part of the cultural change to drive the cash flow performance throughout the period, this gap will narrow. But that will have to happen over the next couple of years to ensure we don't weaken the balance sheet as a result.

On the balance sheet, the key things to focus on are the liquidity and covenant headroom. This slide shows that we have ample liquidity in place over the medium-term. Whilst we paid off the US private placements in March, we replaced them with a new £300 million 3 year RCF, signed in May. At the same time, we agreed with the banks to lift the gearing ratio covenant to 4.5x until March '22, after which it reverts back to 3.5x.

Both the new facility and the raising of the covenant level was done, not because we plan to use them, but just to protect us until we've strengthened the balance sheet.

So just summarising where all of that has got us to. We're done on the detailed reviews, we understand the financial baseline, we've simplified reporting and increased transparency internally and externally. We have a plan to make the business more efficient, saving £40 million per annum. The disposals should raise a minimum of £400 million and we plan to strengthen the balance sheet and the company through self-help and without recourse to shareholders.

So to finish, the outlook for FY22 from the announcement this morning is copied verbatim on this slide, and I won't read it out, I'll just pick out four points.

First we expect half a year of restructuring savings in FY22 that's £20 million. Second, we're cautious on profit improvement in the year given the transition and the uncertainty of COVID on profit. Third, free cash flow is expected to be significantly negative for FY22 as the previously agreed pension contributions and restructurings go out. Fourth, we're confident that we can significantly improve profitability and cash flow generation in the medium term. Now I hand back to David.

David Lockwood
Chief Executive Officer

Yes, follow that.

A bit of business colour on what I think was an exceptional explanation of the financial structure. So from a business perspective, what did we really learn? We have to accept that the expectations for Avincis acquisition in 2014 have not played out. The growth we were hoping

for didn't occur and profitability through competition have been under pressure for a number of years. It's worth noting that over half of the adjustments in the CPBS by value, come from this acquisition alone.

As David said, we already started pre the Group level operational review to address this, hence the exceptional outflows for the Aviation restructuring within financial year '22 and we've taken a different view of how we approach bidding for future business.

We're disposing of the oil and gas business and we're reviewing certain elements of the aerial emergency service business. So that's Avincis.

UK civil market opportunity is smaller at the moment with the in-sourcing of the prime contracts. We do, however maintain some key capabilities that are necessary for both decommissioning and build and both of those continue, so it's still an important market for us.

Customers demand more, and that's not just more content, it's more responsiveness, more speed. That's because the defence world changes very regularly. We're doing things now that 2 years ago we wouldn't contemplate. So things that we considered fixed and semi-fixed in the business now need to be variable, we need to be much more responsive.

So how have we responded? We've refreshed the strategy, we focused on what we're good at and what's core to us, and we are going to align our portfolio to that, which means divesting the things that don't fit that.

The new operating model, David has talked about the financial consequences. They are a by-product of achieving the business consequences of being more efficient, more effective and more responsive by having aligned and integrated support functions and by de-layering the business to shorten the distance between me and the people who do the work. Also getting accountability, responsibility and authority aligned as near to where the work takes place as we can.

We're building, as David said, a stronger balance sheet, and we will come back to one of the subsequent slides, the people and ESG strategy. What will that lead to? This bottom line is deliberately written to be read left to right.

So, a better place to work. As I said at the beginning, we are a people centric business. We need to attract and retain the best people and we need to give them the opportunity to use their talents. It's really clear that where we achieve that, the business performs better than when we've still got a way to go. So we need a Group-wide approach to making this a better place to work and we'll come back to that.

That will inevitably improve delivery to our customers. That will lead to meeting our budgets, which means we'll get improved quality of earnings because we'll be doing what we said we'd do, so the finance can easily follow. That will drive an appropriate balance sheet and create a platform for growth. When you see the subsequent slides and the video on people, it's fundamental to fixing this business. It's not woolly.

Touching on people, this is the change in the management team since I arrived. So the two people above are the people that are in the same post as they were when I arrived in September, Neal had been in post 6 months when I arrived. Under the appointments there's a mix.

So, David is obviously new. There are some known changes. So for example Simon Bowen in - he's the current CEO of Nuclear. Even before I started I knew he planned to retire this year, so this is very much a managed transition to Dominic who joined the company a few years ago from the nuclear industry.

Some, like Tom Newman, Chief Executive of Land actually joined this company as a graduate and it's great to see someone work all the way through in a managed way in the company, it proves we can do it. Nikki Fox joined a few years ago from the oil and gas industry with a very relevant HR background.

John Howie and Jon Hall have been in the company for some time, but are in new roles that are fundamental to achieving strategic engagement in the outside world. So a whole mix of reasons, but either new people or new roles for nearly everyone.

In terms of improving governance, David touched on quite a lot of it. A lot of it is about being a more rapid tone, and more consistent. So consistent reporting, enhanced risk management processes, enhanced financial control processes. These have been designed against the company we want to be. We're running a different business model to before, we're running a more integrated model and these are - this is the governance framework to support the business model we are implementing.

In terms of the operating model, the maximum number of layers that we found in the business - I found in the business, while David was doing the numbers was 14. That's an awful long distance between me and people making decisions. I could sit in business reviews with six

layers of management including me, above the person who was presenting to me, that's a lot of decision making going on. So although the output was the headcount reduction, the input was how do we become a faster, more responsive, efficient and effective business?

One of the interesting things is, when we announced this, as we've said in April, I do a weekly vlog and I have an Ask David where people write to me. Huge support from the organisation and since, when I've been around sites, for this. Everyone recognises that we need to do this. Even the people who could be adversely effected have written to me and said, I'm nervous but this is the right thing to do.

So I've been really pleased, in fact probably since April, the thing that I'm most pleased with is the business' response to change. This is not a change fatigue business, this is a business that wants to change and I actually feel really good about that.

So the majority of the proposed 1,000 headcount reduction will be complete by the end of September. It's obviously proposed because we're still in formal legal consultations in some places, but there seems to be no reason why we would miss that date, in fact we may beat that date.

Alongside that we've been developing the new unifying culture based on the purpose, driving more collaboration, building better career prospects for people so they can more easily move around the business, increasing flexibility and driving the ESG focus.

Practically what can that mean? So sometimes it's easier to join this company from the outside than it is to move within it. So we have different holiday policies, we have different maternity policies in different parts of the group. We have different sick pay policies in different parts of the group. So actually moving within the Group can be very difficult so we are - we're in a process of eliminating that so that it can truly feel like you're part of one Babcock.

So there's a video and I don't want to steal the thunder of the video. The thing that I just wanted to focus on here is, net zero by 2040, this is increasingly important to investors, other stakeholders, customers, definitely our employees. People tend to also think, oh it's just the young people who care about net zero, it's not, it's our whole organisation, I get it from everywhere.

So where have we got to on this? We've done a top down and bottom up analysis. We've had the Carbon Trust review it, we didn't make this commitment lightly. We've worked out the cost, the reason it's 2040 is we've made assessments of progress that is likely within the aviation field and what our contingency plans would have to be, to be contributing to become negative carbon elsewhere if that progress doesn't happen. So it's a framework we have at the moment which we're now filling in with detail plans, but it's a budgeted, costed, assessed framework. It's not just waving a flag. That's a lot of progress in net carbon in a handful of months.

With that, what I'd like to do is hand over to Nikki, the company's first ever CHRO to talk about some of the broader people strategy.

VIDEO

Nikki Fox

Chief Human Resources Officer

As the first CHRO of Babcock, it's my job to unlock the potential of our people so we can drive business performance and deliver a great experience for our customers, our shareholders, and one another. I've taken feedback from across the company about what we can do to become a more efficient and people focused business.

To be the agile organisation that we want to be, we need to be a single integrated company. For me, that means more collaboration, sharing of capability, talent, innovation and best practice across the group so that we can remove the complexity that has stopped us working together. Empowering our people to use their personal judgement to solve challenges, using that deep understanding we have of our customers. A new approach to development and performance. An agile culture that promotes inclusivity.

At the core of how we're changing is our new purpose, creating a safe and secure world together. Putting our purpose at the centre of what we do, we'll build a better, more sustainable business. If we're truly going to create a safe and secure world together, ESG is central to our strategy and everything that we do as a business.

We're committed to acting now, reducing carbon emissions and setting science-based targets to get to net zero by 2040. Integrating environmental sustainability into programme design, to minimise waste, providing high quality jobs that support local economies.

Making a positive difference to the communities we're proud to be part of, being a trusted partner across the supply chain. We're at the start of this journey, and evolving Babcock in this way will mean we can grow to be a strong sustainable company that creates long-term value for our stakeholders and a great place to work for our people.

David Lockwood

Chief Executive Officer

Thank you, Nikki, virtually. So a couple of slides now on the strategy in the future. So we describe ourselves by four sectors, but really we have three activities by nature. We have a strong UK naval business where we design, build, support and decommission both platforms, systems and products.

We have our own key assets, Rosyth and Devonport and we have deep technical expertise, probably only matched in the USA. That has growth drivers around increases in defence budgets, the focus on shipbuilding, infrastructure and submarine support.

We have a UK value added services business which is Land and Aviation, where we have technical expertise in critical and complex assets. We also have that in civil nuclear. I point that out separately because I've been asked quite a lot of questions about civil nuclear since April. Lots of companies around the world, if you're in nuclear, you do civil and military because there is a lot of cross fertilisation and learning.

The civil nuclear business has taken some hits because of strategic decisions by customers, but fundamentally we have really good capability and it is an important stream of our business.

There's a bunch of UK strategies in this sphere, particularly around national resilience and emergency response which enable us to engage there like we've been engaging in naval. So it's a business area where we really see some strong opportunities.

Then finally, international, that's both exporting from the UK and those countries where we have strong positions, so in Australia, Canada and France. We're getting increasingly good at moving capability around the Group to take capability from, primarily the UK, and making it local in these countries. The growth there is in our equipment and systems businesses, what we would think of in the UK as first generation support, exports for Type 31. There is a strong pipeline in military aviation.

So just to give some examples, since April, within Canada, the support for the Canadian submarine fleet has been extended. Within the UK, it's not that well known that we have quite a significant and sizeable business in defence, tactical comms and high frequency and we've won a significant programme for £150 million for the UK defence tactical comms, a programme previously known as Morpheus, as part of an overall £3 billion programme.

We do equivalent work in Australasia. In France we've expanded our defence aviation training with a new €500 million contract. Then in Ukraine we have the Memorandum of Implementation that was signed between the UK, Ukraine and ourselves, which really brings together everything that Babcock does, infrastructure, platform modernisation and new build.

Then finally on this slide I've highlighted the three most active current export campaigns for Type 31, being Indonesia, Poland and Greece. Although there are several sitting just behind that. Those campaigns are a really good example of where we're joined up with UK Government, several departments, DIT, BEIS, MOD, Foreign Office, to drive a true, one UK offering. Really encouraging signs, both in work that's being done within countries and the export opportunities.

So to reiterate David's messages in many ways, but from a business point of view, financial baseline means that we can monitor and reward the organisation based on a sound footing. So we can now manage the organisation as well as account for it in an appropriate fashion. The turnaround is underpinned by real operational activities alongside the financial work that David's talked about.

That previous map of the world could be much more cluttered, there are a large range of medium-term opportunities, which getting this company efficient and effective will unlock. It will also unlock improved cash backed profit. That's the mantra in this company, cash backed profit over the medium-term and the idea is to make the medium-term as short as possible.

So with that, we will now hand over to the operator who is going to orchestrate Q&A. There are an awful lot of you on this call so he or she will have their hands full.

Q&A Session

Kean Marden - Jeffries

Morning all. I have two, so the first - I think in your initial review of the business, David, one of the work streams was to examine whether Babcock required a presence in the US, that isn't mentioned today. Is that potentially something for the future or have you concluded that the growth opportunity in domestic and some of the international markets that you've highlighted today has improved and consequently the US step is not required?

David Lockwood

So the US represents about 50% of the theoretically addressable market, but requires an in-territory presence, which requires potentially significant financial resources. So I think it's a timing issue, we're definitely not ruling it out, it's a timing issue.

Kean Marden - Jeffries

Okay, thank you. Then secondly, and I appreciate the answer is probably going to be, it depends. Can you help us scale your potential role in Type 31 exports? Obviously in the UK you've got a very full role, including manufacturing, that may not be the case in some of the international markets that you've highlighted today. If we're trying to scale that and just think of what it could mean for Babcock, can you help?

David Lockwood

You kind of answered your own question, it does depend a bit. The spectrum - if I take the full range of opportunities, the ones that are just starting through to the more mature ones, they vary from pure licensing through license with engineering support, through potentially in-territory joint-venture arrangements to deliver, through technology transfer where we might build the first couple and be involved in a

shipyard modernisation so the country can build, say the second couple, all the way through to just UK build. So there is a whole spectrum and each country has a different set of priorities.

Kean Marden - Jeffries

Okay, as expected, thanks very much.

Allen Wells - Exane BNP

Hi, good morning guys. Just two from me. As part of this final review process and the additional details that have come out today, maybe just a high level question, if you can update us on your thinking and views around how we or how you look at mid-term recovered, or long-term recovered profitability and margins for the Babcock business.

Then my second question will be around just an update on the disposal plan and what options you're looking at there. Obviously we've seen your comments around the Avincis EMS business and civil training, there's been some headlines around - in the media around AirTanker JV, just kind of an update on your thinking on those kind of non-core assets will be really helpful. Thank you.

David Lockwood

Okay, well it might be really helpful, I'm not sure how helpful I'm about to be on that before David does the finance one. So the only two we've commented on, the rest has been speculation, is oil and gas which is obviously a deal we've signed but is going through approval processes and we have said that we are looking at aspects of the aerial emergency services business. The rest, to be honest, I think for both commercial reasons and broader regulatory reasons, it's just inappropriate to comment until we're further down the line.

David Mellors

On the profitability, you're right we haven't given precise guidance, and until we're through the transition and the disposal programmes, we probably wouldn't give precise, but we've certainly given you some hooks to think about. So as we went through the sectors, I mentioned that we'd be able to improve each of those margins. I also pointed out where two sectors which had quite significant chunks of zero or very close to zero margin programme revenues, which, over time, we would obviously hope to improve back to normalised or average margins as we go through.

Other simple blocks which might help you think about where 2 to 3 years may come from. We're very cautious about COVID recovery in year 1, in fact in the short-term we may get more costs than recovery, but put year 1 to one side, later on that £46 million that hit us last year, one way or the other, we do expect to recover over time, that's one.

The operating model savings of £40 million, although we'll only get half in FY22, we clearly expect to generate and retain the benefits of that. Then the other block is around continual improvement, which is obviously running the business better. There's an awful lot of operating efficiency that we can derive from this new operating model that isn't just about restructuring. So we have far too many legal entities for example, and that drives an inefficiency and an overhead, so we can streamline that. As well as bidding and managing projects better.

So they're the three or four blocks that might help you piece together what the medium-term might look like.

Allen Wells - Exane BNP

Can I just ask one follow-up please? You flagged the £46 million hit from COVID and that you'd expect that to recover over time, but am I also right in thinking that a large portion of that is obviously aviation linked and as discussed that asset might be sold, so we need to obviously just be mindful of that as we think about what the recovered sector margins might be, but the sector mix might be different, is that a fair comment?

David Lockwood

Well, so there's two things in there. The split of the £46 million you can see by sector because I've given you each of the sector's variances so you've got the exact split there. In terms of what may or may not be sold, we're not going to get drawn on that for all the reasons David announced. So it would be wrong to try to guide with or without disposals because we haven't actually said what will be. I think it will be far better and more precise when we have disposal news to then update you on that.

Allen Wells - Exane BNP

That makes sense. Thanks for your time.

Joe Brent - Liberum

Morning, Joe Brent. So I've got three questions. If I could start with the key opportunities, just interested to hear your perspective on what you think the three big opportunities are for the business in terms of contracts.

David Lockwood

Sorry, just to clarify, do you mean - are you talking about new contracts or are you talking about opportunities to improve existing contracts?

Joe Brent - Liberum

New contracts, things in the pipeline.

David Lockwood

Gosh, picking three, that's an interesting conundrum. So I think that developing the HF comms - so the trouble is, with answering this question, there's a number of NDAs to - I'm going to be non-specific. So there are opportunities to develop in the next 12 months our HF

comms business quite considerably, and that would be pretty transformative for us. So I think that would probably be - yeah that's one of my top three.

The first Type 31 export has got to be one because typically once you've got one that makes the second one easier, once you've got a user club, so I think that's number two.

I'm trying to think - I think I stick at those as the top two actually, because I've got a whole bunch in my head. Those two stand out above the others actually.

Joe Brent - Liberum

Thank you. Second question I had was on your £40 million operating savings number, clearly that's a good chunk of savings, but I guess as you get further into the business it's not unusual for companies to come with a second wave which may relate to other savings, perhaps property rationalisation and things like that, is there a possibility that we can look forward to a second set of saving targets?

David Lockwood

So I'll go first and then David will correct me. This was - these savings were driven by the need to have a more efficient and effective business that operated and went to market as a unified force. There will always be - the day you stop going forward you go backwards. We will always be looking at how to be a better business. Whether that comes through in sizeable increments or whether there's another big exercise, I think it's too early to judge.

But as David said, there are parts of the business which we haven't included in this scope where we will be driving - always be driving to get more from less. But I can't tell you whether that's going to be done on an incremental basis or a large exercise basis until we've got through this phase. Do you want to add anything?

David Mellors

No it's absolutely fine.

Joe Brent - Liberum

Thank you. Then my third question, if I may, you touched on a Future Maritime Support Programme, could you give us an update on where we are on that, and apologies if it's in the statement, I haven't got to that bit yet.

David Lockwood

Yeah so we've substantially agreed everything at a high level, but obviously this is a massive programme, it covers owned assets, managed assets, aspects of - it fully covers some sites, it partially covers other sites, so it's a very comprehensive thing.

We have effectively an ITP type arrangement until we get finished. There's nothing to stop us getting finished, it's just a huge amount of work and a large part of it has been done in a COVID restricted way, and that's definitely not helped given this year's scale of what the teams have had to deal with.

But both ours and the ministry teams have done a great job getting through it, there's just loads of now legal paperwork and stuff to get through.

Joe Brent - Liberum

If I can just follow up on that, you're comfortable with the way the terms and that are heading?

David Lockwood

Sorry, I missed that.

Joe Brent - Liberum

Are you comfortable with the way the terms are evolving on that contract?

David Lockwood

Yes.

Joe Brent - Liberum

Thank you.

Charlotte Keyworth - Barclays

Morning David and David. I've just got two questions. The first one is just a follow up on the Type 31. In the presentation you touched on caution on profit recognition in the CPBS. Can you just give us some colour on why? I'm thinking about the fact we're seeing wage and

material cost inflation, a bit of supply disruption and how you're thinking about that as a fixed price contract and when you might expect that programme to break even.

David Lockwood

Should I take that?

David Mellors

Yeah.

David Lockwood

So we don't talk about any individual programme margin, nor do you expect us to, I know. So I won't confirm some of the points you've made in your statement there. We have taken a different assessment of profitability around Type 31 as we have many other programmes, but that's not a reflection of whether we don't think it's a great programme going forward, not just as a standalone, but also a lead on to further exports.

So what was I going to say? We don't really want to be drawn on it. What I did say in Marine was that there was £250 million of low and near zero margin programmes deriving £250 million of revenue, which over time, all of those we would hope to either recover or when those programmes end, replace with higher margin work. So that might help you on the overall Marine margin, but we wouldn't comment on a specific programme.

Charlotte Keyworth - Barclays

Okay, that's really helped thanks.

Then just a second question, it was just slightly abstract, on the off balance sheet receivables factoring. I'm just interested to know, now you've completed your review, out of that £100 million or so, what do you feel is an appropriate level for the aviation markets you're currently playing in, and how might it be treated in a potential disposal?

David Lockwood

Yeah so the factoring - there are two things we looked at. There's factoring of supply chain and financing, you mentioned factoring, so the levels are about the same as the prior year and it's mainly in Southern Europe. I at first wondered if that was a kind of year end exercise, but in fact it's not and in those territories it's economically justifiable, I would say, because actually payment terms even with our customers are relatively lengthy.

So having looked at it, I'm not too worried by the factoring. I wouldn't extend it, and I certainly wouldn't do it in any other territories, but that's not something that we're over-worried about.

Separately, the supply chain financing which we've mentioned, obviously we have said we will run that down to zero, and it was over £100 million, it was £25 million at the year end, and obviously that will run down pretty quickly and disappear, so we'll stop doing that completely.

Charlotte Keyworth - Barclays

Okay, that's great, thank you.

David Lockwood

Okay well thank you very much all, for your time, and I hope very much that this is the last time we do it like this, that next time we're all in the room together. Thank you for paying attention in particular to David's section, and my parting remarks are, we're on the way. Thank you.

ENDS