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Transcript of the half year results for the six months ended 30 September 2021

Tuesday 7th December 2021

David Lockwood

Chief Executive Officer

That's the disclaimer if you could all quickly read it. Well done.

We're going to cover a brief introduction by me. David will then take you through the financial performance. A bit like the half year, there are some complexities in comparators and so on because of the restatement. Then I'll put a bit of colour around our strategic priorities and strategic direction.

But if I was to summarise the six months from my perspective, actually it's gone largely to plan or a bit better than plan. That's true across all dimensions so the inorganic, the portfolio alignment, the organic, the reset of the operating model and the ESG agenda.

On the ESG agenda, I think it's probably the most encouraging thing. There's lots of noise around ESG in our industry, but the people who work in it, in our business, are committed to pulling it to the centre of the organisation. If I look at how we go about bids now, it's gone from being a thing you check off at the end to how we're going to execute the business from the beginning. If you look at the FACT programme in Canada, the way in which we're now embracing first-nation work is not a compliance issue. It's a genuine commitment to the strategy of the Canadian government. I just think we're seeing across the Company a complete change in mindset on ESG, on the societal, on the environmental and on the governance. I think that's great.

Business development, some really interesting orders in the period, which we'll come to. In particular, I've got a slide later on Defence Digital where we've made significant progress. That kind of enthusiasm could lead you to a really positive view on the outside world. The macro environment is a bit difficult.

We are still seeing a lot of volatility around COVID. I would say that, compared with 18 months ago, we kind of know how to manage that. Our agile working strategy helps mitigate some of it, but we are a people-based business. Yes, we employ 30,000 people. Therefore, restrictions on how those people can operate and behave undoubtedly have an impact. COVID and exactly how it plays out over the next period is uncertain.

There are inflation pressures. David will touch on that a bit. We do have some decent protection in some of our contracts but not 100%.

Supply chain, we have strengthened our corporate supply chain capability and we're now taking a much broader view, but it is a fact that supply chain pressures do exist. Because we're not a product business, we're less susceptible, but we are taking it very seriously.

I'll come back to most of that later, but I didn't want to delay your opportunity to see David.

David Mellors

Chief Financial Officer

Thank you, David. Good morning, everyone. Before we go into the results, a recap of the contract profitability and balance sheet review. Hopefully everyone has seen the slides we published yesterday, covering the restatements and the presentational changes of last year, consistent with the March '21 CPBS. There's more detail in the interim statement this morning, so I'll just summarise four points.

The total restatement of H1 last year is £885 million. I've split the adjustments out in the same buckets as the year end on this slide.

Secondly, the biggest of these buckets is Specific Adjusting Items. This is dominated by £760 million of a goodwill adjustment as at September 2020.

Third, underlying operating profit for H1 last year was restated by £26.8 million of which £21 million were one-offs and £5 million recurring, using the same terminology that we used at the year end.

Four we don't restate for changes in estimates. We only restate for prior period errors or accounting policy changes. You'll remember there were a significant number of estimate changes at the end of last year, so those estimate changes will be a variance when we look at first-half profit on second-half profit, because we haven't restated. That's the £7 million box at the bottom of this slide.

The key financial headlines for the period are set out here. Organic revenue growth was 10%. Approximately 4% was due to the recovery of activities curtailed in the prior year due to COVID restrictions. 6% was assisted by the ramp up of existing programmes in marine and nuclear. The underlying operating profit increase was caused by several items I'll come on to in a moment, but the largest of these was the lower COVID impact compared to the prior period.

As expected, operating cash flow and free cash flow were negative as a result of the partial unwinding of historic working capital stretches, higher CapEx and the catch-up pension deficit payments. Resulting net debt is £1.3 billion, including all leases, or £938 million on a pre IFRS 16 basis, which is the start point for the covenant ratios. On covenants, the gearing ratio is 2.8 times at the period end, but it would have been 2.1 times if the Frazer-Nash disposal proceeds had been received in September. They actually came in October.

To Group revenue, if we skip over the foreign exchange and the revenue lost on disposals, the main categories of the revenue variances against last year are firstly CPBS. The impact on revenue was £52 million. This largely are the reassessments of contract progress and profitability across the Group outlined at the year end.

Next, COVID. Last year, the biggest revenue impacts from COVID were the shutdowns in South Africa, the cessation of activities in civil training and lower flying hours in aviation. These activities have broadly recovered, hence the revenue variance here. After these impacts, the £155 million was a result of the organic growth in all four sectors, although driven by the ramp up of existing programmes in nuclear and marine, which we'll see in a moment.

On to profit, we've touched on the CPBS £21 million and £7 million movements, so I'll cover just the last three variances here over towards the right-hand side. The COVID variance of £25 million has the same caveat as to estimation and judgement as before. We've estimated this to cover the revenue deltas due to activity-level changes from site closures and staff absence, as well as direct costs like testing and equipment purchases, and also any indirect impacts such as inefficiency. The £25 million is caused by the recovery of many of the impacted activity levels. Also, we have been able to recover many of the additional costs of keeping sites open and safe. Whether recovery of these costs continue in H2 is uncertain.

The pension charge increase is as we flagged at the year end. This is an IAS 19 charge and has no direct impact on the funding profile of the schemes. The other variance of £6 million is largely down to lower margins on projects, including the first year of FMSP, and higher SG&A costs relating to increased bidding activity and improving the control environment that we began in the second half of last year. The resulting profit for the period is £115 million. The overall margin of 5.2% is something we plan to improve over time with the new operating model.

Now we move on to the sectors with marine first. Again I'll pick out just the key points. 6% organic revenue growth was largely due to the ramp up of the Type-31 and warship support programmes as well as growth in the liquid gas business. Within H1 there was approximately £120 million of low or zero-margin programme revenue which, as we've said before, we'd aimed to get back to sector-average margins over time. The profit impacts, which I've set out on the slide, result in a 6.2% margin for marine, similar to where it finished last year end.

The main points to note on nuclear are the contract backlog is significantly increased due to the new FMSP contract signed in H1. The 14% organic revenue growth reflects the ramp up of infrastructure work and higher activity in submarine support. We had about £60 million of infrastructure work in H1. On margin, FMSP is a five-year contract and we'll be at a lower margin early on until the transformation is delivered. Infrastructure work as well is a slightly lower margin than the sector average.

Moving to land which also includes South Africa, the key points are COVID had a very material impact on this sector in the early months of last year with the South African business and civil training as well as the airports contracts affected. Hence the recovery this year. The CPBS adjustment here is the reduced profitability on programmes, the largest of which was DSG. The resulting sector margin is only 4.9%, but note there is around £100 million of pass-through revenue in the H1 number and a further £80 million of low or zero margin revenue on programmes.

On to aviation, in the prior period, COVID also had a large impact on this sector with reduced flying hours and additional costs required to maintain the services. Those couldn't be recovered from customers for the most part. The flying hours broadly recovered this year, but the additional costs remain. Revenues also grew as a result of the H160 programme in France, which had only just begun a year ago. Sector margins are obviously very thin at 2% but at least are beginning to move in the right direction.

Moving to the cash flow, as we said at the year end, cash flow was expected to be significantly negative this year as we started to clear the build up of creditors and continue to invest in CapEx. Within operating cash flow in the period, the main two impacts therefore are the higher CapEx due to investment in Type-31 and other infrastructure investment within the nuclear sector and (2) the working capital outflow which included about £75 million of reversal of the year-end creditor stretch that we disclosed last year as well as an increase in contract assets, mainly in aviation.

Below operating cash flow, the pension contributions included the first catch-up payment into the Rosyth scheme in the period. The interest and tax cash flows were as expected. I've also included some guidance for the full year on this slide.

Regarding exceptionals, as you know, we're going to restrict the use of this category significantly in future. The restructuring cash flow to date was £9 million. That's the start of the operating model restructuring impact. Some of the operating model reductions are being achieved through natural attrition. Of the amounts this year, there's up to £40 million of restructuring costs, which will go into exceptionals as we said, and potentially the settlement of the Italian fine which, if it does happen, is estimated at £20 million.

Below free cash flow are the impacts of disposals. The oil and gas disposal was completed within the period. The net proceeds were £8 million, but it took with it £130 million of leases. Again I've included some full-year guidance on here, repeating that there'll be no dividend paid in FY22. Our near-term priority is to strengthen the balance sheet and get the gearing ratio below two times.

To liquidity, this slide shows that we have ample liquidity in place over the medium term. In the period, we signed a new £300 million three-year RCF facility and extended the bulk of the main RCF out to 2026. Note again that the net debt on this slide are stated before the receipt of the Frazer-Nash disposal proceeds and the AirTanker proceeds which should come in in H2.

To finish, the outlook for FY22 from the announcement this morning is copied verbatim on this slide. You'll be pleased to know I won't read it. I'll just summarise three points.

First, our full-year expectations are unchanged. There's a range of outcomes due to the macro uncertainties of COVID and increasing inflation. We are in the first year of a turnaround, but we are on track. Second, we continue to expect free cash flow to be significantly negative for FY22 as the pension contributions and restructuring costs go out and we unwind the historic working capital stretches. This is the same guidance we gave at the year end. Third, we're confident that we can significantly improve profitability and cash flow generation of the Group in the medium term.

With that, I'll now hand back to David for the progress update.

David Lockwood

Chief Executive Officer

Thank you. Oh, lost my notes. Oh, completely lost my notes. Oh, well.

Align the portfolio. What we said six months ago was the portfolio alignment was a strategically driven thing. We identified the markets we wanted to serve and the capabilities we wanted to deliver. That led to a disposal programme. We did do a sense check, because we needed a minimum of £400 million proceeds to also make the balance sheet in a safe place to get below two times as David said. We're on track to do that. Having got that, we still are going to complete the disposal programme.

Clearly people always ask, what else is on the list? We always said, we can't talk about that. It's commercially sensitive, not good for the business, but the aim is to be finished substantially in this financial year. That will enable us to then define the Group, define therefore what the right risk profile of the Group is, capital structure and everything and talk about that at the full year, as we said we would when we did the full-year results this year.

The new operating model, as I said at the beginning, this is about being a better business as much as it is about delivering the £40 million savings. It's about how the business can operate much more globally with less layers, better communication, how I have line of sight of all the people who do all of the important work in the business. I won't say that the £40 million is a by-product of that, but the most important thing to drive an international operating model for this Company is to have the right shape of business so that the Company can join up. That's going well.

It also makes us more resilient against the COVID uncertainties, because the business is clean and with shorter lines of communication. If we have to implement short-term actions to deal with how government might respond to a new variant or whatever, we're in a much better place to respond than with a less streamlined organisation.

Alongside that, we've implemented a number of new processes. The one I've picked out here is a new approach to project management and bidding. It's much simpler. It's much more proactive. I once said to someone, a risk register is one of two things. It's either something that you actively manage and drives how a programme out-turns both operationally and financially or it's a list of pending excuses. We are very much culturally and operationally driving the former. I'm not suggesting it used to be the latter or anything, but just we're really driving the way we bid and run programmes is to make it something we proactively drive.

I'm actually going to use the principal slide in a minute to talk about the Australia down-select on Monday, so I won't touch on it now.

We've gone for this thing. We've called it agile working. We don't call it flexible working, because that has connotations in some of our union agreements. Agile working is two things, agility in terms of location where work is conducted. That doesn't just mean home. It can mean more than one workplace. Agility on timing, because the other thing we have discovered is by being flexible on when people work, not only where they work, means that it's easier for people - particularly with, either caring for elderly people or for children, caring responsibilities - easier for them to commit to the Company if we can be flexible. This is identifying ways of working which are good for us and good for our employees. That's being rolled out.

It's been an interesting journey, because typically if you attend offices, you pay for attendance. You clock people in and clock people out. You pay for their attendance. If they're working in a more agile way, you pay for output. It's forced us to think a lot about what people actually deliver as much as their attendance, so it's been a great journey for us culturally.

ESG I've got a slide on, so I won't touch on it here.

Growth opportunities, we've got three up there, the Indonesia Type-31, the MoI with Ukraine and the Mentor programme in France. We can now add the down-select in Australia. Three key non-UK order wins, a ship build, a total programme, pilot training and HF comms, so across the gamut of what we do, all outside the UK.

These are our new principles. They are quite a shock to the system for some in the Company, but they really matter.

If I look at the HF comms business that we won in Australia, this was driven by a massive collaboration between our Australian business and the UK business, so they certainly started with 'be curious'. How might we - we beat a very strong incumbent, so how will we do it differently? How would we make the customer change?

Be kind. That is not be nice. That is do things in a respectful way. There's a lot of challenges working at distance. It's very easy to point fingers. That's worked really well.

Be courageous. Believe me, bidding this at all was courageous. Be courageous. Yes, really go for it.

Outcomes. It sounds obvious, but actually in a poor culture, success of a meeting can be planning the next meeting. This is about actually getting stuff done. That's been a real thing to drive to the schedule. I would say John Howie who is sitting just there, who's chaired the Group Board review, has really driven through outcomes.

Collaborate. Well, it's a given, given what I've just said.

Then own and deliver. This is not just the lead in Australia but in particular the ownership of the delivery in the UK to support successful collaboration. Persuading and convincing the Australian customer that the technology transfer that we committed will happen that will have full capability in-country fast with hard evidence, not just words, was really compelling.

The principles, which we launched midway through this bid, undoubtedly people started referencing them in the calls I was on, started referencing them and calling out bad behaviour using them. It can really help drive an international business.

ESG, so the three of them, net zero, scope 1 and 2 by 2040. We have quite a significant aviation business in our current perimeter. That's one of the things that drives the date, because we have to estimate when the aviation business and technology in aviation is such that you can head towards net zero. Obviously other parts of the business will get there earlier.

We've got climate-related risks and opportunities into the strategic process. But I do think as we drive the engagement in the business, we're seeing lots of opportunity here, not opportunity as in climate change creates opportunity but opportunity to differentiate ourselves. We now have a portal where people load up their ideas, for example in the support business and the infrastructure support, about how you can do it in a more environmentally beneficial way so that there is now a sharing of environmental opportunities for the Group in a way which we've never had before.

Social, I touched on it with the FACT bid, but we are in a war for talent. Our people care - and not just the young people. The whole organisation cares about how we are regarded. We're 14% of the direct economy in Plymouth and probably double that direct and indirect, so we have a huge opportunity to influence the southwest of the UK's agenda across a range of things. That's what our people expect. If we're going to recruit the thousands of people we need over the next five to 10 years, people are going to want to join a company that is playing its role, so this isn't just being nice. This is about delivering social impact for business reasons.

I've touched on agile working. The other thing we're starting to do is set ourselves some hard targets on I&D so, for example, 30% of Senior Managers to be female by 2025. We're currently at 21%, so that's a 50% increase.

We've just appointed our first two female Managing Directors, which is a step in the right direction, because this is not only about the number, 30%, but - at the risk of getting this wrong, not just in the places where you might typically expect females to be, so comms or finance or HR, but also in - so our new Group Head of Programmes is a lady, is a woman, female. I'm not allowed to use the word lady. Oh, I was doing so well. It's Donna, okay. She's Donna. We want a balanced representation across the organisation, not clusters.

Finally, governance matters a lot, improved internal controls so that we actually do what we say we're going to do. Delegations of authority is totally aligned with the delayering so that the delayering empowers at the front. That's where best decisions are made. Things like a new sustainable procurement policy.

I thought I'd touch on here the kind of commentary that's around our sector on ESG and the defence sector. My view, particularly for a company like Babcock which is so people driven, is that those countries which have the capacity to address ESG issues properly are strong and robust countries. They need strong and robust defence to do that. I think with 30,000 people we can lead the way on the whole gamut of this agenda, so I don't see being a defence company as anti-ESG. I see it as quite the reverse. I think it's our job to make that case, not to shy away from defence and ESG. I think we are a key component of a global ESG strategy, not an enemy of it. If I didn't believe that, I wouldn't be here.

Defence Digital, this currently sits in the marine business. It's a very important and growing part of our business. I've just picked out three different areas. The MEWSIC programme, the catchily named Maritime Electronic Warfare Systems Integration Capability, is a major win, displacing a long-term incumbent in the UK, providing electronic warfare for the Navy over an extended period. LE TacCIS which is tactical comms in the UK again. It's an entry-point info programme which has lots of growth potential. Then high-frequency comms where we are a provider in the UK and New Zealand and now down-selected in Australia with major opportunities in the other two Five Eyes countries, Canada and the USA.

A very significant capability taking microwave management from the electronic warfare through tactical comms into strategic comms where we play a critical role for governments, perhaps slightly underplayed by us in the past but where we're seeing real and exciting growth.

Finally, back to the first slide as always. My summary would be that we're on track as David said, that we are managing quite volatile external environments actually increasingly well, where business development is going well both in the UK and outside, and on track for a successful turnaround in a volatile world.

With that, we'll take questions on anything really. I've got to point to people, because there are roving mics. Actually why don't you just pick people who've got their hands up, Debbie? That gives you the power.

Q&A Session

Rob Plant - Panmure Gordon & Co.

Thanks. It's Rob Plant from Panmure. Can you add a [USI] without a business there?

David Lockwood

Almost certainly to do anything in comms in the US, you'd have to partner, so we're partnered with Lockheed Martin outside the States, for example. These are typically collaborations. I can't imagine in comms we would be the prime, but we could certainly partner with people to bring through the technology we've got.

Rob Plant - Panmure Gordon & Co.

More generally are you thinking about potentially entering the US currently?

David Lockwood

We talked about that, I think, at the full year. It's 50% of the addressable market, but for what we do, it's less addressable than if you're a product business. It's a big bet. At the moment, there's plenty to go at in what we already have before we think about that big bet.

Joe Brent - Liberum

Thank you. Good morning. Joe Brent from Liberum. Can I ask three questions, maybe one at a time, if that's okay?

David Lockwood

Sorry?

Joe Brent - Liberum

Could I ask three questions, maybe one at a time?

David Lockwood

One at a time, yes, please.

Joe Brent - Liberum

Make it easier. The first one, on the sales proceeds, it seems to me you're pretty much at your target, £400 million. Would you consider at some stage raising that target to maybe £500 million given there's other things you can potentially sell?

David Lockwood

What we said was we would - we had a strategically led sales process, the first £400 million proceeds of which would be used to pay down debt. Clearly once you've done that and got the balance sheet to a safe place, you then have choices about how to use the remainder of the proceeds. Therefore you don't need to speculate on what that number might be. It doesn't have to just be debt paydown for the rest of the proceeds.

David Mellors

Yes. As we've said before, we wouldn't trail future disposals for all sorts of reasons, so we'll keep the market up to date at the appropriate time. As David said, we'll be finished around the time of the year-end results anyway, so we'll know what the perimeter of the Group is then.

Joe Brent - Liberum

Thank you. The second question, if I may, on inflation. Clearly it's a hot topic at the moment generally. Others have given guidance on what percentage of contracts, by number or value, have inflation protection clauses. Could you give us a little bit more of the science around inflation?

David Lockwood

Oh, that's a financial question, David.

David Mellors

Yes, so very approximately two-thirds of our contracts have some form of inflation protection. That varies obviously, because there are many of them. Some of them would be very well protected. Some of them have indices, escalators and a variety of that. Two-thirds of contracts.

Where we buy, we generally try and fix the prices of supply chains. Often we're back to back, so even when we take inflation risk off the customer on the end contract, we would look to make sure that we're not absorbing that from the supply chain too. Then for the remainder of it, obviously we're a people business. We need to manage the inflation, such as it is, as we do the rest of our cost base, with efficiency and productivity.

Joe Brent - Liberum

Thank you, David. Finally, in the first half, you've [totally] done a good job of recovering some of the overhead costs. Are you confident you'll be able to do that in the second half? How and when will we know whether you can do that?

David Lockwood

Say it again?

David Mellors

Sorry, was it COVID or overhead?

Joe Brent - Liberum

COVID overhead.

David Mellors

COVID. Right, okay.

David Lockwood

COVID overhead, okay.

David Mellors

Should I go or you go? You go.

David Lockwood

I'll go first and then you do it.

David Mellors

All right.

David Lockwood

The only thing I'd - as David said, H1 last year was the bottom of the COVID cost issue or the worst part in that the lockdowns were the hardest and we were all learning how to cope. The comparator year-on-year is the most stark. H2 to H2 is more difficult to predict, because in H2 not only had we started to all understand how we were going to live with this for this period, but also governments were funding quite a lot of that cost. In H2 this year, we don't know exactly what the risk is and we don't know exactly how much governments will fund, which is why you create an uncertainty when you try and compare the two.

David Mellors

Yes, so just to remind you and everyone else, I think of three components of the COVID impact. There's the revenue impact from activity levels, so if something's shut or curtailed or slowed down, that drops through obviously to profit. Secondly, are the extra costs of keeping activities and sites open - whether they be testing or cleaning or equipment or what have you in efficiency, et cetera - so costs incurred to keep sites open. Thirdly is the recovery of those costs which, as we've said, historically in the early stages and until recently obviously through the first half, largely but not entirely, were recoverable.

All of those three things are what we need to think about going forward. When we said at the full year we didn't expect a material boost in profits because of COVID, obviously we can't predict the activity levels, so that's down to local countries, conditions and new variants and what have you. The costs, we kind of know how to keep these places open, but the recovery of costs is obviously not within our control. Over time, will governments around the world expect companies to pick those up more than they probably did a year ago? Possibly. They're the three things we think about.

Kean Marden - Jefferies

Good morning. It's Kean Marden from Jefferies. Morning. Could I, first of all, ask a few questions on the nuclear infrastructure spend? Thanks for detailing the amount in the first half. It's quite lumpy. Obviously we're trying to forecast that division. It's quite an important swing factor. Is it right, given your interactions with suppliers in Devonport over the last few months where you've basically been I think looking for indication people for the work that that revenue number may build up - so I think it's Dock 10 and some of the other docks basically start to - the work starts to ramp up, that £60 million potentially gets bigger?

David Lockwood

Yes.

David Mellors

During the second half of the year, it probably will be that level or it could be higher depending on how things go, so you're right. It is a bit of a bubble on top of the rest of the business, which is why I called out the £60 million in the first half. Of course, that is higher than it was this time last year.

David Lockwood

Yes. There is quite a lot planned. There are limitations in all the sites about how much work can actually - how many people can you get onto a site? How much material can you get onto a site? There are physical limitations in terms of how much civils we can actually do.

Kean Marden - Jefferies

Does that suggest therefore that the fiscal '23 may be flat year on year?

David Lockwood

I think it's too early to say at the moment.

Kean Marden - Jefferies

Okay. Then secondly, could you just provide us with an update on recent trading in South Africa where obviously the COVID wave may have impacted your business again?

David Mellors

To date, South Africa's been open and going well. It has been open since I've been here, 12 months. It was particularly acute in the first half of last year, the shutdowns, et cetera. Open and going well.

Kean Marden - Jefferies

Okay. Then finally, I appreciate you don't disclose bid pipeline anymore. It feels with the additional bid activity cost that's going in, and just looking at the underlying activity in the business, that actually your growth opportunity set is expanding. I'm just wondering if you can help us think about that or scale it in some way. Does it feel like the opportunity's bigger than probably you thought 12 to 18 months ago?

David Lockwood

I would say that the opportunity is clearer. Whether it's bigger or not, I kind of always - one of the reasons I took this job was because I just had this feeling it was big. I think the opportunity is clearer. The nature of our business is you could end up with six silver medals and no business or two golds and lots of business. As we saw recently on the Greek decision to abandon their procurement and buy three French frigates, there's a lot of geopolitical stuff in being a major prime contractor, some of which falls in your favour and some of which falls against you. I'd say the pipeline is clearer and now we need to make sure we win some gold medals.

Chris Bamberry - Peel Hunt

Morning. Chris Bamberry, Peel Hunt. Could you please elaborate on some of the current opportunities in the pipeline across the four divisions please? Secondly, could you give us a comparator numbers for the pass-through low-margin revenues in the first half of last year? Thanks.

David Lockwood

In marine, within the UK, the FSS programme remains an opportunity, however it finally plays out, because I just think there's so much work to do on that that most major yards will do something.

In international, we're in a number of competitions. We've proved in Indonesia we can win, which is good. We now have to prove that isn't a one-off. But there are significant opportunities. As I said, Defence Digital sits in there. We've won the three programmes that I put up, all recently, so we're definitely very competitive in that world. We probably at the moment need to make sure we don't overtrade and deliver what we've got.

In civil nuclear, we keep calling the bottom and then it goes down, so I'm always really nervous in civil nuclear. But one would have thought that with new build at Hinkley, with the SMR work that is being planned in the UK and outside, with the decommissioning work that needs to be done, that we ought to have found the bottom soon. I can always do a big strategic overlay on civil nuclear and then I look at the numbers and there seems to be this disconnect. But we are very well positioned, as the UK's only nationally owned civil nuclear contractor, to take advantage of that in the UK and then outside in places like Canada.

In naval nuclear, obviously it's very, very early days in the G2G discussions on AUKUS, the Australian nuclear submarine programme, but you'd like to believe we have a role to play there.

In aviation, we've proved in Mentor that we can do pilot training outside the UK. Clearly the FACT programme there in Canada, which we've talked about before, is a major opportunity, very digital.

Then finally, in land, I would say we're in more of a reset mode, but there are opportunities in life after DSG and the broader support environment. That puts aside the incremental stuff that you get in the underlying support business.

Have you got anything you want to add on growth or do you want to do pass-through?

David Mellors

No, I'll do pass-through, because it's quite easy. It's very similar. The pass-through levels, which are particularly in land, are pretty flat and have been pretty flat, both last year first half and full year and first half this year.

Chris Bamberry - Peel Hunt

Thank you very much.

Sash Tusa - Agency Partners

Sash Tusa from Agency Partners. Just a quick question about Ukraine. Could you just clarify is your relationship direct with the government of Ukraine? Because clearly there's some risk as to whether that actually is there to be a client in the medium term. Or is your relationship through a government-to-government relationship where the UK government effectively covers at least some of your downside risk?

David Lockwood

At the risk of crossing a confidentiality line, the programme is funded by UK Export Finance, so the financial relationship is essentially with the UK government. The operational relationship is with the Ukrainian government.

Do we have any online?

Samuel MacGregor

We can now move to the phone lines.

David Lockwood

Are you going to read them out or are they going to come from the heavens?

Samuel MacGregor

From the heavens.

David Lockwood

Oh, right.

Anvesh Agrawal - Morgan Stanley

Hi. Good morning. I got couple of questions really. First, on the marine margin and picking your comments earlier saying that you plan to improve them over time. Clearly in the first half, the recovery was led by Frazer-Nash which has now been disposed. Maybe if you can comment on what are your building blocks for marine margin over the medium term, that would be really great. Then just overall, within the strategic plan, what has gone well and what has not gone so well so far? Overall, things seem to be in track, but where you would like the progress to be much faster?

David Lockwood

Well, I'll do the second one first. I think whenever you make a change, as you build up things like the operating model change, whenever you finally implement it, you always ask yourself the question why you didn't do it the week before. I guess on the operating model stuff, you always want to have done it sooner. I've never done a change like it when I haven't felt I wish I'd done it sooner. We're online with our plan, but you always want to go faster.

I think what's gone well is the disposals programme. I think I was probably nervous that we'd - I thought we'd do the deals for the £400 million in year. I wasn't certain we'd have the cash. I think that's gone better. What do you think on that?

David Mellors

It has, because we said we'd do it within 12 months in the full year. We've signed them now and Frazer-Nash has completed.

Then on margins in marine building blocks, the obvious building blocks are firstly the operating model and their share of it. We haven't split that out by sector, but you can take a guess at that. Secondly, we've flagged there's £120 million of low or zero margin programme revenue in that sector, which over time there's no reason why that shouldn't be at normal margins. It will take time. These things don't turn in months or quickly, but there's no reason why those programmes shouldn't be at a good margin. Then thirdly, of course, there's the normal productivity and continuous improvement that we would look to do every year over time. They're the three obvious blocks.

Anvesh Agrawal - Morgan Stanley

Okay. Thank you.

Operator

There are no further questions on the phone lines, so I'll hand the call back over to your host.

David Lockwood

Okay. Well, thank you all for your time. I'm sure we will be speaking before we stand up at the full year. Thank you.

ENDS