Transcript of the half year results for the six months ended 30 September 2022

Tuesday 22 November 2022

David Lockwood

Chief Executive Officer

Good morning, everyone, and welcome to the half year results for the six months ended 30 September 2022. David and I will take you through this and then we'll go to Q&A. When we do get to Q&A, in case I forget to say at the time, we'll be linking this call with a webcast and there'll be a moderator. So, there'll be a slight time lag, that's intentional.

Before we start, we announced last week the results of an independent review by Oxford Economics into the impact Babcock has on the UK economy and UK society. Extremely positive review, kind of reflects what we knew internally but maybe not what the outside world knew about us.

We have a short video now just so you can have a really good insight into what a special business Babcock is.

Video plays

I guess that's why David and I think we have such special jobs really and turning that into a value proposition to shareholders is a great privilege. I thought I'd just go back to this slide. This is a slide we used at the full year. If you're in the middle of a turnaround, being able to say the same thing six months after, six months after, is actually a really good thing. Because a turnaround isn't a straight line and therefore navigating it is more difficult. Therefore, being able to be repetitive is a really good thing.

I just want to touch on each of these. Stabilise is about the strength of the balance sheet, the strength of the P&L and the portfolio. So, once we have completed the two transactions in process, the civil training transaction and the bigger Aerial Emergency Services transaction, that is us complete on portfolio from a - what we want to do.

Clearly, people approach you all the time and if people approach you, you have to consider it. That's the rules. But from a kind of proactive sense of portfolio, that's us done.

In terms of building resilience, as a number of the analysts have commented, we're in line. That's despite a £6 million hit on our challenged programme. I think a few years ago a £6 million hit would have bounced this company around a bit but we can absorb things like that now, which is a sign of the balance sheet and P&L resilience. So, Stabilise, going really well.

Operational improvement, you'll see in a number of the numbers that David will talk you through in some detail, so I won't steal his thunder. Still lots more opportunity. You're never done on operational improvement, there's still lots more opportunity to drive output for customers and also to drive value for shareholders and create a better working environment for our people. That is the platform we always said for profitable growth.

Throughout this David and I will talk a lot about the improvements we've put in the control environment. I've always believed that if you want profitable growth, the more entrepreneurial you want to be, the more robust your control environment needs to be. Those two things aren't in conflict, they're in support.

The combination of fixing the execution and fixing the control environment, will create a platform where we can take advantages of the quite considerable opportunities the market offers. I'll come back to some of that later but now I'll hand over to David for the numbers

David Mellors

Chief Financial Officer

Thank you, David. Good morning, everyone. To summarise, before we go into detail, the main messages are overall performance was in line with our expectations with cash flow ahead. The balance sheet is now much strong and the FY23 outlook is unchanged. So, we're on track and very pleased with where we are.

The key financial headlines for H1 are set out here. Organic revenue growth was 5%, driven by the Nuclear and Aviation sectors. The underlying operating profit increase was 10%, excluding FX and disposals. EPS was in line with expectations at 15.8p and cash flow was better than expected, despite the unwinding of the historic working capital structures and the catch-up pension deficit payments.

Resulting net debt is £1 billion including all leases or £629 million on a pre-IFRS 16 basis, which is the start point for the covenants. On covenants, the gearing ratio at the bottom there is 1.9 times, better than we expected.

So, to Group revenue. If we skip over the foreign exchange effects and the revenue sold with disposals, the main drivers of the 5% organic increase are the ramp up of the infrastructure programmes in Nuclear and growth in the Aviation sector, which we'll come on to in a moment.

On profit, again skipping over the FX and disposal impacts, the other trading variance of £12 million is driven by good performances in Marine and Land, which more than covered a £6 million Nuclear programme provision and a £4 million increase in fuels costs in Aviation. So, the resulting profit for the period is £122 million. The overall margin is up to 5.7%.

Now looking at the sectors, with Marine first. Again, I'll pick out just the key points, 2% organic revenue growth was largely due to growth in the mission systems and liquid gas businesses. Type 31 programme revenues were lower this period following the ramp up last year.

In the period there was approximately £100 million of low or zero margin programme revenue, which, as we've said before, we would look to increase the margin on over time. The profit impacts, which I've set out on the slide here, show growth and improved margin mix resulting in a 7.1% margin for Marine.

The main points for Nuclear are the 8% organic revenue growth is driven by the infrastructure projects in Devonport in the period. We're expecting H2 infrastructure revenue to be similar to that in H1. The profit margin reduction is largely due to the £6 million programme provision I mentioned earlier. The margin mix is also affected by the early-stage revenues of FMSP and infrastructure work is slightly lower margin than other work.

Moving to Land, which also includes South Africa. The key points here are in South Africa, the increase in vehicle sales to the mining industry more than offset the loss of the Eskom contract last year. Just a note on that, our exclusion from the Eskom contract tender has just been overturned by the South African courts.

In the UK the sector has delivered better programme margins in fleet management and training and has managed the cost base well overall. The resulting sector margin of 7.9% was also boosted by a one-off credit of £3 million in the period.

On to Aviation. Revenues grew 10% as we ramp up the H160 and Mentor defence contracts in France. Despite cost savings, the profit in the period was impacted by higher fuel costs in the European AES business and bid costs on a large tender which is due to be submitted in H2.

Moving to the cash flow. Cash generation in the period was better than previously expected but this is mainly due to timing. The two key drivers are (1) net Capex was lower due to more aircraft disposals and the later phasing of capital projects and (2) the working capital outflow was lower than we first expected but this is largely timing of customer receipts and supplier payments.

Below operating cash flow, interest, tax and pensions were all as we expected therefore leading to a free cash outflow of £25 million for the period. I've put some guidance for the full year on the slide here, all of which is before the effects of the Aviation disposals.

This is the bottom half of the cash flow statement and there's nothing particular to pull out this period. But at the bottom of the slide, you can see the closing net debt of £629 million pre-leases and the gearing ratio of 1.9 times.

Completion of the European Aviation disposal is expected in H2 and that should generate cash proceeds of approximately £115 million before completion adjustments and the divestment of around £200 million of leases. The much smaller civil training disposal is also expected to complete in H2.

I've put this slide up at previous results presentations to show the progress on repairing the balance sheet over the last 24 months. Three points to make on our progress to date. As the top box shows, net debt has materially reduced over this two-year period, with a much better gearing ratio. This has largely been achieved through the disposal programme.

Second, as the middle box shows, we've now effectively completed the unwind of the historic window dressing practice at period ends. Three, if we add the pension deficit, the aggregate of all these debt and debt-like items in the three boxes has substantially improved by approximately £1.4 billion in that two-year period.

So, in summary, we're in a much better place from a balance sheet resilience point of view, than we were. To add to the resilience point. If we look at liquidity and debt maturity there are three things to note. Firstly, we've reduced the exposure to variable interest rates by fixing more of our debt. So, we now have only £125 million of debt floating.

Secondly, we have over £1 billion of liquidity headroom, having paid off the Euro bond in October. That's the yellow bar on the chart here. Thirdly, if we assume the £300 million RCF lapses in 2024, we have no refinancing events until 2026. So very long duration.

Next, I'll touch on inflation and supply chain risk management. I've set out a rough split of the contract revenues between those fixed or firm price and those with some inbuilt inflation protection. As you can see in the top box, currently about 30% of our revenue is generated from fixed price contracts. Most of these contracts end in the next one to three years. So, we then have the opportunity to renew on improved terms.

Of the costs within these contracts, roughly 50% is labour or labour related. The remaining 70% of revenue is derived from contracts that already have a measure of inflation protection within them. That's the bottom box there.

I've also listed out some of the things we've been doing to proactively manage inflation and supply chain risks over the last year on the right-hand side. This has been enabled by the new centre-led procurement and commercial teams delivering a standard approach across the Group. We intend to continue this series of measures in this uncertain macroenvironment.

As you know, we have pretty good visibility of our FY23 cost base, both payroll and other costs, and have so far managed to cover the majority of the inflationary increases through efficiencies and negotiations with partners, customers and suppliers. We currently intend to manage these risks in future as we have done to date.

So, to finish, this is the Board's outlook from the statement this morning. With a good level of revenue visibility for FY23, we are maintaining our expectations for the year as we continue to expect the retained Group to turn cash positive during H2.

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

David Lockwood

Chief Executive Officer

Thank you, David. So, we used this slide at the full year and I think it explains really well the compelling offer that Babcock has.

Geopolitical uncertainty has only increased since we did the full year. That creates, as David has just said, both opportunity and risk. The core skill in managing this Group at the moment is to have active plans, which David leads on a lot of, to manage the risk whilst being

nimble and entrepreneurial and taking advantage of the opportunities. I think in the six months, we managed that balance in the geopolitical situation pretty well actually.

On budget pressures, we've seen, in the UK alone, how overall budgets have moved around in six months. Plans have moved around at a national level. It is still a fact that the defence requirements are focusing on the areas where Babcock excels. So, it's not just the absolute budget, it's the priorities. The priorities are very much aligned with what we have to offer.

David has touched on supply chain and inflation. Clearly, of all of the risks, those are the ones we have to had really proactive cross Group plans to measure. So far, they're working very well.

All of that leads to customers wanting value for money, clearly. Value for money that we're prepared to contract for, on the risk basis we're prepared to take. So, you know we're not going to chase value for money deals where we think it's not in the interests of the Company. There's plenty of good work out there. So, we are being robust in our bid approach and I'm going to come on to that in a minute.

Customers want high utilisation, which means they need availability, which means they want things like our land support in the UK to be producing vehicles that are ready for use, in completely different timescales and with a greater predictability. We've made real operational progress in areas like that.

Modernise, it's very difficult to get new equipment into service faster than originally planned. It is relatively possible to upgrade existing equipment. So that's a core part of what we do. Then flexibility, that is operational and commercial, always staying within the bounds of what we consider to be good business.

That drives Babcock at the heart of availability, affordability and capability and I think the six months has shown that when we deliver that well - and we are increasingly delivering that well across the Group, we have a very attractive market.

Driving operational improvement, I'm going to go right to left there. I should have put the slide up the other way around. When I started this job, I said Babcock is a people business. We employ lots of people, as you saw from the video. Making it possible for those people to do their job well, in a positive mindset, with the right culture, is fundamental to delivering this Group.

We have detailed people plans by sector and by country. We've got a first Group-wide survey of employees with a 79% response rate, which is very high. Over 100,000 comments, which are going to take some filtering. But it shows that people are engaged and want this Company to be a success, which I don't think, to be honest, we'd have got that three years ago. So real progress on engagement.

The role framework's important in terms of retention. If you progress in this company, you want to see where you can go. Which means you need to know a route through quite a large company. We didn't have a role framework. We're now making it much easier for people to see a long-term future in the Company. Recently, 300 new apprentices and 150 grads, and you saw the number in the video that we employ on an ongoing basis.

I said create the right environment. So, we've touched on before how we have lots of legal entities, lots of arrangements. It makes bringing the Company together more difficult than it should be and we're working on that. One thing you can do is have a single, global business management system. So, wherever you work in the Company, it looks and feels the same.

That makes moving around easier. It means your quality is better because people are not having to re-learn every time they move. It means your health and safety is better and it means people feel part of one Group. So, this is not just an administrative thing. This drives efficiency, which ultimately drives profitability.

David has touched on the new functions. This is not central control, we call it centrally led, not centrally managed. This is to provide common ways of doing things which are then implemented locally. Again, that is beginning to show real benefit. That focus on driving delivery and culture change is ultimately going to drive profitability.

The last bullet on the left, bidding governance, I was going to touch on in a bit more detail. So, we a simple, five gate process, some people have nine or 12, we have five. Left to right, first three are tracking. Are we looking for the right opportunities? Are we going to be competitive? Is the customer going to contract on terms we want to undertake? Does the customer know what they want?

80% of our business is support. As I said, that's at the centre of what we do. In many cases, customers know the problem but not necessarily the answer. So, in that gate 1 to 3, this is about shaping, helping the customer shape what they want but also how they want to buy it, to make it business we want to do.

Then into gate 4. By the time you get to the bid phase you should really be in a position where what you are bidding is what you want to win. Moving that whole process to the left is fundamental to winning good business. We've said it before but 50% of the risk and the value in a contract is set in the contracts you book in our world. So, getting that phase right really matters.

Next phase is mobilise. We have some pretty horrible examples in the past of orders being thrown over the wall to a delivery team. We've joined up much more actively on some of the wins, like the JP9101 in Australia, we were pre-mobilising well before contract. So, we got a good start and we had a properly managed risk plan. So, you get that bit right.

Then delivery becomes that extra 20%. It doesn't become delivery to fix everything you've got wrong. It becomes course correction, customer change. But it becomes that final piece, it's not a solving this 'into the past' activity. All of this is ultimately about risk management because it's about having the right order book and therefore that your bid margin becomes your reported margin.

Having done all of that you need to capture some things.

So, the Polish programme is a really good example of what I've just said. It went through that process. It was one of the first programmes to go through that process. We had a deep understanding of how our partner wanted to work. We have a team in Gdynia working on the infrastructure as well as a separate team working on the design. We've got the next two orders that came through on that. But it was pre-mobilised, we knew to the name of the person who was prepared to go out to Poland and work in Gdynia and do it. So, it's a classic example of having the right product with the right commercial terms.

Asset availability. The world has become a bit urgent operational requirement like, so people not only want higher availability of mainstream, they also want equipment fast and this ability to be entrepreneurial but under control has come through in a number of areas.

Unfortunately, clearly because they are operational, the best examples I'm not allowed to talk about so you'll have to trust me on that one, but there are some really exciting things going on.

Defence digital – I've just talked about the defence high frequency comms, the JP9101 program in Australia. A really good example of how we actually modified the approach we were in to get to the new way, we had the Australian team leading the customer with the UK team leading the technology joined up. I've met with the Australian customer; they're super pleased about having a local delivery but backed up by the core knowledge in the UK and really pleased about how we've mobilised.

Also in Australia, we won the Regional Maintenance Provider West. They've gone to a regional model, not a platform model. Again, very innovative bid but on terms we would want.

So, if you go down the left-hand column, we're addressing, in different ways, customer needs in all of those programmes but booking them on commercial terms that balance risk with reward for us and for the customer.

My summary: good momentum – I wasn't sure if I was going to say this but I will say it – I think you can feel the momentum pick up on a global basis as COVID restrictions have disappeared and groups can genuinely meet and work together. There's only so much team building you can do on Zoom and Teams and if I look at JP9101, it's a classic example of post-COVID working really making a difference, so I think we're seeing a real acceleration from that.

As David said, HY23 aligned with expectations and actually, confidence in the future. I think we see real growth potential and we can deliver that growth potential and hold FY23 unchanged. So, with that, we're now going to go through to what I said right at the beginning, which is merging two IT systems and introducing a moderator. If it all goes wrong, it isn't me.

Q&A Session

Kean Marden - Jefferies

Morning, all. It's a bit echoey so please bear with me. My first question just regards civil nuclear, which I appreciate is a very fast-moving space at the moment, but I'm wondering whether you can just give us an overview of some of the UK and international opportunities. I'm particularly interested in decommissioning Sizewell, which got parked for a while, that new build announcement recently at Sizewell C and also the US office that you mentioned in the text.

Secondly, just wondering if you can provide an update, please, on your operating performance for some of the key rebids coming up over the next 12 to 18 months. In particular, just looking at the contracts at the back of the slides, Met Police, Phoenix 2 and WAMA in Australia. Thank you.

David Lockwood

Right, so I'll do the latter one first, I think. It's quite difficult to talk about progress on rebids because by definition they're governed by by contractual things we sign up to. So, I've only started with that so I can hand it to David and say can you have a think about what you're going to say on that, because you can answer that one because I can't think what I'm allowed to say.

On civil nuclear decommissioning, in the UK the nuclear decommissioning authority obviously has undertaken a well-publicised review. We are seeing more work coming out. What do I think? You said it's fast-moving; I've never heard civil nuclear described as fast-moving before. I think decommissioning rates will pick up but do I think it will affect the numbers at a Group level? It might on the margins in a couple of years but it'll be on the margins.

In terms of build, obviously we've got Hinkley where our work steps up as we said at the full-year and we've got – into the next phase – and work scope for Sizewell, because it's a different commercial structure, is still being sorted. But again, that's some way out for us because we don't do the heavy civils, the concrete-y stuff, we do the higher-end stuff so we need that done first. So, that will be some years out but the Hinkley is increasing.

Then we've obviously done – have an MOU with an SMR company in America which effectively are small SMRs], they don't compete with the Rolls one and its primary role is hydrogen generation. So, that's quite exciting but again, that's back end of this decade, so I think in terms of the UK, I think there'll be a pickup in decommissioning but I think it's on the margins. There'll be a pickup in our work in Hinkley, but that's in our plan. The other stuff's probably back end of the decade.

In terms of international, we opened the office in the States because we have been asked to join a couple of consortiums to bid for decommissioning work there and you need to do it through a US entity. For me, it definitely falls into the bluebird category. I think there's a chance they'll want our capability because we do have some quite special skills, in which case it will be upside. There's also a chance they'll stick to American-only providers, but I think we've advanced enough that we can take that measured step into the US market. Back to contracts.

David Mellors

So, on the rebids, without going into too much detail on any of them, obviously there are two things that you really need to do. (1) not surprisingly is prepare a competitive rebid but (2) is the incumbent needs to make sure the performance on the current contract is as good as it can be and you mentioned two that are in the land sector.

You'll have seen what the land sector's performance has been like in the first half and it's very pleasing from an operational point of view, so that's good. In terms of – I think you mentioned WAMA in Australia.

So, Australian ship support will be configured slightly differently in the future into the RMPs or regional maintenance providers that David referenced earlier and a key part of us buying the NSM joint venture and consolidating that as a subsidiary earlier in the year was to address that, so we mentioned RMP West in the presentation and the east will come up in the not-too-distant future.

Kean Marden - Jefferies

Thanks very much. Much appreciated.

Robert Plant – Panmure Gordon

Since the full year '22 results, have you had any other fixed price contracts renew and if so, were you able to capture any cost inflation? Thanks.

David Lockwood

So, many in the smaller space. In the chart I put out, I said there's a lot of the fixed price ones are between one and three years. Actually, there's a bunch of them smaller in value that are short-term and that do roll on a relatively frequent basis, so obviously every time we're rebidding new work, we would update our assumptions, not just for external inflation but FX, suppliers and everything else.

Robert Plant – Panmure Gordon

Right, thanks.

Sash Tusa – Agency Partners

Yes, good morning. I've got three questions. First of all, the contract bid that you refer to that's depressing aviation margins at the moment, can you just confirm that that's the Canadian FAcT program?

Then secondly, the nuclear contract that's caused the £6 million provision in this half, is that the same program that caused the £22 million charge in the second half of last year and if so, how long do you expect before you can finally resolve that program one way or another?

Finally, could you just make some comments about the SSS program and how that fitted into or didn't fit into your bid criteria process? Thank you.

David Lockwood

Okay, so the answer to the first one is yes, the answer to the second one is yes and hopefully this financial year, and the answer to the third one was that obviously it was only announced as preliminary selection last week. We've had no detailed feedback and yes, we bid in accordance with the framework I outlined.

Sash Tusa – Agency Partners

Thank you.

David Perry – JP Morgan

Good morning, gentlemen. I have three questions, please. First one, there's a couple of fleeting references in the release to opportunities, current and future, in Eastern Europe. I just wonder if you could elaborate a little bit where you're allowed to.

The second, slide 17, David Mellors, you talk about free cash flow positive in the second half, I just wonder if you could elaborate on the range of outcomes there.

Then the last one, let me see if I can provoke you or not to reply but on your slide 2, you have in the top right-hand corner full year '26. It feels to me things are a lot more stable now. Is there any chance you could tempt us with where the Company might be in terms of FY26, perhaps in terms of margins or sales? Thank you.

David Lockwood

It sounds like the first one's for me and the second one and the third one are for David. So, obviously, as we said in the presentation, we have been supporting the UK government efforts in Ukraine and that continues as we speak. A number of nations in the East have reflected on what they've learnt from the conflict and there's an opportunity to replicate some of the support in those countries, both NATO and non-NATO.

The UK government's primary focus in defence is actually that region, so clearly, quite a lot of that in other countries will be either supported by or in support of the UK government's ambitions.

David Mellors

On the free cash flow, you're right, David, that's what we said and we mean it, obviously, for the retained group. You know or you probably know that the cash flow profile of the aviation business we're disposing of does vary through the year, so the reason we've qualified it with retained group is it actually depends what month we complete the aviation disposal on as to whether they're negative – which they often are in the winter – or whether they get the positive as the work starts again in March.

So, there is a bit of a variability around the disposal but put that to one side, the retained business has now cleaned up the past. So, you've seen in the first half that the window dressing has gone and the pension payments lower down the cash flow statement, so £25 million more of the pension payments, they're catch-up. They've gone as well in the first half.

So, now it's more about just turning ongoing trading into cash flow. We always said FY24 would be our first clean year and that's still absolutely the case. In the second half, we won't have those hangovers, if you like, from the past. However, you do know that the first half was significantly ahead on cash because of some timing differences and you only get cash in once, so we had a better first half, but of course, that's come out of the second.

So, without getting too caught up on it, the full year is still largely going to be as we expected it would be and within that, the full year will have settled £25-odd million of additional pension catch-up payments, as we always said it would, and it will have settled about £70

million of window dressing. That's what it'll have to swallow. Most of that, obviously, will go in the first half but the timing differences will carry over into the second. Key message is the full year is unchanged.

You won't be surprised, we won't be giving margin targets out for 2026 but just to remind you, we've always said that margins in all four of these sectors are capable of improvement and we expect to do that through the turnaround. You'll have seen very pleasing progress in two of the sectors in this first half, Marine and Land.

They were never all going to move at the same speed and they have different challenges and headwinds to overcome but at least you've seen real progress in two of the four in the period we've just reported.

David Lockwood

David, internally we've been very clear about it's the quality of work, not an absolute margin target, because any order – going back to what I said about the bid – is a combination of cash profile, risk profile and margin and it can chase one to the exclusion of the other two, you end up booking bad business and you set a margin target, it's very hard to retain control of the other two, so it's about the right balance between the three and that will vary on different contracts.

David Perry – JP Morgan

Understood.

Anvesh Agrawal – Morgan Stanley

Hi, good morning. I've got only one question and it's just an extension of the previous question, really. As you stabilise the business with your portfolio rationalisation now largely complete, pending the sale of AES, how do you think about the long-term growth outlook for this business? Is defence growth plus the right way to think about it or defence growth across your end market is probably the better way to think about it?

Also, just the free cash flow again, what do you think is a sustainable working capital assumption for this business? Should this be neutral working capital business or consume a little bit of working capital going forward?

David Lockwood

So, I think of growth as in the UK where we – as the video said – are on more major programs than any other contractor. If we grow in line or slightly ahead of budget, that's pretty good, because we'll never do heavy-lift aircraft or helicopters. There are plenty of things in that budget that we will never do so if we grow in line or slightly ahead of budget, that's pretty good.

So, growth beyond that is about the international success and we've seen it in Australia and France, in Poland, so I think internationalising our proposition is the big growth opportunity. Do you want to do the other half?

David Mellors

So, on free cash flow, we did say from '24 onwards when we got rid of the past that this would be a cash generative business and it will be. So, profits will turn into cash at a very high conversion rate and obviously, we still have pension payments below operating cash flow and interest and tax, but operating cash flow should be over the long term at least 80% of operating profit. There'll be good periods and bad periods because cash flows are often lumpy and often lumpy for good reasons.

We try and get mobilisation payments and milestone payments as early as we can in contracts that we're now negotiating. You only get the cash in once so it's a great period when you get the lump, but obviously it brings it forward from another period. There'll always be lumpiness in working capital but over the long term, if you were to look at many periods together, we should be at a high cash conversion rate.

Anvesh Agrawal – Morgan Stanley

Okay, that's pretty clear. Thank you.

Suhasini Varanasi – Goldman Sachs

Hi, good morning. Just one question from me, please. I appreciate it may be a little bit difficult to predict but you've seen a lot of changes on inflation interest rates in the UK. Given where they are at the moment, can you please talk about potential impact to the pension cash outflows, please, in the medium term? Thank you. Next year, at least.

David Mellors

So, the pension cash flows are driven by the triannual valuations, as you know, and although we have several schemes, we have three main ones and we rotate the valuations so that one of the major valuations comes up each year and that's to avoid having a sort of cliff-edge of market assumptions all hitting all three schemes at the same time. So, actually, the cash flows are pretty well defined for the next three years or so in each scheme, depending upon the valuation.

In terms of inflation and interest rates, you'll have seen in the statement that we do have LBIs. We do hedge inflation and even though liabilities and assets have moved very materially in the period, not surprisingly, this is largely has done its job because the assets and liabilities have moved by about the same amount.

We've put the levels that we are hedged to inflation on a self-sufficiency basis, not an accounting surplus basis, on a self-sufficiency deficit basis in the statement and it is something that the trustees of these schemes are looking to over time step all the way up so that when we get to self-sufficiency, we'll be there with a fully hedged position.

Suhasini Varanasi – Goldman Sachs

Thank you.

Alex O'Hanlon - Liberum

Good morning, both. Just one quick question from me. On the disposal of the sale of certain aerial emergency services businesses, I believe that was expected to complete by the end of this calendar year. I just wanted to check if that's still on track.

David Mellors

So, we expect it to complete – well, we said in the half-year, the second half. We can't put a month on it because obviously it's due to regulatory approvals coming through. We have had a number of those. We've only got one major one remaining but I can't predict the timing of that because it's outside of our control, but we're expecting that to go very soon. Whether it's this side of the calendar year-end or just pops over, I can't tell you.

Alex O'Hanlon - Liberum

Perfect. Thanks very much.

Christopher Bamberry – Peel Hunt

Good morning. Just one question. Could you please elaborate on some of the operational improvements you've made on the DSG contract? Thank you.

David Lockwood

In general, it follows the same as all of the improvements. If you've got a front-line operator, whether they're in a shipyard or in a workshop in DSG, there are two things that limit the amount of time they're actually productive. (1) is what we call enablement, so have they got the tools, is their job fully – do they have a full kit, so they've got all the parts they need, if an individual machine needs to be certified, is it certified, et cetera?

That's true in a shipyard, it's true in DSG, so people can't start work until they've got all of that. Then when they finish the work, there's assurance. Someone has to sign off the job and in general in Babcock but it was a big issue in DSG, both enablement and assurance were slow and cumbersome and incomplete on many occasions.

So, we've gone right back to basics, really, and said how do we make it easy for our front-line colleagues to do their job? That is all about the job being fully kitted, all the tools, all signed off and then minimising assurance without losing quality.

So, it's those two things, really, and you can replicate that across the Group, really, that's true whether it's in support or build. It's about enablement and assurance.

Christopher Bamberry – Peel Hunt

Thank you very much.

David Lockwood

Well, thank you very much for those questions. Thank you for listening. I think hopefully you've got a very clear view from your questions and our presentation of both the operations and the opportunity. So, just to reconfirm, guidance remains the same, most importantly free cash flow second half, and all to play for. Thank you.

ENDS