



## Transcript: ~~of the FY24 results update and Type 31 contract update conference call~~

~~Wednesday-Friday 26-27 July 2024~~

### Lockwood

Chief Executive Officer

Right. Well, welcome to our full year results. Obviously, a bit trailed last week with the pre-announcement, but a lot more detail here, a lot more to get your teeth into. Before I put any slides up, I think it's really important to make sure we get the right balance in this presentation. When I look back over four years in this company, in the first year we had a spike just because we managed to avoid a rights issue, that was the kind of territory we were in. Now we're in a completely different territory and hopefully what we'll lay out through is not just the journey, but where we are, a SITREP on today, but also, what I think is a tremendously exciting future for what is becoming one of the world's most important defence companies.

So, we've made really good progress towards our medium-term guidance. If you take the three: cash, we've been well ahead for three years; growth is well ahead for three years; margin, probably about where we expect it to be, but we always said there would be a bit of a trade-off between growth and margin. If we grew more, probably margin would lag a bit just because of the way you account for new programmes. So, on the whole, I think really significant progress on all three, and all three more importantly looking sustainable rather than something you hit and then drop away from.

So strongly positioned in terms of our portfolio. We've always said there are bits we would trim when the time is right. There were things we'd like to buy when the time is right, but every company is always in that position. So, 74% defence with a clearly differentiated proposition that having spent time at RIAT and Farnborough with, actually all four domains actually including space, is recognised not just in the UK but outside. Significant organic growth whilst growing the order book and recognising as well that we consumed FMSP, the submarine programme in the year. So, this isn't a big leap on, say an FMSP, this is across the board. And finally, margins and cash conversion going in the right direction.

And in the end as we go through this, one of the things that we never lose sight of is: our job is to create shareholder value. And there really is only a couple of things in this company that are at the heart of that. The first is deeply satisfied customers. The bulk of that order intake is repeat orders from customers we now satisfy in a way we didn't four years ago. The other is, and we'll see some of this throughout this, we are a people-driven business. So, we need to be able to recruit, train, and retain the best people.

So, we're growing our apprentice schemes, we're growing our graduate schemes. We have a thing called Production Support Operatives, bringing in people who've been in long-term and employment. We've got a whole host of things which I'll come back to about growing a talented workforce and training a talented workforce. And that is our fundamental differentiation. We're not a product company, so we're not driven by tons and tons of IP. We're driven by engineering know-how embedded in our people. So, we deliver shareholder value by that customer intimacy and delivery done by some great people. And that will be, if you like, the golden thread through a lot of this.

I now hand over to the golden thread, flown in yesterday from Australia just to see you. So, you should be really, really honoured, really, because he should be in bed.

### David Mellors

Chief Financial Officer

Thanks very much, David. Good morning, everyone. So, the key messages from me this morning are as follows. Number one, this is a really strong set of results in nearly all respects. Obviously, there's the Type 31 charge, but in nearly all other respects, very positive; and cash flow is significantly ahead. Two, the balance sheet's stronger again both on gearing and on pensions. And three, FY25 should be another year of progress towards our medium-term targets.

So, these are the financial headlines that we published last week, so I'll just pick out the key points as you've seen most of them. The contract backlog was up 9% to £10 billion giving us very good visibility. The organic revenue growth was 11%, that's the second year in succession of double-digit growth. Underlying operating profit was up 34%, or 17% if you exclude the Type 31 charge. Margins are up 40 basis points to 7%, heading towards the 8% target. And free cashflow was significantly ahead at £160 million driven by operating cash conversion of 98%. Net debt reduced to £211 million giving the gearing ratio of 0.8 times. And finally, the first full year dividend since reinstatement is five pence as expected.

So, like last week I'm going to start with the cashflow statement, then the balance sheet and then the results, in that order. And I apologise upfront, this is a really busy slide to start with, but Sam has rather helpfully drawn some red rings around the key numbers we need to look

at in a high-tech solution. As you can see on this chart, cash conversion is over a 100% for the second year in succession. Whether you look before or after the Type 31 charge, we are over a 100% for the two years. So, the key message here is over that two-year period, we've delivered more than a 100% of profits into cash. So, in terms of is the 80% conversion target in the medium term achievable? It clearly is.

The operating cashflow of £323 million in the middle of this chart was roughly a 100 million more than we expected for the year, and that was driven by a better working capital performance. You can see the working capital inflow here of £128 million in the top part of the table. And this is where the £100 million beat came and it was in two parts. First roughly £50 million was earlier customer receipts than we expected. And that's a year-end timing point, comes out of one period and into another. And the second £50 million was just better performance. So primarily a lack of a working capital outflow, which was expected; as well as higher profitability, and the property disposal proceeds of £20 million. So just as a clarification point, that £128 million working capital inflow number includes £66 million of the Type 31 charge as it goes into contract liabilities. It's just the way it's booked. So, the £66 million is part of the £90 million, but obviously it boosts that number.

On capital expenditure, we're continuing to make increased investment in infrastructure and systems as highlighted before. And you can see in the top part of this slide that CapEx is outstripping depreciation as we catch up the underinvestment from previous periods. We've said that before and it will continue for the next year or so. Moving down to pension contributions, that's the £108 million figure below operating cashflow, that's £35 million more than we flagged. So, there's a £100 million off cash contributions in that £108 million. We originally said it would be £65 millions, so £35 million more. We accelerated that £35 million contributions into the year and I'll come back to that. And everything else landed where we expected. So, this all delivered the £160 million of free cashflow at the bottom of the chart, or £260 million pre-pensions if you think of pension deficits as debt. And lastly, I've added some guidance on here for FY25.

So, onto the balance sheet, I've put this slide up before to show the progression of the main captions on the balance sheet. You can see in the top box the de-leveraging over the period to a gearing ratio of 0.8 times. And just to remind you, we were upgraded in December by S&P on the credit rating to BBB+, so well inside investment grade. And that's really important to us and all of our stakeholders. The middle box is the pension deficit. I focus on the actuarial deficit, not the accounting one. And the deficit is a debt like item, so it's important to look at it alongside the gearing ratio, which obviously excludes deficits from calculation. And I'll come on to pensions in a moment. And the third box is working capital. Now we've overachieved working capital for the last three years, leaving us with a very negative working capital position, which is good.

But as I've said before, this leaves us with a risk of reversal, particularly on the big programmes and that could be up to £70 million. We'll obviously continue to do everything we can to mitigate that, but I'm flagging it as a risk. And just also as a point of detail, this working capital balance includes about £170 million of Type 31 contract liabilities; just so that you know it's there. There's nothing more to say about the window dressing box on the bottom here, but I keep it on the slide just as part of the turnaround story.

So now to the pension deficit, as reported last week, we've made quite a lot of progress on de-risking and reducing the pension deficit in the period. The aggregate deficit on an actuarial technical provisions basis is now down to £200 million. And over the last few months we finalised long-term funding agreements with two of the big three schemes that we have, and that covers around 70% of the total pension liabilities. As part of the agreements, we made the extra £35 million contribution that I mentioned earlier, that went into the Babcock International scheme, which is now at self-sufficiency. And that means we don't expect to have to make further company contributions. Both that scheme and the Devonport scheme are now being closed to future accrual as well. All of that means the annual deficit repair contribution will now fall to £40 million from the £65 million. And as I've said before, this is not a perpetuity. So that £40 million will probably stay at that level for about five years before reducing to a lower level.

So, onto the income statement with revenue first, the Group revenue bridge you can see has the effects of the disposals and the FX translation impacts. And of course, the organic revenue growth of 11%, which is driven by nuclear and land. As we'll come to later, nearly £200 million about organic growth is due to the ramp up of infrastructure revenue in nuclear.

This profit summary bridges all the various reported numbers splitting out Type 31 charges and the one-offs and the FX and the disposals; but the focus is really within this central box. This shows the £54 million organic profit increase with nuclear land and the aviation sectors all contributing. The right-hand bar in the box is the FY24 profit before one-offs, which was £311 million for the year at a 7% margin. And just for reference, the EPS number, that £311 million profit would deliver is 40.9P. So, I see that as the start point looking forward.

So, onto the sectors with Marine first. So, the key points here are whilst the backlog grew strongly, as you can see, revenue was flat overall in the year; despite growth in Poland, Canada and Australia and in submarine systems, ship support and liquid gas revenues were down. The liquid gas revenue reduction was despite strong order flow as a result of project startup timing. And obviously profit is dominated by the Type 31 loss of £90 million, so I've given the numbers pre and post that. Obviously, this charge is really frustrating and I'm not going to labour the point. We've spent some time last week explaining what made up the charge and the process we went through to assure ourselves it was the best estimate. There's more disclosure in the announcement this morning, and I know David's coming on to touch on the programme, so I won't labour the point here, but I'm not ignoring it.

The only two points I would make is firstly the loss you take all upfront, even though it covers the estimates out to the end of the contract, but the cash obviously goes out when the costs are incurred. So, if you exclude this, the profit for the sector decrease to £103 million or 6.9%, the revenue increases and decreases, I mentioned before, fell through to profit, although not all in proportion. And this was exacerbated by the programme timing effects in the liquid gas business and emission systems. And additionally, the marine overhead expense increased on prior year.

Nuclear, on the other hand, had an all-around good year with strong growth in backlog revenue, profit and margins. So, the 29% organic revenue growth is boosted by the infrastructure project or MIP revenues which reach £459 million. Even without the infrastructure growth, the growth in submarine support work and in civil nuclear would have driven double-digit growth for the sector in the year. It's too early to be precise about the infrastructure revenues for FY25, but I expect it'll be of a similar order of magnitude as FY24 before it then decreases in 2026 as work packages complete. So, the revenue growth obviously helped the profit increase over prior year, and you may remember that last year we suffered a programme write off of £16 million on completion of a project. We've got no more contracts like that in nuclear, so that didn't repeat. And all of these factors, as well as some productivity improvements, help drive the margin up significantly to 7.2%.

Moving to Land, the main factors driving revenue 17% higher organically were in South Africa. We had another strong period of growth in vehicle sales to the mining industry and aftermarket sales. In Australia we're ramping up the Defence High Frequency Comms project. And in the UK, there were higher volumes in vehicle engineering and training. So, all combining to grow 17%. All of the revenue growth helped the profit, and the DSG contract margin increased in the year. So, we no longer see that in that category of low to zero margin programmes. However, after two years of really good margin progression in land last year was pretty flat, if you exclude the one-off property disposal margins with 7.2%. But we do expect to see margin progression from land moving forward from this 7.2 base.

Onto Aviation, the prior year figures on this slide have been adjusted for the disposals in the prior year. After stripping that out, organic revenues go backwards by 17% as you can see. And this is primarily due to phasing on two French defence programmes, which, as expected, successfully delivered the aircraft acquisition and delivery and moved into the longer-term support phase. And as there are other programmes of this sort that we hope to win in the pipeline, revenues may well be lumpy in aviation, but the margins should be consistent. So also, a lack of significant bid costs this year coupled with some pricing improvements on the HEMS contracts has helped margins increase to 5.6% for the sector. So, moving in the right direction.

So, onto capital allocation, this is the framework we published last year, just touching on the main three priorities. Priority number one, organic investment. So, we continued to invest in the business both through CAPEX and OPEX to support delivery, improve control and enhance growth. We are spending £50 million a year on CAPEX for submarine infrastructure as well as investing in upgraded systems and many other things. Priority number two, financial strength. You've seen the progress in the year on the balance sheet, on the gearing ratio, on the pension deficit and the credit rating. So good progress on priority two. On three, the ordinary dividend, well we've reinstated the dividend this year, as you know. It's at a prudent start point given the free cash flow that we obviously need for investment for the onerous contracts and the pensions. But we intend the dividend to be progressive over time. And as you saw, we accelerated some pension deficit recovery payments. We've got three options below those top three priorities in the boxes at the bottom there. One of them is pension contributions. So, we utilised that in the year and made an extra 35 million to help us get one of those funding deals over the line. So that's capital allocation in action.

So, to finish, FY24 was a really good year despite the Type 31 charge and we can see a year of progress for FY25 too. Just to add some colour to that, we had roughly 70% of the FY25 revenues under contract on the 1st of April, which is about right at the start of a new year. And just as a point of detail, the cash flow may well be H2 weighted just given the year-end timing effects I mentioned earlier. So, with that I'll now hand back to David.

### David Lockwood Chief Executive Officer

Thank you. So, a couple of things. Firstly, this picture here, not that picture there, this picture here, which is on the front of your pack, the top picture is Devonport in the UK, which many of you visited for the Capital Markets Day, which we own. It's Europe's biggest dockyard and where we deliver maritime services, ships and submarines. And we also build jackals and all sorts of things. The picture at the bottom is actually Devonport in New Zealand, which we run and where we maintain the entire New Zealand Navy. So completely spanning the world with two Devonports, and kind of demonstrating that this is genuinely a company that is both international and with international growth aspirations. And in fact, this morning I received a letter from the new defence minister in New Zealand reminding me that I haven't been to see him yet and how important we are to them. So, they're not just pictures, they are really symbolic of who we are.

So, I just wanted to go back because we've talked a lot about turnaround, and generally turnaround means you go backwards to go forwards, otherwise you're not turning. So, I thought it was worth looking at just a three-year horizon as what we've achieved because I think what we've achieved over the last three years gives confidence for the future. So, during an operational turnaround, 30% organic growth. So near double-digit compound, not quite, but near. 61% operating profit improvement. You can read it all. David's talked about the debt. We didn't have a rights issue; we've reinstated dividend and we've reshaped the portfolio. So actually, the operational turnaround has turned into financial turnaround far faster than I think many of us, including me, expected at the time.

But there is one thing left over and I think we need to make sure that we put it in the right box, not ignore it, but get it contextualised. An old SID who used to work with David and I in Cobham once said, "You should make sure investors never look at your company through the worst programme because they'll get a distorted view and that's your job is to provide balance." So, I'm going to try and provide balance on Type 31, not ignore it, provide balance. So firstly, the programme is to design, build and deliver five frigates. It was signed in 2019, bid in 2017. So bid and booked in very benign conditions. As we've said many times, 50% of our destiny is in the contract that we sign. That contract left us with a lot of geopolitical risk that was not ours to manage. It's not the kind of risk we take on anymore. We would never take on risk that is better managed by the customer. We take on the risk that we should be able to own and manage. The next 30% is mobilisation. And to be honest, we, my previous, we got unlucky, booked in 2019, mobilised in 2020, just as we were mobilising. And this wasn't just mobilising to build a ship, if those of you who've been to our site, it's a new build hall, a new panel line, a new pipe shop, a new everything, new design house. So, the whole thing was new. This was building a whole new shipbuilding capability. And we had to do that and first-of-class COVID hit. So, everything was done in lockdown, it was done remotely. And I'm sure people did the best they could in the circumstances they were faced with. And so, as we got to build the ship and you can see on that picture, you can see ship one in the background largely

structurally compete and ship two well underway in front. As we got into ship one, it highlighted some of the issues which probably if we'd mobilised as an integrated team physically, we would've found.

So, from very simple things, I've been asked what does it mean to learn? What does deconstructing the programme and rebuilding it that we talked about, what does that mean? So, for example, we have times when we will weld a very large thing and then have to weld a small thing behind it, which turns out to be very difficult to do. If we just reverse the order, we take hours and hours out of the construction process. And probably if the design teams have been sitting together rather than remotely on each of those systems, all of that would've been worked through, or a substantial portion of it would. So, what we are seeing is when we talk about a detailed review, it's completely deconstructing how we build the ship and then reassembling it, taking all the learning from ship one. And if we look at hours and efficiency and quality on ship two, it is already significantly ahead of ship one.

And when you look at ship three, which takes the full learning and you look at the unit cost of a ship, we still end up with the highly competitive ship that we'd always hope to have. It's just because of those two things, the contract and the mobilisation, we've borne a loss of cost to get there. So, I've been asked, I was just asked by Bloomberg, "Can you say there'll be no more?" We've always said until you finish the first ship, you can't say there'll be no more. But we have dramatically reduced the range of possible outcomes with the work we've done with external support so that we know much more about the learner curve, we know much more about the things still to go and the likely issues. So, I would say we have dramatically reduced the possible range of outcomes. And that's through the progress in the design maturity, progress in the build maturity and so on. So operationally think the team has done a great job. The £90 million, why couldn't we have seen it a year ago? Because we had to have got through the build process to identify the mobilisation issues. We had to have done it to see it. But we are now substantially structurally complete on the first ship.

So that's 5% of the business. So, we now start to think about the 95% of the business. Most of this is a lift in some way from the capital market day of five and a half months ago, which I know a lot of you were at or have read or dialled into, and that's not surprising. We're a long-term business, and five and a half months is a relatively short period of time. So, you wouldn't expect much of it to change, except probably what has happened is it's enhanced. So, defence budget growth is now becoming real rather than just commitments. Asset availability discussions, I had several at RIAT and Farnborough, not just with air but with air, land and sea and space. Value add change, as people learn the lessons from what's happening in the various conflicts, mostly but not exclusively, Ukraine. So, the dynamics, since we spoke in February on capital markets day has got stronger and the nature of the conversations have got in many ways more real.

We are 60% UK, so clearly the UK general election mattered. Back at the capital markets day, the election hadn't been called, but we were speculating about what a change of government might mean, or rather, people were asking me speculative questions and asking me to speculate. I said at the time that I thought Labour's commitment to defence was real. If we look at what they've said just before the election and since the election and all of the very considerable engagements that I've had with Labour since the election, my confidence has only grown in what they mean. And I think that's both the commitment to the defence and the commitment to British-owned defence industry. So, whether it is the triple lock on the deterrent, whether it's saying that they want to have a strategic approach to procurement and understanding that defence industry is an arm of national security, all of those statements, they are very rapidly looking about how they put those into practice within the machinery of government. So, I think all of that is very positive.

We are also very heavily involved in supporting Ukraine and the commitment to boost Ukraine during the war, but also after the war in reconstruction, I think is significant. And in that context, it's very important to work with a government, particularly a government that's laid out the agenda that this government has laid out. It's very important that you are a responsible corporate citizen. So, whether or not from an investment point of view, i.e. the kind of, "Can you invest in defence?" Whether ESG matters for that, it matters to growing our business. So, our customers want to see that we're responsible members of society. And whether that is in New Zealand in how we work with Indigenous communities, whether it's in how we support net zero in the various countries we work in, that is, in terms of uncompleted repeat work, being a clear and demonstrable good corporate citizen really matters to our customers.

But it also matters, I started at the beginning saying that this is a people-driven business that needs to recruit, train, and retain the best people. We have a Shadow ExCo. So, we give a group of people selected from around the business the stuff that we look at as the top team, and they give us sort the view from the trenches, if you will, about how they see the world and see us. And more and more, ESG related issues come back as to what in a key recruitment criteria or a key decision about whether to pursue a career with us. So, delivering a meaningful strategy as a strong member of society matters. And things like being named Employer of the Year for ex-forces people, really matters because we are, I think now the biggest employer of ex-forces people.

That matters to the government because how people leave the armed forces is always a challenge. We're one of the biggest, if not the biggest employers of reservists in the UK. So that interlink with government is hugely important. You've seen this before, but how do you achieve sustainable growth, not blip growth? As a people business, knowledge and expertise of our customers, relationships with our customers, clear understanding is hugely important. If David were presenting this slide, he would add making sure that you are commercial about it, i.e., when you deliver value, don't forget to get paid. And probably in the past, one of our margin drags was we didn't get paid for everything we did. So, making sure the customer understands the value we bring is actually quite important and we shouldn't be ashamed of bringing value to our customer. We shouldn't be devaluing our work by giving it away. So, a growth enabler is all those top things and then the ability to deliver it. And we do that through strategic partnerships. And it's very important, strategic partnerships doesn't mean that I can talk to the head of the Armament Agency in Poland, for example.

It means that, of course, I need to do that and of course, I need, as I did at RIAT to see defence ministers and things like that from Poland. But it also means that Eva, who runs Poland for us, she has relationships the next level down. It means the head of our project team in Poland has relationships with the right people in the Polish defence industry. It means our engineers have the right relationship. It actually means that we've got Rosyth to twin with Gdynia in Poland, where the ships are built. We've got the colleges in Rosyth teamed with the colleges in

Gdynia. And we've got an exchange on apprentices. So, all the way from apprentices, all the way up to ministers, we are joined in Poland on the Miecznik programme. That to me is a strategic partnership, not the fact that I can pick up the phone to one person. And so, we're building that there. We're building it with SAAB. David was out for the first, that's why he was coming back from Australia for the first joint venture board meeting with HII in Australia. And again, with HII, it's not just at the top, it's all the way down. So strategic relationships are deep relationships and we're putting a lot of effort into that. And when we're talking about developing our people and capabilities, one of our core capabilities is managing governments, managing B2G programmes and managing partners. And that has to go deep. It's not just a float across the top. And all of that deep relationship means we can then take the technical capability we have in the group and deliver it in a controlled way to our customers that maximizes margin and minimizes risk. And if we do all of that, we deliver top line growth and bottom-line growth.

You saw this slide before. I'm only going to pick a couple of things out here. I'm going to start with Skynet. So, Skynet was won last year. And when we won it, as soon as they'd awarded it to us, there was quite a lot of concern in government about our ability to deliver it. They'd been working with the previous supplier for a long, long time. We transitioned in March as the government head said he had to take control of the satellites for 92 seconds because there had to be a gap between us and the previous, which was the scariest 92 seconds of his life. Other than that, we've had a completely seamless transition. The contract scope has already grown considerably as they've recognized all of the additional things that we can do. There are hundreds of KPIs a month, we've been going at it now for five months.

We've missed one, which was waived by the customer. So going back to sign the right contract, mobilise and then execute becomes an opportunity. Having looked at Type 31 being that's how not to do it, Skynet is absolutely how to do it. So, it's a good example of the new business in action. The other thing that I was just going to pick out was down on aviation because there are two quite significant opportunities. One is fighter pilot training in Belgium, and the other is air support in Oman. And the reason I'm picking them out is both of those are being led by the aviation sector in France.

So, it's really the first time we've had major international campaigns not led from the UK. So, it's another example of the group beginning to truly behave like an international group. David talked about the Nuclear business. I've got two slides, both of which we had at the capital markets day. So, these are to remind you. So, this is the UK fleet, the current in-service Vanguard, Astute and Trafalgar transitioning. A massive disposal programme. We currently house all of the retired submarines either in Rosyth or Devonport. Gives a 60-year pipeline of work, both the infrastructure to make sure the facilities are able to take, say, Dreadnought, which is significantly larger than Vanguard. And more submarines. And then through the support process, the retirement process, and then the decommissioning process. So, a really significant sole source arrangement that kind of underpins our nuclear credentials.

Then if you add that into the total position, the CASD as we've just said, AUKUS, where we've got the HII arrangement, it's up and running legally with an interesting pipeline of work to get going on in under AUKUS and getting the Australians going. And a lot going on in civil nuclear, which because naval nuclear is on a bit of a rising tide, so is civil nuclear. So, our work at Hinkley is growing. There's more decommissioning work coming out. I was talking to the national decommissioning agency. We've got international decommissioning, we've got the work with we're a build partner of Rolls Royce on SMRs. We've got the AMR relationship with X Energy that we've talked about in the past. So SMR being small, AMR being advanced modular reactors, just to be clear.

So, a huge amount going on in civil nuclear as well. And one of the areas through the Cavendish business where it is probably leading the group in growing a high skilled workforce and some of the innovative things they're doing to attract and grow talent.

So, I'll start at the bottom. It's all about delivering shareholder value. And delivering shareholder value for us is about delivering for customers in the way I've laid out. And then growing our skilled workforce so that we can address all of the opportunities in front of us. We are not short of significant opportunities in all four sectors. And in most of our countries, we need to make sure that we're in a position to embrace them in a way that deliver shareholder value. But it's quite difficult to put into words quite how exciting the next few years could be given the platform we now have.

But I think that focusing on taking the right opportunities, delivering the right growth with the right cash and the right margin will take this company to a really exciting place. And maybe the country with it. And with that, we'll do questions on anything. Except religion, of course.

## Q&A Session

**Sash Tusa, Agency Partners:**

Thank you. Could I start with type 31?

**David Lockwood:**

I thought you might.

**Sash Tusa, Agency Partners:**

Someone's got to do it. You said last week on the call, that a remaining area that is not completely blocked off is integration of the combat management system. Could you just refresh us as to the scope of the CMS? Does that include the integration of the sensors? I think most of them come from the same supplier. And if that's the case, how do you manage or how do you think you are managing the risk between yourself and the supplier and where are the interfaces that worry you?



**David Lockwood:**

Okay, so the combat system is a complete combat system from Thales. So, they have already done the factor acceptance test for the combat system. So that's with representative cabling, representative of everything. So, we don't have that sensor into that sensor integration piece is addressed in the factory acceptance test. So, the integration we have is effectively the physical integration of the combat system into the ship. So that is more around things like are the brackets in exactly the right place? Does it weigh what it should weigh? Those kind of more mechanical things. It's not a systems integration, it's a physical integration.

**Sash Tusa, Agency Partners:**

And so, what's the timescale for that process on the first ship? Is it all in FY25 split between 2025 and 2026 or is it a-

**David Lockwood:**

So, we will break the back of it in 2025.

**Sash Tusa, Agency Partners:**

Okay, thank you. And then you made another comment on the call last week about Type 31 where you talked about the potential for the contract to be extended. Does that mean in terms of scope i.e. More stuff that you put on the ships, or does it mean in terms of potentially additional ships?

**David Lockwood:**

So, they have already announced the so-called capability insertion programme being sole sourced with us. And historically they've referred to Type 31, batch two or Type 32. So, we're just saying we're not taking any account of that. We're seeing it as a discreet five-ship programme.

**Joe Brent, Liberum:**

Good morning, Joe Brent from Libra. A couple of questions if I may. Just starting off, when you talk about low and no margin work, could you tell us the rough fade over the next three years of those sales?

**David Mellors:**

So basically, the only thing left in that category now of any size is Type 31. So DSG was the only other largest contract in that category and the rest really are much, much smaller. So DSG as you know, not only has increased a bit, it's in its last year of the contract before we renew. So that disappears, and Type 31 was about 200 million in the year. So that's the order of magnitude.

**Joe Brent, Liberum:**

Thank you. And on type 31, you've given us the P&L provision. In terms of cash flows, should we straight line that, or is it different profile?

**David Mellors:**

Yeah, well it's not exactly linear, but it is over the course of the remainder of the contract. So, it will be over the five-ish years.

**Joe Brent, Liberum:**

Thank you. And then finally for me, could you give us an indication of the Ukraine effect?

**David Lockwood:**

Numbers-wise, do you want to do Ukraine?

**David Mellors:**

Relatively small in terms of the group, obviously in percentage terms, so a few tens, but good work with plenty of opportunity.

**James Beard, Deutsche Bank:**

Morning. James Bit at Deutsche Bank. A couple of questions, please. On AUKUS, there's been some recent press around some misgivings about progress by various partners over the last couple of years and also some rumours around political uncertainty in the US. What's your latest view, how has that changed over say the last six months? And also interested to hear, David, your progress after your first board meeting over in Australia with the joint venture partners.

**David Lockwood:**

The front end of AUKUS is the Australians using Virginias. And therefore, Australia is all about two things. One is getting Australians working on board Virginia's Australian naval personnel, which is their task and they're addressing that. And the second is being able to dock and support Virginias in Australia, which is an infrastructure issue and train the appropriate people, which is a people issue. So, David will talk about the joint venture in a minute, but that's very much for us, as we're not a build partner of the UK boat. For us AUKUS, the next few years, many years is going to be about our role with Virginia.

**David Mellors:**

And the trip over there was very good, actually. So, both Hill and us are committing some senior level time and resource to this. We've both dedicated some senior resources within the joint venture. We've got a list of opportunities that we're looking at, skills, as David's mentioned. Obviously, the partnering with the ASC over there. So, there's quite a lot of opportunity to go for in what might end up being quite a short space of time that the ASC needs to deliver this.

**David Lockwood:**

ASC, for those who don't know, is the Australian Submarine Corporation, which is the state-owned supporter currently of the Collins class, who have got to adapt to nuclear submarines very quickly.

**David Mellors:**

Thanks.

**David Lockwood:**

Over here.

**George McWhirter, Berenberg:**

Hi, good morning, it's George McWhirter from Berenberg. Just a question on the pension, when do you think you might be able to do a funding agreement on the third pension? And the second one is on the UK election. Are you seeing any disruption linked to that in terms of timing of contract wins? Thank you.

**David Mellors:**

So, on pensions, the valuation for the third of the three big schemes is coming up, so that's an ideal time. I'm not going to make any promises, there may or may not be a deal to be done, but that's the ideal opportunity to look at everything in the round, including the long-term funding of the scheme. So, in the next couple of years.

**David Lockwood:**

And in terms of timing, because we are largely a support business, you have to keep supporting what you've got. So, I think it's going to be more likely major equipment acquisitions, which may get slowed if anything does, and maybe nothing does. So, I don't see a major challenge for us.

**Chloe Lemarie, Jefferies:**

Good morning. Chloe Lemarie from Jefferies, have my first question on Type 31. Could you just help me understand the cash phasing on the programme? Because conceptually you've had a pretty significant year of let's say inefficient work. Going forward you have more work but more efficient potentially. So how should we think about the year-on-year cash impact going forward for the next couple of years?

**David Mellors:**

Yeah, okay. So, as I said before, it won't be exactly linear over the course of the contract. So, it might be slightly more front end loaded, but it is, the cash impact is spread over the course of the contract. So, it's not as if the whole charge gets spent in a year.

**Chloe Lemarie, Jefferies:**

Right. Obviously, I was thinking this year you've had pretty strong free cashflow, but conceptually you would've thought that this was also potentially the year where you had the highest cashback. Is that correct or?

**David Mellors:**

Yes. Yes. So along with many others, there was a negative working capital position anyway, which is good. Obviously, you only get the cash once, but I'd far rather have it upfront. So that's true. But in terms of the losses that we've mentioned, I mean that's the only change here. The phasing is, as I say, not quite linear, but it is spread over the course of the contract.

**Chloe Lemarie, Jefferies:**

Okay. And 2024, obviously you overdelivered on your midterm trajectory to the midterm targets. So how should we think of 2025 in terms of the momentum in both the growth and the margin trajectory?

**David Mellors:**

Okay. So, we don't give point forecasts for individual years. They're medium-term targets for a reason, and we explained that last year. If you end up time boxing, then you can drive the wrong behaviours. So, we'd rather have good long-term business that's heading in the right direction than hanging the company on one-year targets.

However, there should be progress on the margin. There should well be, as David says, there's always a bit of a trade-off, but there should be. On revenue, well, we've already had two great years of revenue growth. I think the big thing to remember in revenue is the infrastructure revenues, the mid revenues, which as I said will probably be flat-ish this year. It's difficult to be precise at this stage, plus or minus £50 million, but it clearly won't grow another £200 million as it did last year. So that's just something to think about on the revenue line. Everything else should be pretty much consistent with what we've seen.

And cash. You know we can do more than 80% in the medium term because we've already done it. But in terms of the one year, and again, I'm not going to give a forecast, but just remember the timing impacts of the year-end, that's all. But it's not as though we're saying we'll have jam tomorrow. We've already got the jam. We had a good year in FY24.

**Chloe Lemarie, Jefferies:**

Thank you.

**Carlos Iranzo Peris, Bank of America:**

Good morning. Good morning, Carlos Iranzo here. One question in terms of capital allocation. Your net debt to EBIDA is already at 0.8 below your midterm target. So how should we think about your capital allocation priorities midterm, especially when it comes to shareholder returns?

**David Lockwood:**

So, I'll go first. So, it's been a slog to get to this point and we're not going to lose it easily. So, there are two things. Three things. Firstly, there are some bolt-on M&A things which would be interesting. So that's a choice. Secondly, as David said, there could be an option to close out the third pension scheme. That's a choice.

I personally keep an eye on the negative working capital because there are kind of standard ratios. We're actually doing better on negative working capital than you would normally expect. So, we need to allow enough for some of that. Not all of it to unwind. It should always be negative, but it is unusually negative at the moment, so we need to just keep an eye on that. So, I think before we get to one-off shareholder returns, I think there are significant value creating things we can do with the money.

**David Mellors:**

**Tom Horsey, Wellington:**

Thanks. Just on that negative working capital, David, you mentioned that there could be a maximum of £70 million of drawdown of that. Can you just elaborate of why that's the number? And then secondly, just conceptually in a couple of years' time when the infrastructure spends ramps down at Devonport, you'll have this shiny new infrastructure. Can you talk a bit about how the potential for that to drive revenue growth and better in-service capability for the customer?

**David Lockwood:**

So I'll do mine first. It's a really good, so if you look at why we're doing infrastructure actually in the Clyde as well as Davenport is because we will have a four-class submarine fleet for an extended period with very different requirements for the different classes. At the moment that we're just about doing everything we need to do, but we could do it more efficiently and do more. So, I think as the submarine fleet evolves and as we start to take the first Dreadnought in, probably just as the MIP comes to an end that we're going to start to see a shift from MIP work to submarine work.

So, the MIP work is being done for a reason, which is there's a lot more submarine work to come in it and people can see it, and therefore we need to be ready for it. So, there'll be a kind of transition from MIP revenues to submarine revenues, and I doubt there'll be a gap. I suspect it'll be a pretty smooth transition.

**Tom Horsey, Wellington:**

And the margin implication of that is probably positive?

**David Lockwood:**

Probably.

**David Mellors:**

Yeah, I mean obviously it depends on the terms you sign a contract on because it depends what risk you're taking. But as far as single source margins go, then we are, and we've said before, the infrastructure revenues are at the lower end of that.

Shall I do my bit?

**David Lockwood:**

Yeah, do your bit.

**David Mellors:**

Okay. So, on the working capital, and let's separate out working capital from onerous programmes. So, I flagged in previous years there's about £70 million, and the only reason is because of the larger programmes that I've seen where we've got mobilization payments or cash milestones ahead of spend. It just adds up to about that number.

Now, there's plenty of other programmes with negative working capital, which is all great, but just for the purposes of this, I've assumed that those can recur. The larger programmes obviously are lumpy. They come along and then they unwind and then you get another one and you might get to it once, you might not. So, it's just an estimate of the larger programmes that are cash positive. That's all, if that helps.

**David Perry, JPM:**

Thanks. It's David Perry at JPMorgan. Just two small clarifications. You use a phrase in the release on Poland of delivering a license. What does that mean? I thought you sell a license, so I just want to understand what work you actually do there.

**David Lockwood:**

Yeah. So, what we meant by delivering a license is we've sold them, yeah, irrevocably sold the three licenses, but then we have what's called a PMO contract, which is actually misnamed. It's really an engineering programme support programme when we have up to 70 people supporting the delivery of the programme. So that's what we meant by delivering the licenses. It's that ongoing work which were paid for separately from the license.



**David Perry, JPM:**

Okay, because it just feels like you got quite a bit of profit of Poland in FY24. Is there a bit of a drop there now in FY25, or can you offset that with something else?

**David Mellors:**

So, the licenses are lumpy for sure. There's no question. But as I mentioned before, what went against that in Marine in the period was, well, phasing on both LGE and liquid gas and on mission systems. So hopefully they won't go against us in future and the extra overhead increase in the sector.

**David Perry, JPM:**

Okay. And then just one very simple one for you, David. You've given these guidance points on free cash flows on slide six. So, when you guide to the interest of £35 million for cash, is it the same for the P&L as well?

**David Mellors:**

Pretty much, yeah. I mean we're not really expecting much difference between the two. Usually, the pension accounting throws up a big difference. We're not expecting that much.

**David Perry, JPM:**

Cool. That was all. Thank you.

**Sash Tusa, Agency Partners:**

I just wondered if I could ask another question actually about infrastructure, but this time surface ship. You've got a frigate support complex at Devonport. That's where the whole Navy's surface ships are going to outgrow it over a period of about a decade or so. So, it's not going to be a great deal of use compared to what it's done in the last 30 odd years.

**David Lockwood:**

Correct.

**Sash Tusa, Agency Partners:**

At the capital markets day, the line was the Royal Navy is going to do everything alongside, and so it doesn't need another support complex. But you made it very clear on the call last week that one of the advantages of keeping Type 31s in the hall or a site is the greatly improved access to the ships, which tends to suggest that the Navy's just trying to cut costs because it's an inconvenient truth. When do you start negotiating with them for new figures for frigate support or surface ship support complex?

**David Lockwood:**

So, two things. When you're building, if you've got it in sections, then you can get into all of the sections. If you go afloat, you've put it all together, so you've immediately got less. Once you've put it all together, we never, even in dry dock, we don't cut ships in half.

**Sash Tusa, Agency Partners:**

But you cut massive holes in, which you couldn't-

**David Lockwood:**

We do cut holes. Type 31 is designed to be supported completely differently to Type 23. So, Type 23 has got very poor access into things like the engine room and so on at the risk of getting a bit technical here. The whole point of Type 31 is you've got much better access. Type 31 is designed for support in a way Type 23 just wasn't.

Do I think they'll need to dry dock ships eventually? Probably, yes. It's quite a long way out. If you think about the first deep maintenance for a Type 26 or a Type 31, we're talking about probably the backend of the next decade. So, there's plenty of time for the Navy to sort out that strategy.

**Sash Tusa, Agency Partners:**

Thanks.

**David Lockwood:**

Nothing? Excellent. Well, thank you all for your time and your questions. So, what do I hope you've taken away? I hope you've taken away a clear understanding of 5% of our revenues, which is Type 31 and what we're doing about it, but actually more importantly, the 95%, which has a completely different narrative about growth, margin expansion and cash. So, if you can write that up, that would be very nice. Thank you very much.

ENDS