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Transcript of the full year results for the year ending 31 March 2023

Thursday 20 July 2023

David Lockwood

Chief Executive Officer

Good morning, everyone. I'd like to welcome the people on the webcast and the conference line. Just so you know there are no planned fire alarms. So -- but there are people who will get you out of the building in the event of said fire. When we get to Q&A, the plan is to take questions in the room first, then I'll hand over to the operator, who would do calls online, and then I'll hand to Andrew who will do calls on the webcast. So just to you know that's the process to manage the technology. And then they will hand back to me for closing remarks unless Andrew decides he wants to do them himself.

So key messages. This has actually been the first fun year in Babcock. I think that's partly because it's been a year without having to work with COVID restrictions, but also because you can really feel the progress start to take hold at an operational level which is starting to turn into the financial results, leaving us better positioned. We have much stronger relationships with our clients around the world. Which, in turn, builds confidence for the future. And that's going to be the message you're going to get throughout this.

I do want to focus on the things at the bottom though. Cash and how we maintain positive cash is really important to us. So we talked before about setting targets and what's the right margin target, the balance between capital employed, risk and cash. So driving cash, number one priority, that will inevitably through good operational performance, lead to margin improvement. Growth is coming just because of that, because as we execute more, customers come to us for that incremental work, which maybe they were holding back when they worried about our execution. So we don't have to do anything exotic to get the growth. We just need to continue to drive performance. All of that has enabled us to issue guidance for the first time. And also for the Board to reconfirm the intention to institute a dividend for 2024. You can see that progression through as the operational performance begins to really bite.

So we had lots of debate about where to put Type 31 Slide in this presentation, and it kind of clings wherever you put it, but we need to sort Type 31 out so we can then talk about the rest of the progress going forward. So Type 31 is five ships up to what's called VAD, Vessel Acceptance Date and not In-Service Date. That's what we're currently contracted for. Operationally, going well. We're about 40% through HMS Venturer, started HMS Active. But as you know, we've declared a loss of ££100 million over the remaining life. So ££100 million provision now. for the cash to go out between now and the end of '28. And David will touch on that as we go through the numbers. But it is one of the reasons why we're committing to a cash conversion of greater than 80% because we do have to fund this, this onerous contract.

So I guess there are three questions I get asked about Type 31, and I thought it was best to just address them upfront. So the first is how has it affected your customer relationship? If anything, it's strengthened it because we've now got a mature relationship where I can sit with a head of commercial in the MOD, and we can agree that we don't agree and that the contract provides the provisions to deal with that, and that's what we're doing. And we can put that in a box and then we can continue to win things like the Skynet program. We announced the next part of the submarine work. We've announced being supporting the UK gifted kit in Ukraine and so on. So the rest of the business is isolated from this thing, which is being professionally and properly handled.

The next thing is about what does it tell you about the control environment. So as you will see through this presentation, since I arrived, we've been strengthening the control framework. And David and I have got a long experience in the value of doing that. So the commercial control environment is now much stronger. This is the last of the programmes that were contracted prior to our arrival, but the control framework is much stronger.

And then finally, how confident are you about the ££100 million. So where are you operational? As I've said, we're 40% of the way through the first ship. We have had both the engineering and operational and programmatic performance and plans externally reviewed. So this is a stronger baseline as you can get at this stage in the programme The other thing I should say actually is notwithstanding that negative and it is clearly a negative. The export programmes continue, Indonesia and Poland continue to run well, continue to generate profits, and it continued to show that the ship itself is highly competitive on the international market and provides a platform for strong profitable growth.

And there are options in the UK as well. So did we want to invest this additional amount in this programme, of course, we didn't. But it doesn't mean that being in this part of the industry is a bad thing. There is still plenty of opportunity to come from this investment. So we put this slide up a while back, stabilise is complete. Portfolio alignment is complete. We're not a forced seller of anything. And so we have kept the businesses that it's right to keep at this time, and we've sold what we wanted to sell. So this is the portfolio we believe we should be running at this time.

Execution is the next key phase and the best parts of early growth will come from that high-quality execution. And we're seeing that on a range of our framework programmes where as our execution improves, so the incremental orders just naturally flow. And that is the best low-risk growth. And then there are other growth opportunities outside, both in terms of increasing our support footprints. For example, we've broken into the Land domain in France for the first time this year. We've broken into a broader range of HF Comms opportunities. So there are plenty of opportunities that are close to home that are things that we're good at and getting better at.

So today, where does that leave us? Much strengthened balance sheet at 1.5x would be 1.1x when the Type 31 losses out of the system, 68% defence on a pro forma basis and very much aligned with our customer needs. So we're about getting the best out of what you've got, being affordable, available and capable. And what the Command Paper the UK has just released as demonstrated as the ability to maximise your existing capability will be a dominant feature for the next few years, and that is Babcock's sweet spot. So as I said, this has led us to be able to come up with medium-term guidance for the first time of margins greater than 8%, cash conversion greater than 80%, that's after funding loss provisions, organic growth mid-single digit, but with strong visibility. So that growth is underpinned by backlog and orders that naturally flow from framework contracts.

So with that, David is now going to excite you with all the financial detail that underpins what I just said.

David Mellors

Chief Financial Officer

Good morning, everyone. I'm really pleased with these results and the progress behind them. So I'll just highlight the four key things before we go into any detail. Firstly, the overall performance was in line with expectations or in the case of cash and debt, significantly ahead of expectations. Second, the balance sheet is much stronger than it's been previously. Thirdly, the FY24 expectations are unchanged. And fourthly, as David has already touched on, we're now confident enough to provide medium-term financial guidance.

So the key financial headlines for the year are set out here. So organic revenue growth was 10%, with growth in all sectors, excluding the Type 31 loss. The reported underlying operating profit was up to £278 million with margin progression of 50 basis points. EPS was in line with expectations at 33.8p. Cash flow was better than expected, as I've said before, and that allowed us to accelerate some pension deficit payments. The resulting free cash flow was £75 million. The resulting net debt was down £200 million to £346 million on a pre-IFRS 16 basis which is the start point for the covenant ratios.

And on covenants, the gearing ratio is 1.5x, as David said, which is comfortably inside the range we'd set for the group of 1x to 2x. And the last bullet on this slide is a technicality to note, the £100 million Type 31 loss gets booked in three places. So a £43 million revenue reversal, a small asset impairment and a contract provision.

So to group revenue, there are two main points on the revenue bridge before we go into the sectors. Firstly, the organic revenue growth of 10% that you can see in the middle of the chart there. And secondly, the FY23 baseline revenue on the right-hand side in yellow, this is the revenue of the retained group for the FY23 year for you to use with forward projections.

On to underlying operating profit, and the bridge here has three main variances to touch on. So firstly, the £36 million profit improvement which was driven by Marine, Land and Aviation. I've called out separately the £12 million one-off non-cash credit there, which was in LandLand and thirdly, of course, the £100 million Type 31 loss.

And again, on the right-hand side, we've given the FY23 profit and margin of the retained group in yellow there. That also excludes the £12 million one-off. So that's the way we see the retained group exiting FY23 .

So on to the sectors with Marine first, there's a lot of detail on all these slides, so I'll just pull out the key points. I've also included the profit and margin before and after Type 31 loss here. So the key points are, firstly, the organic revenue growth of 8%, which is very strong, driven by growth in ship support, Liquid Gas Engineering systems businesses. To note here, there is £260 million of low or zero margin revenue going through Marine currently, and obviously, Type 31 is the biggest component of that. And on profit, the factors I've listed out on the right-hand side here have enabled margins to hold up at 7.8% despite the fact that last year's 7.8% had some higher margin license fees in.

On to Nuclear, the main points are the revenue growth organic was 17%, and that was driven by the infrastructure projects in Devonport, as you can see, we put the numbers on here. We're expecting FY24 infrastructure revenue at, at least, this level, if not higher, depending upon project phasing. Despite the higher revenues in Nuclear, the profits were flat and the margins were down due mainly to future inflation assumptions on programmes and the final project write-off on a program, which is very near completion. Also as a reminder, the infrastructure revenues, I keep mentioning are at lower margin than the rest of the work. But as we look forward, we expect these drags on the Nuclear margins to reduce and eventually disappear. There's no reason why this sector shouldn't achieve broadly the same margins as the others when it's executing well.

Moving to Land. The key factors driving both revenues and higher margins are as follows. In Australia, we've now commenced the defence high frequency communication contract we announced earlier in the year. In South Africa, the increase in vehicle sales to the mining industry more than offset the loss of the Eskom contract in the previous year. And in the UK, the sector delivered better margins and growth in fleet management and training. And the resulting sector margin is boosted by this £12 million one-off, but excluding that, there was still very good progress on the margin to 7.4% in the year.

On to Aviation, the divestment of the European AES business completed at the end of February. So the reported numbers have 11 months of trading within them. So I've put the retained businesses in this middle box here. The retained businesses delivered revenue growth and profit growth in the period. The margins were flat, notwithstanding the fact we had some extensive bid costs on the FAcT programme that we've talked about before. That was submitted during the year, but those costs obviously weighed on the margin during the period.

So on to cash flow, with operating cash first. Cash conversion of 110%, as I've said before, was better than we expected. This was caused by two factors: working capital and capex. So taking each in turn. The working capital inflow of £104 million, as you can see on this slide, was largely driven by earlier customer receipts than we previously expected in the final part of the year. This inflow also absorbs and offsets, more than offsets, the final unwind of the historic balance sheet stretches that we fully paid off during the year. I'll come back to that.

So the second thing that I said drove cash conversion was slightly lower capex. The next four bars on here are the capex and depreciation, you can see they pretty much net off in the year. We expected it to be a bit higher, but that's just capex timing. And the last movement on the chart, this £44 million labelled other. That's the add back of the Type 31 onerous provision primarily. So that all that gets us to an operating cash flow of £307 million. One point to note that we've mentioned in both the release and is on the slide. In the period, we did finance one of our French aircraft contracts during the year. That was done by nonrecourse factoring. That didn't impact operating cash flow, that matched receipts and payments for the aircraft in the period, but there was a £12 million financing charge on that. That's fully settled in the period.

So moving on to the bottom half of the cash flow statement and looking at the two big movements. Firstly, pensions. The strong cash performance I mentioned earlier allowed us to accelerate, £35 million of future years deficit payments into FY23 . So that reduces the burden on the next three years, free cash flow. So the total deficit payments for the year were at £142 million. The expected payments for FY24 are substantially lower at £65 million. And secondly, interest paid was up largely because of the £12 million programme finance charge I mentioned earlier. You may remember that we're 85% fixed on our debt. So we don't have much exposure to variable interest rates, but we did have some. So the fact that the money on the disposals came in very late in the year and we have that small amount of variable interest exposure did tick up the interest paid slightly as well.

And then the next three boxes, the tax, joint venture dividends and exceptional items, they're exactly as we'd guided. So no surprise there. So the resulting free cash flow was £75 million, and I've put some guidance for FY24 on the slide there. So I put this slide up, I put all the previous results presentations to show the progress on repairing the balance sheet and what's going on behind the numbers. So as the top box shows the net debt is now down over £1 billion in this two and a half-year period, we've mentioned the gearing ratio at 1.5x. And pleasingly, we were upgraded by S&P in December to BBB (Stable). So that's good to recognise. The middle box are these historic cash flow period end stretches which, as you can see, started off at £466 million. They're all gone now. So that will no longer be a drag on operating cash flow.

And we've got the pension deficit in the third box here. So if you add these three items, these debt and debt-like items, as I do, you can see that we've substantially improved from £2.8 billion two and a half years ago to less than £1 billion. So in summary, we're in a much better place from a balance sheet resilience point of view than we were.

So to finish with the outlook and guidance, taking these three sections in order just we're back on the baseline, the FY23 baseline just to confirm then, £4 billion of revenue, £265 million of profit. That's the retained Group exiting the year. Secondly, for FY24, we're maintaining expectations for performance for the year. The overperformance on cash in FY23 may mean that FY24 is back-end loaded, but we're still going to go for the same number. And as you know, we have confirmed that we'll be reinstating the dividend in FY24. And then thirdly, the medium-term guidance that David mentioned earlier. So we feel confident enough to put out guidance for cash conversion, margins and revenue growth as set out here for the next three to five years.

So with that, I'll now hand back to David.

David Lockwood

Chief Executive Officer

I told you it's going to be exciting. So how do we get from one to the other is what David's just summarised? What is strong about Babcock, we have great visibility on that revenue growth. So both in the order book, in the frameworks and line of sight of the bids we're bidding, we have clear visibility of that growth. The other thing that's quite interesting is: as we've instigated stronger commercial controls and therefore, have bid in a more robust fashion, it hasn't really affected our win rate. One of the things we were tracking as we got more professional on that bidding was, does that mean by not making concessions to customers, we're going to start losing things, and that hasn't happened so far. So - we believe that there's no drag on growth by being more professional in the nature of the contracts you book.

And as we've said, 50% of your destiny is in the shape of the contracts you book, 30% is how you mobilise, 20% is how you execute. And I will come to that on another slide. So that growth is quality growth. I've got a slide on the legacy fade in a minute. But if you look at the mix over time, the margin improvement is in our hands. It's not a market-driven thing. It's the quality of our execution of the legacy and the new orders that will drive that margin growth. And cash conversion, as David said, is all about structuring the contracts with cash in mind, not just end margin in mind.

This is the fade of the very low and zero-based and zero margin programmes. So you can see the impact on margin that having 10% of your revenue at zero essentially means that 90% of your revenue is generating all your margins. So as that fades, there's a natural margin improvement anyway. And I've touched on this a bit, the bidding mobilisation delivery, 50-30-20. It's a mantra we've used for the last three years. But really, it's the functional processes that go through that, that drive all of that. So the project management framework now goes right back to the bid, – 'how are we going to deliver this?' is understood right at the beginning. It sounds obvious, but it wasn't always the case.

Having a global business management system, so the whole business operates in the same way. So when you conduct a peer review, someone coming from another business recognises what they're looking at means the quality of peer reviews goes up. Having a centrally-led commercial function, which reports to David, means that we understand the commercial risk we're taking when we take it, in a consistent fashion. So we're paid to take risk. We're not a risk-free business. We're not -- so we make our money by taking risk and managing it well. But that means you need to understand what you're taking on from the get-go, so you mobilise to manage the risk you've decided that you're competent to manage.

So having a centrally-led commercial function really, really matters, as does improve financial operating controls for the same reason. So if we look at how we have bid LIFEX programmes on submarines around the world, we've done it differently. We definitely have bid the aircrew training programme in Canada, which is a huge programme quite differently from how it was being bid when we arrived fundamentally. If we look at how we resourced Australian high frequency comms, for example, it was initially going to be a larger UK exported capability. Now, it's an indigenously delivered Australian capability working with the UK because that was the best way to mobilise it. And if you look at the improvement on the DSG contract, that has spun out a whole host of opportunities in the Land domain in the UK and outside. So if you get that right, it just naturally drives growth and margin.

And I will touch on the market, but really, the market is not our issue. The issue for us is, the faster we fix the stuff on the previous slide, the more cash and margin we will generate. In the macro world, geopolitical uncertainty, defence spending, quite a of it promised but not yet delivered, if I'm honest, in some countries and defence requirements, I will come on to people. So there's a lot of change going on and part of the art of running Babcock is we're big enough to be a key partner for governments, but we're small enough to be more nimble than some of the global giants. And that's something our customers really value.

So getting that internal infrastructure right, so we do high-quality work without becoming a global giant, but still being nimble is really important because what customers need is the best from what they've got. So they need value for money because they've got notwithstanding the growth of defence budgets, they've got more demand than they've got cash. They need high utilisation of today's assets, they need to modernise today's assets. We've seen in Ukraine, what happens when legacy assets are put into the battlefield they don't last. And they need flexibility, they need to start on one thing and finish on something else.

So we're doing that on the frontline through equipment support. We do lots and lots of technical training. It's a very strong part of our business, probably an unsung part of our business. And that's all about 80%. And then we do design, develop, manufacture and integrate technology. And that delivers the availability, affordability and capability that we've talked about for a number of years. And just some examples on equipment support, we've won the Skynet program, which is the delivery wrap which takes us into the space domain and creates a whole host of opportunities outside of that initial contract.

RMP West is support for the Australian Navy. And now we're linking the way we do support to the Queen Elizabeth Class in the UK So bringing this together, in technical training, when we bid the FAcT bid, we had people from the UK pilot training and people from the French pilot training, working with our Canadian team on the FAcT bid bringing the whole group together from both the technical, operational and commercial sense to say this is how you deliver integrated pilot training. That's not something we were capable of doing three years ago.

I do want to touch on this. So Babcock is a people business. We have 26,000 people. In many cases, the improvements in outputs we have seen have been delivered fundamentally by the same operating teams just being led differently and working to different process, but the same people. So we've never had bad people. We've always had good people, but we haven't always got the best out of them. So our job is to get the best out of the best people. And that starts with attracting the best people, then training and retaining the best people. And our people and our customers, particularly our people, really care about how we impact the communities we work in.

So firstly, we have to open our minds to employing the broadest range of people, whether that's gender-based, whether it's age-based, whether it's ability-based, whether it's education-based. So we have schemes where we have people who wouldn't normally meet our apprenticeship standards, but we do pre-apprenticeship training so that we can then get them into the scheme. We have much more flexible return to work if people have been off for maternity or paternity. We have much more flexible late career development, so people don't have to make the choice of work or retire, they can go to much more flexible arrangements.

We've introduced a volunteering framework so you can have a day of the year paid to work on some form of volunteering. We have a Shadow ExCo to my team so that we actually get to have the organisation's view of the things we're considering. So we've got a whole bunch of things that are going on which drive our employee proposition, which really matters. So the organic increase in headcount over the last year is about 900 people, which is really good going in a tight labour market. Tight labour market around the world, and we have to keep that up by, as I say, attracting, training and retaining from the broadest possible church. So this isn't kind of a bolt-on to our business. This is kind of who we are and really matters to our employees, our customers and the communities we work in.

So the great thing about making money is that you can have a capital allocation framework. It's not much point having one if you're not making any money. So our number one priority is organic investment. We have a whole bunch of things we can do to make this business better, to improve the margin through better systems, to grow through investment in new capabilities and we have now elevated that from a kind of sector level allocation choice to a Group level where do we replace our bets. We obviously need to maintain a strong balance sheet. It has been a slog to deal with the on and off balance sheet financing, and we're never going to give that up lightly. And we need to pay an ordinary dividend because it's the sign of a healthy company and it's a rightful expectation.

Outside that, there are bolt-on opportunities. They will be very close to home. They will either be to help with new geographies where we've already got a presence, or they will be technology based We're not going to try and throw sixes. They are -- these are going to be to underpin the core organic plan, if we do them at all. David has said in a number of these presentations, you sometimes get windows of opportunity on pensions where you can do deals, where you get good value for money. So we're always looking at that as the best way to manage the pension deficit most cost effectively. And if we see acceleration opportunities that make sense, we will do them if the funding makes sense. And then obviously, ultimately, if there are surpluses after all of that, then there'll be further shareholder returns.

So my summary is really the first slide, which is: excellent progress in operational terms, which has turned into excellent progress financially, much better positioned in the marketplace which does give us real confidence. And with that, on to questions.

QUESTIONS AND ANSWERS

David Lockwood - CEO

So we're going to do questions from the room first as a reward for turning up. But I don't know who's in charge of the mic, so I don't know who's going to -- Debbie is going to decide who gets the first question well done, Debbie.

Chloe Lemarie *Jefferies LLC, Research Division - Equity Analyst*

Ooh lucky me. Chloe Lemarie from Jefferies. I have a couple, please. First one is on AUKUS actually. If you could help us frame a little bit what you consider as the potential addressable work that you could win on what could be...

David Lockwood - CEO

On AUKUS?

Chloe Lemarie *Jefferies LLC, Research Division - Equity Analyst*

Yes.

David Lockwood - CEO

So I think on Pillar one which is the submarine partnership, which is obviously closest to home. In the near term, the big need from an Australian perspective is the infrastructure to support the Virginias that we'll be rotating from America. So I think that's the big near-term stuff, and that's the discussions that we would have, obviously, the build programme for the UK probably some way out.

Chloe Lemarie *Jefferies LLC, Research Division - Equity Analyst*

Okay. The second one is probably for David, the other one. On free cash flow, if you could come back on the big driver for the performance in fiscal '23, notably thinking on the balance sheet window dressing unwinding and whether there were some working capital cut-off effects. And then when we think of FY24, how will these evolve?

David Mellors - CFO

Yes. Okay. So primarily the big thing was earlier receipts than we expected about £70 million in round numbers. You only get the cash once. So if you to look at that on its own, you'd say, well, then FY24 should be lower by that much, then shouldn't it. But we think we can still perform FY24 as originally expected. Therefore, we'll overachieve if you like. So that was the big one. And when I said it will be back-end loaded, obviously, most of those early receipts came out of the first half. But we think by the time we get to the full year, we can still generate the cash we originally expected out of FY24. Is that what you wanted.

Chloe Lemarie *Jefferies LLC, Research Division - Equity Analyst*

Yes. Just a follow-up on this. On the Type 31 loss impact on free cash flow, how should we think about the phasing?

David Mellors - CFO

So we haven't been precise about that, except because we don't really want to give in-year numbers. But if that £100 million is over the life of the programme and the life goes out to 2028. So I think up until that.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

I'm David Perry at JPMorgan. So I've got three. Maybe first one might be for Mr. Lockwood. You had the press release last week on Vanguard and you alluded to some positive discussions with the MOD on a new contract to replace FMSP, I think. Could you just elaborate a little bit on what the new terms will be and when that's expected to be finalised?

David Lockwood - CEO

Thanks, David. Can I elaborate on the terms, probably not much beyond what's in the release in terms of that's the direction of travel. I think no one wants the kind of discontinuity that we had between MSDF and FMSP when we were going on to one year, as you know, we went into a one-year programme to bridge the gap prior to my time, when you've got a long-term support for a fleet. So the aim is to make sure that doesn't happen again. So to finish the discussions well inside the FMSP framework.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

I think the sentence was contract terms similar to your peers, which I presume is say, BAE. I think its peers in a nuclear enterprise. Do I surmise from that its cost plus that you're aiming to achieve?

David Lockwood - CEO

Well, similar.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

Okay. And so when would it -- could it be in place?

David Lockwood - CEO

So I think we started with the next boat saying this was the initial order on the terms. When do I think it. Well, before the end of FMSP, I think after that, it's quite difficult to be precise because obviously, it's a very big order, and there's quite a lot going on.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

Okay. Can I ask a couple to Mr. Mellors then, please. So first, on the EBITDA margin guide, thanks for the medium-term guidance. So I think it's at least 8% in three to five years. So can you just give us some sensitivities to what determines whether that might be three or five years? And what does at least 8% mean? I mean, how much can I dream? What's a realistic ceiling. And then just -- can I just check with you on the free cash flow guide for this year? You've given us a lot of the moving parts, so 80% cash conversion. You've given us tax pension interest, just to make sure I'm not missing anything. I think that gets you very close to triple-digit free cash flow in FY24 unless I'm missing something.

David Mellors - CFO

Okay. So margin first, we've said three to five years. I'm not going to pin it down to any one. There'll be margin progression from now on. It won't necessarily be linear, and we will get in that period to above 8% as we have said. You can get into all sorts of detail on timing and amounts and how much is infrastructure revenue because that might go up quite a lot before it comes down and that's a lower margin. So there's quite a lot of effects that could just confuse if we went into that. So that's why we've tried to stay quite high level. There will be progression each year, and we'll get above 8%, and that will be -- that would be a start point. On free cash flow, not that we give specific in-year guidance, but I can completely understand why you've taken the moving parts that you have and it sounds like your math is broadly accurate as well.

David Lockwood - CEO

Can I just say, David, the other -- there is a link between growth and margin progression because if you win just in round numbers, a large programme that you bid at 10%, you're likely to trade the front end of it, lets say, 5% or less depending on your -- the risk profile and with the expectation that back trades at 15% because that's just how the accounting rules work. So bizarrely, if we're successful, say, in the export markets to the upper end of our expectations, that will actually hold back margin progression just because of accounting of the orders in the early stages. So that's the other reason we're not being precise because of the interaction between growth and margin.

Joe Brent *Liberum Capital Limited, Research Division - Head of Research*

Joe Brent at Liberum. Three questions, if I may. Firstly, on Type 31, I think you're actually right to sort of prioritise that in the slides. And my sense was that the £100 million should be enough. Could you give us an indication of kind of what your confidence levels are? When we expect to hear more? What the parameters might be because £100 million is obviously a precise number and something that is presumably quite hard to pin down. The second question.....

David Lockwood - CEO

Brent, can I do one at a time. I'm getting old. The -- so the first -- so as I said, we've had all of the estimates, programmatic, technical and operational externally verified. So we're as confident as we can be on those. And as I said, that the programme to go obviously includes appropriate contingency for the risks we can see. When we did the contract and balance sheet review, you will recall that we reduced the trading margin on Type 31 from whatever it was to zero because we said we -- and I said that at the time, the big key de-risking milestone is the first ship integration because that's when you know you've got a product. So we're 40% to the way through the first ship. So these estimates are based on a lot more information than we had three years ago, but we're still 40% of the way through the first ship. So that's the big milestone to go to know that you've really de-risked the program.

Joe Brent *Liberum Capital Limited, Research Division - Head of Research*

The second question was on the strategic development of the group. You've said the disposals are complete. But when the strategic review was done prior to you're joining in 2019, there were other assets highlighted then that might have been seen as noncore. Now clearly, you have your own view. But could you just tell us why things like rail, baggage handling, some of your energy businesses and South Africa, why those are a core going forward?

David Lockwood - CEO

Okay. So because we're not a forced seller, our job is to look at what's in the interest of shareholders, which is what price could you achieve versus the value these businesses just generate. And that includes management overhead. So if you take something like the LGE business, for example, that's a very, as David said, that's a strong business that has very low management overhead from people like us. It's very well run.

And you'd want someone to pay a very good price to buy that business. And if you can't see that in the market, then it's in shareholder interest to retain.

So there will always be businesses like that, that are on the kind of not right at the core of your group description, which are nonetheless strong businesses that contribute well to the group, and that's kind of the basis on which we evaluated all of the businesses. And at some point, you have to declare yourself done. Otherwise, everyone in the business who works in the business is constantly uncertain, and you can't take the group forward. So that's why we decided we had to declare an end to the process and having got the balance sheet to where we needed it to be. And having got the prices we wanted for the things we sold, that's why we called a hope.

Joe Brent *Liberum Capital Limited, Research Division - Head of Research*

And then a final question, if I may, probably for David Mellors. On the pension, a lot of companies are reporting reduced balance sheet deficits and produce technical provisions. I think yours has deteriorated despite the extra money. And I note that your pension scheme is unusually well matched assets liabilities with the LDI. Could you just talk through the mechanics and why they haven't got better?

David Mellors - CFO

Yes. So actually, in the year or two before it had got substantially better and it reversed a bit. I always look on the actuarial basis, not the accounting basis, but in actual fact, the explanations are sort of the same here because it's assets lagging liabilities. So it's some of the growth assets that in the second half of the year didn't match interestingly enough. It looks like they have come back a bit in the first half of this year. So the other thing I try not to do is get to transfixed by the short-term movements in these things because it's a long-term liability.

The fact of the matter is I don't expect the cash outflow in FY24 to be much different, and it may well be that assets and liabilities move around a bit, but the funding plan is set for all of the three big schemes. So that's what it was. It had come down a lot in the previous two years. It's reversed a bit. It's still down substantially from where it was two and a half years ago.

Sash Tusa *Agency Partners LLP - Partner and Aerospace & Defence Analyst*

Sash Tusa from Agency Partners. I wonder if I could just follow up on the question about FMSP contract terms. I was slightly confused. Is HMS Victorious is effectively the major element of that? Or is it just the -- because I think the contract or the statement that you put out was linked to the HMS Victorious.

David Lockwood - CEO

Yes. So Victorious -- so there are several things that take place under FMSP, including submarine refits at Devonport, which is the big activity. So it's not the only thing, but it's a kind of -- it's a directional thing.

Sash Tusa *Agency Partners LLP - Partner and Aerospace & Defence Analyst*

And then your relationship with HII, what triggered that? And is it specifically AUKUS focused? Or are there nearer term opportunities you're looking at? Does it tie in for example, the work that you identified as being required in Australia for the Virginia-Class.

David Lockwood - CEO

So they build Virginias, as you know, and they also do decommissioning of nuclear assets. So in many ways, they look quite like us. So we've been talking to them about a range of opportunities. And the reason the MOU is a bit generic is because there are a wide range of things we can do together. And we're -- but some of it was getting into the market, so we felt we also get it out publicly. But there are a wide range of things, some much nearer term than AUKUS.

Sash Tusa *Agency Partners LLP - Partner and Aerospace & Defence Analyst*

And then just final question, the DSG -- oh sorry, the contract support Ukrainian vehicles and equipment. Does that all come through in the current financial year? Or is that a...

David Lockwood - CEO

So the initial element is this year.

Sash Tusa *Agency Partners LLP - Partner and Aerospace & Defence Analyst*

Okay. And is that on different terms to the DSG contract?

David Lockwood - CEO

Yes-ish. Well, there are some that flows yes-ish. Yes. There is a person behind you who is -- will give you....

Christopher Bamberry *Peel Hunt LLP, Research Division - Analyst*

Chris Bamberry, Peel Hunt. Three questions. Just going back to the cash flow this year, you obviously haven't changed your expectations despite the outperformance last year with the customer receipts. Could you give us a little bit more detail on how you expect to achieve that? Are you getting better, I don't know, upfront payments or whatever that sort of thing?

David Mellors - CFO

Yes. So we're -- we have made progress in the way we approach bidding, execution and everything else, so across the life cycle. We've still got some way to go. But the short answer is, yes, we expect to make that up through better performance all the way through the life cycle.

Christopher Bamberry *Peel Hunt LLP, Research Division - Analyst*

Secondly, when will you get the first Type 31? When will that be 100% integrated? What's the kind of time line for that?

David Lockwood - CEO

You mean -- so the In-Service Date is a customer date, not our date because we're only contracted up to Less Acceptance Date. So it's quite difficult to answer that question because that's their gift, not our gift. I can't actually remember what the current plan -- their plan is. I have to come -- we'll come back to you on what their planned day is.

Christopher Bamberry *Peel Hunt LLP, Research Division - Analyst*

Okay. And finally, looking at the pipeline for the next 12 to 18 months, what are the major opportunities that could be awarded in that period? And could you give an idea of the scale of some of them?

David Lockwood - CEO

Yes. I actually think the good thing about the near-term growth is that isn't reliant on single big chunks. So the bulk of it is the extension of existing frameworks or incremental stuff on vehicle support, that kind of stuff. We're not -- the only really big like multibillion contract award of new stuff that is potentially around is the FAcT program, which is adjudicated next year.

David Mellors - CFO

Yes. And to the other point, because I know you're focusing on the near term is if you look at how much revenue we had in the bag on the 1st of April, in percentage terms, it's at least what we had a year ago in the 1st of April. So in terms of what's already secured, that's quite a big chunk of that already.

James Beard *Numis Securities Limited, Research Division – Analyst*

It's James Beard at Numis. Two questions from me, please. The other part of the press release from last week regarded your win on the maintenance and your gifted assets in Ukraine. Obviously, you flagged that's sort of initial 1-year opportunity. What's the sort of longer-term potential on that?

And then second question was on submarine decommissioning because that was something else mentioned in that press release last week. Any – there's sort of initial sort of showing opportunity later this year. But is this likely to be a particularly near-term opportunity? Or is this going to get sort of pushed further and further out to the right as has always been the case with UK nuclear submarine decommissioning?

David Lockwood - CEO

I'll do the second one first while I think about the first one. The – both nuclear submarine decommissioning and actually conventional [seal] decommissioning is the 'jam tomorrow' in this business when I was thinking about joining and I looked at some of the things we were saying it was always going to be big stuff. So eventually, people will need to decommission legacy nuclear platforms, whether they are submarines or conventional civilian reactors, but it does always seem to move to the right. So -- we're seeing some activity now on nuclear submarine decommissioning, but I would be surprised if it is something David will be calling out as a delta between FY23 and FY24, when we stand up next year.

On Ukraine, I think there are -- so I think now that the war has gone for the length of time that has general support to Western donated kit is a major issue. So I think being involved in that, starting with the UK kit, is important and has opportunities to both grow the depth of the UK support but also potentially spread that to particularly other smaller NATO nations who may not be able to set up their own support. So I think it's a -- it has sort of depth and breadth opportunity in terms of growth. So it's very important we execute the initial phase well.

And when I met recently with -- so I've met recently with the Deputy Defence Minister of Ukraine and the head of their state industry, defence industry and getting this working well is a key thing for them. So that's important. I think over time, all governments want to transition rather than supporting Ukraine directly, they will want over time to support Ukraine in doing it. Ukraine placing direct contracts effectively, but I think that's kind of war evolution dependent.

George McWhirter *Berenberg, Research Division - Analyst*

It's George McWhirter from Berenberg. Just on the pension, what sort of opportunities are you looking at to potentially de-risk that, for example, do a pension buy in?

And the second question, just on pension contributions this FY24. Can you comment on the size of what you expect that to be?

David Mellors - CFO

Yes, sure. So I take the second one first. So the deficit contributions for FY24 will be about £65 million, so down from £142 million. You may know this, but there are three big pension schemes. We've actually got a number of smaller ones, but there are three big ones, and we stage the valuations, the triennial valuations so that no two of them fall at the same time. So you're not -- so the kind of market risk, if you like, is spread. So there's kind of always one valuation going on at a time.

In terms of the de-risking, all the usual stuff is the answer. In terms of buy-ins, buyouts, that's probably a little way down the track, not all that far. But right now, the best thing we can do is make sure we've got the right investment strategy, is head towards self-sufficiency, is manage the liabilities with -- obviously, this is a trustee action but with us supporting and in consultation. So to the extent there are any of the usual liability management actions, we would expect to take those.

There will be a point for each of those three schemes in the not-too-distant future where it would be opportunity to do buy in or at least look at it, its market condition dependent, obviously, sometimes it can be very expensive sometimes not. But there maybe that in the not-too-distant future, window opens up on one of those schemes where we could do something like that. And the important change on that, just to reemphasise the point is if you'd asked that two years ago, the answer would be, that's so far away. So it's not going to be next year, but it's on the horizon.

Andrew Gollan - Director of IR

Right. We'll just hand over to the conference call line. Operator, please?

Operator

We will now begin questions from the phone line. (Operator Instructions) So it would appear we have no questions on the conference line at the moment. We will now hand back to the Babcock team.

Andrew Gollan - Director of IR

Okay. I'll take one question, a written question that's come in from Suhasini Varanasi from Goldman Sachs. It's around medium-term revenue growth targets we have. Can you talk about the revenue drivers we have here, price versus volume? And what makes you confident about the future prospects given the historical trends?

David Lockwood - CEO

So price versus volume is a very good point, but it's also capital employed and risk. So I would say that the big drivers at the moment are pushing up availability and upgrades everywhere. And the -- and our core goal is to make sure that we get that balance of risk, capital employed, i.e., when we get paid the cash flow thing David talked about our margin right, particularly in the non-UK markets, but we're not short of opportunities at the moment. In fact, our #1 challenge to make sure we can mobilise when we've won. And obviously, our #1 obligation to all of our customers, which our UK customer knows and everyone knows is to make sure the UK submarine fleet is fully supported -- and sorry, the other part of the question was there was -- it was two stage.

Andrew Gollan - Director of IR

It was just, what makes you confident given Babcock's historic trends?

David Lockwood - CEO

Well, historic trend, but I don't quite know what it means, whether you're asking Babcock historic trends or global historic trends. I think from a global point of view, defence markets are at least stable everywhere, if not growing, whereas historically, we've been working in declining markets. So I think that's probably the biggest positive.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

David Perry. Just two very quick follow-ups on existing questions. The gentleman asked about pipeline opportunities. And one you never mentioned was the Poland frigate. Can you just -- but it does feature quite high in your actual release. Can you just tell me what's going on there? Is it you're selling a product, a license? What's the scope and timing?

David Lockwood - CEO

So at the moment, we're finalising discussions for the execution phase. So we've currently been paid effectively for license and consultancy. But the expectation is we will be involved in Poland in the delivery of frigates. And the detailed mechanism for that is -- should be sorted by the autumn.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

Okay. And then just the other clarification for David Mellors. Just a second ago, you said on pension, more than likely to do a deal than two years ago, but not next year. Is next year fiscal -- you're saying not in fiscal '24 or not in fiscal '25?

David Mellors - CFO

I didn't say either of those things, but it certainly won't be in '24. I wouldn't have expected. So I think this is a medium-term thing now, whereas two years ago, it was a pipe dream.

David Perry *JPMorgan Chase & Co, Research Division - Head of European Aerospace and Defence*

So just you weren't ruling out doing something in fiscal '25, the year ending March '25.

David Mellors - CFO

I'm not ruling out anything. I'm just saying the first thing we've got to do is get the liabilities de-risked and down in order to make it economic before you start talking about buy-ins and buyouts. It's clearly a medium-term thing in each of the schemes. They're all in different places. But maybe I got you too excited. I wouldn't expect anything in the next year except continued de-risking.

David Lockwood - CEO

Okay. Right. Well, thank you for your time and attention and questions. And I mean what day is? I can't remember, it's Thursday. So enjoy the second day of the test. Thank you.

ENDS