

February Trading Update 2020 Transcript

Wednesday 12 February 2020

Archie Bethel
Chief Executive

Good morning and thank you for joining the call this morning. You will have seen our trading update statement we issued earlier this morning and for the first nine months of the year. Franco and I will take questions on this statement but before doing that, I'd like to highlight a few things.

It has been a frustrating third quarter. On one hand, we've seen across marine, nuclear, land and most of aviation, trading performance pretty much in line with a slight layer of expectations. Whilst on the other hand, we have seen the oil and gas market trend downwards again.

In the trading statement, we've updated detailed guidance to reflect trading so far this year. We expect revenue to be around £4.9 billion with underlying operating profits of around £540 million.

Free cash flow should be above £250 million and we expect to reduce net debt year on year and deliver earnings per share in line with current consensus expectations. So overall, we remain on track to deliver our short- and medium-term targets.

Disappointingly, in our aviation business, oil and gas has deteriorated further since we last updated the market and we're now flagging an £85 million exceptional charge relating to this.

So what is causing the pressure on oil and gas? Well competition has got tougher and we have lost several major bids in the last few months. There are three large providers of helicopter services who operate worldwide in oil and gas. All three have emerged from Chapter 11 bankruptcy protection with reduced debts and written down assets.

This is effectively resetting global market pricing levels, forcing us to respond quickly to remain competitive. This accounts for around three-quarters of the exceptional charge and we are also re-structuring our aviation sector to address the cost-base as the oil and gas revenues reduce and contract delays in southern Europe push revenues out into future periods and we are also exiting our oil and gas businesses in Ghana and Congo.

So let me now say a bit more about the rest of the group. Overall, underlying trading has progressed in line with what we talked about at the half year. Marine continues to have a - to be - to have a strong year ahead of our expectations as activity levels are high across the business, including high demand for the liquid gas marine transportation systems.

Land is also having a good year with continued progress across defence programs and strong trading in South Africa while our nuclear sector is trading in line with our expectations.

In the wider aviation sector, it's not all been bad news. UK and international defence continues to perform well and aerial emergency services in the UK, France, Scandinavia and Canada continue to perform in line with our expectations but we have been unable to offset the issues in oil and gas and delays in southern Europe.

Looking ahead, we will present our full year results on 27 May and we look forward to talking in more detail then. So I'm now going to hand over to you and Franco and I will take your questions.

Q&A Session

Joe Brent - Liberum

Three questions, if I may. Firstly, could you give us an indication of the probability of - in-sourcing Dounreay.

Secondly, Dominic Cummings has made some fairly negative comments about the industry. I'd be interested in your perspective about that, does anyone care?

Thirdly, on the order book and pipeline, clearly it looks robust but I don't think there's been much winning recently. Could you give us an indication of whether you think that will change and why perhaps order intake has been a bit weak in the last quarter?

Archie Bethel

I'll take these. I'll take them in the order you're giving them. Okay, in sourcing at Dounreay, the article and the address at the weekend, I think our view - our answer to that, I think was the exact same as NDA's. One, we don't comment on speculation. There are no discussions going on between Babcock and the NDA about significant changes to the Dounreay contract. So I'm not going to comment any further on that.

Dominic Cummings. This clearly, an SDSR who will be coming along, I think that's more than that is going to happen and I think it will be a pretty all-encompassing one. Babcock as one of the key suppliers will be involved and have inputs to that, so we will be involved in that process as we always are.

What I would highlight is, Babcock's main role with the Ministry of Defence is as a support partner. There's a lot about reducing costs, improving efficiencies, approving availability of assets and taking down the through-life cost of these assets.

So I think what we do as our core business will be pretty much in chime with what some of the elements that - of the strategic defence review. So I think in - we expect to play our full part in that and I think that's something that's coming and we'll all hear lots more about over the next few months.

I think in terms of the order book, the order book stayed the same so they're - we've had no big exceptional orders to announce in the last three months, so we've had a steady input of orders. So we're maintaining the order book which means we must have booked the best part of probably a couple of billion.

We did have one or two ones that we didn't issue that were sizeable. In aviation, we had the - in France, we won the helicopter - the search and rescue support contract for the Royal - for the French Navy, alongside the Airbus and Safran.

So there were a few kind of notable ones but I think the order book at £18 billion and the pipeline staying at £16 billion demonstrates that we continue to re-generate the order book as we go.

Franco Martinelli

The two that I'd pick out there, Joe, is the H160 military air in France. We had highlighted that there were a couple of those and there's still some more to bid so we're pleased with that and we did sign an increase into the UK flight training. So as Archie said earlier, the military area is going well.

Archie Bethel

We did book - or become prepared better for the £600 million of the work in south - southern Europe. Although it's pushed to the right this was new order intake.

Robert Plant - Panmure Gordon & Co

Morning chaps, I think you said three-quarters of the restructuring charge relates to oil and gas. Is there a quarter that isn't oil and gas related?

Archie Bethel

No, I think I said three-quarters was related to primarily the oil and gas. So the aviation sector restructuring has fundamentally been driven by oil and gas but it will involve more of the aviation sector as we resize that for the impact of oil and gas.

Robert Plant - Panmure Gordon & Co

That extra quarter, is that mainly southern Europe? And if that's the case, I've felt it like it was a timing issues in southern Europe or do you think some of that revenue won't come through?

Archie Bethel

What it is, that - it's not specifically related to southern Europe. The southern Europe revenue does come through it. It's the restructuring will be - as we go down in the oil and gas, the business is changing size, I'm always continually looking to see opportunities to make all of the businesses more efficient and more effective and it seems to me, as we address this oil and gas issue, it's also good - it's also the right time for us to look at the overall total structure of that sector.

So there won't be any - not any specific plans which related just to southern Europe or to any specific part but we are looking at how we can address the reduction in top line by - to protect the bottom line and that's by taking out some costs.

Charlotte Keyworth - Barclays Investment Bank

Three questions. The first one, just on aerial emergency services. I wondered if you could give us just a little bit more colour on what's actually driving the deferrals in Italy and Spain. And why you've got confidence, as a follow on from the last questions, as to why they're going to come back - that revenue?

Secondly, more broadly on aviation services, you've talked about this resetting pricing for oil and gas. Even following this restructure, is there a possibility we are looking at any kind of divisional margin reset beyond 2020?

Then just finally on cash, the impact of the restructure is £30 million this year and given free cash guidance is unchanged, I'm assuming that's taken as an exceptional. I guess on the exceptional point, you are in the middle of the trustee negotiation with Rosyth at the moment. Might we expect a one-off payment in H2 as an exceptional as well? Thank you.

Archie Bethel

I will come back and I'll try and talk with these cash ones. On the emergency services, I think - I guess what we've said is that at the half year, we were sitting waiting on a bunch of - I think it was about £800 million at that point and we're still waiting on the results - the results on. So a lot of progress has been made, so I think as we've said, £600 million of that has been placed, or we are preferred bidder on, so we've done pretty well out of that set of outstanding orders.

I expect that the ones that are orders are orders and the ones that are preferred bidders, I expect to turn to orders over the next two months so that they will be fully in the order book by next year. So that's a pretty high level of confidence I can have in that business being there for next year.

The causes of the delays, well that's difficult that we have customers who were re-looking at many things and I think, as we said at the half year, there had been some discussions in particular with regulators in terms of various things. So the delays were frustrating but pretty pleasing that they've come through and we've retained them at a kind of a high market share in actually unspent.

The second one was about aviation?

Franco Martinelli

No, Charlotte, I don't think we've reached this and I think as Archie said, we're looking to protect our margin and that's why we've taken the actions that we are to - so we're not looking to reset, I think we just need to - and that's why we're taking actions.

In terms of the exceptional cash, yes, you're right. It is £30 million in cash terms. I think just to clarify, under the new accounting standard, it's only £10 for net debt because some of that cash is leases which already in net debt. So that's true. So that's the answer to that question.

The final one is the pension and we're still comfortable with - we will be over £250 million free cashflow. Finally, the H2 pension exception, I don't expect that to happen now this - we haven't quite agreed the deal. It's nearly agreed, as I said before, but it's not quite there. Pensions always move slowly, slower than we think. So the additional payment will be on in next year, which we still think will happen.

Sam Bland - JP Morgan

A couple from me, please. Just the first one is on the £250 million free cashflow target for the year. I guess you've retained that, albeit there was a fair bit of work to do in the second half. Just to have an update on yes, is that progress on cashflow coming through in the second half as expected.

The second one, related to that, is can we have an update on the total size on exceptional cashflows after the free cashflow line expected, let's say for this year and next? Thank you.

Franco Martinelli

The good news is, as of the end of December, we're ahead of where we expected to be in terms of free cashflow so that does help us in terms of working capital and CapEx, which are the main drivers. So we are ahead at the end of December and - but the final quarter is very important as we've said repeatedly. So it will depend on that final quarter. So we are ahead of where we expected to be at the end of December, so that improves our confidence at this point.

In terms of exceptional items, yes, previously we had guided for about £40-odd million for this year. That's in terms of IFRS16 that's only going to go up by about £10 million as we said previously and in terms of cash, if we do it in cash, by £30 million. So that's in answer to previously.

As for next year, it was pretty flat and it's probably going to be on a - because we had some disposal of the EC225s which we expect. Now that we've marked them down further, we can proceed with. That - so for the next year, it will be a small outflow, okay? Because of what we just said.

Allen Wells - Exane

Just a very quick follow up from me, just to understand the Italy and Spain issues. You talked a little bit about the delays in the potential revenue moving into following periods, but you haven't obviously changed your top line guidance. How do I reconcile that?

Then you also in the comments make a point of the £600 million of additional wins that you've won since then. Obviously, it's difficult for us to quantify what does that actually mean? Is that enough to offset some of the head wins that you had or were expecting? Is that more than you - I don't know how to quantify what £600 million means in that context as well. Thank you.

Archie Bethel

Okay, in Italy and Spain, the £600 million slip isn't for the whole year so there's probably this year, the impact of that slippage on aviation is probably about £100?

Franco Martinelli

Just about £100 million.

Archie Bethel

Just under £100 million. So the £600 million, these contracts run over four or five years. I think, that's even - I think that will be offset simply in marine. So if it's just a simple numbers game, then I think we're going to be ahead in a couple of areas but mainly marine.

So we are sticking to that top line guidance in terms of what the - our top line should be and I think the £600 million in aviation services, that pushes into next year, gives us a next year in that aviation air emergency services business, a good start in terms of backload of already in the book.

Alan Wells - Exane

Then a very quick follow up question, just on - just general oil and gas. You flag it's getting worse again. How do you think about the options and the plan for that business? Obviously, you're trying to manage costs to manage a difficult period but if this continues to get worse, it feels like it's a very tough business to be operating in. What options do you think you have there and how do you view the outlook from here?

Archie Bethel

Yes, it's been a tough business for a few years and I think it's getting smaller. The problems are getting less. We've already - last year, the EC225 issue and when we get rid of them, we've got rid of five of them, then we're making progress. This year, I think that there's a competitive market. I think pulling out of Ghana and Congo, we're really retrenching back to, as we've been doing for the last few years, back to Aberdeen.

It's now a relatively small business. Even up at Aberdeen we've significantly downsized it and by taking this - proper write downs of these assets, we're almost at the stage where there's very little value in that part of the business.

We're clearly under an obligation to complete the contracts that we have up there and we're delivering on them very well but we've no intentions to join the chase to the bottom with the other two and we're trying to manage that as well as we can, painful as it is, but we - and protect the rest of the aviation sector in the business from major problems there and I think again, we've done that reasonably well.

So yes, I think we don't see - it's a difficult business to see long term what's going to happen when there's so much disruption going on around about this business and we are still seeing companies that have committed a sharp turn and we've still seen them in a price war with each other, which as I say, we don't really want to join.

I think we're in control of it. I think it's tough. I think we've taken the right decisions and doing our best in what is a pretty difficult situation.

Sash Tusa - Agency Partners

A couple of questions, I'm afraid again on aviation but then one on marine. You said just now that post the write downs, there is very little value left or very little asset value left in the oil and gas parts of aviation. I think I rather foolishly assumed after £81 million of charges in the last financial year that you'd pretty much written it down. So I found another £80 million a bit of a surprise this morning.

Yes, are you - I just wondered if you could quantify what assets you have left there and what the exposure is? Have you written the - all the Super Pumas now down to zero and do you have other helicopters that you couldn't redeploy into other parts of the business? I'll - perhaps I could follow on after that?

Franco Martinelli

Yes, we've written down the assets to a pretty low value now. There isn't - as you quite rightly said, very much. The real big part of it is the writing down of the leases on the S-92s. We have reduced on ECC25s, in leased assets from six down to one and we have reduced our S-92 fleet on leases from 15 down to seven.

So we've done a lot of reduction but we have still got leases for those helicopters and the market has moved as the guys have gone into liquidation and reset the lease rates which we hadn't foreseen. So it's not really assets in the classic meaning of the word, it's more the market to market releases, just to explain where we go to.

Archie Bethel

Yes and I would stress, last year Sash, last year was all about the 225s and of course the 225 issue was driven by technical problems that grounded the 225s. So the S-92 is - I think we've done pretty well there, we've only got one left on lease out of the - we had 13 nationally, we've dealt with them all. We're down to one on lease. The S-92s, this time last year we had 15 of them, we're down to seven.

So we haven't - we have pretty much been on track and it really is frustrating that we didn't see the impact of the of these other companies coming out so quickly in terms of how Chapter 11 allows them to reset the values and the three of them are dominant in the market around the world, not just in Aberdeen. So they have effectively set the value of the S-92 which is a way, way below what we're actually paying in terms of lease costs. So we just had to take action on that.

Sash Tusa - Agency Partners

Okay, great. That's very useful. Just a detail question on aviation. There was a report from the Norwegian government that they had had to keep helicopter availability up in the north of Norway because you had had problems standing up the air ambulance service there. I just wondered whether you could provide a bit of colour on whether that was just a ramp up glitch, or whether that was something that has affected the wider ramp up of the air ambulance service there?

Archie Bethel

Okay, in Norway there was an issue. We have been doing the ramp up and it's gone pretty smooth. We did have an issue where we had a technical fault with one of the new aircraft. We're putting safety first as we always do. We grounded the fleet of 12 aircraft - new aircraft, until - for such time as we ascertained what the issue was and how serious it was.

It turned out to be a pretty minor problem but we did have the aircraft grounded for about a week and during that time period we also brought in some aircraft from Sweden and other parts and the customer provided some.

We had a week where we did have an issue related to a technical issue but it turned out to be pretty minor and we were back in action very quickly. So I think the customer was pretty impressed with how fast we responded to it and took the right decisions and we demonstrated basically the resilience of not needing to interrupt - not - even such a big grounding, not interrupting the service.

Sash Tusa - Agency Partners

Great, thank you and then just one question. I just wondered whether you had any update on the Type 31 programme? Are you still happy with the timescales for delivery that you last announced?

Archie Bethel

Yes, absolutely, but it's still early days but yes, we're making progress in all of our milestones so we're still pretty much in the finalisation of design phase. The supply chain procurement phase and we're well into the construction phase at the site. So yes, I'd say we're pretty much in line with where we said we would be.

Robin Speakman - Shore Capital Markets

Just to clarify, it sounds very much like from the statement this morning that you are actually pulling out entirely of aviation in the oil and gas market. Is that correct? And further to that, the assets that are utilised in oil and gas, you've kind of partly answered this but can you move some of those assets into other areas in aviation? Does that have an impact on next year's CapEx in aviation and indeed on asset sales as well?

Archi Bethel

I think the well-run route of oil and gas aviation for us is that we don't intend to invest further, or stay in that market and I think we've been steadily over the last four years now decreasing the size of that business. So - and I think as we emphasised, last year in the capital markets theirs is part of adjacent markets, adjacent businesses, we are always looking at what's the long-term future of that?

In terms of the assets, we don't - I mean one of the positive things is, we don't have any at the moment, we don't have a big issue with excess assets so we've done pretty well at getting rid of these as we've needed to.

I think on the 225s, we've only got the one, so we have reached a - we have redeployed some of these and we'll continue to look at that as a possibility. The S-92s are a bit different. They're huge machines, mainly suited to search and rescue. Oil and gas and then search and rescue. We will look at, is there options to deploy these and actually, the writing down of asset - of the lease values helps that process. So we'll continue to look at - continue to look at those whenever we can.

But I say at the moment, we don't - we expect them to be in contract. Their written down values, we expect them to be on contracts in Aberdeen.

Okay, well once again, thank you for joining the call this morning. I think overall, the business is in good shape. I think the numbers that we have confirmed in guidance today are pretty much in line with what we said they would be.

We're being pretty upfront about the continuing issues in oil and gas and I think we have acted very quickly to address that so they should not have an impact - any long-term impact on the business and that's the most important thing. We'll update you on all of this at the year end in May so thank you again for joining us this morning.

Ends