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Transcript: HY25 results

Wednesday 13 November 2024

David Lockwood
Chief Executive Officer

All right then. So good morning, everyone. Welcome to our half year results for the six months to the 30th, September 2024. Obviously, this is the results for six months, but we only stood up doing a business update 12 weeks ago for the full year and we've had the AGM statement as well since then. So, this will be a comprehensive walk through the numbers from David and then a what's happened since we last spoke to you from me. For the six months, successfully deliver performance and growth. We'll touch on it quite a lot between us, but we said when we first started in Babcock, performance drives growth in a company like Babcock, because we have a lot of frame contracts where customers have a lot of discretion about whether or not to take optional work. So, if you're performing badly, they don't. If you're performing well, they do. Those frames then generate further growth.

In terms of securing the position of the company performance is the bedrock of growth. So that's why those are in that sequence. We did deliver 11% organic revenue growth in the period. Orderbook broadly flat, but as David will talk through as he goes through the detail, largely driven by consuming frame contracts, because our order intake is necessarily lumpy. And indeed, in some ways, the lumps get bigger the better you perform, because if you're performing well in a support contract, people tend to give you longer periods, which means you get fewer bigger lumps. So, it's nothing to concern about. Strong cash conversion again and progress towards our margin targets. Really, I think, significant progress in the period towards our medium-term guidance. But to fill all the colour on that before I come back and just talk through the highlights of the last period, David will take you through the numbers.

David Mellors
Chief Financial Officer

Thank you, David. Good morning, everyone. My three main messages today are, number one, this is a really strong set of results with revenue and profit growing well. Number two, cash flow is significantly ahead at H1, albeit with some favourable timing. And number three, FY25 will be another good year of progress towards our medium-term guidance.

These are the financial headlines released this morning. The key points to note are that the organic growth was up at 11% and that's on top of the last two years of double-digit growth. Underlying operating profit was up 10% at constant currency, notwithstanding the strong comparator period. Margins were 7%, which was flat. And margins, we had a very strong comparator period. EPS was up 14%. Cash conversion at 80% assisted by some timing impacts I'll come on to. But this cash conversion coupled with the reduced pension obligations delivered much higher free cash flow of £95 million and debt reduction to 0.6 times on the gearing ratio. And finally, the dividend is up 18% to 2.0p.

So, let's start with the income statement with revenue first. This is the summary revenue bridge by sector before we go into the sector detail. You can see the organic growth for the group of 11% broken out by sector. And three of the four sectors are growing well, particularly nuclear and land, which I'll come on to in a moment.

Next. Profit. This summary shows the 10% organic profit increase by sector. And again, we'll come onto the sector detail in a moment. But the summary here shows the very strong performance in nuclear, good performance in land, partially offset by marine. And this is what we expected, given that the prior year was particularly strong in marine with the recognition of significant license fee income on Arrowhead 140, which we disclosed a year ago.

Now moving to the sectors with marine first. The key points here are revenue grew 6% organically in the half, despite the prior year having license fee revenue. This growth was mainly driven by the ramp up of the Skynet program and the return to growth of the liquid gas business. Skynet revenues in the first half were approximately £70 million. And additionally, zero-margin program revenue was approximately £100 million, and Type 31 is the largest part of that. Profit decreased to £40 million in the sector, which actually was a similar level to H2 last year if you take out the Type 31 charge. And the reason for the period-on-period drop versus H1 last year, again, was the absence of license fees this period, which were very strong last year.

On top of that, I mentioned last year the increase in Rosyth overhead and support expense. And obviously, we had that for the full six months this period. So, the low margin of 5.1% was also diluted by the prudent initial margin recognition on the Skynet program, which we expect to increase over the next year as we work through the program. So, whilst 5% is low for marine, we still expect that to achieve the medium-term goal of 8% or above.

Nuclear, on the other hand, had another very strong period. The organic growth was 22%. We saw very significant growth in civil nuclear, 30% up with growth in both new build and decommissioning. Submarine support volumes also increased, including the ramp up of the Victorious deep maintenance work. And infrastructure or MIP revenues in the half increased to £273 million leading up to the point where we reopened 9 Dock in September, which was one of the three big infrastructure projects ongoing. For the full year infrastructure revenues are not easy to forecast accurately. I do expect the infrastructure revenues to decrease on the first half peak now 9 Dock is open. Broadly, I think the full year will be similar to last year, but with risk on the upside.

Moving to profit, all the revenue increases help the profit growth, obviously. But margins were also boosted by the new revenue mostly being at better margins than historically. And furthermore, inflation recovery within some contracts improved, partly due to contract changes. And we also have a small amount of risk release into profit as milestones are achieved. And I've noted that on here. So, all these factors help the margins take a big step forward to 8.7%. So nuclear hit its medium-term goal ahead of schedule.

Moving to land. The main factors driving the revenues 9% higher are set out here and include increased land support activity in the DSG contract and higher vehicle volumes, both Jackal production and South African mining trucks. And this revenue growth drove profit increases too, but also profit was helped by the improved DSG performance in the final year of the contract. And this sector also benefited from better inflation recovery, again, partly due to contract change. And also, there was a small property provision release, that I've noted here, £3 million, just for transparency. Overall then the land margin at 7.7% is much better than the 5% we had three years ago or so, and well on the way to 8%-plus.

Onto aviation. Thankfully we don't have any divestment impacts to strip out of the numbers anymore, so it's a lot cleaner. As expected, organic revenues went backwards 4%, which is the impact of last year's H160 aircraft deliveries in the comparator. And now that program is in the longer-term support phase. And on that topic, I flagged before, there are other programs in the pipeline with this similar sort of upfront revenue profile, largely due to aircraft delivery, which boosts the early phasing of revenue, which we hope to win. So, revenues may be a bit lumpy. And you may have seen in the announcement this morning that we have been notified we're the preferred bidder on the Mentor2 program in France, which is a significant program of this type.

So, we intend to get that under contract in the second half of the year, and I can give you more about the financial profile at the full year. So that's a good news story.

Moving to the profit in the half, profits were flat in aviation. And again, the comparator had some one-off credits in it to a small degree. Margins were 5%. This is obviously much better than three years ago when this sector was hovering around break even and is progressing towards the 8% goal.

So, onto the cash flow. This is the usual busy slide that gives you all the detail and I'll only pick out a couple of numbers. But the key point is in the title and that is that free cash flow is significantly ahead at H1.

So, into the detail then. In the middle of the table, we have the operating cash flow of £135 million and cash conversion of 80%. This operating cash flow was higher for H1 than expected and this was due to working capital. So, in short, there was very little working capital reversal in the half and that flattered the H1 performance.

At the full year last year, we disclosed about £50 million of early receipts from customers, and we flagged that they would reverse this year. And not surprisingly, most people expected them to reverse in H1, as did we. And indeed, they did. But would you believe it, at the H1 period end we got a similar amount from a number of customers. Which is great news to have that cash early, but it is over and above the normal cash cycle and it's unlikely to keep happening. So that will reverse in H2.

So, looking down to free cash flow, you can see the pension deficit repair contributions have reduced period on period following the two pension scheme funding deals we disclosed last year. And everything else landed where we expected. So, this all delivered £95 million of free cash flow, or if you think of the pension deficit as debt, £190 million of free cash before debt pay down.

Lastly, I've added some detailed guidance on the slide here for the full year. Overall, given the performance to date and the timing differences, the full year will be H1 weighted.

And so, onto the balance sheet. I put this slide up at each result's presentation to show the progression of the main balance sheet captions all in one place, because I think it is important to see them all together. The key takeaway of the slide is that the balance sheets in a much more robust position than it has been.

In the top box you can see the deleveraging over the period to a gearing ratio of 0.6 times. And that's a rolling 12-month calculation, that gearing ratio. So, it still includes the 90 million charges from Type 31 at the year-end.

The middle box is the pension deficit and the important actuarial deficit as well as the accounting one. I'll come on to pensions on the next slide, but as deficits are not included in the gearing ratio, it's important to have them set out alongside.

The third box is working capital. So, we've overachieved on working capital now 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 big programs. And this remains the case.

Also, to remind you, included in here is the Type 31 contract liability, which is about £180 million. So, there's no new news on working capital, but just reminders of what we have flagged before.

And there's nothing really to say about the last box, the window dressing box at the bottom, but we just keep it on to convince you we're not dipping in that pot.

Pensions. Pension deficit position next. This is the updated slide showing the journey from the 700 million deficits to where we are today. So, on an actuarial technical provisions basis, we are now down to £160 million, or there or thereabouts, compared to 300 a year ago or 200 at the year-end.

We disclosed in the summer, we've agreed long-term funding deals with trustees of two of the three big schemes. And these schemes are now closing to future accrual right now, at the moment. And these de-risks the schemes and reduces the annual deficit repair contributions to the 40 million that we mentioned. And that will be the case for the next few years.

And the third big scheme, Rosyth, we are undergoing the valuation as at March '24 right now. So, there'll be more on that hopefully at the year-end. So, lots of good progress on the pension obligation.

This is the capital allocation framework we published last year. So just to touch on the top three priorities. Priority one, organic investment in the business. As you know, we're in an investment catch-up phase both through CAPEX and OPEX to support delivery, improve control and enhance growth. We're spending £50 million a year CAPEX on submarine infrastructure. We're investing in systems and capability around the group, amongst other things. That's priority one.

Number two is financial strength. And you've seen the balance sheet improvement. You know we're now BBB+ with Standard & Poor's. And it's very important for all our stakeholders we protect that strong balance sheet.

The third priority is the ordinary dividend. And we said last year we reinstated the dividend at a prudent level given the investment priority and the need to trade out onerous contracts and get the pension schemes to a better place. And we intend the dividend to be progressive over time.

And then there are the three options in the boxes below those three priorities. And you know we've already taken the pension option, the acceleration of the pension schemes. We did that at the year-end to enable the long-term funding arrangements. And we've started to look at a couple of potential bolt-on acquisitions. Any bolt-ons we do will be very focused and of course we'll ensure we keep the strong balance sheet.

So, to finish on the outlook, H1 was a really strong start to the year and we're confident we can get to the FY '25 expectations. Just to support that, we had around 90% of this year's revenue under contract at the half year, which is about the right shape. So that supports what we thought, it's the right shape for H2. And we remain confident that we are progressing towards the medium-term guidance.

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

David Lockwood

Thank you. Can I just go off script for a second and just say, I've waited for eight years for David to say, "And that's a good news story."

So, delivering sustainable growth. The bedrock is operations and delivery, as I've said. We've talked a bit about the market dynamic. We also talk a bit about how military need is greater than budget growth. And how is that reconciled? It's reconciled by the kind of things Babcock does. Availability, capability and affordability most crucially.

So, across all of the western defence scene everyone has talked about getting better capability, better lethality from existing budgets, as well as budget growth. And that's kind of central to what we do. So that reconciliation we see ourselves as a big part of.

And we deliver that through ever enhanced, through life support, delivering greater availability, through developing products. And Type 31, I don't like focusing too much on 31, because it's a relatively small amount of our revenue, but it's a good example of taking our experience in creating enhanced support environments and turning that into highly capable, but highly affordable new platforms. So, 31 grew out of our understanding of support.

And finally advanced training, because that again is about helping the people who operate the equipment use them and utilise them more effectively, so they deliver more capability from existing platforms. And we've talked about our strategy for growth. This was in the capital market's today, which is about optimising our position and selecting new programs in the UK.

And that's about what we bid, but also what we don't bid. So, you will have seen in the announcement we withdrew for a competition in the training environment in the UK. That was because we have very, very clear criteria for bidding or not bidding. And probably in the past we've carried on too long to the point when we might as well finish. This was a very-

The point when we might as well finish. We can't see how this program would shape up to meet our investment criteria, so we stopped. And a couple of people have written that up as a bad news story. For me, I think it's a really good news story, because it shows the discipline we now have in where we invest our bidding resources. We want to expand in the focus countries, these are Canada, France, South Africa, Australasia, and you've seen the down selects in France to support that. Good progress on JP9101 in Australia. Drive direct exports, but also strategic partnerships. Now, I'm going to touch on that, because I think, in a number of markets, going in with a local partner to grow our presence is the best way to do it.

But as I keep saying, successful program delivery drives growth. So, the infrastructure at work at Devonport, which is astonishingly complex, turning Victorian docks into something that will last through to the second half of this century, is an amazingly complex task. Working very closely with our customer to make that happen. The DSG contract we talk about a lot, but when I arrived, was the thing that hung around our neck in terms of coverage. Now it's seen as performing really well, we have lots of incoming international delegations looking at how we do it. The extension really takes us to the next level. So, a good example, secure comms.

I just want to focus on Skynet, because we talk about the difference between the old world and the new world. And I've said, since I got here, 50% of our destiny is the contract we sign. This was a good contract. 30% is how we mobilise. We put huge amounts of effort, not just the business, but the corporate functions which didn't use to exist, working with the business to mobilise. That has gone super well and has already generated additional work, which wouldn't have happened if we'd been bouncing along the bottom. And then energy transition, David touched on the growth in civil nuclear and how we are growing our resources to support energy transition and civil nuclear. Very important. I said I'd just touch on collaboration. So, the first one is the joint venture with HII in Australia. We have a broad relationship with HII, looking at a range of opportunities. I was out with Chris, my opposite number, three weeks ago. We're just running down the list of things we can do together, and it's a very positive list. The one that's got the most attention is the joint venture in Australia, looking at helping build Australia's sovereign nuclear capability. Australia will be the first country ever to go military nuclear without a civil nuclear industry to base it on. So that's a really important business and David sits on the board of it to make sure that it's joined up to the mothership but has real potential.

Second is PGZ. Again, we have a central contract, which is Miecznik, their version of Type 31 where we've extended the support contract through to 2031. But again, I was there a couple of months ago and definitely there's options to grow, use that to grow the broader PGZ relationship. SAAB, where we have the design contract for the Corvette, which should lead to further work, part of a broader relationship with SAAB. And then probably the new one for everyone, ST Engineering, so Singapore-based, who have some great technology. This is initially for a UK programs, so this is collaborating with a company for the UK program. But in that collaboration, we own a number of export markets.

And we've just completed a very successful field test in South Africa, witnessed by the UK government, so very significant relationship and, again, can go beyond the single product. So, I think this idea of a company of our scale, working with local champions to grow in their market, our market, and then more broadly, is going really well.

UK, everyone's talked about this, additional 3 billion for defence, recommitment to the 2.5%. We've spent a lot of time pre-election and post-election with the government and officials. I think both the defence review and that whole shaping is going well. And if you look at the sovereignty messaging coming out from government, and if you look at the value for money messaging coming out from government, both defence and treasury, I think all of those very much work in our favour.

So, we are a people business, we are not an IP business. We're a know-how business; know-how travels in people. So having the right people in the organisation, recruit, train, and retain, is fundamental to our success in many parts of the business. Civil nuclear, I've highlighted, our growth is dependent on having a supply of people. So, we have, as it says here, our largest ever intake of early careers, that's apprentices and grads, are all schemes that have subscribed. To help train them, we've launched a nuclear skills academy with City College in Plymouth. I won't read the whole lot. We've got exchange programs now going with Poland. We've completely stepped up our people agenda in the last two or three years, and that's gone really well.

We've just completed our third global people survey, and the encouraging thing there is that the really growth scores are in how people now see Babcock as a place to grow their career, much more than they did two or three years ago. How they see us focused on them, their communities, and the mission so that the whole almost corporate well-being scores about, "Why would I want to be in Babcock?" have advanced year-on-year, which is going to drive our attention statistics. So, it's a good lead indicator on retention. So, it's not something we will ever get complacent on, because it is, for us, a super important metric. But that whole people pipeline going very well.

So, what we said 12 weeks ago, which is we're on track to deliver the medium-term guidance. We want the value we deliver to shareholders to be sustainable in the long term, yet we're a long-term business, we should be a long-term sustainable business. And all of the numbers point to that answer. So, with that, we'll take questions from any... God, that was quick. I didn't even get to say, "We'll take questions except for anyone over there."

Q&A Session

Sam Burgess, Citi:

Thank you for taking the question. And morning, David and David. Sam Burgess from Citi. Just two, if I may. Firstly-

David Lockwood:

One at a time, though, in the normal tradition.

Sam Burgess:

Yes. Once HMS Venturer is delivered next year, it sounds like everything is well on track with it, would you be comfortable in saying that the risk of further provisions to the program is very low? You've spoken before about substantial retirement of risk once the first one is delivered. If you could just comment on that first, that'd be great.

David Lockwood:

So, from an operational point of view, the big thing now is to integrate the combat system. That's the last big thing. Once that's done, yes, from an operational point of view, we're in a much stronger place. Do you want to add anything?

David Mellors:

No.

David Lockwood:

Nope.

Sam Burgess:

Great, thank you. That's helpful. And just on DSG, great to see the strong performance. Given you've negotiated new terms on the contract, which will come in H2, should we expect the profitability of that contract to improve even more?

David Lockwood:

I'm not allowed to talk about numbers, so you better look at David.

David Mellors:

So yes, it will be a better contract. The performance has picked up on the old one, but there will still be a... Yeah, we may initially be prudent, as we have been on Skynet, but I don't think that needs to worry you. So, will it help towards the trajectory of eight medium term? Yes, it will.

Sash Tusa, Agency Partners:

Sash Tusa from Agency Partners. Nuclear keeps on getting stronger and stronger, and it seems to continue to exceed the expectations that you would've had of it even six months ago, but certainly a year ago. Part of that is just the flow coming through MIP, and you've said that may peak or that may have peaked. But I wonder whether, more broadly, you think that there's a risk that MIP and your other nuclear contracts are being used as risk mitigation by the UK government in case there's slippage on Dreadnought?

David Lockwood:

No, because if you look at the dock we just finished, that is to make it capable to take Dreadnought for slippage. So no, I don't think that's the case. And I think we're still in a position where particularly for non-UK work, our ability to bid is resource constrained. So, if we can continue to drive the people agenda, I still think, particularly in civil, there's plenty of growth opportunity in nuclear, so it's a no.

Joel Spungin:

Hi there. It's Joel Spungin from Investec. Just a couple of questions. So, the first thing is on, David, probably for on Skynet, did you say it was a 70 million contribution in the first half? And you mentioned that you've been prudent in terms of the margin. Can you just maybe elaborate on that, in terms of what the margin profile roughly is going to look like, and how long it's going to take to get to a normal level?

David Mellors:

Okay. You know we never talk about individual contracts and margins. So let's imagine that in the fullness of time it won't be a million miles away from our group target. And let's imagine that in the initial year it started off at a very prudent level. So, it is the first year or so. It's that mobilisation phase we've talked about before, where 50% of the issues are in the contract, 30% is in the mobilisation. So, once we're through the full mobilisation... So, give it a year and we should be more confident to recognise it at a different rate.

Joel Spungin:

Thank you. And then maybe just one other one, which is I was wondering if you could maybe talk about the impact of the increase in NI on costs in your UK business and how you are planning to recover that.

David Mellors:

Yeah, okay. So that, overall, for the group at the gross impact will probably be about £20 million a year. As you know, we have some contracts that are cost recovering. So some of that will be recovered straight away through those contracts. Others, we have rolling contract renewals or what have you, so it will be picked up in the fullness of time anyway. And then the net impact is in the noise. I mean, as far as our trajectory to 8% goes, it's just another just road bump really.

Chris Bambury, Peel Hunt:

Morning, Chris Banbury. You mentioned that you didn't go ahead with the tender of the Army Collective Training Scheme. Just really a bit elaborates a bit more on what you didn't like about the risk profile there, that sort of thing.

David Lockwood:

Well, when we look at any program there's, what's the capital employed, what's the risk and what's the margin? Yeah, there's some very basic things. And the more capital employed, the more risk, the higher margin you need. And it just didn't meet our criteria, and we have a sufficiently strong pipeline of opportunities. We don't need to chase things that don't. And one of the reasons for highlighting it was the fact that it was part of our pipeline was mentioned in the Capital Markets Day. But also, I think that bidding discipline, getting that first 50% right, not talking yourself into something you shouldn't really be doing, is one of the core things that grows the quality of the revenue and grows the margin. And it's very easy to take a bad opportunity and put stretch and help, and in the end talk yourself into something. And I think it's a good example of the discipline we now have in our bidding process.

Chris Bambury:

Second question, if I may, the upcoming Strategic Defence Review. What are your hopes and expectations around that, particularly in terms of the reform of procurement? What do you think might happen?

David Lockwood:

So, I mean, both the party in opposition and the government has said a bit like actually the last government said, they want more collaboration where it makes sense and less competition. I think that's good for us, because in long-term frameworks, collaboration means you can do things that are good for both sides. So, I think that's positive. They've talked a lot about sovereignty. Well, we're British, so that's positive. So, I think there are a number of positive themes. I think what we need to wait and see is, how those themes turn into practical policy and process change.

Sash Tusa, Agency Partners:

Sash Tusa, Agency Partners, again. Mentor2, I think you said in the statement it's 800 million. I can't remember if that's euros or pounds or that's close enough. Roughly what would you expect the proportion of capital equipment to long-term services revenues to be? Is it a third up front over the mobilisation phase or a quarter or something?

David Mellors:

Yeah, so the reason I said I'll give you more detail at the full year is I think we need to get the contract finalised first.

David Lockwood:

It could be shaped differently.

David Mellors:

Yeah, it could be shaped slightly differently, but I do expect there to be an upfront revenue phasing.

Chris Banbury:

But for previous contract, Mentor1, roughly what was the proportion?

David Mellors:

So, I don't think it will

David Lockwood:

Sorry. It's not going to look at all like Mentor1. It's not, Mentor1 is not a relative benchmark to Mentor2. The way the customer is contracted, it's quite different. David?

David Perry, JPM:

Yeah, good morning. One for each of you please. David, you had your slide on the international partnerships. Maybe just a bit more colour on AUKUS and also the Saab JV, just timing on any contracts there. And then for David M, please, on your divisional slides you talk about EBIT. On three of the slides, you actually mentioned inflation, but I think maybe in a more positive way than before. Can you just pull it all together and say what the risks and non-risks are of inflation for the group as of today?

David Lockwood:

So, mine is relatively easy. So, for Saab, we are under contract for the design phase. So, like any procurement of its nature, the customer has to sign off the design before we move into the next phases. But so far, our relationship with Saab, which is very, very strong, continues to hold up well and the Swedish customer appears to be content with what we are or more than content with what we're doing. So, I think that's positive. As far as AUKUS is concerned, we have, as we've said before, I think last year we are under contract for some AUKUS support work already in the UK. Do you want to talk about the JV since you're on the board?

David Mellors:

Yeah. So, the JV, actually largely the same as we said 12 weeks ago, there's a lot of engagement with the ASC in Australia, no significant contracts to date. We are obviously working hard with HII around skills, skills development, infrastructure, that kind of thing. And we'll keep you posted. But both us and HII are a very positive and committed to it.

And on your inflation question, so in both nuclear and land, there were a few contracts where we have had a level of contract change to protect against inflation, where historically we may not have had. In the main, we're in a much, much better position than we were two or three years ago on inflation. There was a secondary sort of benefit, if you like, in that even those contracts that had indexation, often it was lagging indices. So, whilst inflation was spiking up, it would go against you, but when it's coming down it's slightly more favourable. So, I think there are a few million in both sectors is the impact, but I think the message is we're in a lot better place from an inflation point of view than we were.

David Lockwood:

Any other questions? Well, that could be the quickest half year we've ever done. So, thank you for coming and we will see you after the year-end audit. Thank you.

ENDS