Babcock

Babcock International Group PLC
FY25 full year results transcript

25 June 2025

David Lockwood, Babcock CEO:

Perfect. Well, good morning, everyone in the room and online. Welcome to the preliminary results for the year ended 31st March 2025 for Babcock International Group. So, quite a lot to cover. It's been quite a year for the group and quite a year for the UK and quite a year for the world. So, I think it's clearly a new era for defence. If you look at what's going on at NATO today, Babcock is represented there because industry is close to government in working out how to make the world a safe place. That is one of the key things that's making the global market conditions increasingly supportive for companies like Babcock. When you have declining budgets, which we've had for most of my working life, industry is somewhere where you make cost savings. So, everything about your relationship is set up like this. At a time when the free world is having to think about how to defend its values, industry becomes part of the solution, so you have a completely different relationship.

If I look at the tone of discussions I was having with governments at the Paris Air Show last week, it's about how do we drive capability? It's about how do we move faster together? It's a together thing. Yes, we need contracts. Yes, we need to be measured. Yes, governments need to get value for money, look after taxpayers' money, but the way in which we're doing it is completely different from a year ago. And that's true also in civil nuclear where we're looking to progress civil nuclear as a key part of the green energy agenda. To partake in that kind of discussion, you need to be a strong company. And we've spent the last few years making Babcock that strong company that is now coming through in financial performance, which has enabled us to upgrade in year, it's given us balance sheet strength and has actually given us some capital to allocate, which not so long ago seemed a bit of a fanciful thought.

So, probably the core of most board discussions, in one way or another, is about capital allocation both through the year and then at checkpoints at the half year and full year. We will come back to our capital allocation policy, but it is primarily about investing for growth but also having a focus on shareholder returns. We've increased the dividend this year and we've announced our first buyback, but most importantly, we've announced an upgrade to our medium term guidance. David will take us through that later. But just to set the scene, medium term in the city is a bounded number of years. David will touch on it, but clearly beyond that, we're seeing increases in spend outside that time window. And when I come back, I want to try and give a picture of the overall landscape, both within the medium term guidance and beyond. But that excitement comes after the key part of the show, which is my esteemed colleague.

David Mellors, Babcock CFO:

Thank you, David. Good morning, everyone. FY25 was a good year on pretty much every measure and my main three messages today are number one, this is a strong set of results with revenue and profit growing well and ahead of our expectations at the start of the year. Number two, cash flow was very strong alongside significant investment in the business, which when coupled with the pensions progress further strengthened the balance sheet. And number three, we've upgraded our medium term guidance and announced the share buyback. So, onto the trading results then. There are some very positive numbers on this summary slide. Some of these were announced in our April post-close statement, and there've been no changes to those numbers, so stepping through them quickly. Organic revenue growth was another year of double-digit growth at 11%. Underlying operating profit was up 17% and margins continued the upward trajectory by 50 basis points to 7.5%.

Cash conversion was 82%, despite the high capital investment in the business, and free cash flow was £153 million, again, despite the high capital investment and £40 million of an accelerated pension contribution. All the above led us to earnings per share growing by 23%, and this enabled a 30% increase in the ordinary dividend growing ahead of earnings and a £200 million share buyback announced this morning. We'll now move on to revenue. This shows the 11% organic revenue growth by sector before we go into the detail. Marine and nuclear were the real drivers of the top line, although three of the four sectors grew in the year and aviation, we expected to be roughly flat due to project phasing. And I'll come back to the sectors in a moment.

Next, profit. This slide reconciles the various numbers to avoid confusion. You may remember that FY24 had a couple of material, one-off items netting to a £73 million charge. There was a £90 million programme charge in Marine and a £17 million profit on disposal of a property in Land. So, last year's reported profit and margin are on the far left of this slide. And then we add back the £73 million net charge to get to the £311 million or 7% in the middle of the slide. And that's a more meaningful baseline of FY24 performers. And against that baseline, we achieve the 17% organic profit increase in FY25 to £363 million. And the 7.5% margin, though the sector detail that I'm about to go through, will use the reported comparator numbers just so that you are aware.

Onto the sectors. And there's a lot of content on these slides for reference, but I'll just pick out the key points. Marine first, it was a good year in marine, a good performance with revenue growing 12% organically. This growth was driven mainly by the ramp up of the Skynet programme in the first full year and the return to growth of the liquid gas business. Now, profit and margin variances in Marine need some explanation as there were a couple of lumpy items last year. As I said, last year had the £90 million programme charge in the sector. So, whilst the reported profit and margin improvement on this slide looks huge, if you add back the programme provision to last year, it then looks like performers went backwards. However, FY24 also had very strong profit contribution from the Arrowhead license sales we made, which were never going to be an annual event. They weren't a one-off, but they were never going to be annual. So, my summary of all of that is that Marine has made real progress in the year operationally on both profit and margin.

And the FY25 numbers are a clean baseline for the future. And the 6.1% margin was a decent return from where we were and importantly, is heading in the right direction. For those new to the story, this sector has about £200 million of zero margin revenue going through it, which is primarily Type 31. And this weighs on the margin in Marine by about 100 basis points and will do for the next four years or so. Also, on the margin, the first year of the Skynet programme has been recognised at a prudent level and we expect that to improve over time.

So, the Nuclear sector had a very strong year growing at 19% organically. Cavendish Nuclear led the way with a 28% revenue growth due to increased demand in civil new build and decommissioning. Submarine support revenues also increased, including the ramp up of the Victorious deep maintenance work and infrastructure revenues or MIP grew in the year to £504 million, but they did peak in H1 following the opening of 9 Dock. Moving to profit. Cavendish Nuclear not only benefited from the very high growth, it also improved its margins in the year as we disclosed at the investor teach-in day last month. And as we said then, Cavendish makes double-digit margins. The Naval Nuclear revenue growth also helped drive a better profit performance. And this was assisted by improved contract delivery, some contract change and inflation recovery within some programmes. And all of these factors restored the margin to a more normal level for this business at 8.8%.

Moving to Land. The highlight of the year was the signing of the £1 billion ‘Reframe’ contract, which is the five-year extension of the army equipment support. And this is not only because it's a really important order, but it's the culmination of several years of recovery from a position where neither the customer nor we were happy with DSG. Revenue growth was more modest in Land overall. We had a good growth period for UK and international defence with vehicle support and build. And there was also growth in South Africa, particularly with equipment sales to the mining industry and this was partially offset by lower revenues in the rail business. On the profit line, last year land had the £17 million property disposal profit, which I mentioned earlier, and that distorts the reported numbers on here. Ignoring that one-off, then profit was up 10% and the margins were up 50 basis points, so good progress. And overall, then, Land reached 7.7% margin, which is much better than the 5% it was on a few years ago and is on the way to a more normal margin for the business.

Onto Aviation. The highlight of the year in aviation was the signing of the French Mentor 2 contract we announced a few months ago. This is another important milestone in the building of a French defence business. On the revenue line, as expected, organic revenues went backwards by 4%, which is the impact of last year's H160 aircraft deliveries in France, with the programme now in the longer term support phase. These types of contracts do have lumpy revenues as aircraft are delivered, and I expect more of that in the future. Moving to profit. Profits and margins both increased in aviation with margins now up to 6.2% and further progression expected. And this is obviously much better than a few years ago when the sector was breakeven.

Moving to the cash flow. This is the usual detailed slide, but I'll only pick out a few key numbers. In the middle of the table, we have the operating cash flow of £296 million and cash conversion of 82%.The first thing to note is that this good cash conversion was delivered while still investing heavily in the business. And you can see this when comparing the Capex line and the depreciation line for both of the years on the table there. And this is the continued upgrade of infrastructure and systems around the group to drive better business performance. Organic investment in the business is our number one capital allocation priority. The second thing to note in the operating cash flow was the very small change to working capital. So, the combination of advanced receipts from customers and programme milestones allowed the working capital to be flat year-on-year, whereas we were expecting a reversal. And this reversal will happen in future, but we'll work hard to minimise the impact on any one year.

Now down the bottom half of the table, we have free cash flow of £153 million, which was good, especially as it's after an additional £40 million of pension contributions, which I'll come on to. So, to me, the business generated nearly £200 million of free cash flow in the year despite the high levels of investment. I know some investors view pension deficit as debt and therefore, consider free cash flow before pension deficit contributions. And on that basis, the result would've been about £240 million of free cash flow in the year.

The second priority in our capital-allocation policy is the retention of a strong balance sheet, and this is important for customers as well as other stakeholders, given the critical things we do. For those new to Babcock, this slide shows how quickly the group has deleveraged from a very weak position a few years ago to a BBB+ company now with a gearing ratio of 0.3x, and this shows how cash-generative the group is.

The other topic which has historically impacted the assessment of balance sheet strength is the pension deficit. As I've said before, we always focus on the actuarial technical provisions measure of a deficit, not the accounting numbers, as this more accurately reflects the cash flows. The key points to note on this slide are that the aggregate deficit of the schemes is now around £125 million, so substantially less than it was in prior years, and during the year, we completed long-term funding agreements with all of our top three schemes, giving both the trustees and ourselves better visibility of the route to self-sufficiency and beyond for the schemes.

And as consideration for these deals, we accelerated £40 million of deficit repair contributions in FY25, and as a result of all of that, we now expect future deficit repair contributions to total just £20 million per annum for the next six years or so, and so that's substantially less than historically. So just to tie things back to capital allocation, our policy states that accelerating pension contributions is a capital-allocation option, should it be attractive. And so, the £40 million accelerated contribution in the year and the benefits it unlocked was capital allocation at work.

So, to the medium-term guidance. At one level, this is really simple. Medium-term revenue guidance and medium-term cash flow guidance continue on the same trajectory as previous, and we've had a double upgrade to the margin guidance. The first upgrade is to achieve the 8% margin earlier than we originally expected, and the second is to raise the target by a hundred basis points to at least 9% within the medium term. At the Capital Markets Day last year, I said that 8% was a waypoint, not a destination, and we expect to achieve that waypoint in FY26. On the revenue line, the mid-single-digit growth is a realistic target given the pipeline of opportunities we have today, and the cash conversion of 80% plus recognises that this is a highly cash-generative group that continues to invest, but also, that we expect some unwind of working capital over the medium term.

Given that the margin guidance is the one that's changed, I just wanted to add some colour on how this is achieved. As you can see from the graph on the left, we've established a track record of margin improvement over the last few years, and you can see that in the sector numbers. The right-hand side illustrates the actions that get us to 9%. These are a continuation of the margin accretion actions delivered to date. The zero margin revenue of £200 million on Type 31, when that trades out over the next four years, that gives us about 30 basis points on the journey. And the remainder is driven through improved delivery, better risk management, and increased efficiency. And the actions that get us there are similar to the ones we've already taken around the group, and there are many examples I can give of things we've already done around the group and many of those that are to come. And this is continuous improvement everywhere rather than pulling one big lever in the centre, and this underpins our confidence in the delivery.

So, 9% plus it is, and with that, I'll now hand back to David.

David Lockwood, Babcock CEO:

Right. I'm going to explain the world in 10 minutes. So, as David said, everything is underpinned by performance. I was asked in a recent investor conversation, "What is the biggest risk in this group?" And the biggest risk is one we will definitely avoid, which is complacency on delivery. We have done a great job, I think, in getting us to a place where we do deliver, but there is still loads to go for, as you saw on David's last slide, and so growth is underpinned by today's performance, and keeping driving performance will underpin all of the subsequent slides. So, whilst I talk about the big stuff, the thing you need to remember is we will never take our eye off the ball of performance,

Because that performance drives access to this market, that there are major structural drivers which are going to be around for a very long time. However, the various conflicts end, the world will feel unstable. Governments will feel the need to look after their citizens. So, for the first time in my career... I just told a journalist, actually I had to wait till my 60s to become cool as a business leader, because it's now cool to be in defence, which is amazing. We actually matter, and people recognise we matter. So, whether it's global insecurity, but also the drive towards green energy, all of these things are moving in the direction of Babcock, and only a high-performing Babcock is able to access those opportunities. And one of the key things in this is to try and combine that with the medium-term guidance and the long-term upside.

The medium-term guidance... I mean, David was supposed to say. He didn't. Medium term is three to five years, hopefully the front end of that. So, it's this term of this government in the UK. It's the current Australian government. We're talking about the current political cycle. So, we're not counting things that are committed into future governments. So, in the UK, we've got a commitment to increase defence spending in the next Parliament and then defence and security in the Parliament after that. That's outside the medium-term guidance window. So, our medium-term guidance is based on what we can see of this, and manage, and that's largely in our control, in that window. There is clearly significant growth opportunity beyond that as governments commit to their increased spending.

So, to access that, you need to be in the right markets. Defence spending almost speaks for itself, where we are with the five eyes, so we do some stuff in the States with things like missile tubes, but particularly the other four, a very strong place to be, and with a growing capability for the export markets. You know our capabilities. You've been to capital markets days. Whether it is military flying, whether it's land support, as we've seen with the DSG refresh, 'Reframe', the ability to operate in the near term is about optimising what you have today, whether through training or upgrade or greater availability. That's core to Babcock's existence. As we look forward, the nuclear subs programme is underpinned in the UK. We're already doing some work on AUKUS. So, there's a whole bunch of key programmes that sit in our time window.

And then finally, I think we've talked a lot about whether we operate through strategic partnerships with SAAB, HII, in Poland, with Safran we signed last week at the Paris Air Show, whether it's a licensing model with PT Pal in Indonesia or whether it's direct export working in conjunction with the UK government. And that ability to collaborate with governments with industry, is core to driving success, and we'll use different models in different places. And as David said, sometimes we'll get a lumpy license fee. Sometimes we'll have a more enduring revenue stream when we're building for an export customer. We'll pick the right model for the right market.

So the UK, as I've touched on, 2.6% within the medium-term guidance window, 3% next Parliament - is outside the window, and then the 5% national security by 2035, clearly outside, but all of it providing a long-term trajectory, and whether it's ultimately 5 or 4.8 or 5.2, what Rachel Reeves said recently is true, which is for the first time in generations, plural, the defence industry can plan on growing budgets, not shrinking budgets. The UK SDR, I'll come on to the next slide, but it largely underpins what we want to do, and as countries are looking at how they're really going to defend themselves, the 'British-first' approach in the UK, the 'Europe-first' approach, is very much driving to identifying key long-term partners. And that's not just capability, as David said. That's strong balance sheet. Are you going to be here? Can we absolutely depend on that if we commit to you for 20 years, that there's a tangentially zero risk of you not being here in 20 years? So being the shape of company that can make those kind of commitments and can be trusted to deliver on them is fundamental to drive the growth.

So, if we look at the SDR requirements, I would describe this as largely confirmatory of our strategy. Some of the stuff, which is growth orientated, which sits outside this Parliament, has the caveat 'when money allows' on it, that's the stuff that's in the next parliament, which will drive further growth. But the commitment to the existing nuclear fleet, obviously fundamental, and the growth into a bigger nuclear fleet. To put that in context on a timeline, the Dreadnought is a 2030s platform. AUKUS is a 2040s platform. So, when we think of it in terms of upside versus medium-term guidance, within medium-term guidance it's largely about the support of existing, plus getting ready for Dreadnought introduction through things like MIP, plus a bit of front-end AUKUS, and then outside that you get the growth into the larger fleet.

Cutting-edge frigates and an affordable navy is obviously core to who we are, and we have the ten-year contract to support the carriers so we're in a strong position to support the transforming of the aircraft carriers into a multirole platform. And I can keep going down. So, in the army, obviously DSG gives more availability. A lot of the training we do will help with this conversion into a more flexible army. Training for next-gen Air Force is obviously key through Ascent, and stuff that we can then take some of those skills, particularly skills on non-flying training, into export markets. So, all of that, fundamental. And then the engine for gross sovereign warhead, well, you know if you were at Cavendish teach-in, that we're a big player in AWE and defence exports. I've said many times, we can only export where the UK has a strong presence and is welcome. It's soft and hard power together. And when we look at where we've succeeded and where we failed, success is where we go hand in hand with government into export markets.

Defence dividend is really important. We have talked about it quite a lot, but never in this language. So, this is about, effectively, how you get societal support for a growing defence budget by showing its broader value-add to society. So, we already make a significant contribution to the UK economy, well beyond the spend by the government. We do a lot of regeneration. A lot of our sites are in quite low-social-mobility, low-economic-growth areas, and so we've already been putting a lot of effort in terms of how we recruit, how we train, use of local SMEs. That is now getting ramped. We're already the UK's largest employer of veterans. We offer every person who is leaving the Armed Forces an interview guaranteed. We help them find the right job and then they get an interview. The government has ambitious targets for spend with SMEs; we already spend over half a billion with SMEs. You can go down the list. We already do a lot of what was defence dividend, but I do think that being able to put a wraparound that and have government value it properly will help secure our position in the UK. And then probably the thing that will excite our employees most is we're going to launch our first ever all-employee free share scheme. (Well, I guess I've just done it actually. Sorry, Louise. Anyway, I've just done it, there I've launched it.) That's the flattest launch you'll ever hear. There's going to be one.

In the civil market, I think the graph on the left is the most astonishing. That's the history of nuclear in the UK, so up to a peak in the late '90s and then in decline. And now in a very short period, if you look at that graph, doubling the maximum we've ever achieved. That's the government's ambition in nuclear. Quite hard to put numbers on what that means to Babcock, except for it's big. And quite a chunk of it, if you look at the shape of the graph, you get that big step up just outside the medium-term guidance period, so we will see consistent growth in Cavendish as you saw and as if you were at the teaching there is just really big upside beyond that, but difficult to quantify.

David touched on capital allocation; organic investment really matters. A lot of our sites were tired, a lot of our systems were poor. David's talked for the last few years about the need to have ‘man-draulic’ systems to achieve control where the automated systems were letting us down so it will drive efficiency. We need both physical and IT investment, that will continue, but it's clearly making us not only a more cost-effective business, it's also improving our operational performance.

Financial strength, I've touched on why customers need to believe in the long term. There's also, in the UK, Rachel Reeves has talked a lot about so-called crowding in private sector investment on the capital front end to level up effectively the spend profile for government and to accelerate capability. Now we're not quite sure exactly how those will play out. We're starting exploratory discussions, but it's really important that we can always play. And it's quite difficult to know at the moment what that ticket price is. But as one of the two major UK defence contractors, it would be a shame if we missed out on opportunities because something came along we couldn't fund. Difficult to know now and I expect that to evolve with the appointment of the National Armaments Director, the publication of the Defence Industrial Strategy. I expect that to become much clearer over the next 12 months.

Ordinary dividend up 30%, I think we'll focus on the increase, not the absolute. And David's touched on pensions. And that leaves two things. It leaves M&A and shareholder returns. We take M&A very seriously. There are key areas where we think it could add value to the business, but we are custodians of shareholder money like governments or custodians of taxpayers money and it has to make sense. We have got quite a long way through two in the year and walked away, I think, for very, very, very good reasons. We won't do it just because we feel desperate to do it, we'll do it when we find the right thing on the right terms.

And the other alternative is shareholder returns. We've looked at the balance sheet, we looked at M&A and we've decided we can do a buyback, this year, because that's part of our capital allocation policy. Doesn't mean it'll be every year. It could be that there's acquisitions one year, but the board, under Ruth's guidance, spends a lot of time talking about capital allocation and the right choices. And then obviously that crystallises at certain points, typically half year on year. I think you can be confident as shareholders that the Board understands its responsibilities on capital allocation to drive shareholder value. The other thing I'd say about the buyback is when we look at our plan and we look at the opportunities, we still think that's good value. It wasn't ‘buyback in the absence of any alternative’, it was because it was the right value alternative compared with, for example, the two acquisitions we looked at. If you look backwards, strong financial performance in the year, as David laid out. If you look a long way forward, the global momentum is in our direction. And if you look in the near term, that's enabled us to upgrade medium term guidance. And then finally, we have a Marine investor event in Rosyth on the 4th of September. Now September is traditionally a really good time for weather in Scotland and that is a small window. I really encourage you to come up and see all of the exciting things that we do in Rosyth beyond Type 31.

And with that exciting questions please. There is a roving mic and I'm not quite sure if we're taking questions online, are we?

Samuel MacGregor, Babcock:

No, just in the room.

David Lockwood, Babcock CEO:

Just in the room. That'll teach you to not come.

Q&A

Sash Tusa:

Thank you, Sash Tusa from Agency Partners. Looking at the medium-term guidance for revenue growth, how much of the £500 million roughly of MIP and £200 million of Type 31 do you expect to have dropped out from the revenues by the end of the far distant part of your guidance period, five years? i.e. should we see that 5% as being 5%, including £700 million of fade and so closer to double digits underlying, or do you still expect to have a big chunk of that £700 million in there, albeit it won't have been growing very fast, if at all?

David Lockwood, Babcock CEO:

I'll let David do the detail, because as you know I get into trouble if I talk about numbers. But we certainly don't expect to stop shipbuilding, so we expect Type 31, this programme, to be replaced by other shipbuilding programmes. It depends whether you count that as a fade or a replace. We expect MIP to continue, but probably not at these levels.

David Mellors, Babcock CFO:

Good answer. I'm not sure what I can add to that. MIP, as you know, is hard to be precise on the forecast. We do think it's peaked. We don't think it's going to disappear so it may tail off a bit. And Type 31, as the programme, will be going for the next four years or so, but we expect to replace that with future programmes. And all of that is baked into the medium-term guidance.

Chris Bamberry:

Morning. Chris Bamberry, Peel Hunt. A couple of questions please. With the margin guidance for 9%, you highlighted about 30 bps of the improvements coming from zero fade. Off the other factors, are any of those particularly important or is it relatively well spread in getting to the target? And secondly on FMSP, could you please give us an update on the progress of the discussions and perhaps how the new contract might differ from the existing one? Thank you.

David Lockwood, Babcock CEO:

I'll do FMSP and then David can do margins. We signed the heads of terms on the replacement programme and now we're into the detail. And it is a big programme if you look at the annual revenues and you multiply that by any number of years, it's a big number to go through the system. The current programme finishes at the end of March this year, so it needs to be replaced, clearly. I would say the big difference is, and it goes back to my opening remarks about how the market's changed, the big drivers really for the last 20 years have been cost out. The big drivers going forward are about on-time and accelerated capability, so us being incentivised and actually the government partners to being incentivised to work with us to deliver more, faster, and bizarrely, not bizarrely, as you can imagine, if you deliver faster generally it's also ends up being cheaper. The big shift is from a cost analytic to an output analytic.

David Mellors, Babcock CFO:

And on the margin, we did have a go at this actually, but if you remember at the capital markets day, we said those six things are quite interlinked. They're not actually separable when you look at it and you think, well, is growth at a higher margin just growth or is it better productivity as well? But I think the simple answer is it's probably broadly spread across all of them. And if you look at the number of actions we've got, it's probably broadly spread. It might be slightly different in different sectors. For example, aviation I think will be more driven by the move to being a defence business. And obviously that's going quite well in France, and you've seen that, but across the group it's probably evenly spread.

Chris Bamberry:

Thank you.

David Perry:

Hi, it's David Perry at J.P. Morgan. I've got three please. First one probably for you, David L. Can you just talk a little bit about the nuclear deterrent in the SDR? Intrigued that it was the second bullet point in the press release and I'm a bit embarrassed to say I don't really understand what they were talking about. They're talking about renew and a sovereign nuclear deterrent/warhead. I'm just intrigued what renew means, I didn't know these things wore out. And they talk about £15 billion. I don't know what that includes and what is the accessible pot for Babcock, is the first question?

David Lockwood, Babcock CEO:

From a submarine point of view. I'll talk about it as I think about it, not as the press release. There are two constituent elements, the deterrent, there are the submarines and the weapon system. On the submarines firstly they said Dreadnought wouldn't get 'LIFEX'ed, which is actually quite important. I should be not of this world when these decisions get made, but you've got Dreadnought, then you've got SSN-A, then you've got Dreadnought replacement. That's laying out the timeline. That's quite important because obviously we LIFEX V-Boats at the moment. That doesn't reduce our workload it just means that we'll do proper deep maintenance rather than LIFEX, which is different. On the deterrent there is a programme at Aldermaston to effectively develop a new warhead including material, and that's what that £15 billion is. And a sizeable chunk of that is accessible to us.

David Perry:

Okay. And has it always been, or is this a new opportunity?

David Lockwood, Babcock CEO:

I would say that there is a growing chunk that's accessible. If you look at the history of Aldermaston or AWE going back a few years, for a while it was a GOCO, Government-Owned, Contractor-Operated, if you're not British, run by Serco and Lockheed Martin. That was then taken in-house, it wasn't renewed. And then they run it largely and now they're going back to a more traditional government-owned, but with significant subcontracts. They're moving to a new model so I would say it's an evolving opportunity.

David Perry:

I was going to ask, my next question is to David M., but I'm going to be greedy and just keep the mic and just follow up on Sash's question.

David Lockwood, Babcock CEO:

Can I just say how much that doesn't surprise me.

David Perry:

Well, Sash asked the question really politely, but I'll just ask it more bluntly. If I read the first 10 pages of your release and I listen to your comments, I can't reconcile it to mid-single-digit organic growth. It just seems like it should be a lot higher. What is it we're missing, or do you think you're just being very prudent?

David Lockwood, Babcock CEO:

I don't think we're being very prudent because we have got a tail-off in MIP to compensate, first of all, because we're not doing the, 'if you don't count this kind' of thing, it's in-aggregate. So, we've got a tail-off in MIP number one. Number two, if you actually just do it from a budget's down point of view, within the time window, budgets aren't growing that much for spend. Governments don't just spend on industry, they spend on the armed forces, they spend on pensions, they spend on all sorts of things. Budgets aren't growing that much in the time period of the medium-term guidance and so I think it's well-centred. Could it be better? Of course it could be better. I certainly hope it's not worse, but I think it is what we can see today that makes sense. We don't have to pull rabbits to make it happen. If we pull a rabbit, we'll beat it. I think what I was trying to lay out is, I think if governments around the world, get near their targets, then there is real opportunity to go significantly beyond, outside that time window.

David Perry:

Okay. Very clear. And then maybe the next two for David M. David, you said in your speech, 8% was seen as a waypoint. What about 9%? Is there anything about the government contracts that give you a natural ceiling, like the single-source regs or anything? Or would 9% also be a waypoint? And then, the second and last one, is, you had a slide on capital allocation, but if I can just probe a bit more. You should, based on the new guidance, generate well over £200 million of free cash flow every year now. So just a split, in particular I'm intrigued, between dividends and share buybacks, unless you do something else. If you could just talk to that?

David Mellors, Babcock CFO:

Right. Okay, fine. So, 9%. I think it's a little early to say whether that's a waypoint or not. I think certain businesses, so Cavendish, for example, are already passed it. I think certain others, particularly ones with regulated pricing as you suggest, may have a ceiling. So, I think for us at the moment, it's definitely a good target. We did say 9% plus, but I think it's a little early to say with the current business mix whether it's just a waypoint that we would then go beyond. So that's that one. I've forgotten your second.

David Lockwood, Babcock CEO:

I'll answer the second one. So, we've seen dividend as a board as a long-term commitment that we won't step back from. At the moment, given where we are and all of the potential capital allocation opportunities, including working with governments plural, buyback is a point-in-time decision. We're not saying that buybacks will happen every year. We're saying this is a buyback because it's this year's decision. If we see a big organic or inorganic growth opportunity that consumes capital, it might not be a buyback in a year. So, one is a long-term commitment, the other is an in-year decision.

George McWhirter:

Morning. George McWhirter from Berenberg. Two questions, please. Firstly, on the nuclear dismantling and refuelling opportunity, I think you won a contract on that recently for about £100 million and I think it was also in the SDR. Can you just comment on how you expect the revenue from that to trend in your midterm guidance, please?

David Mellors, Babcock CFO:

Yeah. So, there's the contract and then there's the overall programme. We do expect it to be a growth engine and, therefore, it is part of medium term. It will obviously go beyond the medium-term window. That contract will spread over a number of years, so in the scheme of things it'll be relatively small, but obviously it's a new contract stream, so it's growth. But we are hoping, and we can't predict the phasing exactly, that this will be the start of a much bigger programme.

George McWhirter:

Thank you. And the second one was just on the JVs that you've talked about. So, with quite a few different companies, which ones of these do you think will be most relevant for you in the midterm guidance, please?

David Lockwood, Babcock CEO:

Oh gosh. I think that's really difficult to answer, and I wish you hadn't asked. I think that's why it's good to have multiple choices. So, if I look at PGZ in Poland, it could just be a bit more frigate support, which is £100 million, currently £100-million order that runs over a number of years, or it could be much bigger. If I look at the deal, we did with Safran last week, if we win two or three of the orders we targeted, that could be material, or we might not win. Ditto Saab. So, I think I would look at it slightly differently, which is we take them all very, very seriously. We don't need to land them all big to hit medium-term guidance. Going back to David's point, if they all landed big, that would be more than we're planning.

James Beard:

Morning. James Beard from Deutsche Bank. Two questions, please. Firstly, you mentioned you walked away from two M&A opportunities during the year. Could you give us a little bit more colour about why you walked away from those opportunities? And secondly, on AUKUS there's been some recent press speculating that the new US administration might be slightly more doubtful about that programme going forward. Can you just give any additional colour from your side on that?

David Lockwood, Babcock CEO:

Yeah. Okay. So, I think in both cases the upside that we could see ... No, actually even that's not true. So basically, when we diligence the business plan, it didn't stack up. In one case, our view was the capex requirement was materially different to the one in their plan, enough to make the plan not valid. In the other case, there were business-winning assumptions that we didn't believe were valid and, in fact, proved not to be valid. So those are the two reasons. In terms of AUKUS, any new administration reviews, all its big programmes, particularly its international one. The UK reviewed

GCAP within the SDR. You could argue it reviewed AUKUS within the SDR. Since the SDR restated its commitment, it must have reviewed it. So, I don't think it's unusual for an administration to review a programme seriously. I think it's a natural thing to do. Nothing we're hearing from our US partners I would describe as worrying at the moment, but they've obviously only just started the review.

Sash Tusa:

Thank you. It's Sash Tusa again. On the single-source regulations office (SSRO). SDR has some quite interesting comments in two separate places about how the government intends to change that and how that SSRO appears even to them to be a burden on industry, rather than a benefit to government. What would you like to see in terms of changes? And do you think we will ever see any material impact from that?

David Lockwood, Babcock CEO:

The answer to that could take up the rest of this, so I'll try and be concise. It's a very good question. It's a really important question. It goes back to what I said about the last two decades. The last two decades has been about cost. SSRO is about cost, inspecting cost, and then auditing costs. It's all about cost. And if that's not your primary concern, it's a key concern, but it's not your dominant concern going forward ... If you want to motivate industry to be innovative, if you want to motivate industry to take on more risks, deploy more capital, that the way the rules are written, don't make that easy.

So, when government talks about collaboration, I think what it's trying to talk about is changing the capital risk, innovation delivery, change that whole dynamic to motivate industry to step up. And the current regs aren't designed to do that, they're designed to control cost. So, I think it will be a big part of the National Armaments Director's job to work out how to measure those things. And the government has indicated they want to do it collaboratively with industry to work out what motivates industry to do those things. So, I think it's actually quite a big opportunity where government gets more, but we can take on more of the things we are good at, so we get more.

Sash Tusa:

Thank you. And then a couple of questions on aviation. Again, SDR states fairly bluntly that the Hawks need to be replaced as soon as possible. It then says the UK needs new fast jets and it uses the term "fast jets." But you seem to be proving in France that you can train pilots to go straight into a combat-capable jet using turboprops. Can you persuade the UK or the RAF of the efficacy of the mental process, as opposed to buying a Hawk replacement?

David Lockwood, Babcock CEO:

Okay, so I read "fast jets" as they need to replace F35, not they need a fast jet. The Hawk is not a fast jet; it's a slow jet. What's a medium-speed jet? It's a subsonic jet. It's a subsonic jet.

Sash Tusa:

My point is it still says "jets" and not "fast jets” directly.

David Lockwood, Babcock CEO:

So, I think the evolution of ASCENT from its current training environment into a new one is one potential opportunity for collaboration. Not saying it'll happen, but clearly it runs for another few years and could be adjusted to deal with a number of these questions.

Sash Tusa:

And then, just final aviation question. You seem to be dipping your toe in the water of some sort of Red Air capability in France, which was something that a couple of years ago you said you didn't want to get into. Now that was specifically related to ASDOT, which had extremely demanding requirements and similarly very high costs. What's changing now? And what do you see as being the next opportunity?

David Lockwood, Babcock CEO:

Now, what we said was we wouldn't do fast jet Red Air and we're not doing fast jet in France. We're doing L39, we're doing the subsonic jet part. In our bid we're working with a company called Top Aces on fast jet Red Air. We wouldn't do fast jet Red Air.

Sash Tusa:

Thanks.

David Lockwood, Babcock CEO:

Any other questions? Excellent. Well, thank you for your time. And I hope to see nearly all of you in Rosyth on the 4th of September. If you think you need a pass, talk to Andrew. Thank you.