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Babcock International Group PLC
FY26 post close trading update transcript

13 May 2026

David Lockwood, Babcock CEO:

Thank you very much, and good morning, ladies and gentlemen. Thank you for joining this call at relatively short notice to discuss our financial year FY26 results. I ought to start by saying we're still in closed period, so we're not doing a full results presentation today, and we can't give any financial information beyond what's in the statement.

As usual, we'll do an overview, some of the key strategic points from today's announcements before I hand over to David to talk about some numbers. Obviously, you all know this is my last calendar year, so it is bittersweet for me because so much is going really, really well, and that actually includes some Type 31 stuff when we get to it. But we have got the Type 31 provision, which David will talk about.

But overall, the financial year was really strong performance across all of the underlying businesses, across all of our medium-term targets. And in November, I talked about the good momentum and delivering growth. And obviously, we are significantly past our mid-single digit guidance, and encouragingly, that's across a range of activities. And that's because what we do in defence and security is still really relevant.

And even as different wars ebb and flow and different debates happen about different capabilities, the core of what Babcock delivers is going to remain and become more relevant for at least a decade, I would say, and probably much, much longer.

We're delivering the growth strategy with an ever-expanding set of opportunities across all the divisions, and that's helped deliver the top line growth of 10%. If you look at the underlying results, we're making significant progress in all areas against our margin targets.

And finally, on the cash flow, obviously, you will see the balance sheet remains very strong, so we've been able to announce a further £200 million buyback programme on top of the £200 million programme we completed recently.

At a strategic level, I think some of the most encouraging developments are in the way we've approached some of the international business. The relationship with Saab continues to strengthen. The relationship our French company has with a number of innovative companies in France and working on how to go to market.

The relationship with HII around AUKUS, Virginia, and so on, and things like the Indonesia programme for the initial £4 billion, but plenty more to follow. So, what would I pick out? Well, firstly, Indonesia, I was there quite recently. This is a whole Government effort on behalf of Indonesia, multiple cabinet ministers and led by the president, and with real impetus to get that under contract across the whole range of activities.

We've talked before about the opportunity for US, Virginia class build, and despite some of the noises out of the US, one of the consistent things is the need highlighted by both the political and official class to grow the supply chain into the Virginia class to accelerate production.

We won our initial GLV orders, both UK and export. This is the Land Rover replacement vehicle, General Logistics Vehicle, which has, we believe, huge potential and where we are Toyota's global partner. The FMSP bridging contract is quite important. It's unfortunate that we had to have a bridging contract and not move to the next long-term relationship. But within it, we see the moves to the new ways of working, which are beneficial for us and for the Government.

And finally, in a joint venture, we became the Government's owner's engineer partner in civil nuclear for the SMR. Across a range of activities, turning prospects into business wins. As I said, the bittersweet is obviously Type 31. At the highest level, when you look at all of the reprogramme, the re-evaluation, we still end up with certainly Europe's and possibly the world's most affordable, most capable general-purpose frigate.

So, the endpoint still remains a highly desirable endpoint. As we've said before, the way we're getting there isn't the most desirable way to get there. And I've said for some time now, ship 1 is really the prototype where we debug both engineering and production. We debug a lot of the stuff that took place. It's from the bid phase in 2017 through its contract award in 2019, engineering through COVID. Ship 1 project after that, we're into programme. There is some contamination of ship 2 by ship 1 because it's caught up because we are getting better.

So although we've hit a very significant number of operational and delivery milestones, as part of that debugging, we have identified the need, particularly in outfit for rework, which has led to updated drawings, which has created additional cost, and in particular, has made us reevaluate our risk contingency to make sure that we have a properly balanced financial view of the programme going forward. David will talk about that.

Rework isn't unexpected, but because of where it's occurred, some of the cost of fixing it, because we've had to burrow deep into the ship, has been more complex and more expensive than we thought. One of the things we've done is entered into an up-to-date engineering maturity review. To take the learning from the compartments we've reviewed and therefore be able to tackle the issues earlier elsewhere.

The charge is obviously £140 million. You've seen that in accounting. You provide for it now, but the cash cost will go out over the rest of the period. It is really disappointing. I can't tell you how disappointed I am. It's not what I would have wanted in this year. But I think it demonstrates that as an executive team and as a board, to be honest, having been on a board call last night, we are determined to always do the right thing and always be straight with you about the state of the business, all the good stuff I've been through, but also some of the less good, and in particular this.

So, with that, I will hand over to David.

David Mellors, Babcock CFO:

Thanks very much, David. Good morning, everyone. As usual, I'll start with three performance messages. We've had strong underlying performance, excluding the Type 31 charge, obviously good growth across the board and margin expansion.

Number 2, we've had very strong cash generation, which I'll come on to. Number 3, we've got a positive outlook. So FY27 opening backlog was good, and we're reconfirming both our medium-term guidance and obviously no change to FY27 expectations.

As I've done before, I'll start with cash flow and balance sheet numbers because these aren't impacted by Type 31, and then I'll come back to the income statement afterwards. If I start with free cash flow, we delivered underlying free cash flow of £262 million, which was a significant improvement on last year. And this was driven by underlying operating cash conversion of 85% before the charge.

And that's ahead of our medium-term target of 80% on average, as you know. We can come back to the detail of that later. We've achieved this while continuing to invest in the business through the Capex line in line with our capital allocation priorities.

And we've looked at the short-term investment pipeline as well as the year-end balance sheet when deciding if we have surplus capital, as we've talked you through before, and we work through our capital allocation policy.

As a result of the cash and what we see in the very near-term pipeline, we've decided we do have £200 million that we will commence buying back our shares after the preliminary results with, and that'll be executed over FY27.

The balance sheet at the year-end remains strong. So Gearing is 0.2x. Net debt is £329 million. I'll now move to the income statement. At a group level, organic revenues grew 10%. We will take an estimated revenue reversal of about £100 million on this Type 31 charge. It goes into revenue and cost provisions. It'll be about £100 million in revenue and about £40 million in cost.

Before that, 10%, this organic growth was driven by strong performances in Nuclear and Aviation, which grew at 14% and 34% respectively. In Marine, revenues grew at 8% on a constant currency basis, largely a continuation of what we saw in the first half. And whilst Land declined overall 3%, it returned to growth in H2.

And if you remember in H1, we were mobilizing the new DSG contract, the defence business has picked up in second half, despite the lag in the civil businesses of rail in South Africa. Underlying profit for the year increased 19% from £363 million to £433 million before Type 31, resulting in an 8.2% margin, which is 70 basis points up on FY25.

And looking at the sector performance, we put the detail, some of the detail in the statement. We'll obviously give you more at the preliminary results. But if we look at operating profit improvements across the sectors, Nuclear increased 23%, Land was up 10%, Aviation 52%, and Marine was up 15% before the Type 31 charge.

And also at the sector level, Nuclear's margin increased 70 basis points to 9.5%, so they're already meeting the group medium-term target of at least 9. Land increased 110 basis points to 8.8. Aviation was up 90 basis points to 7.1. And in Marine, underlying margin improved to 6.5% before obviously the charge.

So, a good performance across the business, revenue, profit, margin, cash, which we'll obviously give you far more detail of at the preliminary results. So now onto the Type 31 charge, which David's talked about the causes. So, this £140 million is a full re-estimate of the programme given recent performances. Ship 1 completed the structural build and moved into the outfit and commission stage.

The revised estimates cover not only production costs of material and labour, but also a revised programme risk contingency for future risk. Obviously, the charge will be subject to audit. It'll be fully recognized as a charge in FY26, with the cash costs being incurred over the life of the programme.

The £140 million, as I said before, will be recognized. We estimate about £100 million of revenue reversal just because of the technical accounting way we do it, and around £40 million as a charge within the income statement. The whole thing will be recognized in FY26.

And so, we'll give more guidance at the preliminary results, but our expectations for FY27 today are unchanged. We started the year with a good revenue cover of around 70% of FY27 revenue under contract at the first of April. It's a similar percentage to last year, but it is good. If I look back over the last few years, it's usually high 60s, so 70 is a good start point.

We reconfirmed our medium-term guidance of average revenue growth of mid-single digit, underlying operating margin of at least 9%, and underlying operating cash conversion of at least 80%. Obviously, these numbers are subject to audit and the detailed review by the audit committee. That will all happen in the proper way before we announce our preliminary results.

With that, I'll now hand back to David.

David Lockwood, Babcock CEO:

So, we're open for questions.

Q&A

David Farrell - Jefferies

David Farrell from Jefferies. I've got two questions, please. Just firstly, in relation to the Type 31, could you just explain a little bit how the combat mission system gets integrated at the same time as doing the reworks that you'll have to do on ship 1?

And then my second question was in relation to the Indonesian licenses. I think you kind of previously alluded to the fact they might drop in FY26 or FY27. Where you stand on realizing those two licenses, please? Thank you.

David Lockwood, Babcock CEO

Okay, I'll have a go at the first one. So, part of the reprogramme David talked about, in agreement with the customer, is to ensure that we don't have what is in engineering and production terms referred to as concurrency.

So, you don't want to be doing engineering and build and integration simultaneously because it compounds the risk. So, we are as far as possible, and there will always be some overlap in ship 1. We have deconflicted structural fit out, and we'll fit, and we will deconflict as far as possible, fit out from combat systems integration. So, it's a very good question, and part of the risk analysis we've been through, and the reprogramming has been to mitigate that risk.

David, do you want to answer the license?

David Mellors, Babcock CFO

Yes. We said in the fourth quarter we thought we might get it by the year-end; we couldn't be sure. We didn't get it by the year-end. So, the £433 million wasn't as a result of the Indonesian licenses. We're expecting those in early FY27.

David Farrell - Jefferies

Okay. Thank you.

David Perry - JPMorgan

Hi, David and David. I've got three questions, I think. Excuse me. The first one is, I know it's not a full results release, so we're going to have to wait to see some of the detail, but any comment at all on what led to the free cash flow beat, where we're going to see that on the cash flow statement would be helpful.

The next one is your outlook statement. You say expectations are unchanged for FY27, year-end, March 2027. I just wonder what those expectations are. I mean, whether they're the same as what investors and analysts are expecting because you've beaten your EPS versus consensus 7%. The new share buyback will add a few percent to EPS. You just mentioned Indonesia wasn't booked in FY26.

I mean, I don't know what that is, but my estimate is about £20 million of license fees. So just wonder if you can give any colour on what you think we should expect for FY27 or what your expectations are. And then the last one is I think you've kept your guidance for cash operating cash conversion unchanged in the medium term, but obviously, you've got to digest this charge, which I think is going to be post-tax. It's going to be about £100 million over, say, four or five years. Just want to check if this cash conversion guidance includes swallowing Type 31 or whether it's like excludes that. Thank you.

David Lockwood, Babcock CEO

Rather wonderfully, David, I think those are all questions for Mr. Mellors.

David Mellors, Babcock CFO

Okay.

David Perry - JPMorgan

Now, David.

David Mellors, Babcock CFO

Yeah. Yeah. Let me try all of those so David doesn't. Free cash flow, we will give you all the detail. On operating cash conversion, which was 85%, it's slightly up. Capex would be a little bit down on where we guided, that would probably be nearer £110 million than £130 million. Working capital was the other moving part, which was very good. And that was across the board. There was no single one-off in that. That drove operating cash.

Interest, tax, and pensions overall were about where we thought they were. So, it's mainly about the operating cash conversion. In terms of FY27, I take your point. We've obviously only just started the year. We've started it with a good backlog of 70%.

As I said, that's a good place to start. It still leaves 30% to book and bill. So, I think it's a little early to change our view of the world, say, for example, with the license popping out of FY26 into FY27. That will certainly help, but let's get further down that book and bill before we revise any of our expectations because it is a good start, but it is only the start. I think in terms of where...

David Lockwood, Babcock CEO

Sorry, David, having said everything, leaving it all to you, just to add to that one, the other thing I would say is we, there is still a fair degree of uncertainty about how the UK will balance its Defence Investment Plan. And I think with our guidance where it is and our expectations where they are, we can accommodate any outcome of that. I think we will once that is however it becomes public, once that plan becomes clearer, then it will be much easier for us to articulate how things go forward. Sorry, David.

David Perry - JPMorgan

No, that's alright.

David Mellors, Babcock CFO

And then the third one is kind of the same answer, but the other way around. So yes, of course, the cash on the Type 31 thing won't help. But as you say, you spread that over the life of the programme, and we'll just have to manage that. It's not helpful, but it's not big enough for us to knock us off course.

David Perry - JPMorgan

Okay. Thank you. Very helpful.

Sash Tusa - Agency Partners

First of all, good morning. It's Sash Tusa here. I've just got a question on the Type 31. And, what I'm sort of like concerned about from today is that you don't seem to have had terribly good visibility into the programme. And what I'm looking back at is notes from the investor day that you did at the beginning of September last year.

Quite a lot of the comments haven't aged very well, I'm afraid. It was described as being a no change programme. Learning curve is exactly as planned, very stable. We got the first 80% wrong, getting the last 20% right. Okay, maybe it's just 90% wrong and the last 10% right. But why do you think that your visibility has been consistently so low in this programme?

You've had to have three sets of charges, over the last four years. Why should investors come away from today thinking that this is it, particularly given that the combat management system is outstanding as an issue?

David Lockwood, Babcock CEO

That's a really good question, Sash. So, if I'll go back to my Type 1 as the prototype. We identified, when I arrived, we talked about three major engineering assumptions that were made in the bid and were subsequently implemented in the design phase, which partly took place pre-bid, in the 2017 to 2019 period, and then in the kind of primarily in the 2019 to 2021 period.

And particularly in fit out, that included assessments around things like firefighting, things like, I think I've said many times the original design was for a 50-percentile male Dane, we designed for a 90 percentile, or 90% of women. And also, a different regulatory environment.

What the debugging in ship 1 has done is identified non-compliance with some of those during stuff that took place pre-bid and during COVID. Why should you believe? Because that is a really good question. Because if you go back to the earlier assumptions, they were largely assumption-based. Because we are now well into the fit out of ship 1, they're now fact-based, and the fit out is what drives the mission system integration.

Because obviously that's where you put in everything that the mission system then integrates into. So, I think I've said many times, we know that the factory acceptance test, the sure test of the mission system has been completed. So, we know it works as a system. So, it's about getting the physical integration of that system onto the ship right.

And one of the reasons I mentioned about the deconflicting earlier on of engineering, build, outfit, and integration is to exactly address that situation. So, if I look at the data set we have now compared with even a year ago, we have a lot more data. It's, it is not good. I mean, no one's trying to pretend this is good. It's not good that we have identified through the prototype engineering errors going back multiple years.

That's not good. But in doing so, we de-risk the balance of the fit out and the integration. And the other thing I would say is David talked about the risk provisioning we've taken to recognize what is to go based on that data. Do you want to add anything, David?

David Mellors, Babcock CFO

I'm not sure there's any I can add, actually. Sash, does that answer the question?

Sash Tusa - Agency Partners

Yes. Thank you very much indeed.

Joel Spungin - Investec

Yeah, good morning, gents. I've just got one broad question I wanted to ask you. Basically, just thinking about some of the media coverage, what's going on in Iran, and some of the stuff that's been out there, criticism of the Royal Navy and the inability to, it appears, get more than one ship out to sea in an emergency.

I'm just wondering like what conversations you've had with your customer, with the Government about the state of readiness of the Royal Navy, whether there's been any blowback to you about the state of readiness, or indeed whether or not the Government's willing to consider, actually, spending more money to improve the situation we're in.

David Lockwood, Babcock CEO

Yeah. Okay. There's lots of questions there. So, in terms of war fighting, obviously there's not much I can. Do we have lots of conversations? Yes, we do. None of them I can really talk about here. I mean, the size of the Royal Navy's capital ship fleet, frigates and destroyers, is public information, and it's a recognized thing that the retirement of old vessels and the introduction of new has led the fleet to be smaller than normal.

So, we do have discussions about what we can do to keep the existing fleet more available. We largely maintain the 23s. We don't maintain the 45s and the OPVs. So, we maintain less than half of the ships that are in use. Is there discussion? Absolutely. So, you may have seen reported, for example, our concept of so-called ARMOR Force or the hybrid navy, when you can force multiplier a frigate or a destroyer with having uncrewed auxiliary vessels alongside it operating as like a mini fleet.

So, we're having strategic discussions, and we're having now availability discussions. In terms of what that might mean, that was what I was really alluding to in terms of Defence Investment Plan. Yeah, how much money the Navy gets for near-term capability is still not clear until that plan is published.

So, it's difficult, we are doing obviously operational things all the time, but in terms of a bigger strategic move that might affect us strategically, we'll have to wait and see what comes out of the Defence Investment Plan.

Joel Spungin - Investec

Okay. That's helpful. Thank you.

Operator

There are no further questions. I want to hand back the... apologies.

Sash Tusa, Agency Partners.

David Lockwood, Babcock CEO

You have to have two, Sash. Otherwise, it's not a proper call.

Sash Tusa - Agency Partners

Well, I mean, there's no point in ending much before about nine to fleeting, is there?

David Lockwood, Babcock CEO

No, absolutely no.

Sash Tusa - Agency Partners

So, I'd just like to pick up on the point that you made about DIP [Defence Investment Plan]. I mean, first of all, just do you have any view? Clearly, we've just got any understanding at the moment of DIP. I mean, do you think it is likely this year, or do you think it's possible that it just gets cut up into smaller parts?

Probably more importantly for you, are your negotiations about the submarine part of FMSP tied at all to the timings of DIP, or are you confident that they are separate from that? And if it's the latter, do you think you can get FMSP over the line within the six-month extension period?

David Lockwood, Babcock CEO

So, the second part's easier than the first, so I'll do that while I think about the first. There is still a nuclear financial ring fence and FMSP nuclear sits inside that, and we've already got the two-year extension on the surface fleet, which partly goes back to the previous question about the surface fleet.

So, the Defence Investment Plan should not contaminate, meaning should not contaminate the discussion. Can we get it over the line? That is everyone's intent. Everyone understands the benefit for both the Government and for us in terms of getting it done, so it's a genuine win-win thing.

Obviously, something of that scale needs to go right to the top of Government, and there are some preoccupations at the moment, so we'll need to get airtime with Government outside the MOD. I don't think there'll be any problem getting it through the MOD.

Well, it's sort of, how's it going to get all the way through Government? So, I wouldn't say it's done till it's done, but I don't think the Defence Investment Plan is in the way, and I don't think that we don't have major disagreement. Well, we don't have disagreements, actually. We don't have any disagreements. We know what we want to do together.

Sash Tusa - Agency Partners

Okay, great. Thanks again.

David Perry - JPMorgan

Hi. Thanks for letting me back. I thought, David Lockwood, I should ask you a question. Can you just talk a little bit about the pipeline? I think a lot of investors, and I was certainly excited about the pipeline chart you showed back in November.

David Lockwood, Babcock CEO

Yeah.

David Perry - JPMorgan

And at the time, you talked about some of those or many of those being secured within 12 months to 15 months.

David Lockwood, Babcock CEO

Yeah

David Perry - JPMorgan

We're six months on and none of them have really been announced, although Indonesia clearly there's been some quite a lot of progress. Can you just comment on how things are going there and which ones look hotter and whether you still think we're going to see some good new business before, I guess it would be before the end of this calendar year?

David Lockwood, Babcock CEO

Certainly. Well, I hope it's on my watch, actually, to be honest. So, if we do civil nuclear, lots of good stuff going on there. Well, Cavendish Nuclear more broadly. And you have seen there the owner engineer contract for the first SMRs, which puts us in a really strong position both as the Rolls-Royce SMRs roll out in the UK, but also, they seem to be having significant export success. And every government will need the equivalent however they structure it.

So, once you're established, particularly if it's a kind of government to government relationship, say like in Czech, we're in a very strong position there. So, I think that I would describe that as that is something we have won and which has further growth potential, along with a lot of other stuff in Cavendish.

In Marine, we have won a number of smaller things, but we did get the FMSP surface ship extension for two years, which again shows kind of our importance to government in the surface ship domain. The Swedes publish the agenda for the cabinet meeting every fortnight, and every fortnight we're expecting to see the decision on their ship on there.

Every fortnight we're told it's going to happen, and then it's not there. So yeah, that's Sweden and Denmark. That's just governments. And as you know, the Danes in the last six months called a snap general election, which also put a delay in, which no one could have foreseen. But those continue. You're right about Indonesia. We're making. I was out there. We were doing an industry day for local industry with full cabinet minister support.

Fantastic session. I mean, that really is beginning to accelerate. In Naval Nuclear, we've talked about the FMSP extension. That is not only an extension, but it's also a stepping stone to the new contract structure. So that was good.

In Land, we have won our first GLV orders both in the UK and export, so that's really good. So that's underway. That's a good example, actually, of Defence Investment Plan because we're obviously the UK partner for the Patria 6x6 vehicle, we've got the GLV competition. That's a good example of where government might do both simultaneously or they might sequence them, it's quite difficult to, going back to the guidance question, to know until we see the Defence Investment Plan, how they position those two programmes in their operational priority list.

So, both are military priorities, but you've got to pick an order. Aviation, you've seen, has had a very good period, and we are actually winning quite a few smallish things, but building real international momentum in Aviation, including in Australia.

Yeah, actually, there's been no headline grabbing big thing, but if you look at the size of the order book and you think we've consumed a whole year of FMSP, but only added six months, and it should have been adding five years. If we'd added five years, i.e., we got another four and a half years of FMSP Naval Nuclear, the order book would be stonking.

David Perry - JPMorgan

Okay, and just one very quick follow on. You said, hopefully, on your watch. When is your last official day, David?

David Lockwood, Babcock CEO

Oh, that isn't agreed. Sometime after Harry joins the board before I leave it. I mean, to be honest, the transition is going really well. Harry's now fully up and running as my deputy, chairing a bunch of stuff. He joins the board in June. There are a bunch of both internal but also external sort of government things.

We'll find the right time to hand over sometime through the summer, and then I'm around into early next year to support Harry and in particular to support some of the international stuff. So, it couldn't be going better, actually. I didn't know that I would like him this much.

David Perry - JPMorgan

Okay, thanks.

David Farrell - Jefferies

Hi. Thanks, Dave. Pretty much everyone else is having another turn, so I thought I would as well. Just in terms of kind of the international opportunities for Type 31, when do those need to Land to ensure that you sustain the right level of utilization at your shipyard in Rosyth? Because presumably you'll start work on ship 5 of the UK order at some point this year.

David Lockwood, Babcock CEO

Yeah. Sorry, carry on. Sorry.

David Farrell - Jefferies

My second question was just maybe thoughts around in terms of capital allocation, how you're thinking about any M&A opportunities that might be on the horizon?

David Lockwood, Babcock CEO

Yeah. So, the first of those is it's more complicated than 31. So, if you came up to Rosyth for the capital markets, I can't remember if you did, missile tubes is very significant. There's still a big support activity that is ongoing there.

We've got the HII work ramping up, and we've got whatever is next for the Royal Navy because the Government have said existing Type 26 and Type 31 doesn't complete the Royal Navy. So, the 31 exports are only part of the picture, and so when we do workforce planning with the Scottish Government, we don't really have a downsizing option, but we do have a kind of how big could big be option and how do they help us with workforce planning.

So, I would phrase the question slightly differently, which is do we have a good plan for managing chunky workload assumptions? Because Rosyth has a relatively small number of relatively chunky opportunities. And I think now one of the things we've been putting in place in the background, which going back to one of the early questions, gives you more confidence about the existing Type 31 programme is a very sophisticated skills management system in Rosyth. So that we can manage the load.

So, I think when you look at it from a Rosyth perspective, I don't think we worry overly about one or other particular opportunity because you don't need to win many to have an upsizing problem, not a downsizing problem. And the second question which I've forgotten was?

David Farrell - Jefferies

Just around kind of thoughts on M&A, given the kind of the capital allocation, £200 million buyback. I know it's something that you've kind of thought about.

David Lockwood, Babcock CEO

Yeah. Yes, there are a couple of things that are ongoing. I would describe them as regional and capability bolt-ons, which we are taking very seriously. In a market that has been very hot, there are some fairly average businesses people are touting around for extraordinary prices.

And I think that's always a good way to destroy shareholder value. So, we are not losing our discipline even though we've now got money to spend. And that's why we're doing the buyback. So, we will continue to look for areas where they are more readily addressed through acquisition rather than organically. But we won't destroy shareholder values to follow them up.

David Farrell - Jefferies

Okay. Thank you.

Operator

There are no further questions. I will hand back to David Lockwood for closing remarks.

David Lockwood, Babcock CEO

Yeah. Well, thank you for that set of questions, and particularly for moving away from 31 at the end. That was a relief. We look forward to seeing you again with the full set of results.