

## **Babcock International Group PLC FY26 full year results transcript**

22 June 2026

### **David Lockwood, Babcock CEO:**

Good morning, ladies and gentlemen, and welcome to the Babcock Full Year FY26 results. I'm David Lockwood, the CEO. We'll do the normal format. I'll do a brief intro. David will go through the numbers and then we have a special star turn from Harry who is going to replace me shortly, and then we'll do Q&A. So please pay attention to me and David while you wait with bated breath for Harry, because I'm sure that's what you really care about.

So when we were rehearsing, we went through what are we trying to achieve with these results? And really it's to make people look through two things, which is the near term turbulence in the UK and the Type 31 and see the strong results of the company as it moves into an even better position. So if you look at the underlying results, they're really good. I'll come onto a slide with those later. And we've reconfirmed the medium term guidance. That includes the cash guidance whilst absorbing the Type 31 charge.

We have really strong differentiated defence and nuclear capabilities. And when I come back after David's done the numbers and talk about the external drivers to our growth, I think you'll see a really tight fit between what we're capable of delivering and what the market wants. And that's come through with real strategic momentum. The opportunity set across everything we do is growing quite significantly. And the most important particularly for a business to government organisation is to ensure that you retain strong disciplined capital allocation to make sure that we never lose sight of our core responsibility to shareholders.

So I thought we'd take Type 31 upfront so that we can then talk about the balance of the business, and David and I don't keep saying, "After Type 31," all the way through. So from a contract point of view, in the last 12 months, rework and productivity did not proceed as planned, particularly on outfit, which really only kicked off in anger in the financial year we're reporting. So particularly on rework, although the number of incidents they were the top end of the expected range, they weren't sort of out of range. The cost of rectification was higher than we thought.

So we've got a revised cost estimate that's involved, taking £140 million charge. Significant portion of that, we haven't split it, but it is an increase in contingency. So we have a very clear set of base operating assumptions to get the program back on track, but clearly we have to work through curves of improved productivity and reduced rework. So we have a contingency to cover that going slower than the base plan says. And as I said earlier, the cash impact is over the remaining life of the program and is absorbed within the medium term guidance. The program itself, however, is making progress. Ship one is now outfitting, as I've said. Ship two is floated off and is in the final top structural phase. Ship three, keel laying has taken place and block assembly is underway, and ship four has commenced. So the program itself continues to progress to deliver the capability the Navy needs.

So when you look through that, this is the strong underlying performance I started with, which is organic revenue growth of 8% above our mid-single digit, margin improvement stepping towards our 9% plus, cash conversion continuing above 80% and a strong balance sheet. Given the number of big programs we are looking at and some of the discussions with governments plural, it's really important to maintain a strong balance sheet. Customers need to have very strong confidence that we will be a reliable supplier for multi-year critical programs to the defence of their nations. And the fact that we can absorb the Type 31 charge inside our guidance is one of the things that gives people confidence that we are that strong company.

So to take you through the numbers that underpin that strong company, my long-term partner in crime, Mr. Mellors.

### **David Mellors, Babcock CFO:**

Thank you, David. Good morning, everyone. As this is David's last set of results, I thought I'd take a minute to reflect on his Babcock career and I'll do it from a shareholder perspective because this is an investor meeting and I'm a shareholder, he's a shareholder. So we'll do it from a shareholder perspective.

So David joined in FY21 and when we did these results five years ago at the end of '21, the only topic of debate was whether we could survive without a rescue rights issue. The share price touched £1.99 and the market cap was about a billion pounds, so we were quite low down in the 250. And as the track record shows, if I can flick it on, there we go. As the track record shows, not only did he not take money from shareholders in a rescue in his time here, he's returned

or is returning half a billion to shareholders. And that's on top of a 400% increase in the market capitalisation of the group. So huge value creation in the time.

From a strength point of view, we were in quite a weak position five years ago. The balance sheet now's much stronger. So again, not just surviving, he's built a platform that's really solid for the future success of the group. And whilst doing all of that, he grew the group over 50% organically, increased the level of profitability and all at a high cash conversion. And that was all done in an ever-changing external environment. So it started off in lockdown with lockdowns and semi-lockdowns in different countries. We've had wars. We've had in the UK alone four prime ministers, at the moment, and four secretaries of state and six defence ministers, all of whom David's had to build relationships with.

So from the outside, it's been an extremely impressive performance, but having had the privilege of being on the inside and seeing all the things every day he's had to deal with, particularly in the early years, I think he's made it look a lot easier than it really was. So from my point of view, it's been a really exceptional innings. So as a shareholder and on behalf of my fellow shareholders, and there's quite a lot of them here, I'd like to congratulate you on and thank you for what you've done for the group. And I think you deserve round of applause.

Right, that's enough of that. Let's do the numbers. Okay, FY26 was a very positive year from a performance point of view, as these highlights show, meeting or beating expectations on all metrics. The majority of the underlying financials I'll present here exclude the Type 31 charge, and that's not because I'm ignoring it. David touched on it earlier. We spent time on it last month, happy to spend more time on it, but I'd like to give the right amount of time on the rest of the group performance.

So stepping through these quickly and before going into detail, organic revenue growth was 8%, operating profit margin improved again by 70 basis points to 8.2%. These first two delivered operating profit up 19% to £433 million pounds and all the above led to earnings per share up 20%. Cash conversion was 84% delivering free cash flow of £262 million pounds and on shareholder returns we completed the £200 million pound buyback just after the year-end and we've announced a further £200 million pounds to be executed in FY27, and the dividend is up 15%.

So let's break down the revenue growth first. This summarises the organic growth by sector. Three of the four sectors grew in the period, led by nuclear as you can see, but with good performances in marine and aviation. The land sector revenues were lower in the period as a result of the non-defence businesses. I'll come back to that. And as the graph shows, all of this led to a 10% organic growth before the Type 31 revenue reversal and 8% after, and I'll come back to the sectors in a moment.

Next is the summary of profit. In absolute profit terms, all the sectors contributed to the profit improvement resulting in the group delivering £433 million pounds for the year, up 19%. Furthermore, as you can see from the slide, all sectors improve their profit margins in the year, helping the group to 8.2% overall. As I've said before, each sector can get to the 9% target in the medium term and are moving in the right direction and nuclear has made it already.

And whilst we're on margin, as you know, we set ourselves two targets a year ago. The first to get to 8% margin for FY26, and the second we raised our medium term margin guidance to 9% plus. As the graph on this slide shows, we hit the 8% in FY26. And as the trend line shows, we make progress every year toward the medium term 9% plus. The drivers of the margin improvement are on the right-hand side here. Basically they boil down to three things, growth of quality business, and that means price and terms as well as other things, productivity of our people, and the efficiency of our processes and overheads. None of these drivers are new. They're the ones that have delivered the improvements to date, but there's still much more to do across the group. So we're confident in the 9% plus.

So we have the usual sector slides now with plenty of content for reference, but I'll just pick out some key points. I've set out the marine numbers before and after the Type 31 charge for clarity, but I'll concentrate on the numbers excluding the charges I said earlier. So it was a good performance from marine, with revenue growing 8%, organically profit up 14% and margins moving upwards by 40 basis points. As we said at H1, the revenue and profit performance improvement was largely driven by the LGE business and the Skynet contract in FY26.

On LGE, you may remember in FY25 we won over £400 million pounds of orders, which was a record period. And we flagged at the time that this was a short term surge in new contracts following the new ship build market. LGE delivered £358 million pounds of revenue in FY26 and that's the biggest reason for the revenue and profit variances in marine year-on-year. On top of that though, the Skynet contract, which mobilised FY25, had additional services contracted in the year. Just as a modelling point, Type 31 revenue before the reversal was £190 million pounds in the year, which was booked at 0%. Nuclear, this has been another very good year in nuclear, in both the civil and naval nuclear

businesses, with good progress on all measures. Just a note on order intake and backlog first. The main reason why the backlog looks low is that we traded the final full year of the FMSP contract revenue in the year but only booked the six-month extension order. So apart from FMSP, nuclear had a book-to-bill of comfortably above one in the year. And once we signed the new contract, the multi-year contract that follows FMSP, the backlog will be substantially more than it is now.

On revenue, both Cavendish and submarine support activity grew well, more than offsetting the expected reduction in infrastructure revenues. So just expanding on all these points a little, Cavendish grew 18%, largely in clean energy, with more work at Hinckley Point, but also growth in AWE. Submarine support work grew 26% with activity increases at both Clyde and Devenport benefiting from some of the infrastructure upgrades as well as productivity improvements in both locations. Infrastructure, or MIP, revenues reduced as we expected following the opening of 9 Dock, last year and then 15 Dock. And all of the above enabled the profit increase of 23% and the margins to reach 9.5%.

Moving to land, revenue decreased 3% organically in the year, due to the declines in rail and the South African vehicle business in our civil revenues. Defence revenues grew 6% in the year after a slow H1 as the new DSG contract mobilised. And additionally, we received some small but important GLV orders, some of which were delivered in Q4.

Margins in land improved well in the year, partly due to the change in revenue mix as civil revenues reduced and defence increased, but also profits had a small net benefit of around £4 million pounds from some contract completions. Aviation had another good year on all metrics.

The 34% revenue growth was due mainly to three things. Firstly, the growth in France from the mobilisation of Mentor II, as well as increasing military helicopter support activity. Second, scope growth and additional services in the UK defence contracts. And third, the mobilisation of the Canadian BC HEMS contract. The profit in margin in aviation are benefiting from the absolute growth in revenues and the increasing proportion of defence revenues. Now 55% of aviation revenues are from defence contracts.

Moving to the cash flow, again, this is a detailed slide for reference. I'll only pick out a couple of the key numbers. The most important number is the free cash flow number, £262 million pounds at the bottom of the slide, substantially up on prior year. Two things really drove this. Firstly, a good operating cash conversion of 84%, as you can see in the middle of the table, and secondly, substantially reduced pension deficit payments in the bottom half of the table. And this is a result of all the work in prior years on pension deficits. And lastly, I've put some full year guidance on this slide here for FY27.

Capital allocation. This is the same capital allocation policy that we published some years ago, and the priority order hasn't changed. We always repeat it to assure you that it hasn't changed and that we continue to apply it. Priority number one remains organic investment in the business. On top of the traditional Capex for productivity improvements and the like, we're working on a number of relatively significant investment opportunities to enhance growth. An example of this would be in Rosyth with the upgrade of the missile tubes facility to allow higher production volumes. We normally expect a strong customer demand signal for such investments, so which ones we end up backing and when will remain fluid until we know. The amount of capital we might need for such investments in the next 12 to 18 months is a key part of our assessment of whether we have surplus capital or not at any one time. The status of priority two here in the policy, the balance sheet strength, is good, triple B plus. And as David said, this is essential for customer and supplier confidence as well as investors and other stakeholders. So, we'll retain the investment grade.

Dividend is number three. And then on the three capital options at the bottom on the left, we've looked at a number of potential bolt-ons, but nothing has yet met our requirements. No news on pensions this year in the middle. And on shareholder returns, you know we completed the £200-million-pound buyback just after the year-end and we announced a further £200 million to be done in FY27. And the buyback also provides an investment return floor for the higher priority options to beat.

So just summarising before I hand back to David, it's been a really strong performance in FY26, meeting or beating on all metrics except obviously for Type 31. We're confident in the FY27 expectations given the revenue cover at the 1st of April of 70%. We're reaffirming our medium-term guidance of mid-single digit organic revenue growth, 9% plus margins and 80% plus operating cash conversion, and we'll execute another £200 million pounds of buyback for FY27.

And now, for the final time, I'll hand back to David.

### **David Lockwood, Babcock CEO:**

Yeah, for the final time. So, the risk of making this a bit yucky over a beer, David and I worked at ... So, we've worked together for 10 years. We have done over a thousand investor meetings, over 20 investor conferences, and over 200 board meetings. So, he was very nice about me, but it has been a team sport. And then just to finish the yuckiness about Babcock, not Babcock's yucky but I'm being a bit yucky, I would say that you cannot deal with what we dealt with without a chair who knows how to be supportive at the right time and challenging at the right time, and Ruth completes the team. So that's been a fortunate thing in dealing with what we dealt with and now for Harry in taking this platform to somewhere really exciting. Anyway, enough of that niceness. And I have to say that Brem's already sorted, so there was nothing in there, just to be clear.

Right. So, start outside in. These are very much the things we said a year ago and they've only become more exaggerated in the last 12 months, leading to, I guess, two big things that drive opportunity. One is the scale of budgets, and however they increase and when they increase, they are increasing. We're not in the UK talking about cuts, we're talking about the size of the increase and whether it funds everything people want to do. Not that the number isn't getting bigger and no one is walking away from their longer-term aspirations.

The second is this move to hybrid warfare that Harry will touch on, when I think our core strength is that we intimately understand the existing portfolio of equipment and therefore are in a tremendous position to look at how that equipment is integrated into the new equipment that comes along to create the hybrid warfare. In civil energy, we've seen tremendous progress actually, not just policy announcements, but genuine progress orders being placed for small modular reactors, sites being identified, planning regulations being changed to speed up the deployment. Government gets a lot of criticism of what it's not doing, but actually the way it is enabling the resurgence of nuclear energy in the UK actually I think is a real success story that's probably undersold and we see that both in large reactors like Sizewell C, and in SMRs, and indeed in AMRs in things like the announcement we made about working with X- Energy and Centrica in Hartlepool.

For the UK, our core revenue stream in the UK is around conventional equipment, the support and supply of mostly support. As you can see on the Babcock current role, we support all the armies, land vehicles, all the nuclear submarines, 60% of surface ships. We do Skynet. So, we are a major, major element of the UK's war fighting capacity today and we're supplying new kit and bidding to supply new kit on things like the general logistics vehicle and the Portrayer six by six. And then we have a good training business that sits at high end training, sits behind that. So, as we look at getting ready for war fighting, in the kind of conventional sense the core skills could not be more important, and you get volume increase through increased utilisation and by the need to adapt for new war fighting.

Underneath that, the big growth opportunities of the move to hybrid warfare with autonomous, un-crude and so on, and here I think Babcock does have a very unusual position because we are not a core technology OEM, we are a very benign partner to tech SMEs. So, we can turn defence tech into defence capability by both production and indeed offering build support and by integrating it into the overall system. And you will have seen through the year, if you follow our press releases, a number of announcements most recently last week in France with a French drone SME when that is the role we play. These tech SMEs do not want to build lots of factories. They don't want to manage the defence customer. They want an interface, so they focus on what they can do well, which is high speed tech generation, and we focus on what we do well, which is turning that high-speed tech into high-speed capability. And I think because we're not a tech builder of our own, we're not predatory to these companies, so we're a very benign partner.

And that leads to what I think is the Babcock advantage, which is we deliver mission-critical defence and strategic resilience by that lifetime capability for tech conversion. And we can do that because we are deeply embedded with the customers. If you have that degree of support to your customers, you know everything about not just the equipment, but how they want to use the equipment today and tomorrow. And then we have flexible partnering models, whether it is with big companies like HII or smaller SMEs like we do with Supacat to deliver vehicles. They are a tech SME. We do volume, we do integration, we work with the army on capability that it's a perfect model for us. So, I think Babcock's advantage is very different from most of our peers.

And that's led to a building of momentum. So, four examples here Indonesia, you've heard about the £4 million framework. In fact, Harry and I are meeting the Indonesians this afternoon to move this through to the individual contracts. This is a classic example of taking some of our core capability, which is the type 31, and then combining it with offshore patrol vessels, inshore patrol vessels, fishing vessels, long range surveillance to create President Prabowo's vision of maritime and protein security for an archipelago nation. UK government export finance is secure. This is about delivery of a complex program that delivers a national imperative for a close ally of the UK. Submarine

build, we're now qualified on the Virginia class submarine, as well as obviously qualified on the Columbia, initial engineering contract has been placed, and then we're moving forward and there's a detailed slide on this, but the HII relationship, really important. Like utility vehicle, we call it the GLV general logistics vehicle. We've won contracts in Albania and the UK, as David said, we started to deliver. We are Toyota's global partner and there are a range of other opportunities in the UK, obviously Land Rover replacement, but more broadly. One army officer in one country said to me, "Having done a trial, I now know why the bad guys have used this for so long. And I think it is a fantastic platform."

And then in nuclear we have the SMR rollout. We've won the owner's engineer contract in a JV model. Whoever buys SMRs is going to need an owner's engineer, a government side person. No one's ever done this before, so everyone needs engineering support on the buying side. Having won the first contract for supporting the Rolls-Royce Reactor, clearly, we're in a strong position to support any government who wants to buy the equivalent reactor.

And that adds up to a 25-year growth story, so not just short term perturbations or even medium term guidance, but in almost everything we do, whether it's defence, nuclear, or defence programs, we can see a range of opportunities that means as a board the company can plan obviously for a budget year, a planning period, but also have a long-term vision and this is before you layer on the world as it evolves.

And just to go a bit deeper on a couple of those, so the HII collaboration is I think a really good example of the direction of travel of the company. So, from nothing except just general conversations two or three years ago off the back of AUKUS, we now have the H&B Defence Joint Venture in Australia, which has its first contracts. Small, but it's up and running. We obviously have and is the bridge head almost certainly into infrastructure at Henderson as the Australians build out. We have what we call armor force, the hybrid navies, where HII already have an uncrewed platform, which is big enough to keep up with a frigate the size of the Type 31, but small enough to operate as a slave to the command ship. So, we're collaborating on that. They have a UUV launch and recovery system, which we are taking into Europe. We are working together on civil nuclear, particularly decommissioning. And as I've already mentioned, we have Virginia class submarine builds. So, we're broadly similar size in our markets. We have a very similar culture and some very significant opportunities in a relatively short period of time for our industry. And for Virginia class submarine building in particular, the lack of capacity in the US system is well known. The president's and indeed previous president's desire to get the build rate up is well known.

Rosyth is I think the only nuclear qualified shipyard outside the US, which is approved to build for either Virginia or Columbia. So, it has fantastic potential to help fill that capacity gap in the US and the aim is to get up to block build. So, we started with a fairing, then we're getting... The aim is to get up to block build and really exciting opportunity where everyone, the customer, HII is the prime, we as the partner, everyone has the same objective. And obviously UK nuclear is entering a multi-decade growth cycle. I touched on it earlier and Cavendish Nuclear is already scaling in that. It is the UK's premier nationally owned nuclear contracting business. So outside any production that we might do of AMRs for people or any other partnerships we might have on the production side, you only have to look at that left-hand demand for nuclear-powered energy that sits in the government's clean energy plan to know that there is tremendous market potential.

And even if that curve can't be achieved and it's slightly flatter, the potential for Babcock in clean energy is just enormous. And that's not a bad place to hand over to Harry, because obviously he's just finished in our nuclear business. He's now operating as deputy, soon to take over, and a lot of what's happened in nuclear on his watch has been that quiet transformation of Cavendish. So, with that, the star turn.

### **Harry Holt:**

Thank you, David. Hi, everybody. So, I've met many of you before at the Capital Markets Day event that we held down in Davenport actually a couple of years ago and then more recently at the nuclear teaching that we did in May of last year. But for those of you that I haven't met, I'm Harry Holt. I'm the deputy CEO and I'm the incoming chief executive officer. I've had a career of two halves. I spent over 20 years as an officer in the British Army, spending time leading men and women on operations around the world, as well as filling some of the key roles in the Ministry of Defence. So, I understand our key customer very well as well as understanding our ultimate end user community. Since then, I've had over 15 years in industry. The majority of that time spent with Rolls-Royce on their executive leadership team in a number of senior P&L and functional leadership roles, notably running Rolls-Royce's nuclear division where I set up and initiated Rolls-Royce's SMR business all those years ago and then laterally as their chief people officer driving a group-wide transformation.

I then spent a year in an electric aviation startup called Vertical Aerospace doing EVTOL aircraft before joining Babcock some three years ago where, as David said, I've been running the nuclear sector. So, it's a huge privilege to be taking over from David. I am fortunate to know the business pretty well and I'm also fortunate to have had a decent amount of time in transition, a period of time where I've been able to orientate around parts of the business that I know less well, particularly overseas, a period of time where David and I have been able to do work together to signal continuity and stability internally within the organisation, and a period of time where I've been able to get out, talk to customers, talk to stakeholders and talk to our people to assess where we might further develop opportunities for the future.

I think it's testament to how well the transition has gone that I've actually been able to put out a series of internal organisation announcements under my signature but on David's watch, which has ensured that we maintain momentum, we don't have a lull as we go through this handover, and the organisations see David and I in strong alignment with one another and they get that core theme of continuity and stability.

A lot of people ask me how do I feel about taking on the reins at Babcock? Well, I feel both purposeful and excited. Purposeful, because what we do really matters. We are living through a pivotal moment in history where all of the major vectors of global change, whether that's climate change, societal change, technological change or geopolitical change are all currently fueling and feeding off one another to create one of the most uncertain, unstable and dangerous periods in recent history. And that's what gives our purpose such relevance and those underlying trends that I've just described I think are unlikely to diminish, irrespective of whether the various flashpoints in the world flare up or cool down and it's those underlying trends that I think make what we do so purposeful. And excited, because of course it's those same underlying trends that are driving growth in our core markets of defence and civil nuclear.

So purposeful and excited. So, this next chapter for Babcock under my leadership is going to be built on the strong foundations that I've inherited and that I've helped to build. And those strong foundations are made up of a core strategy that is still valid, made up of strong alignment between the board and the management team, and made up of a business that has strong capabilities and attractive positions to grow a resilient, to address a growing and a resilient market. That new chapter will have some enduring themes, obviously growth and performance to continue the trajectory that we've been on over the last few years. That growth will require strategic clarity and capital discipline. It'll require us to stay very close to our customers, understand deeply their requirements, and then only invest in the areas where we have strong competitive advantage, and we can generate attractive returns.

I expect focus on the new nature of warfare. This is more sophisticated and complex than simply drones. This new nature of warfare is about increasingly autonomous, un-crude combatant platforms fighting alongside their crude combatant counterparts in all of the fighting domains: on land, at sea and in the air. And it's this connective tissue between the two, the communications, the cyber, the systems' integration, and indeed the training and simulation, as well as the platforms themselves where I expect us to grow. Expect focus on war fighting readiness. War fighting readiness is really code for sweating the availability, the readiness, the integration and effect that we can achieve with today's suite of platforms and equipment. And as David said, and as you know, that is our core business. And expect focus on national strategic resilience.

So, the UK, other NATO partners and key allies are all focused on energy security, they're focused on critical national infrastructure, they are focused on their industrial and supply chain capacity and resilience. National strategic resilience. And then the other theme of performance to maintain our focus on operational execution, we have commitments to the market. We have customers who rely on us for their products and services, and what we do is mission-critical in an ever more dangerous world. So, a continued focus on operational execution and an ambition to go on raising that performance bar over time. So, my initial priorities are indeed on operational performance. I've been really clear with the company, they need to keep their head in the game and not get distracted by all the excitement of a CEO transition. Talent and team to make sure that I've got the right people in the right roles for this next chapter, and also managing the top team through this period of change.

And strategic clarity to make sure that we take stock of the dynamically changing world in which we live. We assess where we've got the strongest right to win and we identify the opportunities for high quality, sustainable midterm growth. So, I will come back in November when we do our half year with more on all of the above. As I said, my very immediate focus over the next weeks and months is to make sure that we maintain our discipline, we maintain our direction, we maintain our delivery and we don't get distracted by David's departure. That gives me enough time to continue this engagement that I've been on with customers, stakeholders and indeed shareholders on the board, so that I can come back in a few months' time in November and lay out our strategic priorities in a disciplined way to make sure that we maximise the opportunity set and maximise value in the midterm. Thank you. Back to David.

**David Lockwood:**

So given the news flash that's just come up, I desperately want to say that we've handled our succession rather better than some other people, but I probably will resist saying that. Oh, shoot. So, as you I hope can see from what I've presented, what Harry's presented here, the board ran a really thorough process that led to Harry's appointment in January. By the time I leave next January, we will have had a fade in, fade out transition that I think enables continuity where it makes sense and change where it makes sense. If I had been staying, there would have been changes to deal with the changing external events. So, change is necessary in all companies. So, I just want to say that I am supremely confident in the next phase with Harry at the helm, will enjoy watching it and will actually not miss my 1001st investor meeting.

So, the summary is where we started, which is strong underlying results that underpin a range of choices for the company and the ability to invest in that exciting future Harry's just outlined. Differentiated capabilities, which I hope you've heard from both of us, that clear strategic momentum with a pipeline of opportunities, which means it's about choices. It's not about searching for things to do, but also as Harry said, that ongoing capital allocation to only going for areas which deliver the appropriate returns with the appropriate risk and the appropriate opportunities to win. So, I think not on my watch, but I think a truly great future for a truly great company is just opening up. And with that, I shall hand over for questions. Remember we do... Well, I haven't chosen say anything about religion, but since it's my last one, we'll do anything.

**Q&A****Sash Tusa, Agency Partners:**

Thank you. Sash Tusa, from Agency Partners. I wonder if you could give us an update in as much as one is possible, particularly given very recent news about FMSP and just lay out the process for renewal of the contract, and what happens if for political reasons the government is incapable of signing a new contract by the end of September, which is the current deadline.

**David Lockwood:**

So I'll do a little bit, but then I'll hand over to Harry, because he's led a lot of the negotiation. We support nuclear submarines that have nuclear reactors in and also retired submarines with nuclear reactors in. There is no way that is going to stop. So if for whatever reason we couldn't get under contract, there will just be an extension to the extension. From a financial point of view, it's not a particularly big deal. The really big thing is once we get under the long-term contract, there are opportunities for both us and the government in terms of performance that can be released. So it's a delay in an opportunity, not a threat I would describe it as, but Harry?

**Harry Holt:**

Yeah, I agree. What we do down in Devonport and up in Clyde is absolutely at the center of what defence does. I mean, we all know that the continuous at sea deterrent is the cornerstone of the UK's deterrence and defence policy. So as David said, that work is not going to stop. We're currently on a six-month extension, the majority of the actual work to get us to the gateway agreement is done. But as David said, it requires obviously funding certainty and also given the size of the deal is going to require pan-Whitehall approval. So those two things have to happen over the next few months.

**Sash Tusa, Agency Partners:**

So if I could just follow up on that, when you say that it needs funding certainty, does that mean that this is all tied up inside the defence industrial plan or is it broader? I mean, what's the nature of the funding certainty that this particular deal needs?

**David Lockwood:**

So no matter what the subject matter is, the list of everything they would like to do is bigger than the budget and the sequencing of that budget on the fringes always is an issue. So nuclear is a bit different from conventional, but on the other hand, it'll have to coexist in a defence budget. So I think there's moving around the fringes between years and so

on and there is some discretionary scope which could be in or out. So it's that, it's not the core being of the facilities, the boats and so on.

**Sash Tusa, Agency Partners:**

Yeah. Thank you.

**James Beard, DB Numis:**

Thanks. Morning. James Beard at Deutsche Bank. Two questions please. I was wondering if you could give us a little bit more color on progress with frigate export sales. We obviously had slightly negative news from Sweden, so any more color around that and potential decision timeframes in Denmark now that they have a new government installed.

And then second question for David Mellors. In terms of the progression towards the 9% medium term margin targets, just wondering if you could give us some color on the expected timeframe there and also the drivers of future margin uplift. How materially do they differ from how you have delivered margin uplift historically?

**David Lockwood:**

Well, I'll answer David's question. So David will say to you that the 9% plus will be delivered in the medium term.

**David Mellors:**

I would actually.

**David Lockwood:**

Yeah. Sweden was obviously a disappointment. It's not a type 31, it's obviously a new frigate design. Actually, well, it's frigate or a large corvette, take your pick. If you read the Swedish press release, Naval Group and the kind of ship actually comes quite a long way down. It starts with a lot of the geopolitical stuff, the government to government. And we have always said that these competitions comprise three elements and the weighting is different between the three elements. There's an industrial element, there's a Navy to Navy element and there's a political element and these decisions almost always get made by head of state, not secretaries of defence. So we believe we had a very compelling, probably the most compelling industrial offer, but there are other forces at play in Sweden as you can imagine. The easiest thing is to read their press release.

Denmark is different because the spec is a type 31 type spec, so that's the first thing. Secondly, the origins of type 31 are the Iver Huitfeldt, the current incumbent Danish frigate. And the industrial element matters a lot more in Denmark than it does in Sweden. So the weighting is different in Denmark and the core drivers are different. It is a head of state. I mean, it is a new government, it's a head of state decision ultimately. So difficult to put a timeline on it. I think if you ask DALO their procurement agency, they would say their work is done. So it's when it gets to the top of a prime minister's inbox and I'm not going to guess that. David, your question.

**David Mellors:**

Right. Well, as David said, it's in the medium term. The drivers are the same. They're the ones I laid out. We said a year ago the medium term, we deliberately don't time box these things because we're all human, it does lead you into silly things. Margin and risk go together. There'll be times when we deliberately take say cost plus type arrangements, which typically would be lower margin because that's the sensible thing to do given the risk profile.

So the margin progression will continue. Obviously it's slightly easier when you're down at 5% than 8.2, so it won't always be at the same rate that we've done historically. So for example, I'll give you an illustration. When we did the Capital Markets Day in Davenport, we said that the new team at the time had reduced the number of operational processes on the site from 5,000 to 2,000 and they'd done that quite quickly. Now there are still plenty of productivity improvements to make, but you can't keep taking big steps like that the higher up you get. So the medium term, which last year was say three to five years away was about the right timeframe.

**David Lockwood:**

Told you so. Next question.

**David Farrell - Jefferies**

Thanks. Hi, David Farrell from Jefferies. I actually think both of my questions are for David Mellors, I'm afraid. Just when you look at the 30% delta for this year's guidance in terms of the top line, can you just kind of explain what fills out 30%? I think you said you're 70% covered for the current year from a revenue perspective. And then I think I read a couple of weeks ago that the SSRO calculation had changed around the profit uplift on the risk side of things, potential uplift kind of being potentially 10%, not 2%. Can you just kind of talk to any changes in the SSRO calculation and how that might benefit?

**David Lockwood:**

I'll do the second one actually, because I'm just feeling like I can.

**David Farrell - Jefferies**

Please do.

**David Lockwood:**

So there is currently what is known as a sprint, although it's not really a sprint, led by the Defence Joint Industrial Council looking at a whole SSRO consultation thing, and there was one of those two years ago that led to no change. So there is lots of talk, but at the moment, I can't remember who you've nominated for the sprint, but ...

**David Mellors:**

Linda.

**David Lockwood:**

Linda. So it's a joint government... Linda's really good. There's a joint government industry what makes sense for every one review. I think it's foolhardy to prejudge it because at the end of the last one, nothing changed. Sorry, do you want to give a different answer to that?

**David Mellors:**

No, I'll give you one. So the other 30%, which is normally just slightly higher than 30%, we still have really good visibility of. We have framework agreements, but as you know, we don't count orders until they're contracted. So a lot of it is the contracting of expected work under frameworks, which happens regularly. There'll be work that can't stop but is just let on a slightly shorter term basis, and so a lot of that we would expect to just come through over time.

Normally we're at about 90% of the year under contract by the half year, that's another measurement point I always put in, and then we should have it all by kind of end of January, February as it comes through. There are some smaller businesses which have much less of a forward load like the vehicles business in South Africa, but very much more marginal. So for the defence businesses, we've got pretty good visibility and it's mainly the contracting of stuff that we can see or is under frameworks anyway.

**David Farrell - Jefferies**

Okay, thanks.

**Chris Bambery, Peel Hunt:**

Morning, Chris Bambery, Peel Hunt. Just looking for a bit more flavor of the M&A pipeline. You had a couple of potential opportunities in NDAs in terms they've obviously not come through. Just could you give any more flavor of what happened there and some of the current opportunities you have.

**David Lockwood:**

Yeah. I mean, maybe Harry should talk about the current opportunities because they're going to happen on his watch. But I think if I talk about the discipline, which I'm sure will remain. So there were one in particular, which was outside the UK in a country we're very keen on. We got a long way through diligence and spent decent amount of money and then we found a very significant accounting issue that was both a valuation point, but also we were very much believe we were acquiring a strong management team, probably stronger than our own.

And over time as we got underneath the skin of the problem, that led us to conclude both that we couldn't get to the price, but also particularly in terms of the people capital, we weren't sure we were getting what we thought we were getting. So that's a good example of just doing proper diligence, taking time to reflect on what that diligence tells you and then acting in the interest of shareholders. So that's the kind of thing that happened. Pipeline, Harry?

**Harry Holt:**

Yeah. So we've got a strong pipeline which we keep under constant review. Obviously given what's going on in the world, the valuations in our core markets of defence and civil nuclear are quite high at the moment. As David said, it's really important that we maintain discipline. We haven't done M&A for a while, so we need to make sure that when we get back into the acquisition market, it's with a business that makes sense for us and we can integrate it properly.

**Chris Bambery, Peel Hunt:**

Thank you.

**David Lockwood:**

I was going to say we've got ... Oh, we've got time for one more.

**Sash Tusa, Agency Partners:**

Thank you. So I just wonder if you could give some color on where the major infrastructure program goes from here. Revenue's down last year. Does that now just continue to fade out or does it stay at broadly current levels for a bit? And what's the phasing of the last two docks at Davenport under that?

**David Mellors:**

Yeah. Do you want me to do numbers?. Okay. So from a numbers point of view, you know we can't forecast this accurately so we'll give you a range. I would expect somewhere between 400 and 450 this year and we'll keep you updated. So similar-ish and again, as far as the out years are concerned, we'll keep you updated as we go along.

**Harry Holt:**

Yeah. And more generally at Davenport, obviously we've got the 10 dock program and we've got the five base and berth program, but outside of Davenport, the requirement for the defence nuclear state to recapitalise is well known. So we would expect recapitalisation both at Clyde and maybe even in Rosyth. And then as David mentioned earlier, the whole Aukus opportunity is heavily focused in these early years on infrastructure at both Osborne and Henderson, and so we would hope to be able to address that market as well.

**David Lockwood:**

Yeah. And the other thing we have mentioned in the past is although they haven't decided how to contract it yet, there's potential infrastructure opportunities with AWE as well. So thank you all very much for your time and for those of you who I've known for a very long time, who've come up with all the questions that have made these things interesting, thank you for your participation.

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