QinetiQ
Interim Results

Video Webcast

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Transcript

Steven Lamacraft: Good morning everybody. Welcome to our FY25 interim results. Thank you all very much for being here in person, for making the effort. We appreciate it. And for those online as well, thank you for joining. I'm joined by our CEO Steve Wadey and our new CFO Martin Cooper. And without further to do, I'll hand over to them, but thank you very much.

Steve Wadey: Great. Thank you Steven. And I'd like to add my welcome to you for joining our half-year results today. It's great to be with you and look forward to your questions later. Now, I know many of you do know him well, but I'm really delighted to introduce Martin Cooper, our new group CFO, who formally joined us in September and it's been really great to have Martin on board and I'm really enjoying working with him.

We've achieved a good first half performance across the group. This has been delivered thanks to our incredible people who are committed and have delivered our high value services and products that are critical to national defence and security priorities. This picture is a great example. The 10-year, €284 million contract signed in August to deliver aerial training services where we play a vital role supporting the operational readiness of the German Armed Forces. Our strategy is working and we have a good long-term outlook to deliver enduring value for our customer's mission and our shareholders.

Our agenda today is as follows. I'll start by giving you a review of our first half performance. Martin will then provide a commentary on our financial results. I'll come back and give you a strategic outlook. And we'll then open up for questions both here in the room and online.

So our review of the first half. Let's start with our headlines for today. First of all, I'm very pleased that we have delivered good consistent operational and financial performance across the whole group against a backdrop of significant political change and an evolving threat landscape. Secondly, we remain on track to deliver £2.4 billion of organic revenue at approximately 12% margin by FY27. And our visibility to the achievement of this goal is increasing. And finally, with our strong balance sheet and continued discipline on capital allocation, we're announcing today an extension of our £100 million share buyback program by a further £50 million. In summary, we are well positioned and have a clear strategy to deliver long-term sustainable growth and compelling value for shareholders.

Moving on to our financial performance. We secured more than £1 billion of orders in the half demonstrating high demand for our capabilities. With a book-to-bill ratio of 1.3. Revenue is up 7% through consistent operational performance. Up 8% on an organic constant currency basis. Operating profit is up 7% with stable margin of 11.3%. This has been achieved through strong program execution across EMEA services, and pleasingly, our performance in global solutions, including Avantus, has been in line with our expectations. We've achieved good cash conversion at 84% with leverage at 0.6x, excluding the benefit of the £112 million sale of Cody Technology Park, of which the proceeds have now been received in our second half. And as I've just mentioned, we've extended our share buyback program and maintained our dividend growth at 7% increasing shareholder returns. Overall, we've delivered a good first half performance and are on track to deliver our full year guidance.

This performance has been underpinned by a number of significant operational highlights across the group, including the €284 million contract in Germany that I mentioned earlier. Major highlights include commencing the next phase of work on the DragonFire laser weapon program to accelerate the deployment of this disruptive counter-drone technology onto Royal Navy warships in 2027.

We delivered critical work to NATO. This includes a maritime exercise in Portugal to experiment with the integration of autonomous systems. And we commence the design of Formidable Shield 2025, which will be NATO's largest integrated air and missile defence exercise.

In Australia, we continue to perform under the major service provider contract winning $148 million of new orders to provide engineering services on critical land ammunition programs such as the new Naval Strike Missile.

In the UK, we won a three-year contract worth up to £150 million to help deliver the next generation of tactical communications for the British Army, adopting new technologies to enable better and faster decision-making on the battlefield.

Our US business achieved more than 10% on-contract growth across our major five-year programs that provide engineering services and mission support for the Space Development Agency, Strategic Capability Office, and the Tethered Aerostat Radar System program for Homeland Security. And I'm really pleased that we won a significant aerial target systems contract from the US Army. A brilliant example of our strategy in action entering the US market as a prime contractor by leveraging our world-leading expertise in aerial targets and training services across the group.

Now, whilst each of these highlights are significant in their own right, many are just the start of programs that underpin our long-term outlook, and I'll come back to that later in this presentation. With that, I'll hand over to Martin who can take us through our financial results.

Martin Cooper: Thanks, Steve. And good morning everyone. It's just over two months since I joined QinetiQ and I've already been able to get to see many of the operations and business sites firsthand, enabling me to get a clear view on the value drivers, capabilities and opportunities that lie ahead. Many of you will know that I've worked most of my career in the defence and security sector, and I truly value the critical importance of what we do for our customers.

Here at QinetiQ, the depth of embedded capability in our teams, the technology innovation we perform, and our differentiation, and hence opportunity set going forward is outstanding. And there are a number of areas we can help the external market to better understand the high-quality, critical and enduring nature of what we do. These are the main reasons I joined, and I'm delighted to be here working with Steve and the wider team and bringing my skillsets to the business to further build on what has been a strong multi-year period of growth for QinetiQ.

My near-term focus will be on driving further value-accretive organic growth, and continue to strengthen core business processes. So as we grow in scale and complexity, we do so from firm cost-effective foundations. Turning to the results for the half. I'll start with the financial highlights before moving on to the key financial metrics at a group level and details on our two reporting segments. I'll finish with outlook and capital allocation. For reference, the dollar rate for the half averaged 1.29 compared to 1.25 last half, which has provided a headwind to the reported growth rates of around 0.5% for revenue and profit. And as usual, the technical guidance is in the back-up material, and I'll be very happy to take questions at the end. So onto the numbers.

Reflecting the strong demand environment for our six distinctive offerings, we booked over £1 billion of order intake, up 9% on a strong comparator last year. Backlog remained flat versus FY24 at £2.9 billion. Revenue increased to £947 million, a 7% reported increase, resulting in a book-to-bill of 1.3x. Program execution on the backlog and milestone adherence was good across our major contracts, driving the strong revenue and underlying operating profit growth, both at 7%. Underlying basic earnings per share at 14.2 pence increased by 6% as the higher effective tax rate more than offset the ongoing benefit from the buyback program. Turning that profit into cash was much improved at 84%. It underpins our full year guidance of circa 90%-plus.

Good business performance and cash generation allows for effective and value creating deployment of capital. Shareholder returns have increased in the period with excellent progress made against our buyback program with £46 million of shares retired, and the £32 million final dividend paid. Return on capital remains strong and at the top end of our midterm guide of 15%-20%. And as Steve referenced in a continuation of our disciplined value-enhancing capital allocation, we are maintaining our 7% progressive dividend and an increase to the current buyback program of £50 million, which we expect to roll on after the completion of the existing program in January. So a good reported first half in line with full year expectations all delivered against a geopolitical transition in the UK and an FX headwind.

Moving to the key group financials, starting with orders which grew 10% on an organic basis. Orders booked in the period included the 10-year contract to provide aerial training services in Germany, as mentioned by Steve at the start, continued demand on our engineering delivery partner program, and in the US, the next year of funding was received for FY24 contracts won together with new business and on-contract growth on the Space Development Agency and Strategic Capability's Office programs. During H1, we received £133 million of new contract awards in the US of which £61 million were multi-year and unfunded. This is lower than the prior year, which included the major order wins for SDA, SCO, and TARS.

The chart at the bottom right highlights that we closed the period with a robust funded order backlog of £2.9 billion with the additional US unfunded backlog of £0.6 billion, we have a total position of £3.5 billion providing excellent visibility for future growth. Revenue for the half at £947 million grew 8% on an organic basis as we executed effectively on our order backlog. At around 46% of our expected full-year guidance this is in line with our usual cadence and underpins confidence in our full year guide. Growth was driven by strong performance in our engineering delivery contracts in the UK and Australia, together with increased volumes in aerial targets across the world.

As we look to the second half, our revenue under contract is at a similarly high level to last year of approximately 90%. Our good program execution and milestone adherence led to a 7% increase in underlying operating profit to £107 million at 11.3% operating margin consistent with last half year and our guide for the year. At the right you'll see a table reconciling underlying operating profit from segments to statutory profit covering the key points. Income from research and development expenditure credits is in line with last half year. Amortization of intangibles is down on a reported basis due to FX impact, as the intangibles primarily relate to the US and Australia acquisitions in recent years.

As outlined in May, the digital platform represents a discrete multi-year investment project to enable our global growth strategy and our AUKUS customer needs. We continue to expect around £25-£30 million of additional spend over the next three years, which will fade through to completion. The values here reflect the implementation costs. All recurring costs such as licenses and maintenance are reported within the underlying cost base. And as a reminder and as outlined in the release following the sale and lease back of the Farnborough site under IFRS 16 and right-of-use accounting, a one-off non-cash accounting loss of approximately 30 million is expected to be recognized as a specific adjusting item at full year.

Turning now to the segmental splits of the group performance, starting with EMEA services. Orders grew 16% to £730 million at a book-to-bill of 1.2x. This drove funded order backlog up to £1.6 billion, excluding LTPA, providing visibility on our sales growth expectations. Revenue growth at 10% was driven primarily by execution on the EDP framework contract and growth in the Australia sector. Operating profit grew to £83 million on continued good operational performance, delivering margins at 11.5%, consistent with the outturn for FY24.

Next to global solutions, which posted total orders of £304 million at a book-to-bill of 1.3x. As we saw good order flow from US funding on FY24 contract wins and on contract growth together with strong aerial targets orders, as referenced, earlier new unfunded orders in the period reduced due to a higher year prior comparator. Funded order backlog is up 17% on year-end to standard £0.4 billion. Together with the strong US unfunded orders of naught 0.6 billion, we have confidence and visibility in global solutions growth in the coming years. Global solutions revenue was in line with last year's half with a number of moving dynamics. There was increased revenue from the TARS and SDA contracts, which led to growth in the legacy Avantus business. The US Robot CRS(I) program completed, but that was offset by higher levels in our targets and other product lines.

On the back of this sales mix change margins increased slightly. So overall global solutions and EMEA services have delivered in line with our expectations in the half and are well positioned to carry that through to year-end. Cash generation was strong with £131 million of net cash flow, which equates to a conversion ratio of 84%, a particularly good performance given the FY24 high cash conversion of 104% was in large part driven by early receipts from FY25. CapEx spend was £49 million in the half tracking in line with our annual projected £90 to £120 million spend. As we continue our investment in infrastructure and capability enhancements. £21 million of this relates to investment in the LTPA. And as a reminder, the LTPA Capex is funded through the contract. This means that although QinetiQ funds upfront investment, it's paid back through depreciation over the contract.

To complete the cash analysis, the movement in net debt is shown here. We generated £47 million of free cash flow and delivered a significant step-up in shareholder returns at £78 million. This increase in shareholder returns meant the leverage ratio increased marginally from year-end to 0.6 times. For clarity, this excludes the impact of the sale and lease back of the Farnborough site. The proceeds were received at the end of October. And all things being equal, lowers the leverage by 0.2 times.

So pulling all that together and moving on to the outlook. On the back of a good half, our guidance for the full year is unchanged with us expecting to deliver high single digit organic revenue growth compared to FY24, at a stable operating profit margin and cash conversion at circa 90% plus. At FY27 outlook is also unchanged with its on track to achieve £2.4 billion of organic revenue at approximately 12% margin with high levels of cash conversion. And to help you with your models, we've provided an estimate in the statement of the net debt movement expected at year-end, taking into account the sale and lease back and the extended buy-back program.

Finally then let me turn to capital allocation. We continue to see the business delivering strong cash flow and the focus and priority is unchanged from the prelims in May, with the near term actions prioritized on driving program performance, investment in the business and organic growth. Alongside our progressive dividend policy, we continue to see buybacks as a compelling component of shareholder returns as illustrated by the progress made on the current program and our announcement today of extending that by a further £50 million. We are comfortable our balance sheet position and it gives us flexibility for growth and enables the potential for further shareholder returns as we look to deploy capital in the most value enhancing manner. In summary, this has been a good financial half underpinning our full year and FY27 guidance. Our high backlog and opportunity setters are a strong indicator of our prospects, good operational performance, seeing that translated into consistent sales and profit growth. And through our capital allocation, we are demonstrating that we will allocate our growing returns in ways that continue to create value.

Finally, I would like to thank all our teams for delivering for our customers and this half year result. Before handing back to Steve, I'd like to clarify that going forward, we will drop our pre-closed statements in April and October and instead move to a more normalized reporting cycle of a Q1 update in July aligned to our AGM, interim results in November, a Q3 trading update in January, and the preliminary results in May.

With that, back to you Steve.

Steve Wadey: Great, thank you Martin. So let me now take you through our strategic outlook. The global threat environment continues to evolve and there is rising global instability. Ongoing conflicts in Ukraine and the Middle East, as well as growing tensions in the Indo-Pacific are accelerating the pace and expanding the breadth of the threat, further stretching allied capability across the globe. In two of our three home countries, new governments have or are taking office, the Labour government in the UK and the Republicans in the US following last week's election. And in Australia there will be an election early in the new year. In this period of political change, the importance of international cooperation through alliances such as NATO and

AUKUS will continue as our governments look to respond to the highest threat environment for a generation whilst balancing fiscal pressures and budget prioritization. Within this world of significant tension and change, the need for strong national defence and security capability will endure. Focused on building greater resilience and rapid modernization to stay ahead of the threat. Our strategy and unique value proposition are well-matched to respond to these market dynamics.

Within this geopolitical context, the changing character of warfare is driving our customer's capability and investment priorities shown on the left-hand of this slide. Irrespective of the current market dynamics, these priorities will continue to drive demand for our differentiated capabilities, research and development, engineering services, test and training, and cyber and intelligence. Let me give you four examples. Achieving technological superiority is driving the need for autonomous systems and human-machine teaming. These next-generation systems are as a result of long-term R&D into disruptive technologies. As seen by our pivotal role in the US Army's Robotic Combat vehicle program. The proliferation of drones is accelerating capabilities into service by adapting systems to new missions. Our expertise in engineering services has recently been used to help adapt a Royal Navy air defence missile for use against ground or surface targets. The need to maintain operational readiness requires tests and training against highly representative threat scenarios. As a global leader in test and training, demand is increasing for our unique capabilities. As demonstrated by the German and Spanish Air Forces both coming to the UK for their long-range missile firings.

Finally, national security requires an edge in the cyberspace to enable superiority in the battle space. As an embedded partner of scale in both the UK and the US, we have a critical role to support our defence and intelligence customers with our cyber and data intelligence solutions. Our differentiated capabilities are highly relevant and critical to meeting the enduring needs of national defence and security.

By focusing on our customer's needs, partnering with industry and investing in our capabilities, we have progressively won larger, longer-term programs enabling us to deliver consistent performance and attractive returns. Today, our combined healthy order backlog and pipeline is worth more than £15 billion, approximately eight times our FY24 revenue.

To give you an insight into our pipeline, I've shown 10 examples of our major growth drivers that are both a mix of renewals and new business opportunities. Let me highlight three of them. In the UK, negotiations on the long-term partner agreement are going well. And next year, subject to government approvals, we remain on track to secure the contract extension through to 2033, continuing in our role as the UK's strategic partner for test and evaluation. In Australia, the government has identified Test & Evaluation, Certification & Systems Assurance, known as TECSA, as a sovereign priority. And our formation of Team TECSA is a great example of industrial leadership, bringing together the best of industry and academia for the benefit of our Australian customer. And in the US, based on our strong delivery on the TARS Program, our border surveillance system for Homeland security, we have a significant opportunity to provide the equivalent program in Poland through a US foreign military sale.

Whilst we may not win all of the examples shown, our pipeline is robust and prudent with many additional growth opportunities beyond the £11 billion identified. We have significant revenue visibility underpinning our confidence in delivering long-term sustainable growth for many years to come. In order to stay relevant for the long-term, we remain focused on investing capital into our people, technology and capabilities.

As announced in April, I made a number of new leadership team appointments, Martin as group CFO and also Iain Stevenson as Chief operating Officer, both on making a significant and positive impact in the business. In delivering for our customers, the single biggest contributor is our people. We continue to make progress, creating an environment where they can all thrive with our highest ever level of employee engagement. Cutting edge technology is a key enabler of our growth and we continue to invest approximately £20 million per year in R&D aligned to our customer's priorities. Developing industrial partnerships as a route to market for our technology is critical to delivering attractive returns. Good examples are our laser technology with MBDA in the UK, autonomy with Oshkosh in the United States, and electric drives with RENK worldwide. To create more value for our customers and support further growth opportunities, we're investing in our digital platform to improve the exchange of technology and information, as well as collaborative working across the company. As an example, the Team TECSA, opportunity that I've just mentioned will benefit from increasing collaboration and leveraging capability between the UK and Australia.

As Martin just said, investing in the business and organic growth is core to our growth strategy, building an integrated and differentiated company that delivers long-term value for our customers and our shareholders enabled by our talented people.

So pulling this together, we have a clear investment case, which is unchanged. Our company has a robust purpose-driven strategy. We are focused on our AUKUS customers and their allies with a unique value proposition, which is aligned to their priorities and highly relevant to the enduring and evolving threat. By continuing to execute this strategy underpinned by disciplined capital allocation, we will see increasing demand for our capabilities and achieve our guidance, shown on the right of this slide, delivering high single-digit organic revenue growth at good operating margin with high cash conversion and attractive return on capital employed. We are a differentiated company with a good long-term outlook, delivering attractive returns to our shareholders.

So in summary, faced with continued and rising global instability, I'm incredibly proud of the outstanding skills and capabilities of our people, fulfilling our purpose by serving the national security interests of our customers. Building on our strong track record, we have delivered good consistent operational and financial performance across the group. We remain on track to deliver £2.4 billion of organic revenue at approximately 12% margin by FY27. And our visibility to the achievement of this goal is increasing. And with a strong balance sheet and continued discipline on capital allocation, we are increasing returns for our shareholders with a 7% dividend growth, and extending our share buyback program by a further £50 million.

In summary, we are well positioned and have a clear strategy to deliver long-term sustainable growth and compelling value for shareholders. Thank you. And Martin and I have been now happy to take any questions.

So we'll take questions first in the room and then we'll go online And just in terms of protocol, if you can say who you are and your organization and then we'll answer your question. Sam.

Sam Burgess: Great. Thank you. Sam Burgess, Citi. Just three if I may. Firstly know that continuing resolutions have impacted the US business in the past. Any thoughts on whether a GOP sweep could make that revenue a bit more predictable?

Secondly, I noted that in the revenue by customer slide, the level of DOD revenue is halved year-on-year and government agencies seem to have substantially increased. Is that a change in the customer at Advantis?

And then finally, just on the army training transformation contract, I know that several prospective contractors have dropped their bids. Any colour on how you think about that contract, and why QinetiQ a best place to deliver on it?

Steve Wadey: Okay, great, Sam, I'm happy to take all of those. I'm already thinking what can Martin answer in those, but maybe I'll start each of them.

Martin Cooper: I'm ready. I'm ready if you need.

Steve Wadey: I would start on each of them and then maybe we'll get some sort of bills from Martin.

Martin Cooper: Absolutely.

Steve Wadey: I think first of all on the continuing resolution, and obviously you are right and it's fresh news today with the throughput of both houses last night. I think the main thing I would say is, and we said this in May, we planned for it. We planned for what would happen with the UK election. We planned for what would happen with the US election. Therefore, we've assumed a level of disruption in our guidance. So irrespective of what this means from a continuing resolution, we're confident that we will execute in line with the guidance that we have given.

In terms of your second question, the mix, good spot in the appendix where you can see the balance change is exactly what you said. If you remember that the Avantus customer base, includes intelligence agencies, it includes Homeland Security, not just DOD. DOD was more the legacy, and we've seen some of those programs such as CRS(I), if you remember, come to a conclusion at the beginning of this year. So again, what you see there in the difference between US DOD and other US customers is exactly what we planned in terms of the mix of the business changing post the acquisition.

On ACTS, I think that you saw it on our pipeline chart of one of the 10 major opportunities. And those pipeline opportunities, we really consider those as high quality, good contracts that we can and go with.

And I think that takes me to a broader point that our strategy and our discipline only really considers those high-quality contracts. So they've got to be in line with our strategy, training is absolutely central to our strategy around create it, test it, use it from a value proposition, and they've also got to meet all of our financial hurdles in terms of margin or capital and returns.

So ACTS for us is absolutely on point as a strategy. The British Army have a real need for innovation and partnership. If you've followed the story of the current chief of general staff, he's looking at objectives to significantly multiply the lethality of the army.

A program like ACTS is an integral part to that. We believe we've got a really strong team. We're delighted to be partnering with KBR and PA Consultant. We've got a very compelling value proposition. We've got a track record of partnership. We have many long-term partnerships that we're adding value to our customers.

So yeah, we're pretty excited. We're one of, we believe now, four remaining teams left in that competition. We think the requirement will endure. We look forward to the down select, but it's on point strategically and it'll meet our financial hurdles. Otherwise, we wouldn't be proceeding with a program like that.

Hopefully that answers and, Martin, you can think about where you'd like to navigate and build.

Martin Cooper: Yeah, perhaps just I'll very much leave three to you, Steve, as you've covered.

I think just to build out on one and two, I think on the CR at the start of the year in May, then Stephen has, quite rightly, sort of around lessons learned and we'd planned appropriately for a CR. I think it's about 10 out of the last 11 years there's been a CR, so everyone's well versed to it and used to it. It's all about the extended length. And I guess that's to your point, Sam, is hopefully it might be a bit shorter in coming years given where it is. But I think also in our review we don't feel that our orders and sales to go will be too impacted because we've done a good scrub of that. So we feel good around navigating the CR this year.

And I think just to the second point, again, as I sort of referenced in my script, but to give you some more colour, I mean on the space development agency, the TARS contracts, there have been some very major revenue growth drivers in the second half, which are obviously non-direct DOD. And similarly on the order intake, I think you'll continue to see that. So some of our major orders, as we said on the SDA, over $45 million of orders booked in the first half, high numbers on SCO and TARS as well as we see that on contract growth. So I think you'll continue to probably see that mix shift carry on.

Sam Burgess: Great. Thank you.

Steve Wadey: Thanks, Sam.

Joel Spungen: Hi, there. It's Joel Spungen from Investec.

Steve Wadey: Hi, Joel.

Joel Spungen: Hi. I just got a couple, so maybe can I just start with the margins?

Steve Wadey: Sure.

Joel Spungen: Obviously you highlighted obviously margins and EMEA services were down a little bit, up in global solutions and you explained obviously mixed affecting the global solutions margin.

I was just wondering, within EMEA services, you said it was in line. Why were your expectations that the margins in EMEA services would come down in the first half? And is this the sort of pattern that we should expect for the full year, i.e. a continuation of higher margins in solutions, lower margins in services?

Martin Cooper: Yeah, sure.

Steve Wadey: You want to take that?

Martin Cooper: Steve, yeah. Sure.

I mean I think if you look at the exit rates of the half and the full year number, that was 11.5, which is exactly what we've delivered. So that's why it was in line with our expectations. As ever, you get contracts rolling on and off in the year. In the last first half of last year there were a couple of contracts that rolled off that led to some risk retirements and profit, but that's just natural. So 11.5 is what we ended last year. That's why we guided to that level. So very comfortable, nothing to flag. So I would expect a fairly similar level in that sort of elevens-ish range for the full year.

And similarly on global solutions, again, this is a bit more driven by the product mix. As I said, the CRS(I) program, as I think a lot of you know, wasn't a very high-margin program, and that's been replaced by some other programs like the aerial targets which generate more normalized profits. So again, fairly similar. So we didn't want to make a big thing up or down about either of those. It's just normal course of business.

Joel Spungen: Maybe if I just one more question just on the sale of the Farnborough site. I was just wondering is that very much, I mean obviously it's a one-off, but are there other assets in the portfolio that you could look to do something similar with? Or is this pretty much it?

Steve Wadey: I mean, if you look back over the last three or four years you'll have seen a number of property disposals. This is the last, and it's certainly the biggest. The number of sites that we now own as a company is very few, and we lease our sites.

And I think this is a very good example of our strategy in action and the discipline on capital allocation. Our business isn't really being a landlord. You'll have seen from the announcement our occupation on the site had come down to about a third of the site, which meant in terms of investment and management, it was quite a significant activity. So it's much better that we've got a world leader property developer nurturing and growing that site, and they've got some great plans that are kicking into action now, which we'll be the principal tenant, but other tenants will benefit from that. And it means that we can put our capital to work where our shareholders and we would want it, which is on investing the business and following through on the capital allocation policy.

So we're very pleased with that deal, and it's in line with our strategy, but there aren't another two or three of those to come, unfortunately.

David Farrell: Hi, David Farrell from Jefferies. A few questions from me.

Reading an interview with Shawn Purvis last night, she talked about an expansion into Huntsville, in Alabama and that's being significant for QinetiQ's US growth strategy. Can you just talk about what the significance of that is, please?

Steve Wadey: Yeah. So it is a good point actually, David. So if you understand the industrial landscape and the customer landscape in the US, Huntsville, Alabama is a major growing area. It's called Rocket City, actually if you want to get into the colloquial term, and actually we want to build presence there. US Army is dominant, NASA and space is dominant around that area, and we've strategically decided, as we've gone through our reset last year and we've focused our growth on national defence and security priorities, to make sure that we are focused on the customers down there.

So I mentioned one of the operational highlights that I'm delighted, we sort of pointed to it in May and it happened, was winning this aerial target systems contract, ATS-3, that is the US target system management office based in Huntsville. So this is about building proximity to our customers and looking to expand and grow on areas aligned with our strategy.

So Shawn will have been talking about that, and I think we opened the office maybe 10 days ago, and that's going to build our capability and our presence aligned to that customer.

David Farrell: Okay, thanks. I have a couple more follow-ups. We've obviously got the defence review ongoing in the UK as a result of the change of government. Can you maybe talk to kind of how that might be impacting your intelligence business, in particular the award or contracts that are coming through perhaps, or not coming through?

Steve Wadey: Yeah. I mean, it's not dissimilar to my answer to Sam's question about continuing resolution again, and you heard Heather and I talk about this in May. We knew that we were going to an election, I think the day before our results, I think, it was announced and in setting our guidance for the year, we did plan for a level of short-term disruption, and I think we have seen a small slowdown in that area, but nothing that fundamentally sort of questions or challenges our view. I mean, we are very pleased if you look at the current UK government posture, pleased to see its commitment to the 2.5%. We wait for clarity of exactly when that will come. The fact that the defence sector has been identified as one of the eight priority growth sectors, I think that's very important. Something not just in my role as chief executive of QinetiQ, but leading the defence growth partnership for the UK is something I'm very pleased to see.

And within the SDR, both on defence and intelligence, we put a very strong input into the SDR as a company, and we've had some great dialogue on that submission. I think our core thesis going in is we need to focus more on innovation and partnerships to achieve more with whatever resource defence in the UK gets allocated through the comprehensive spending review.

And I think that reinforces one of the core messages I was trying to get across today is that whatever the outcome of that SDR, it will underline and drive the importance of our enduring capabilities, research and development, test and training engineering services and, to your point, cyber and intelligence.

So I think that let's park any short-term disruption, which is quite frankly normal through a new administration and SDR, and focus on the long term and with a really healthy backlog and pipeline, we are confident on our in-year guidance and the multi-year guidance that we've shared.

David Farrell: Thanks. And maybe a final one for Martin. I think this time last year you grew at 16% or 19% organic revenue growth. We've obviously seen 8% today. It's really impressive.

How are you delivering that? Is that headcount? Is it greater amount of pass-through revenue coming through? Is it better utilization of assets? How can you really break it down for us to understand the drivers of growth?

Martin Cooper: Yeah, it's a very good question. I mean, I think if you look at, there's a question that I think the full year about headcount growth in EMEA and that was strong last year in the first half, that's stabilized. It's not grown as much, but we've obviously exited that rate with the higher number of people so that throughput, we are seeing increased task order work. Back to Steve's point around demand environment, there is a little bit around some of the nature of contracts.

So it's quite hard to unpack, but if you stand back around the fact that, yeah, our guidance is 7 to 9%, this is bang in line with what we'd expect to be doing. So there are always going to be puts and takes of the different portfolio. We've seen some good growth in Australia in the first half, for instance, around some of the engineering services work, some high-growth task orders as well. On the flip side, some programs have dropped off so that's the nature of where we are now.

So on a headcount basis, it's not grown so much in the first half, but we came out with the strong backlog and the exit rate from last year to deliver that. And so that's why I think we're tracking at the rate we are.

David Farrell: Thanks, Martin.

Steve Wadey: I would just build on that. I think Martin is absolutely right and if you remember and Heather broke this down, the 16% had some, yeah, other factors like high inflation benefits, so you can't quite compare the 16 with today's environment of eight.

But Martin's core message is absolutely right. We're in line exactly with what we planned, the good programs, good program execution. Should also remember on resourcing that when we win certain programs, when we won the TARS contract in America, the resource came with it because we were replacing, we displaced an incumbent. So yes, some of our program execution is through recruitment of new programs, but some of it we bring, yeah, the resource with the contract win so you have a mixed effect.

Martin Cooper: Yeah, thanks very much.

David Farrell: Sorry to be clear, it was the fact that you had a high hurdle last year to go up against, not that the 8% should be higher.

Martin Cooper: Yeah, absolutely.

Steve Wadey: Yeah, but to your point, it's absolutely in line with what we guided. We gave the rationale of why we would be in the seven-to-nine category and we're in the middle point.

Martin Cooper: Yeah, thanks.

Richard Paige: Morning, Richard Paige from Deutsche Numis, a couple from me, please. You obviously make no secret on strategically you've focused around the AUKUS agreement. We're obviously seeing European spending increase in recapitalization there. To what extent is that an opportunity for the business, please?

Steve Wadey: Yeah, I think a couple of things, Richard. Thanks for your question.

I think, first of all, yes, we've said AUKUS is important, but I'd just like to clarify because sometimes the word AUKUS means different things. First of all, I'd start by clarifying our strategy right from 2016 has been focused on AUKUS nations so the demands of Australia, the UK, and the US. And I think the core strategy was launched about focusing on each of those countries.

AUKUS is a partnership, as you are right, brings additional sort of vectors. It brings the nuclear submarine program, and it brings other disruptive technologies, what's known for the experts in the room, as Pillar 1 and Pillar 2. And I think that sometimes I say that deliberately, Richard, because I think people think, well, is our whole strategy based on AUKUS Pillar 1 and AUKUS Pillar 2? No. It's focused on those three countries and the benefit of the Pillar 1 and Pillar 2 agreement.

You'll also notice that we've been very clear that our strategy refers to AUKUS and its allies. We have presence in Germany, we have presence in Canada, and we nurture opportunities with those countries. You'll have seen in the last couple of years talking about NATO and the importance of NATO. One of the operational highlights I shared today, I think it's very meaningful. If you can go and look up the experimentation exercise online, it was called NATO's REPMUS exercise. It was a huge exercise, 13 or 14 nations in Portugal looking at how do you fundamentally force-multiply a maritime force through the integration of autonomous drones. And in fact, the team that were part of designing and running that exercise, two weeks later, they were in Australia doing exactly the same on a program called Autonomous Warrior. And now we've got Formidable Shield coming back to the UK next year, won a significant contract in the half, and we're preparing for that.

So yes, Aukus, because the core three countries are Aukus countries, but I think it's a lot more than that. I think NATO, Germany, Canada, other opportunities. I've referred to, Poland today. A great opportunity. We've got a strong reference, brilliant performance execution going on in the US on our TAS program. The US and Poland have just signed an MOU in the summer and they want another repeat, effectively, of the TAS system in Poland. And we're the only multi-site provider in the world of Tethered Aerostat Radar System. So there's an opportunity through a USFMS program to provide a repeat. So it's a great question because when you look at this ten-year pipeline, there are a lot of opportunities that aren't just what people might be perceiving as Aukus. Thanks for your question, Richard.

Richard Paige: Secondly, targets, phenomenal growth again in the period... the framework contract we've just mentioned in the prior questions in the US. To what extent are you able to leverage those opportunities to other parts of the business?

Steve Wadey: Sorry, in what sense, Rich?

Richard Paige: In the sense of being able to build on that with bringing other parts of kinetics offering?

Steve Wadey: Well, I think it's a great question, and I tried to bring out that for many years our strategy is not running independent businesses in independent three countries. It's about the power of collaboration to create value internally that brings value to our customers externally. And I'm genuinely delighted with the win of ATS-3 in America because it proves you very point. It proves your very point that we, well, A, we acquired brilliantly with the ATS program. We integrated it well into the company we acquired well with Air Affairs and also with our business in Germany. And the ATS-3 win in America is about leveraging capability. We took our people and our skills in Australia, Germany, and the UK, and were able to put a proposition, to the earlier point from Sam, which was very compelling to the US Army. So we've leveraged capability and got, effectively, an additional return on that investment now through the contract that we've won. And we'll execute that as we go into the coming months and years.

So that principle of leveraging capability is core to many of our opportunities and therefore internal collaboration on this pipeline and everything that sits within this pipeline is a key enabler. It's also why we've invested in our discrete digital platform to enhance the way we collaborate internally within the company, within obviously security constraints to drive this growth. So, yeah, thanks for the question again, because it illustrates leveraging is key to the additional value that will be created through this strategy.

Martin Cooper: I think that just to perhaps build on that as well, I mean if you think about your first part and your second half and you link to the huge capitalization going on in many countries now of aircraft, the threat around there, around un-crewed systems and various other things, everything that we do looking forward, be it through targets, testing, evaluation, testing things is all going to become very, very highly relevant for a lot of countries who haven't necessarily had to do this for a long time or done it. So we do feel we're very well positioned and, to Steve's point, so for me, those two questions are quite closely aligned across the whole getting platforms into service.

Richard Paige: Thank you. I was about to say, I'm conscious you want to get Martin involved, so I was going to ask a simple national insurance question.

Martin Cooper: Simple? Simple? I'll stick to targets, I think. Sure, Richard.

Steve Wadey: Go for it.

Richard Paige: I'm assuming it isn't a major factor for you, we just want to check that in terms of the UK changes of-

Martin Cooper: Yeah, I mean on our basis calculation at the moment, we think it'll be around a £7 million impact. I mean, we will look to be able to cover that off in the coming years through efficiency in the business. So we don't expect any major impact to our guidance at all. Obviously, it will only kick in for FY '26 for us coming on the 1st of April, but we don't expect material impact to guidance for that. We'll look to cover that off. And there has also been some tweaks around RDEC as well, so we might be able to get a little bit more RDEC credit out also.

Richard Paige: Brilliant. Thank you very much.

Steve Wadey: Thanks, Richard. Any more questions in the room? Okay. Should we go online? Are there any questions online? There are.

Operator: Yep. To ask a question over the conference call, please sign by pressing star one on your telephone keypad. And we do have a question from George McWhirter from Berenberg. Please go ahead.

George McWhirter: Oh yes, good morning. Thanks for the questions.

Steve Wadey: Hi, George.

George McWhirter: Two, please. Hi. Morning. Just following off from Richard's question on the targets business, at the CMD last year, I think you mentioned that the threat representation business generated about 200 million Australian dollars of revenue. So following this 95 million US aerial targets contract, what growth rate do you think that the targets business can generate in the next three to five years? As I assume it's probably likely higher than the group average. And the second question is just on capital allocation. So the balance sheet remains pretty under-levered despite the expansion of the shared buyback. So how are you thinking about the shared buyback versus M&A and what does the M&A pipeline look like? Thanks.

Steve Wadey: Okay. Maybe I'll take the targets point. Maybe, Martin, you can do capital allocation.

Martin Cooper: Yeah. Sure. Yeah.

Steve Wadey: I'll come back with a few thoughts on that as well. So well remembered, George. We did talk in our capital markets day about the importance of targets. And you've seen through the results, and Martin brought it out financially that our targets business is growing. In fact, we should broaden the term, we call it our global threat representation business. It's not just targets, it's targets, it's the services of targets and it's also our airborne training services. And you're right in terms of the rough scale. And I think to keep it simple, this is just one of many contracts in the airborne target and services area that supports to our ongoing growth. And you are right that we would probably expect to see growth rates there as we have over many years that are slightly higher than our normal global solutions growth rates.

And the reason for that is... In fact, it's what Martin just said. As our various customers are training and enhancing their operational readiness, they need more representative threats to train against. And that's why we're seeing the increasing demand. So the ATS-3 contract is just one good example created through leverage across the group where we're actually fulfilling that increasing demand. And I think you'll remember from the capital markets day, we said we are probably in the top two or three leaders in the world now on providing threat representation and we do expect that market to grow. We've just done an independent study looking at worldwide trends in threat representation and we see it as a really good underpin for the future as part of our strategy. And my last point, George, on it would be, let's just remember why we focused on threat representation and it's because it's an integral part of the core enduring capabilities that we see for our customers. So if you are a world leader in test and training, you need to be able to represent the threat for our customers to test and train against.

And that's why we effectively chose to vertically integrate into this area and then expand across the world because we knew over a long-term cycle that this would see increasing demand. So hopefully that answers your question, George.

Martin Cooper: Thanks, Steve.

George McWhirter: Yeah. That was Great.

Martin Cooper: I think I'll just build on the targets as well. The $95 million was a framework contract. We wouldn't expect all that to come to us, so just don't build all that into us, although we expect to grow the business as you said. But just for clarity, not all that $95 million will come our way, unfortunately. Right, onto capital allocation. I mean, I think it's really a reiteration, George, of my statement messages as you've just heard. I mean Steve and I are very happy with the leverage that we currently sit at around a sort of a 0.4, 0.5 times once you take into account of the sale-and-leaseback number. We're very strongly of the view that at the moment we're focusing on organic growth, as you heard, in investing in the business and driving the best business performance we can on an organic basis.

And, within that, we'll also maintain a very balanced capital allocation framework. So you have the ongoing CAPEX spend that we've outlined and including with the R&D and OPEX spend at sort of around £120 million a year. We've got your progressive dividend at 7% growth that's consuming around £55 to £60 million a year. And then at the moment we have the buyback programs ongoing, which obviously we see as very compelling value at the moment. And that utilizes most of the free cash flow and keeps the leverage as it is, whilst also giving us flexibility for growth going forward, but also for further shareholder returns should they meet our criteria. And at the moment they certainly do so, Steve and anything to-

Steve Wadey: And I don't want to repeat what Martin said. I fully agree. As we said in May, George, our focus is organic in the near term. We've got a really good capital allocation policy. You've seen the discipline in that with what we've presented and the additional share buyback today. And the focus, absolutely, is on investing in the business and investing in those opportunities in the pipeline to drive our sort of underlying long-term growth. Of course, acquisitions are part of the long-term strategy and if they're value accretive at the right time, we'll consider them in the future. But that's not our focus right now. It's absolutely on the organic growth that both of us have reinforced. Hopefully that answers your question, George.

George McWhirter: Yeah, that's really helpful. Thank you.

Operator: Thank you. And as a final reminder, that is *1 for questions over the conference call. There appears to be no further questions over the call, so I'd like to hand the call back over to you, Mr. Wadey, for any additional or closing remarks.

Steve Wadey: Great. Thank you. First of all, just come back to the room, has anybody got any follow up or additional questions here? Okay. Great. Well thank you for your time. Good set of results and if you've got any further questions, happy to follow them through after the event. Thank you.

Martin Cooper: Thank you.