QinetiQ Group
Preliminary Results 2023

25th May 2023

QinetiQ
Great. Well, good morning, everybody, and good to see you all here. Welcome to you in the room here, but also those joining us online on the live webcast. This is our full year results for FY '23, and we've got some really exciting results and new ambition to share with you today.

I'm John Haworth. I'm the Group Director of Investor Relations for QinetiQ. And I'm joined here today by Steve Wadey, our Group CEO; and Carol Borg, our Group CFO. As normal, Steve and Carol will run through the presentation, after which there will be an opportunity for you to ask questions. Thank you very much. Steve, over to you.

Steve Wadey - CEO

So good morning, everybody, and welcome to our results for FY '23. Thank you for joining us for those here in the theater and also those online. I'd like to start by thanking our incredible people. They have responded to the heightened threat environment and supported our customers to deliver a really excellent full year performance across the group.

In March this year, the President of the United States and the Prime Ministers of the United Kingdom and Australia announced a pathway to developing next-generation nuclear powered submarine incorporating technology from all 3 nations. This historic announcement demonstrates the first commitment of the AUKUS trilateral partnership to cooperate on the most sensitive nuclear technology.

They also made a second commitment to further trilateral collaboration, strengthening their joint capabilities by enhancing information and technology sharing as part of their shared mission of global security and stability.

Our purpose and strategy is directly aligned to serving the national security interests of our AUKUS customers. With a strong track record of growth, and increasing demand for our high-value solutions, we are upgrading our long-term guidance.

The agenda this morning is as follows: I'll start by giving you the strategic and operational headlines. Carol provide a commentary on our financial results. I'll come back and provide you with a strategic update and then Carol and I will jointly give you more detail on our financial strategy and the upgraded guidance. We'll then open up for questions.

So let's start with the headlines. We delivered excellent operational performance across the group. Orders are up 41%, a record high of GBP 1.7 billion, growing our backlog to GBP 3.1 billion. Revenue is up 20% and profit is up 30%, up 11% and 12%, respectively, on an organic basis, excluding the impact of the write-down in FY '22.

Cash performance remained strong with 106% conversion and returns are healthy with EPS up to 26.5p and the full year dividend at 7.7p and up 5%. Significantly, through the disciplined execution of our strategy, we have more than doubled the size of our company over the last 7 years.

Looking forward, the defense and security context is heightening the long-term market demand for our distinctive offerings. As a result,
we now see an addressable market of more than GBP 30 billion per year, and we have delivered a step change in our global growth platform with 2 strategic acquisitions in the United States and Australia. Both are performing well, and integrations are on track.

Based upon our building momentum and expanded market opportunity, we are targeting high single-digit organic revenue growth at 11% to 12% margin and have increased the scale of our ambition to grow the company to approximately GBP 3 billion of revenue by FY ’27, including further strategic acquisitions.

This upgraded guidance will approximately double our revenue and profit over the next 4 years, a 20% improvement to our previous guidance. To realize our increased ambition, we have a robust plan with the right skills and capabilities to deliver our future growth sustainably and enhance shareholder returns.

Our excellent performance has been underpinned by a number of significant operational highlights across our 6 distinctive offerings. In the U.K., we secured our largest contract of the year, a GBP 260 million renewal of the Maritime strategic capability agreement. This contract provides sovereign test and evaluation capabilities for the Royal Navy surface and submarine fleet, enabling the U.K. to fulfill a strategic role within the AUKUS partnership. We also won an GBP 80 million 10-year contract known as Societis to accelerate the production of mission data, including training and mission rehearsal to improve the protection of all U.K. military platforms against rapidly changing threats.

In the U.S., we strengthened our cyber and information advantage offering through the acquisition of Avantus. I’m delighted that our new team continues to deliver high-quality operational outcomes for our customers, and has been selected for an $80 million multiyear contract by a national intelligence customer.

We’ve had a strong start to this year and the business is performing in line with our expectations.

In addition, our existing U.S. business has delivered 25% revenue growth and $280 million of new orders including a $93 million 4-year engineering services contract for digital night vision technologies to enhance the Warfighter situational awareness.

In Australia, we also strengthened our threat representation offering through the acquisition of Air Affairs. Together with our existing business, we continue our strong customer relationships and have delivered 26% revenue growth. Through team collaboration, we also won a $13 million high-energy laser program by leveraging our laser technology from the U.K. into Australia.

In Germany, we delivered record flying hours and finally, our Target Systems business has seen its highest demand with GBP 58 million of new orders. We’ve had a really excellent year. And these are just a few of many operational highlights that demonstrate how we are serving the national security interests of our customers.

I’ll now hand over to Carol to take you through the results.

Carol Borg - CFO

Thank you, Steve, and good morning, everyone. In this section of the presentation, I will provide more detail on our FY ’23 financial results. Like Steve, I have been extremely pleased with our results. We have delivered excellent operational performance, deleveraged our position and continued to deliver impressive revenue growth at stable operating profit margins.

Firstly, our key financial highlights. In FY ’23, we have delivered record-high order intake of GBP 1.72 billion, growing 41% on a reported basis demonstrating high demand for our distinctive offerings. Strong revenue at GBP 1.58 billion, growing 20% on a reported basis, delivered through good program execution across all of our major contracts and this year with the partial contribution of our recent acquisitions and disposals.

Good underlying operating profit at GBP 179 million, growing 30% on a reported basis, which at 11.3% margin reflects investments in the 3 capability areas that we have spoken about before, our people, technology and net zero, all necessary to support our delivered growth and further enhancing our capability to achieve our strategic ambition.
Strong cash performance with underlying net cash flow from operations at GBP 270 million, resulting in a cash conversion ratio of 106%. Our strong underlying cash performance and continued discipline on working capital management has reduced our leverage to 0.8x net debt to EBITDA.

Underlying basic earnings per share of 26.5p increased by 29% due to our excellent operational performance. And finally, our return on capital employed has reduced as expected, remaining at an attractive 23% due to the acquisitions made in the year.

So overall, an excellent underlying performance in FY ‘23 with all metrics exceeding our expectations, which is a strong foundation to deliver our future ambition and upgraded guidance.

I will now provide further detail on our performance, making reference to our organic growth rate, excluding the impact of the GBP 14.5 million profit write-down that we experienced last year, demonstrating transparently our true in-year performance.

We have delivered excellent order growth, securing GBP 1.72 billion in-year, growing 41% and 37% on an organic consistent currency basis. In EMEA services, this includes the GBP 260 million MSCA contract, as mentioned by Steve, and GBP 404 million of Engineering Delivery Partner framework orders, representing 23% of our in-year order intake.

In Global Products, our largest order is the $93 million DNVT award previously described. It is pleasing to see our continued success in winning new business with our distinctive offerings in line with our previously communicated desire of moving towards larger, long-term contracts, as I’m illustrating on the charts on the right-hand side. The upper bar chart illustrates, in FY ’23, 47% of our orders were greater than GBP 5 million in contract value an increase from 28% in the same period 3 years ago. The lower bar chart shows the order backlog, despite the naturally reducing impact of the long-term partnering agreement, which now represents less than 43% of total backlog, it is a significant achievement to increase our order backlog to 1 billion as at the 31st of March demonstrating excellent order growth across all 3 of our home countries and [shoring] up our revenue coverage in future years.

We have delivered strong revenue at GBP 1.58 billion, growing 20%, 11% on an organic consistent currency basis. This has been driven by increased delivery across all of our major contracting frameworks, the largest being a 37% year-on-year increase in EDP framework revenue in EMEA Services and good growth in global products across both the U.S. and our Target Systems businesses.

Inorganically, we reflect the partial year contribution of our recent acquisitions in Avantus and Air Affairs and disposal of our Space NV business. The investment we have made in recent years into our business winning capabilities across our 3 home countries is delivering results, driving this impressive level of continued revenue growth across the group. We start FY ’24 with 61% of our in-year revenue guidance under contract compared to 65% at the same point last year. This represents a more sustainable level of cover that we can expect moving forward as a result of the evolving geographic mix across the group, reflecting the markets we are growing more significantly in.

We have delivered strong underlying operating profit at GBP 178.9 million, which is 11.3% operating margin. This represents an increase of 30%, 12% on an organic consistent currency basis. EMEA Services has been impacted by the investment made in our people this year as a result of the cost of living pressures.

Global Products delivered double-digit margin of 10.4%, reflecting strong performance in the U.S. Our acquisitions, Avantus and Air Affairs have delivered operating profit margin in line with expectations.

Now turning to the segmentation of our group performance. First, we have EMEA Services. EMEA Services has delivered significant year-on-year growth, demonstrating our strategy to win larger, longer-term contracts. We have increased orders by 49% and revenue by 10% on an organic basis. Our largest EMEA order is the GBP 260 million MSCA contract, and we have successfully acquired and integrated Air Affairs, both of which Steve and I have mentioned earlier.

Operating profit has seen a modest decline to 11.6% margin against the strong prior year comparative period, reflecting the additional
investment made in our people, which we communicated in our interim results. The investment focused on our lowest paid employees as well as ensuring we retain and attract highly skilled employees to underpin our future growth.

EMEA Services has a funded order backlog of GBP 2.8 billion and a significant increase in our book-to-bill ratio of 1.4x, excluding the LTPA giving us good forward revenue visibility.

Next on Global Products. Global Products has had a number of notable achievements in-year, in particular, the strong performance across both our Targets Business and in the U.S. where we delivered $280 million orders and 25% revenue growth in addition to successfully acquiring and integrating Avantus.

Global Products has delivered a strong year-on-year growth, demonstrating that we have the right team and capabilities to deliver across this segment. We have increased orders by 2% and revenue by 15% on an organic basis. The largest order is the $93 million DNVT award, again, as both Steve and I mentioned earlier. Operating profit has seen a strong recovery with double-digit margins at 10.4%, ahead of my previous guidance.

Our strong performance in the U.S. demonstrates greater stability, resilience and consistent performance, giving us confidence that we have a strong foundation for future growth, both organically and inorganically.

Global Products is inherently a shorter order cycle business and, therefore, has fewer larger longer-term contracts than EMEA Services. Global Products has a book-to-bill ratio of 0.9x and a growing funded order backlog of GBP 300 million.

We have delivered excellent underlying net cash from operations -- cash flow from operations at GBP 270 million, which equates to a cash conversion ratio of 106%. This cash conversion is as a result of our strong underlying cash performance and continued focus and discipline on working capital management.

We’ve invested GBP 109 million in capital expenditure, predominantly driven by the ongoing LTPA commitments, enhancing our capabilities for our customer. Upon the completion of Avantus -- of the Avantus acquisition, we communicated that leverage at completion was 1.1x on a full year pro forma basis, and that we were actively planning to rapidly deleverage to less than 1x before the end of the first full year after completion.

I’m delighted to report that we have delivered against our commitment within the first 4 months of ownership, much quicker than originally anticipated. A key component of delivering our strategic ambition is to have a robust financial framework that ensures efficient use of our balance sheet. This has been evidenced by the efficient funding of our recent acquisitions of both Avantus and Air Affairs, where in line with our plan, we have closed FY ’23 with GBP 207 million net debt.

I’m extremely pleased with our strong cash performance and efforts to successfully reduce leverage. As I have previously mentioned, the group could maintain leverage of up to 2x. However, as we have demonstrated with the Avantus acquisition, we deploy strong discipline in the utilization of our balance sheet actively working to de-lever as quickly as possible to ensure we are able to support our growth ambition.

With that, I will now hand back to Steve to present our strategic update and upgraded guidance.

Steve Wadey - CEO

Thanks, Carol. QinetiQ is a purpose-driven company - to protect lives and secure the vital interests of our customers. Our purpose drives our strategy to build an integrated global defense and security company operating in attractive markets with distinctive offerings to deliver sustainable growth for our shareholders.

As part of our environmental, social and governance responsibility, we’ve adopted this simple framework to focus our strategy and ensure balance across our stakeholders. Through partnering with our customers, we are seeing higher demand for our offerings in response to the conflict in Ukraine and rising tensions with China. Our people remain at the heart of delivering our strategy. We continue
to focus on retaining and attracting the best talent to deliver innovative solutions for our customers with greater agility and pace.

With our strategy and capabilities aligned to our customers’ evolving needs and a track record of 7 years of growth, our company is at an exciting stage in its development. We're therefore increasing our ambition to approximately double the size of the company to GBP 3 billion of revenue over the next 4 years, accelerating profitable growth.

By focusing on our customers’ mission and creating an environment for our people to thrive, we will deliver enhanced shareholder returns. The global security situation continues to worsen, and tensions remain high. In Europe, Russia’s invasion of Ukraine is reshaping their relationship with the West and the threat from China remains uncertain. These dynamics are driving defense and security policies, prioritization of budgets and modernization of capabilities. This picture shows our addressable market for each of our home countries and our current market share.

The United States has requested the largest ever research and development and test and evaluation budget at $145 billion, increasing 40% since 2020. The U.K. has refreshed its integrated review and is investing GBP 6.6 billion in R&D and experimentation over 4 years. And the Australian government has recently completed its defense strategic review and is increasing defense spending by 7% to $53 billion.

Beyond the new nuclear submarine program, all 3 countries are committed to working together on a range of advanced capabilities and technologies critical to future warfare, such as advanced cyber and directed energy. These areas align well with our strengths and provide attractive opportunities over the long term.

In response to this geopolitical context, we do see greater opportunity from the widening threat spectrum and our enhanced offerings. As a result, we've increased our addressable market from GBP 20 billion to more than GBP 30 billion per year. This increase is driven by RDT&E markets growing in each of our home countries, adding intelligence and security markets for the first time and our offerings being increasingly aligned to high-priority customer needs, enabling us to grow market share.

With an addressable market worth more than GBP 30 billion per year and higher customer demand, we have significant opportunity to accelerate our growth. Within this market context, our strategy is unchanged and is increasingly relevant. Our multi-domestic strategy has a clear focus of building 1 integrated global defense and security company, operating in 3 home countries with 6 distinctive offerings.

We’re focused on co-creating high-value solutions for high priority segments, investing in innovative business models, technology and digitization and leveraging our offerings globally through single routes to market.

Let me give you a current example of our strategy in action using our tester valuation offering, shown by the picture on the center right of this slide. In the U.K., we committed GBP 400 million of capital investment to modernize our capabilities under the long-term partnering agreement. This week, these capabilities are delivering Formidable Shield 23, NATO’s largest integrated air missile defense exercise testing the alliance’s response to the world’s most challenging ballistic missile threats. Test and evaluation has also been declared a critical sovereign industrial capability by our Australian customer. We’re therefore leveraging our world-class skills and capabilities from the U.K. into Australia building local capability through investment in our sovereign skills program.

The formation of the AUKUS trilateral partnership with its shared defense and security mission, further underpins the relevance of our purpose and strategy to national and global security needs. Over the last 7 years, we've built a company delivering excellent operational performance through disciplined organic and inorganic growth, we have more than doubled the size of our company to GBP 1.6 billion of revenue at 11.3% margin.

Organically, we've continued to focus on our program and supply chain management to achieve good delivery across all our major contracts. For example, full rate production of the (inaudible) robots in the U.S., a 3-year extension to our major service provider contracts in Australia and 97% of our engineering delivery partner outputs delivered on or ahead of time, securing more than GBP 400 million of orders in the U.K.

All of our acquisitions have enabled us to expand our customer base and create leverage and additional revenue synergies. Overall, they
contributed double-digit revenue growth under our ownership with MTEC, Inspire and Naimuri achieving 25% growth over the last year. By focusing on our customers’ needs, we are also expanding revenue visibility with our 3-year revenue cover more than doubling to GBP 2 billion.

We continue to invest in cutting-edge technology to create operational advantage, such as the use of directed energy to counter hypersonic weapons. We deliver innovation by partnering with our customers and the industry to co-create solutions that rapidly pull our technology through into operational use. This approach has enabled us to win larger, longer-term programs, as described by Carol earlier and increase our 5-year order pipeline by more than 50% to more than GBP 10 billion.

Our strong track record of organic and inorganic growth underpins our confidence to deliver an increased ambition. We have a clear business plan which guides our strategic focus and investment choices to enhance our global platform for growth. The picture on the left illustrates the breadth of our offerings in each home country with the acquisitions of Avantus shown in green and Air Affairs shown in orange. The integration of Avantus is ahead of plan and will complete before the end of this year. The business continues to perform well, delivering high-quality operational outcomes for our customers and winning $100 million of customer business, including 100% of recompetes. The leadership team is now fully integrated and working together to pursue a number of revenue synergies by leveraging and cross-selling our offerings to both existing and new customers. For example, our sensor solutions from the U.S. Army into the U.S. intelligence community. As I said earlier, we’ve had a strong start to this year, and I remain excited about the opportunity we’ve created, building a disruptive mid-tier defense and intelligence company in the largest defense and security market in the world.

We’ve also strengthened our role as a global leader in threat representation through the acquisition of Air Affairs. Integration is progressing to plan, and the business is also performing well including securing the next phase of airborne training services for the Australian defense force.

As demand for threat representation increases, we are focused on leveraging our airborne training and target capabilities across our target systems, German and Air Affairs businesses to pursue new customer opportunities globally. A recent example is the successful sale of our banshee target into the U.S. Army’s Threat Systems Management Office. By coherently growing an integrated global company relevant to dynamics of today’s world, we have made significant progress in delivering our strategy.

Building on this strong momentum and with heightened threat context reinforcing the long-term needs of our customers, we are upgrading our long-term targets. Following the acquisitions of Avantus and Air Affairs, we will achieve our previous growth ambition and guidance organically. Given our significant growth potential, we have chosen to increase the scale of our ambition to GBP 3 billion of revenue by FY ’27.

As I explained before, due to the geopolitical context and higher customer demand for our distinct offerings, we see a larger addressable market of more than GBP 30 billion per year. This provides us with a significant opportunity to accelerate our growth. We are upgrading our revenue target to deliver high single-digit organic growth supplemented by further strategic acquisitions to build the company to GBP 3 billion of revenue, approximately doubling revenue and profit over the next 4 years.

As we pursue our strategy, the geographic mix of the company will change, as Carol said earlier. Whilst the U.K. will scale by 50%, we will more than double the scale of the business in Australia and the U.S. This evolving mix across our home countries will result in delivering higher revenue growth at 11% to 12% margin representing upper quartile performance. The result of this upgrade in our long-term targets will deliver an increase of approximately 20% profit by FY ’27 compared to our previous guidance.

We remain disciplined in the execution of our strategy and have a robust plan to achieve this increased ambition, which will accelerate sustainable, profitable growth.

Underpinning the delivery of this plan, we remain focused on continuously improving our culture to drive innovation to enable our customers’ mission. Creating an environment for our people to thrive is absolutely critical to our performance. We’ve increased employee engagement to a new high and invested in our response to the ongoing cost of living pressures to retain, attract and reward the best talent across the whole company.
We've also continued to strengthen our leadership with over 35% of our top 100 leaders being American or Australian. We have a leadership team with the diversity, skills and experience to deliver the scale of our long-term ambition.

In response to today's threat environment, our people are delivering for our customers with increasing agility and pace. They are focused on co-creating innovative solutions that are directly aligned with the priorities of our AUKUS customers in advanced technology areas such as sensing, autonomy and directed energy. To (inaudible) our relevance at the forefront of innovation, we continue to invest in our internal research and development program at approximately GBP 20 million per year.

Our people are also passionate about protecting the environment and delivering sustainable solutions for our customers. This year, we've continued to make progress on our net zero plan and reduced our Scope 1 and 2 emissions by a further 12%. To accelerate progress, our top 1,000 managers now have 17.5% of their personal incentives directly aligned to delivery of our ESG commitments. This is just one example of why we have been rated as a top ESG company in our industry by Sustainalytics.

Given our strategic market alignment and our excellent track record, I'm confident that we have the capability to deliver our future growth sustainably. So having provided you with a strategic update, Carol and I will now jointly describe how our company strategy is underpinned by our financial strategy and how that translates into our upgraded guidance.

Our company is driven by our purpose, which is strategically aligned with our AUKUS customers. These markets have an enduring need to respond to an increasing and complex threat environment. We have a strong track record of performance underpinned by a normalized level of investment to ensure our growth is sustainable. Core to the company's ongoing success is our focus on our customers and people. Pursuing this strategy, we will deliver high single-digit organic revenue growth at stable operating margins. As an asset-light company, we will maintain high cash generation, delivering attractive returns on capital employed to enable compounding growth. Through disciplined use of our balance sheet, we will complement our organic performance with strategic acquisitions. ESG remains at the heart of our strategy to ensure our growth is sustainable. Through disciplined execution of this approach, we will achieve the upgraded guidance churn on the right of this slide, which Carol will describe in more detail. In summary, our strategy is building a world-leading defense and security company with attractive returns for our shareholders. Carol?

Carol Borg - CFO

Thank you, Steve. So let me demonstrate why we have confidence in our ability to achieve our new upgraded guidance. This chart shows our track record over the last 4 years against our 4 key parameters of organic revenue growth, operating profit margin, cash conversion and return on capital employed all overlaid with our new upgraded guidance.

We have a proven track record of delivering high organic revenue growth. Our new upgraded guidance explicitly articulates that we will deliver high single-digit percentage organic revenue growth between 7% to 9% sustainably over the long term.

In recent years, we have consistently delivered an operating profit margin in the 11% to 12% range. Further, as the company grows in the U.S. and Australia, the change in geographic mix will impact group margins. Our operating profit margin includes a normalized level of investment, which, coupled with our evolving geographic mix, will result in us delivering our higher revenue growth at stable operating margins between 11% and 12%.

We have delivered high cash conversion consistently over the last 4 years. Our growth trajectory requires modest investment in our working capital. Hence, we are guiding a cash conversion ratio at 90% or greater. The high-quality cash generation of our business allows us to deploy capital for inorganic growth that has a long-term compounding effect on shareholder returns. To this end, we are confident in our current guidance of return on capital employed to remain at the upper end of 15% to 20%.

In conclusion, the increased market opportunity, heightened demand for our distinctive offerings and our track record demonstrates our deliberate focus on sustainable performance, giving us confidence in the new upgraded guidance we are communicating today.

So now that we've demonstrated track record, how do we fund our ambitious plan. This slide demonstrates how our disciplined capital
allocation policy is put into action supporting us to achieve our growth ambitions. Our first priority is investing in our capabilities to grow, both organically and inorganically. All investments need to pass through 3 distinct gates, strategic alignment, economics and deliverability. As we articulated during the Avantus acquisition, we have a disciplined process that ensures that all investments are delivering returns ahead of our weighted average cost of capital within the third year of operation.

Secondly, it is important that we maintain a strong and efficient balance sheet. We have an asset-light, cash-generative business model with a strong focus on cash conversion. And as we have demonstrated this year, the ability to deleverage to support our future growth plans.

Finally, on an ongoing basis, we review the appropriate returns to our shareholders through our progressive dividends and other means. We are pleased to confirm today the full year dividend of 7.7p, an increase of 5% on prior year.

So in conclusion, we maintain a rigorous approach to the deployment of our capital. We have a clear and concise capital allocation policy that we continue to deploy for the benefit of all of our stakeholder groups: Customers, employees and shareholders.

My final slide is the outlook statement, articulating our new upgraded guidance, which I will transparently describe across 2 time horizons. FY ’24, expectations unchanged, in line with current average analyst profit expectations.

We enter FY ’24 with confidence, a healthy order book and positive momentum with 61% revenue under contract. Consistent with our upgraded long-term guidance, we expect to deliver high single-digit revenue growth compared to the FY ’23 pro forma revenue with pro forma meaning the full year effect of the FY ’23 acquisitions and disposals. This equates to high teens total revenue growth compared to FY ’23 reported revenue.

Operating profit margin will be at the lower end of 11% to 12% range and capital expenditure is expected to remain within the GBP 90 million to GBP 120 million range. Longer term, guidance upgraded. In April 2022, we set out an ambitious plan to grow the company to more than GBP 2.3 billion revenue by FY ’27 and beyond. We have made significant progress since then and are today upgrading this plan and increasing our ambition for the company.

We are now targeting high single-digit organic revenue growth supplemented by strategically aligned acquisitions to build a circa GBP 3 billion company by FY ’27. This increased level of growth will be delivered at stable margins of 11% to 12%, and reflecting the evolving geographic mix of the global company.

Cash conversion will remain strong at over 90% supporting our ability to deploy capital effectively to achieve our long-term growth ambition and deliver a return on capital employed at the upper end of 15% to 20% range.

With that, I'll now hand back to Steve to conclude.

**Steve Wadey - CEO**

So in summary, I’m incredibly proud of our people who have supported our customers and delivered a really excellent full year performance across the group. We’ve achieved a record order intake of GBP 1.7 billion, up 41%, growing revenue by 20% and delivered GBP 179 million of profit.

We’ve continued to drive disciplined execution of our strategy, doubling the size of the company over the last 7 years. World events have heightened the market needs for our distinctive offerings. As a result, we’ve increased the scale of our ambition to build the company to approximately GBP 3 billion of revenue by FY ’27. This upgraded guidance will approximately double our revenue and profit over the next 4 years, a 20% improvement in our previous guidance.

To realize our increased ambition, we do have a robust plan with the right skills and capabilities to deliver future growth sustainably and enhance shareholder returns. We move forward with optimism and are proud of the critical role we play, serving the national security interests of our customers. Carol and I will happy to take your questions.
QUESTIONs AND ANSWERS

John Haworth - Head of IR

So we’ll start with questions here in the room first, then we’ll go on to questions on the phone line. I could ask you to introduce yourself and the company you are asking your question from, that would be great. There’s a few mics in the room.

Samuel Burgess - Citigroup Inc., Research Division

Samuel Burgess from Citigroup. I just wanted to ask a question about margins going forward. Obviously, this year, like many others, you felt the impact of wage inflation, and I know you took action on that in November. Do you see that persisting into FY ’24? And is that baked into your margin assumption? And is that sort of one of the reasons why we’re at the lower end of the 11% to 12% range?

And then going beyond FY ’24, are there any specific areas where you can see scope for improving that margin towards the upper end?

Steve Wadey - CEO

Do you want to take that directly?

Carol Borg - CFO

Yes, sure. Thanks, Sam. You’re right, Sam. You’ve articulated what we announced in our interims, which was an investment of GBP 15 million that we put into our people in response to cost of living. We see in FY ’24, the full year effect of that investment. And as I said, it was only a part year in FY ’23. And that’s the reason why we are guiding FY ’24 at the lower end of 11% to 12% margin range. So that’s exactly right you’ve interpreted that correctly.

In terms of our longer-term guidance, as we’re saying in this presentation today, our higher revenue growth with an evolving geographic mix gets us to 11% to 12% margin in FY ’27. So if not for our increased ambition, we would have delivered, as Steve mentioned, our previous guidance of 12% to 13%, but this evolving geographic mix puts us into a different margin bracket.

Steve Wadey - CEO

Thanks, Sam.

Sash Tusa - Agency Partners LLP

Sash Tusa from Agency Partners. Just a follow-up, first of all, on Sam’s question there on margins. You talked about the geographical mix driving your new margin targets. Is that because the U.S. and Australia are fundamentally lower margin than the U.K.? Or is it because the mix of business that you are looking for in the U.K. is lower margin but possibly higher return on capital?

Steve Wadey - CEO

You will take first? Predominantly the first part of your answer is the answer. So the U.S. and Australian markets that we would be looking to expand in are at a slightly lower margin, maybe 1% to 2% less than we are. So when you look at the volume of incremental revenue with that difference of margin, you then get the blended margin that Carol just described, but as he also pointed out, that isn’t a change to our previous guidance. We would have absolutely at the same geographic mix, maintained the (inaudible) 12% to 13%. And clearly, it will depend exactly of those targets that we ultimately acquire in that next phase of growth.

Sash Tusa - Agency Partners LLP

Great. And then a different subject, AUKUS. I wonder whether you could talk about AUKUS and ITAR, historically, U.K. companies, European companies have found it very hard to transfer technology into the U.S. without it being trapped by ITAR and certainly almost impossible transfer technology out of the U.S. to Europe. Do you see AUKUS as being a genuine triangular relationship between the 3 countries? Or is it that the U.K. you in the U.K. will transfer technology from the U.K. to Australia or from the U.S. to Australia, but you won’t be able to transfer it between the U.S. and the U.K.? Or do you think it will be better than that?

Steve Wadey - CEO

How many permutations?
Sash Tusa - Agency Partners LLP

Well, I mean basically, is it triangular?

Steve Wadey - CEO

I mean maybe I’ll take the question in a slightly broader sense. If you step back and look at what the 3 nations have announced together, they’ve announced clearly the nuclear submarine program, which is what’s called Pillar 1, and we talked about that at the start of the presentation. But they also announced a second pillar which is around technology and, specifically to your point, information sharing. So they have set out an ambition to share their resources in the most effective way because they want to strengthen their capabilities, given the threat environment. That’s what there is their strategic ambition. So I think part of the answer to your question is we will see how this evolves. But it only last week, you heard a new announcement from the U.S. government, where they will now consider the Australian industrial base as an integral component of the U.S. industrial base. And I think we will see more of this going on that as the partnership strengthens, the confidence builds, I think we will start to see maybe multiway technology and information sharing as part of the long-term objective that they’ve set.

And maybe it’s a small example, but I mentioned at the start of the presentation, a laser energy program contract that we have won in Australia, £13 million program. And that is a collaborative program, and it requires information and technology to be exchanged between Australia and the U.K. Maybe a small example, but it’s an example, and I would expect those to be built upon as the AUKUS partnership matures.

Richard Paige - Numis Securities Limited, Research Division

Richard Paige from Numis. Just a couple of questions from me. First of all, (inaudible) I’ll keep it calm today. EDP, some big numbers in terms of the revenue and order growth in the presentation there. And in the year. Can you just give us a sound check as to the size of that contract now and where we are with it and what’s driving those moves and sustainability of that?

And then secondly, probably aligned to Sam’s question again, but you mentioned retaining talent, attracting talent. What is the – given this is such a strong growth market and outlook, what’s the situation on recruitment and retention for you and what implies in terms of wage inflation more broadly?

Steve Wadey - CEO

Okay. Well, let me take both and if you want to add, Carol. So first of all, EDP, I remember back in 2018 when we announced it, and I said that EDP could be as large in the company as the Long-Term Partnering Agreement. And I think it would be fair to say that most of the community didn’t believe that because it was a GBP 18 million framework contract at that point in time. And I think that, that statement has turned out to be true when you look at the order and revenue throughput. And EDP is a really important program for our self, across the whole of the U.K. to bear to help our U.K. customer deliver their outputs more efficiently and at greater pace.

And I think I referred to a statistic that in the last financial year, that community across the whole of the EDP enterprise. So they’re not just QinetiQ, and that’s a really important point. 97% of outputs on or ahead of schedule is really strong performance. And the fact that the customer is seeing that value, and it’s not just the value of the EDP tasks, but it’s the value of the EDP task of how they interrelate with their much wider procurement programs. That’s the due to the level of value that our customer sees in EDP. And that confidence that they see has (inaudible) through to the volume that is coming through the contract. I think I mentioned in November last year that we’ve just been through a major value for money test. So the customer has had to test this program is working, and it is working. They’re comfortable with that. They’re seeing the value. And that answers your sustainability point.

So a really important program, and we hold it in high regard with our customer relationship. In terms of recruitment, recruitment is important. I don’t think I speak to any company leader that isn’t talking about skills and their people as a primary driver of their performance. And that is true for us. And you will have seen yourselves externally, and we certainly are doing a huge amount internally of connecting people with our purpose because all of the people who work for QinetiQ are passionate about our customers and the reason why they do, what they do. We’ve been really looking at the environment of how they work our culture. We spend a lot of time developing our culture, our focus on our leadership and then, of course, it ultimately then comes back down to reward and incentive and you saw the
measures that we took last year.

So we’re very focused on this subject. Attrition, actually, we’re doing really well on attrition. Interestingly, in the U.S., and we only were doing a U.S. review this week, in fact, our attrition of Avantus, as an example, actually has come down since we acquired the company. That’s a really good message. We’re down in sort of normal market levels.

In the U.K., we think we’re a little bit lower than market norm in the U.K. And then, of course, the other side of that is recruitment. And if our People function are listening right now, they are working really hard because with these plans and these ambitions, we need more people that are connected with our purpose, like the culture that we’re developing and really empowering them to deliver faster, more effectively for our customers.

So it’s a great question, Rich, because it’s probably one of the biggest things that we as a team are focused on now to make sure that we’ve got the skills, the capabilities. And if I wouldn’t mind just mentioning one of the points in the presentation, which is around leadership, so we spent a lot of time over the last 2 years really prebuilding, what I would say, prebuilding the leadership capability to execute the plan that we’ve shared today.

When I started in the company, 2% of our top 100 were non-Brits. Today, 35% and our Australian and American to support this ambition. And I remember when we started to disclose this, some shareholders said, “Well, why can you some Brits from London think you can win and grow in Australia and the U.S. Well, the answer is by building teams with the skills and experience in the market.

Last year, we recruited Shawn Purvis. You’ve seen a genuine transformation in the U.S. on our performance, both organically and then the integration of Avantus. A few weeks ago, I announced the recruitment of Gary Stewart that we’ve recruited from Rheinmettal, he’s based in Canberra in Australia and that supports the Australian dimension. So yes, the people dimension, the recruitment dimension, we can’t -- and I think I said we can’t deliver this plan without the people and we’ve got the right skills, experiencing our leaders to do that.

**Annabel Hewson - Stifel, Nicolaus & Company, Incorporated, Research Division**

It’s Annabel Hewson from Stifel. Two questions, 2, if I may, please. Firstly, just on record flying hours in Germany and that 58 million number for the targets. I mean that is a direct correlation to where we are geopolitically? Now do you see that pushing on from here? Or are we sort of flattening at a high level? Or what’s the sort of sense check you get from sort of the customer discussions you’re having at the moment? And the second one, obviously, a more exciting question on RDEC and obviously, the accounting change -- just how we think about the factor in the tax rate. I know we’ve got a slide in here, but if you can give us some more color that will be helpful.

**Steve Wadey - CEO**

I’ll do the less exciting one. You can do the more exciting one. So actually, we don’t see it changing in the foreseeable future. The German flying is really high, and if anything, we see it increasing during the next few years. And we’re in dialogue with the German customer right now about servicing that. So we see that. And then on the Targets Business. I mean the Targets Business has done phenomenally well this year, and it goes right back to the origin of the acquisition of our Target Systems business. We always saw the potential by thinking about strategy and leverage with our test evaluation and training capability and then taking those capabilities into other countries. And you’ll know what you’ve followed us for a period of time. There was a bit of a blip in that due to the COVID pandemic, but we are absolutely out the other side of that and now back on our growth trajectory. And you may have noticed in the presentation. I really wanted to build out that we shouldn’t really be thinking about acquisitions as discrete items. That’s never the way that we thought about our organic and our inorganic growth. We think about them as building blocks that we look for multiple leverage, whether it’s organic or inorganic, where we can drive real advantage. And the fact that we now have a Targets business, a German business and an Air Affairs business, we’re a global leader in threat representation and we have synergies between customers, between capabilities that allows us to grow.

And for me and one of our shareholders that’s got an incredible memory wrote to me last week, having seen our announcement of the sale of our Banshee target into the U.S. Threat Management Systems office that I mentioned in the presentation because that’s been one of our long-term goals to take our target capability and break into the U.S. market, and that’s exactly what strategy-led teams can deliver. So we don’t see it relenting in the foreseeable future. Now to an exciting subject.
Carol Borg - CFO
The more exciting topic is RDEC, research, development, expenditure, credits, so (inaudible), basically, innovations, we have -- as part of our distinctive offerings, we enjoy the tax benefit that we get from our innovation and we had previously reported as a credit in the tax line. So net profit is unchanged. It was just on the tax line. We have reconsidered our accounting treatment of that and have decided to move it to operating profit, but outside of operating profit by segments, which is the profitability that we have shared with you for consistency.

So what we've tried to do is actually transparently show you the effective tax rate with RDEC, as if it was included in the tax line or without it, if it was an operating profit, so you can see for your modeling and what you can do. But the key takeaway is that it makes no change to earnings because it was already in there. It's where it's reported in it's a more disclosure point, technical accounting disclosure point. And you will affect your modeling in terms of effective tax rate based on how you've treated that within your individual analysis. But if you need some more information, Annabel, John, would love to talk to you all about it. Yes, so it's effectively just a disclosure point.

David Farrell - Jefferies LLC, Research Division
David Farrell from Jefferies. A couple of questions from me as well. Just going to Global Products, obviously going very well. You highlighted a number of contract wins, but the book-to-bill was still only 0.9x, orders up 2% organically. Understanding it is a shorter cycle, but that still needs to be above 1 for it to grow. So can you just kind of explain what's going on there a bit more?

And then a second question, getting into the weeds a bit more, if I look at the adjusting items, there is an investment in digital that's gone from 1.8 to 5.3, I think it is. I thought that investment was going in through the non-adjusted line. So can you just explain what's going on there as well, please?

Carol Borg - CFO
Yes, Global Products, David, just to remind you, we also had the complex project write-down in FY '24, and we disposed of the Space NV business. So 2% the order growth is, as I mentioned, excluding the effect of the complex project write-down in FY '22 and it also is on an organic consistent currency basis. So that's just to put that in context.

Secondly, Global Products is a shorter-cycle business, absolutely. And we do have less long-term visibility in terms of the revenue profile. I still think that the Global Products business is growing in terms of the funded order backlog, and we could see that by the U.S. new orders of $280 million and the $58 million in terms of the Target business. So I think it will hover around the onetime, but I don't think we'll see it as good as the EMEA Services given the nature of the business that it has been.

Steve Wadey - CEO
(inaudible) before we mix. I think the other thing I would say, though, you also remember that different markets contract in different ways. So everything that Carol said about Global Products is true, but back to the geographic mix, as we grow, let's say, our U.S. sharing global products that operates in a different contracting while they don't tend to have fully funded multiyear contracts in the same way, you will see that number vary between our halves as we report.

And as an example, on Avantus, we've entered this year with a growing budget and we've got exactly the same revenue cover this year as the business had last year. So you've got to be careful looking at some of the discrete reporting because it's very variable on timing of awards about when contracts are fully funded.

Carol Borg - CFO
I might make a further build on that build. I think the other key information in Global Products is we've returned to double-digit margins, right? And I think I was here this time last year saying we would take the year to get there and we got there. So I think there's -- it's a combination of both the new orders in the U.S., the great performance in our Targets business and also returning to profitability.

On digital spend, we have taken an accounting policy -- great accounting questions today. We've taken an accounting policy decision that due to our technical debt, if you like, within our infrastructure -- our digital infrastructure, we feel that our investment in digital would be distorting in nature if the non-recurring portion of it was running through underlying profit.
So what we've done in agreement with our auditors is we have taken a decision for the next few years, our digital program that is nonrecurring in nature to report that in specific adjusting items to not distort the effect. Having said that, all of our underlying digital spend licensing, those sorts of things run through underlying operating profit as per normal.

So you should think of our digital spend as our kind of one-off expenditure in actually maturing our environment for our people to thrive based on upgrading our digital infrastructure to be -- to fill our strategic ambition in terms of working across our 3 home countries. So that's how you should read and we will continue on digital spend in the next few years. And so you'll see that in specific adjusting items for the next couple of years.

George Mcwhirter - Berenberg, Gossler & Co. KG, Research Division

It's George Mcwhirter from Berenberg. Just on your future guidance for FY '27, you're targeting 7% to 9% organic growth. It seems quite a bit higher than general budget growth in your key markets. Can you just give a bit of color as to how confident you are into achieving that quite high growth?

Steve Wadey - CEO

Confident, otherwise, we wouldn't have published it. And I guess the reason why comes back down to the relevance or offering and demand. We've got high backlog, as you've seen, I mean, the relative backlog. I think Carol broke that down, you can see is growing at quite a high rate. Organically, and if we focus on organic, we've had some very significant long-term contract wins that really support that higher revenue guidance coming through. So I mean, 1 example that I can bring into the room is the SOCIETAS contract. That was a competitive program. It's really exciting. It's a takeaway from another industry. It's GBP 80 million as an initial contract. That contract will grow.

We're already delivering ahead of schedule for our customer. The customer is delighted with the way that we are, again, bringing together an industrial team of specialists around mission data. It goes to the heart of U.K. platform protection in every theater in the world. And as we perform that program, that will flow through into that revenue growth. And it goes right the way back to the origin of changing customer focus, really getting to understand needs, partnering with industry to then shape and win those top programs. So when you see our backlog going up organically because that's where we've won those significant new programs, we'll then start to see that flow through into our increased organic revenue guidance. That's the logic after sort of years of work, you're starting to see those benefits coming through.

John Haworth - Head of IR

I can see that we've got about over 100 people on the webcast online watching this. So if there's anyone that would like to ask a question on the webcast, please do use the phone line provided. I'll just see if there's any more questions in the room here before we go on to the phone line.

Charlotte Keyworth - Barclays Bank PLC, Research Division

Charlotte Keyworth from Barclays. With all this that on international growth, I thought I'd ask a question on the LTPA. We -- I can see from the pack that you've actually been eating into your order backlog for LTPA over the last 3 years, which kind of surprised me a bit. And I think it's due for renewal in 2028. So I wondered if you could just maybe give a bit of an explanation of what's going on there for tasking. And also with the CapEx still quite elevated in '24, how that tracks going forward into sort of the '27 year, the all-important target year?

Steve Wadey - CEO

Yes. So first, the dynamic that you see in the backlog isn't a surprise at all. It's really mechanical. The contractor has got non-tasking component that's contracted through '28, as you quite rightly point out, and then you have variable tasking on top.

So that part, the non-tasking component was loaded into backlog at the point the contract was done. So as you work through in years, you see that naturally reducing mechanically, which is why Carol brought out that you've got to separate the LTPA from the non-LTPA orders to understand the underlying growth in our order backlog that goes back to why you're seeing that come through in revenue
growth.

In terms of the LTPA, I mean, it remains one of our primary contracts. It is really important to us. The contract is performing exceptionally well. The relationship with the customer is very good. As you say, it comes up from major renewal in 2028, but we shouldn’t also forget that the contract has a 5-year extension available to it. So if the customer wants to proceed with a 5-year extension, they can do that very easily. And of course, what’s important to us is making sure that the LTPA is relevant, is modernized and is delivering the outcomes that they want.

So I mentioned, Formidable Shield. I mean Formidable Shield is an incredible showpiece event, which actually illustrates the value of a sovereign T&E capability to our customer, and they’re delighted with that, and not just the U.K. customer, I think we’ve got about 11 allies using that capability in the last couple of weeks.

And then, of course, in terms of the future, we are in regular dialogue about future needs, how we can modernize, how we can modernize the way that the program is currently running to bring in more digital technologies, prepare for other advanced systems. How do you run test and evaluation on AI-based or autonomy based systems. So it’s not a static conversation. So it’s important. It’s performing well. We’re very conscious of 2028. We have a 5-year extension if the customer wishes to take that, and we’re looking to modernize and become increasingly relevant in line with what’s going on in the world.

Carol Borg - CFO

Maybe on CapEx, Charlotte, as you know, that we committed GBP 400 million on capital commitments in the LTPA. To date, we’ve probably spent about half of that. CapEx from -- spent on LTPA out of the GBP 109 million that I mentioned was around the GBP 45 million mark, so it still remains a big component of our total CapEx spend.

We expect that FY ’24 will be our peak year in terms of LTPA CapEx spend. So within the guidance range that I mentioned of GBP 90 million to GBP 120 million, we expect that the LTPA will contribute approximately half of that.

John Haworth - Head of IR

Great. Thank you. Let’s turn over to the phone lines. So Mary, and over to you on the phone lines to see if there’s any questions from the webcast.

Operator

(Operator Instructions). There are no questions on the phone at this time.

John Haworth - Head of IR

Okay. Thank you. Well, I think we’ve had a really good discussion here. So I think we’ll probably close there. Steve, any final comments?

Steve Wadey - CEO

No, great. We’ve had a good year. Really pleased with our upgraded guidance. And if you got any questions or clarifications, please come and talk to us after. Thank you