QinetiQ Presentation: Acquisition of Avantus

Monday 8th August 2022

Transcript

John Haworth: Good morning and welcome to our presentation where we will explain our acquisition of Avantus Federal in the U.S. that we announced on Friday evening. I'm John Haworth, Group Eirector of investor relations at QinetiQ. I'm joined by Steve Wadey, our CEO, Carol Borg, our CFO and Shawn Purvis, President and CEO of our U.S. business. Steve, Carol, and Shawn will run through the presentation, after which there'll be an opportunity for you to ask questions. In order for you to ask a question, please use the telephone line provided, Steve over to you.

Steve Wadey: Great. Thank you, John, and good morning everybody and welcome to our Webex this morning. I'm absolutely delighted to share with you that we've entered into an agreement to acquire Avantus in the U.S. The conflict in Ukraine has reinforced the vital importance of a technologically advanced defence and security industry, especially in precision effects that we see on the TV, but also in the rapidly growing domains of cyber and information that we don't see. This deal is a major step forward in delivering our long term global growth strategy, and is totally aligned with our customers' mission, both now and in the future. We've selected Avantus as a high quality business with state of the art mission-focused cyber and data analytics capabilities, similar to those that we have in the UK. The combination with QinetiQ, which meets all our acquisition criteria, creates a powerful and differentiated team, provides an exciting new platform to build a disruptive mid-tier business in the U.S., an opportunity to leverage our capabilities for our customers globally, and offers compelling returns for our shareholders as we drive growth.

Steve Wadey: So let me start by giving you a summary of the strategic rationale and the key transaction terms. These are the seven key highlights of the deal. It's an all cash acquisition at $590 million, including a net tax benefit worth $70 million to us. Avantus is a market leading mission focused cyber, data analytics, and software development solutions provider for U.S. defence, intelligence and Homeland Security customers. It delivered approximately $300 million of revenue last year and has 1,150 employees. Avantus provides a strong and aligned cultural fit, focused on its customers and employees, and has a very talented management team and employee base, which augments our strengthened U.S. leadership team that we have recently built. The combination of Avantus and QinetiQ transforms our U.S. business with complementary capabilities, to create a platform to accelerate growth in our customers' high priority segments aligned with the U.S. national security mission. Avantus is a mature and highly integrated business that is aligned with our global strategy to focus on and build six distinctive offerings by extending our customer base and increasing our breadth and scale within the U.S., whilst providing further growth opportunity from global leverage.

Steve Wadey: Financially, the business is highly attractive, with a $2.4 billion order pipeline providing significant visibility, and at least 10% forward revenue growth attracting stable double digit operating margins. The business case for the acquisition is compelling, with enhanced shareholder returns and effective use of our balance sheet. The deal is a strong strategic fit, compelling economic case with high confidence integration, and a major step forward in delivering our global growth strategy.

Steve Wadey: The key terms of the transaction are, from a valuation perspective, the deal is an all cash acquisition at a purchase price of $590 million, including the $70 million tax benefit. The last 12 month performance of the business to June 2022 was $298 million of revenue, with $35.5 million of adjusted EBITDA, representing an enterprise value multiple of 14.6 times, net of the tax benefit. In terms of financial performance, we expect the business to deliver at least double digit revenue growth and stable operating margins, consistent with our group guidance. Therefore, the deal will be immediately earnings accretive, with double digit EPS growth by the end of the first full year, and return on invested capital will exceed our cost of capital by the end of the third full year after completion.

Steve Wadey: The financing of the deal is very conservative, through a combination of existing cash and new debt facilities, creating leverage of approximately 1.3 times net debt to EBITDA, whilst targeting rapid de-leveraging to less than one times by the end of the first full year after completion. The deal is subject to U.S. regulatory approvals and customary closing conditions, and we expect the transaction to complete by the end of the calendar year.

Steve Wadey: In conclusion, this is a fantastic strategic acquisition for our company that is completely in line with our global strategy, creates an exciting platform to grow in the U.S., and will deliver enhanced shareholder returns.

Steve Wadey: So let me introduce the agenda and team for this morning's presentation. First, we have Shawn Purvis, our president and CEO of QinetiQ US. Shawn joined QinetiQ in February and is making great progress with her mandate to deliver our short term operational performance. Today, she will talk to you about Avantus and the powerful combination with QinetiQ US as part of our strategy to realise our long term ambition and deliver a disruptive mid tier business in the U.S. I will then give you more colour on the strategic rationale for the acquisition and the role it plays in delivering our group's global growth strategy. Then Carol Borg, our group CFO, will talk you through the financial aspects of the deal and why it offers compelling returns for our shareholders. Finally, I'll run through the transaction timetable and summarise before we take any questions. I'll now hand over to you, Shawn.

Shawn Purvis: Thanks, Steve. We're excited today to discuss our proposed acquisition of Avantus into the QinetiQ US portfolio. Avantus is a United States defence contracting company, providing mission and operations support in the areas of cyber, data analytics, and software development, to the United States Defence Department, the intelligence community, and the Department of Homeland Security. Avantus has over 1,100 employees of which 92% are cleared. Their skill sets are in the expertise of data engineering, cloud development, and cyber and intelligence analysis. The security cleared employees are individuals who have been granted access to support the customers' most exquisite missions. They are passionate and dedicated to providing the best solutions to our current customers. The Avantus employee demographics are an excellent fit for QinetiQ. Their diverse employee population is over 33%, and over 88% are direct billable to current contracts. All are steeped in highly technical skill sets such as engineering, technical program management, intelligence analysis, and operations.

Shawn Purvis: The company's core capabilities align nicely to our current strategic areas. Avantus's work and intel analysis, data software, and digital engineering align to our information advantage and test evaluation areas. They develop and deliver automation, software, and systems applications in support of the customer. Their mission enablement, augmented intelligence, and cyber operations align to our technical engineering and training focus areas, by delivering key artificial intelligence, data processing, training, and cyber range program support to the government customer. Their core markets split between the United States defence and space, the intelligence community, and the department of Homeland Security. For example, in the defence market for a space related customer, Avantus provides engineering and analytical support in advancing a critical evolving mission, and the agile development of innovation space concepts they deliver in support of the national defence space architecture. They work to identify existing and future requirements based on evolving threats, identifying and analysing concepts and technologies for mitigating operational gaps, and they develop a concept for operations for how a system of systems would be used in support of the defence customer.

Shawn Purvis: For an intelligence customer, the Avantus team supports a dynamic cyber tool test automation program that seeks to improve and evaluate a wide range of capabilities before fielded to operations. This work also includes special projects groups who manage and maintain and enhance complex operational network and associated automation frameworks. In all, Avantus has a strong portfolio, a powerful set of capabilities, and is poised to deliver key requirements to customers in support of the United States national defence strategy.

Shawn Purvis: The combination of Avantus and QinetiQ US make a powerful United States defence contracting company poised to deliver critical services, technologies, and solutions to our government customers. From a competitive and customer perspective, this combination allows the newly combined company to address an expanded customer market. It positively shifts the current portfolio into a balanced DOD, intelligence, federal, and civil expanded market arenas. The combination also provides a solid foundation for revenue growth and expansion, with new business development opportunities that will utilise our strong capabilities of cyber, information solutions, mission services, and program support. Our planned investment in capture and business development resources are targeted to accelerate the revenue synergies and double digit forward growth with stable margins. The Avantus business has a strong cultural fit to the QinetiQ US. They're mission led, customer focused, and the integration of the two companies will strengthen our workforce, particularly in the technical data analysis, engineering, technical program management skill sets.

Shawn Purvis: The future combined leadership team are recognised successful leaders within the government contracting community. This integration provides a powerful and highly confident leadership team poised to deliver on our strategic growth plan in the United States market. On day one, we plan a detailed focus integration plan that will target our people, processes, and tools. The current performing business from Avantus will operate as a business unit led by current Avantus senior leadership, to ensure customer continuity and continued focus on program delivery. From a systems and processes perspective, the team will be focused on creating an integrated business platform that will integrate and leverage the best of breed from each company, and will create a cohesive environment for our employees, unlocking the full potential for value creation. I will now turn it over to Steve Wadey to speak to our global growth strategy.

Steve Wadey: Great. Thank you, Shawn. So let me put Avantus into strategic context at group level. So QinetiQ's investment case is to build an integrated global defence and security company, delivering mission critical capabilities for its customers, operating in attractive markets with distinctive offerings, and delivering good returns for its shareholders. Our major focus for growth into our addressable market is worth more than £20 billion per year, as shown on the left hand side of this slide, and that focus is into our three home countries, Australia, UK, and U.S., where we are pursuing similar opportunities to support those customers' shared defence and security mission.

Steve Wadey: Our strategy to grow into this addressable market is disciplined and underpinned by our clear capital allocation policy. We drive organic growth by investing in our distinctive offerings to build local differentiated capability. In addition, as we have described many times before, we have been actively seeking strategic acquisitions to complement our organic growth that strengthen our capabilities, extend our customer base, and build scale, with Australia and the U.S. prioritised. The U.S. market, as shown by the green box, represents our largest growth opportunity. Avantus is a highly attractive acquisition to enable our long term growth in both this market and globally. The business, which doubles our scale in the U.S., is at the heart of the customer's mission in rapidly growing cyber, data analytics, and software development segments, which attract higher growth rates than the overall market. The business, which we have diligenced thoroughly, is mature, highly integrated, and a similar people based business profile to QinetiQ, and a great cultural fit. And the complementary capabilities, customer relationships, and contract vehicles, create a strong platform to drive U.S. growth, including revenue synergies.

Steve Wadey: In summary, Avantus is completely aligned with our global strategy and meets all our acquisition criteria to accelerate growth in the largest defence and security market in the world.

Steve Wadey: As I've shared with you before, we deliver value for our customers and enable growth by focusing on our six distinctive offerings. Our long term objective is to build a company with a full suite of offerings in each of our home countries, so that we grow coherently into our addressable market. The picture on the right illustrates in blue the current breadth of our offerings in each country, and the capability acquired with Avantus is shown in green. As you can see, we are acquiring capability directly aligned with four of our offerings.

Steve Wadey: With the bulk of capability aligned to our engineering services and support, and cyber and information advantage offerings. Here, you can see, we are creating a business in the US with a very similar capability and risk profile to the business we manage successfully in the UK. Therefore, the acquisition offers low operational risk to the group. This coherence also provides further opportunity for global leverage in support of the trilateral partnership between the governments of Australia, the UK, and the US, known as AUKUS. So, why is this different to QinetiQ’s distant history? There are three main differences that give me confidence. Avantus is strategically aligned and selected as a high value business attracting high value margins, coherent with group capabilities. We built a strong leadership team led by Shawn whose capability and values are aligned with the group and will be augmented by the great talent who will join us from Avantus.

Steve Wadey: And we've established an effective governance model through our US board, which Andy Maner, Avantus' founder and current CEO, will join. And our special security agreement, known as the SSA, with the US government. In addition, as Shawn mentioned, we've developed a high confidence integration plan focused on our customers, people, and systems and processes. The acquisition of Avantus is a good example of our disciplined execution of our strategy, and demonstrates good progress to realise our growth ambition by creating a global leader in high-value solutions to national defence and security challenges. So, let me step back and look at the effect of acquiring Avantus to the group on delivering our five year global ambition. Over the last six years, we've grown the company by 75% to 1.3 billion pounds of revenue, as shown from the first graphic on the left to the second graphic. The third graphic shows the FY 22 pro forma revenue for the combination of Avantus and QinetiQ. Group revenue grows by 25% to 1.6 billion pounds, and US revenue more than doubles to 25% of the group.

Steve Wadey: In May, I explained that we are at exciting stage in the development of the company, with recent events in Ukraine reinforcing the long-term needs of our customers for our high value solutions. And as a result, we've increased our ambition to grow to more than 2.3 billion pounds over the next five years, as shown in the fourth graphic on the right hand side. This acquisition creates a platform to accelerate both US and global growth and is a significant step towards delivering our long-term ambition. We remain focused and on track to build an integrated global defence and security company to deliver sustainable growth with enhanced returns for our shareholders. I'll now hand over to Carol to talk you through the financial aspects of the deal and why it does offer compelling returns for shareholders. Over to you, Carol.

Carol Borg: Thanks, Steve. And good morning, everybody. Like Steve and Shawn, I too am delighted with this acquisition. And in this next section, I'll outline some of the key financial metrics and why we are confident that this will deliver strong returns for our shareholders. I'll be addressing three distinct areas, Avantus' strong financial profile, our conservative financing strategy, and how this delivers shareholder value and returns. So, here I'm showing the financial profile of Avantus under our four key financial metrics: orders, revenue, operating profit, and cash, all shown in Avantus' year end. Firstly, on the top left, our extensive due diligence has concluded that Avantus has a robust order pipeline. With an order pipeline for the next five years at $2.4 billion, and at a win rate on primary competes at greater than 90%, this gives us good forward visibility. In the 12 months to June 2022, Avantus has won in excess of $400 million of orders and has 76% of their expected 2022 to 2024 revenue covered by a combination of backlog, which is secured, and anticipated high confidence wins on contract growth, extensions and recompense.

Carol Borg: Next, onto revenue. Avantus has a strong track record of revenue growth, both headline reported and on an organic performer basis. In the 12 months to June 2022, Avantus has delivered revenue of $298 million. We are predicting at least double digit compound annual growth for the foreseeable future, which is achievable due to the nature of work performed being consistent with areas of increased spend and focus in the US defence and security budget. Now onto operating profit, bottom left. Avantus has delivered attractive and stable double digit operating margins. In the 12 months to June 2022, Avantus delivered adjusted EBDA of $35.5 million, an EBIT or operating profit of $32.2 million, resulting in an operating profit margin of 10.8%. We see absolute profit increasing as a function of the revenue growth, with some modest percentage margin improvement opportunity in the mid to long term, to the lower end of our group guidance. And finally onto cash. Like QinetiQ, Avantus is cash generative, asset light, advisory and solutions based business, with operating cash conversion in excess of 90%.

Carol Borg: So, in conclusion, Avantus is a highly attractive business with significant order visibility, providing revenue growth at stable margins. We have put into place a conservative financing structure to secure this acquisition. We have 350 million pounds of fully committed debt, financing with our key relationship banks, all of whom continue to show strong support to our global growth ambition. As previously referenced by Steve, our capital allocation policy has been deployed and we will be using existing cash to partially fund this deal, resulting in a reduced interest rate exposure. Further, we have flexibility within our existing revolving credit facility, 275 million pounds, that is currently undrawn. You will recall that I have previously mentioned that our balance sheet could support a two times leverage if we felt it appropriate for the right acquisition. At completion of this acquisition, we expect a very conservative leverage of 1.3 times net debt to EBDA, and a targeting to reduce leverage to less than one times by the end of the first full year of completion. This is achieved through the cash generative nature of the combined business, with a further potential to accelerate de-leveraging with proceeds from any non-core disposals that we constantly review as we continue to deliver on our strategy.

Carol Borg: So, in conclusion, this conservative financing structure makes more effective use of our strong balance sheet. My final slide brings together our compelling business case, with enhanced returns for shareholders. In order to do this, let's look at the acquisition through our three investment gates. Firstly, strategic fit. As described by both Shawn and Steve, the Avantus acquisition is the right strategic choice that will support us in delivering our global growth strategy. This increases our breadth and scale in the US, and is fully aligned with our six distinctive offerings, particularly in the areas of engineering services and support and cyber and information advantage. Further, this doubles our size in the US, making us more relevant and accelerates our growth in the world's largest defence and security market. Secondly, economics. As I mentioned previously, Avantus is a mature business with significant order visibility, revenue growth at stable margins, and strong cash conversion. Our purchase price translates to what I believe is a fair valuation for a high quality asset.

Carol Borg: Our business case has a forward multiple forecast that is expected to reduce to single digit by the end of the third full year, following completion. This transaction also creates relief, which is anticipated to generate a cash tax benefit. We have modelled what this means for the combined US business, discounted by our weighted average cost of capital. This has resulted in a tax asset with a value of $70 million in net present value terms to QinetiQ. The acquisition does provide us with opportunities for revenue synergies, predominantly across our existing US business, and potentially globally, which have been incorporated into the business case. Thirdly, integration and deliverability. Shawn described earlier that we have a robust, jointly developed plan to integrate and deliver the Avantus business case.

Steve, further elaborated on what we have done by taking a very deliberate and different approach to this integration. We have a solid business case that we continue to performance manage against to ensure that we deliver against the commitments that we have made today. So, what does that mean for the combined, enlarged QinetiQ? Avantus is a mature organisation which should provide comfort that there is low operational risk. Fundamentally, this acquisition delivers attractive financial characteristics, consistent with what you have come to expect from QinetiQ. Whilst we do not expect analysts to update their models yet, this acquisition provides no changes to our previously stated guidance, except an improvement to our revenue growth.

Carol Borg: Let me take you through our guided financial metrics and what we expect post completion. Revenue growth will improve modestly from mid single digit organic growth to mid to high single digit revenue growth, due to the growth expected from Avantus. Operating profit will remain consistent within our guidance of 12 to 13 percent in the mid to long term with 100 basis points invested in the short term. ROCE will remain strong at the upper end of 15 to 20 percent, highly attractive and favourable compared to our aerospace and defence peers. Capital expenditure will remain within the upper end of our guided range of 90 to 120 million pounds, with the Avantus business requiring limited capital expenditure investment. And cash conversion will continue to remain strong. So, in conclusion, this is the right strategic acquisition for QinetiQ that grows our global company in line with our strategy and financial plan to deliver enhanced shareholder returns. And with that, I'll hand back to Steve.

Steve Wadey: Great. Thank you, Carol. So, let me briefly describe the transaction timetable and then summarise before we take any questions. As I mentioned at the start of the presentation, the transaction is subject to US regulatory approvals and customer closing conditions. Over the last three years, we have established a highly effective governance model with our US board, chaired by the honourable Dr. John Hillen, and the SSA with the US government. The effectiveness of our board and SSA, along with the advanced preparation of our filings, gives us confidence that we will obtain the required approvals and complete the transaction by the end of the calendar year. So, in summary, the combination of Avantus and QinetiQ transforms our US business and creates a platform to accelerate growth in our customer's high priority segments, aligned with the US national security mission. We have a strong and aligned cultural fit with a very talented management team and employee base, which augments our already strengthened US leadership team. And the business case for the acquisition is compelling, with enhanced shareholder returns and an effective use of our strong balance sheet. The deal is a strong strategic fit creates a compelling economic case with high confidence integration, and is a major step forward in delivering our global growth strategy. Shawn, Carol, and I will now be happy to take any of your questions. Thank you.

John Haworth: Thank you, Steve, Carol, and Shawn. In order to ask a question, please use the telephone number provided. Please, could we ask you to introduce yourself by name and by company name. I'll now hand over to Serge our operator for our first question, please.

Call Operator: Thank you. As a reminder, to ask a question, please signal by pricing star one. We will pause for just a moment to assemble the queue. Now the first question comes from Richard Page from Numis. Please go ahead.

Richard Paige: Thank you. Morning all. Looks a very exciting deal. I guess a couple of things for me. First of all, is obviously, the business has grown at 10% organic on the top line in recent years, as you described. And obviously you are looking for at least 10% revenue growth going forward. Could you just provide an outline in how that compares with underlying market growth rates, please? And then on contract profile, obviously it looks like that looks pretty broad. Just wondering if you could provide a bit more detail or granularity around the sort of largest contract size as a percentage of sales potentially? And then on margin profile, looks to be towards the upper end of this sort of levels of activity. Could you just expand a bit more on how you expect to drive for the sort of modest improvement you speak about, please?

Steve Wadey: Okay. Thanks, Richard. Three good questions. So, let's take the first one. Yeah, I'll make a start and then ask Shawn to sort of comment as well. So, you are absolutely right. The business has got a very strong track record and it's been growing at at least double digit margins in... Sorry, revenue growth in recent years. I guess behind your question, you are getting to confidence in our ability to see that forward revenue growth rate at 10 plus percent margin. And there are... Sorry, revenue growth rate. There are several reasons why we have that confidence. The first thing I'll point to, and I think both myself and Carol refer to it, the team have developed a very strong pipeline.

Steve Wadey: The pipeline is some $2.4 billion on an equivalent basis to the overall orders pipeline that we share at a group level. And within that pipeline, they've demonstrated great customer focus around the customer set that Shawn has described. And through a combination of strong customer focus, a really strong business development team, good industrial partnering, we have good confidence in that pipeline and their ability to perform win re-competes and new awards.

Steve Wadey: Within the pipeline they've also been following a very similar strategy to what QinetiQ has followed in the recent years. So starting on relatively small contracts, winning and repeating, but progressively building confidence and maturity and focused on larger, longer term deals.

Steve Wadey: So as they've developed, that pipeline has grown. And to your question about the sort of contract mix, we probably won't go into specific contracts, but what we can describe is that the pipeline is full of several contracts in the 10 million or tens of million class, and more recently has now got some programs in it in the hundred million plus class.

Steve Wadey: So I think it's a combination of the confidence of historic growth, Richard, and following a very similar strategy to focusing on winning larger, longer term contracts. And that gives us the confidence in the growth rate. That probably sort of blends into both questions one and two.

Steve Wadey: Shawn, would you like to make some sort of comments to build upon that?

Shawn Purvis: Yes. Great. Thanks Steve. I echo your comments and agree with the profile of the company thus far. Carol alluded to on contract growth and re-compete being very high across their markets, which show good customer performance, delivery of requirements, and when you look towards the whole of the pipeline, show significant ability for us to continue to grow both in those current customer markets, but also to be able to take those technologies into adjacent customer markets as well.

Shawn Purvis: From a execution across the pipeline as Steve alluded to, the organisation has continued to invest and expand. The combined organisations together will be able to go across all three of the domains that I mentioned to do not only current contract and grow those contracts they have today, but take on those larger integration intelligence surveillance reconnaissance type programs that are, which span across the portfolio and require the combined capabilities of both of our current organisations. Very strong in their current experience, very strong in their first wave of pipeline. And the combined organisation together will be able to take on a bigger mission across the United States Intelligence, Department of Defence, and Homeland Security portfolio.

Steve Wadey: Thanks, Shawn. And maybe the third question around margin, Carol?

Carol Borg: Yeah. So, well, just maybe an add to the revenue growth from my perspective, Richard. Yeah, the QinetiQ UK cyber and intelligence business has equally performed in this at least double digit growth.

Right? So in addition to what the US can do in its own right, I think QinetiQ has the broader capabilities, the scale to actually demonstrate. Those of you that have been following us for a while, will have seen that and enjoyed that for the last number of years. So that also gives me confidence that there's a broader family in which we have proven delivery in this.

Carol Borg: And then specifically onto the question of margin growth. You're right, Richard, that we are seeing Avantus in the last 12 months has delivered 10.8% operating profit, which is very close to our current guided range in the short term. We see some modest margin improvement. And that's going to be driven by us moving along in the value chain. This is a high quality asset. It provides very high quality dedicated solutions for our customer, which can yield a higher margin. So we believe that there's not a lot, but there's some modest margin improvement that is available over the mid to long term, which is why I feel confident that we hold our group guidance in the mid to long term to the 12% to 13%.

Steve Wadey: Yeah. And if I might just add on onto that point, that Carol just made Richard. I think Shawn alluded to investment. So within this case, we are increasing our investment. And that investment will build further capabilities that will support further expansion of the pipeline and support the revenue growth that we've discussed. But it will also support exactly what Carol was saying, which is going up further in the value chain. And this company is a company that operates at a high position in the value chain. Hence, it attracts the margins that it attracts with the opportunity for modest improvement as Carol describes.

Steve Wadey: So Richard, I'll give you the opportunity if you want to come back on any of those questions or whether we've answered them for you.

Richard Paige: No, that's very clear. Thank you very much.

Steve Wadey: Thanks.

Call Operator: Thanks. The next question comes from Charlotte Keyworth, Barclays, please go ahead.

Charlotte Keyworth: Morning everybody.

Steve Wadey: Hi Charlotte.

Charlotte Keyworth: Thanks for taking the question. Hi. I've just got the one, actually. I've just been listening to the commentary and you've mentioned the word mature several times and high quality, and it's clearly got a lot of characteristics that QinetiQ holds in terms of cash generation and being an asset like. With any kind of large scale M&A, the integration piece is critical. And with something that's clearly functioning very well already, I'm interested to hear a little bit more about integration, what your thoughts are on that, because it's where a lot of the value can either be destroyed or created.

Steve Wadey: Great. Well, absolutely. I mean, Shawn described quite a lot in her presentation. I might go to you first on it, Shawn because I think you touched on the critical points. And then I'd sort of like to make a sort of couple of builds on that. But Shawn, can we go to you first?

Shawn Purvis: Sure. Great. Thanks. And thanks for the question. So first, we do agree the current platform is quite mature in that the organisation has been very deliberate and thoughtful about their acquisitions, their integration of their acquisitions and their processes. So continuing through each of their journey to unlock value along the way.

Shawn Purvis: As I mentioned in my remarks, what we see, where our first thoughts here are to take the combined leadership team between our current QinetiQ US team, worth the senior leadership team of Avantus, and integrate into a corporate organisation, really leveraging some of those key personnel that have both capabilities in their current market, but also can stretch across the whole of the portfolio.

Shawn Purvis: The current P&L business will come in as a single business unit and be a direct report into myself, aligned with our other two business units, and we'll be very thoughtful and mindful about how we then take a look at that portfolio, integrate, look across the contract vehicles that now the two combining companies will have and be able to go to market in a much stronger way than before.

Shawn Purvis: We also think there's extreme power in some of their best practices. They have an integrated talent management system. They have a different business development cycle component. When you integrate the back office with the front office, unlocking the value of their processes, their procedures and tools, but also their people and their culture and the integration of some of where they have continued to grow and have really deep, good customer intimacy, sound business development processes and procedures, contracts, and supply chain.

Shawn Purvis: So we are excited about how that integration comes in and we believe will add value immediately as the teams come together, start to look across the whole, really look at best of breed across both of the organisations and then integrate that leadership team at our corporate level to be able to unlock the value right off the gate. So a great question on that. Steve, over to you.

Steve Wadey: Yeah. Yeah. Thank you, Shawn. And just to sort of say some different things rather than repeating what Shawn has said. I think one of the things that I was really pleased with through the diligence process is the conversation that we had about integration because from a philosophical point of view and a cultural point of view, we were at one with the Avantus leadership team. And the way that we thought about how you go about successful integration and the philosophy is simple to describe it was number one, putting our employees first, and making sure that they understood the logic for the acquisition, the approach to integration, the combination that would come from bringing the companies together. Secondly, by focusing on our customers and remembering that this is all about creating a platform for growth. And then thirdly, looking at how we optimize our systems and processes as an enabler for our employees to deliver for our customer.

Steve Wadey: And Shawn used a phrase during her main presentation around best of breed. And that is very much the philosophy here. We're bringing together two companies in the US of similar scale and we're going to be combining them. And I think that Charlotte, for me, that alignment from a complimentary capability and alignment from a sort of a cultural and philosophical point of view, brings a high degree of confidence.

Steve Wadey: Now sitting underneath that, we've developed an integration plan. We'll have milestones and objectives and targets that we will achieve and deliver. And as we both alluded to earlier, that integration will also be supported by investment. And that investment will go into critical capabilities such as increasing our business development, strategic capture capability, increasing the volume of investment in our internal research and development so that we're developing new state-of-the-art technologies or tools that we can cross sell to our customer, as well as optimising the various systems.

Steve Wadey: So I think, we've really thought through the integration from a planning and an organisation point of view, but more important to that, I think we've got the right philosophy, mindset and culture between the teams to make this a truly successful combination. And if I may just come back to the word mature and high quality. I think it is a really important point, Charlotte of why this acquisition is so different to QinetiQ's distant history. This is a high value asset operating in frontline high value segments in the US, and that's why it's attracting high margins. So it's a really great asset for us to build this platform to drive growth.

Steve Wadey: But Charlotte, I'll give you the opportunity to come back, whether that triggers any further question or whether we've answered your question.

Charlotte Keyworth: Thanks, Steve. That's really interesting. I've actually got one more question for Carol if I may.

Steve Wadey: Sure.

Charlotte Keyworth: Just in terms of leverage, so we're at 1.3 times when the deal completes, and then we're going to rapidly leverage to one times at the end of year one. I just wanted sort of in terms of medium term guidance, I mean, now we've done the transformative deal. Where do you think the right balance sheet is for QinetiQ going forward? I mean, will we return to a net cash position eventually given the cash generation from the combination of the two entities? Or can you see kind of returning to the level we're at today?

Carol Borg: Charlotte, I mean, it's too early to say. I think in terms of what it is, we've got our clear strategy in terms of achieving the 2.3 billion in revenue by FY 27. This acquisition is a great step towards that, but we'll continue to deploy our strategic vision of looking at things that are non core whilst we are increasing our focus on the US, UK, and Australian market.

Carol Borg: So I don't really have a prediction at the moment. I think for me, let's get through. This is fantastic. Let's get through to completion. Let's begin the integration journey. And let's see what comes along in the future. But what I can say is that I'm really comforted that this is a conservative financing structure. I've been out publicly to say that we could withstand the two times leverage. I'm really pleased that we've conservatively financed at 1.3. I'm immensely pleased that the cash generative nature of this business brings us below one within a very short period of time. So let's just see how it. Let's just work on performance and delivery. That would be my kind of response.

Charlotte Keyworth: Great. Thank you very much.

Steve Wadey: Thanks Charlotte.

Call Operator: Thank you. The next question comes from George McWhirter from Berenberg. Please go ahead.

George McWhirter: Good morning. I have three questions, please. Firstly, the press release indicated Avantus had competed several acquisitions over the past few years. Can you just give a bit more detail into which areas of the business these have been focused on? And secondly, do you think you may look to compete further acquisitions to strengthen Avantus' capabilities within QinetiQ in the future? And the last one, Carol, you mentioned during the presentation about the potential for disposals to accelerate the delivering timeline. Can you comment on which areas of the business these could be coming from? Thank you.

Steve Wadey: Okay. I think Shawn, I might just ask you to make a few comments on prior acquisitions. And then second and third, I might actually just combine them because I think I've got a similar answer that'll cover both the second and the third one. But Shawn, could I ask you just to say a few words about prior Avantus acquisitions?

Shawn Purvis: Right. Yes. Thanks Steve. And thanks for the question. As we sat with the management team and Steve alluded to, we had significant amount of detail on their history of their series of acquisitions. One of the areas that was most promising was that they were deliberate and they were strategic as they continued to grow and expand across the markets that we talked our way through. So for example, in the customer areas of the United States intelligence customer, they've made several acquisitions that have moved them into the heart of that particular mission of that customer, and then grown that contract on contract growth and/or re-compete on both of those components of the organisation.

Shawn Purvis: As they then looked across Department of Defence and looked to expand to support the United States combatant commands or the United States special operations command or space as space deployment agency stood up, SPACECOM stood up, they also procured several acquisitions that allowed them to provide program management mission.

Shawn Purvis: Positions that allow them to provide program management, mission operations and/or technical and engineering support in the department of defence. So again, they're deliberate in terms of the market on the intelligence organisation. Again, deliberate in the market as they expanded across the department of Homeland Defence. And then Department of Homeland Security, their acquisitions have allowed them to have both contract vehicles as prime, but also perform a statement of work in support of all of department of Homeland, Department of Transportation and federal civil markets across the Department of Homeland Security. And for each of those markets that they have continued to both grow in organically, they have merged that and enhance that with that inorganic acquisition in those domains. Been very thoughtful and deliberate about what they procured, been very thoughtful and deliberate about ensuring that they identified their gap and their acquisitions filled those gaps.

Shawn Purvis: And then very quickly turned into value, whether it be prime contract roles, customer access, customer intimacy, or augmenting the acquisition technology and capability with the current portfolio. So what we've seen across all of their seven to eight acquisitions, we've seen them be a creative value creation in each one of those markets. And very deliberate and mindful of the kinds of technology, the kinds of individuals and the culture that they've brought in that's continued to enhance what we've seen today. Part of the reason why you hear us talk a bit about how excited we are, it's the whole of the portfolio and how we do believe that it'll have immediate value and synergies as it comes into the QinetiQ US market today.

Steve Wadey: And I think that's great, Shawn, and I sort of build upon that and then move into question two and three at the same time. I think the thing that I would add is that again, their philosophy to identifying those acquisitions and how they've been integrating them is exactly like ours. That it's not just looking at acquisitive growth, but it's the combination of that inorganic growth that complements how they drive organic growth, and then move up that value chain into those larger, longer term programs. And it's exactly the same philosophy that we have applied. And let's not forget that in our own history over the last six years, we've done seven acquisitions and three disposals. So George, to move into your question two and three, about further acquisitions and further disposals, I'd make a couple of comments.

Steve Wadey: First of all, short term focus. Right now, our short term focus is laser focused on completion, getting through all of the submissions with the US government and closing this transaction. And then we would immediately flip into delivering on the commitments that we've made in terms of integration and performance. So short term, its completion and operational performance. But that said, we also have a long-term growth ambition and our long-term growth ambition continues. This is a really significant and strategic step and puts us well on the path.

Steve Wadey: But as a mature company, our strategy will continue to look at our portfolio. And as we described in May, we are actively managing our portfolio and we described that our priority for acquisitions is in the US and Australia. And as we develop and grow, I think I used this phrase in May, some aspects of our portfolio become more in focus, some markets become more in focus. That's an area where we will look to invest further in terms of long-term growth and other aspects of our portfolio may become less focused, where we would look to dispose. And that's part of just being a mature, global company that continues to execute in a disciplined way on its long-term global strategy. So, George, I don't know if you want to come back, but hopefully we've answered all three of your questions on that.

George McWhirter: Yeah, that's really good. Thank you very much.

Steve Wadey: Thanks George.

Call Operator: As a reminder, to ask a question, please signal by pressing star one. Our next question comes from Sash Tusa from Agency Partners. Please go ahead.

Sash Tusa: Thanks very much, indeed. Good morning. I've got three questions, at least two of which are pretty gormless. The first of which is, I don't understand this tax asset. Is it that you are paying 590 million and then get 70 million back at some stage, or you pay 500 ... or the deferred tax asset is separate. I mean, how should we model those, the cash outs compared to the cash in, and over what time period would you expect that deferred tax asset to be realisable?

Steve Wadey: Okay, we'll do that one first, or you want to do all three questions, Sash. Tell us your three questions.

Sash Tusa: Certainly. The second one is really what Avantus is selling is billing, because I don't think I understand this. My concern, I think is that it might be a business that basically builds highly classified bums-on-seats, and that there isn't a great deal of sort stickiness in the revenues. So I wonder if you could just describe, are you billing or is Avantus billing workstations populated per quarter, or per month or whatever, or is it delivering particular packages of work and how is that deliverable defined? Or, is it delivering software as a service, or something in between? And then the third issue really that I just wanted to check on is, does Avantus have any non-US revenues at the moment, or has it had any non-US revenues? And if what it's doing is highly classified, even within the context of Orcus, how likely is it that it's going to be able to export or work abroad in the future and how does QinetiQ’s ownership change that?

Steve Wadey: All right. Great. Well, I'm happy to sort of pick up the last question, Shawn, maybe the second one. And Carol, we'll kick you off with tax assets.

Carol Borg: Tax asset, the sexy one. Okay, Sash, the tax asset. The way I think about it is we've bought two things. We've bought a cash generative operating business for $520 million, and we've bought a tax asset that gives us relief worth 70 million. So the combine of those two is 590 million. What are the characteristics of the tax asset? You will expect that Avantus ... Well, the combined US business will still show a P&L tax expense over the life as it generates profit. It is a very profitable combination, but we get a relief from a cash perspective on tax for a foreseeable future. Actually, it goes out for quite some time as a result of this benefit that's being created. So for your modelling purposes, think of it as its own kind of cash flow stream that you can incorporate into your models. Basically meaning that the US business will be not paying tax for quite some while, or whilst showing a tax expense. I hope that is kind of-

Steve Wadey: Do you want to just check, does that answer your question?

Carol Borg: Does that answer the question?

Sash Tusa: Yeah. That's great. Yes. Thank you. That's super. Thank you very much.

Steve Wadey: Great. So let's go on to the second question. Shawn?

Shawn Purvis: Yes, thank you. So at first I would say in the US market, in the way our customers, the United States customers in the intelligence Department of Defence and Department of Homeland both procure, it is people. But it's not commodity kind of services, it's high end, highly cleared, highly sought after cyber intelligence analysis, mission operations and support. The delivery of that ends up in software development, systems development, the creation of a system of systems, if you will. The IT systems integration role and integration of components of the ISR, the intelligence surveillance reconnaissance mission. So that can be hardware and systems, but also the bulk of that and the power of that is turning the collection and the processing that happens with those platforms, those kind of big platforms that you see down into the ground stations, into finished intel. And that is in direct partnership with the government customer. The kind of individuals, the kind of the quality of individuals that are part of this organization as part of the QinetiQ US current team, are those that are highly sought after in the market.

Shawn Purvis: Their skill sets span across the engineering domains, the computer science domains, the data analysis and the data scientist domains. And they are essential to the mission and essential to the customer as shown by ... and some of what we've articulated today, the phenomenal on contract growth, the current contracts in their portfolio, but also the really outstanding, over 90% re-compete of current portfolio with the current customers. And so we've been very deliberate with that. This is not a commodity type business, meaning it can come in with a low barrier or low entry. It really does require both the contract access, the skill set access, the employee access and the level of customer intimacy and knowledge of the mission that is unique to these individuals, these 1100 plus individuals that are part of the portfolio.

Shawn Purvis: So when I think about how US procures in general, it's a base plus four auctioneers. We call a five year programs in general across our current market. These are those organisations, these are the contracts that allow us to continue to come in with current personnel, but then expand and grow and move up the value stream with the customer and tackle some of their real hardest challenges across the whole of the Department of Defence, the intelligence market and the Department of Homeland Security market.

Steve Wadey: Great. Thank you, Shawn. If I can add, I think what Shawn said is also totally consistent with the comments that we were making earlier, Sash, about this pipeline that's going into larger, longer-term contracts. So many of their contract vehicles are quite long-term contract vehicles ranging from three to five years. So these are sort of really quality contracts and high quality activities that we're performing for the customer, hence the ability to attract high margins. If I go onto the third question ... Avantus' history, you are right, there is in big picture terms, no non-US revenue. However, looking forward in our pipeline and our strategy ... And I will put this in the area of opportunity.

Steve Wadey: I refer to this as further opportunity. There are some significant opportunities to expand the capability set into non-US revenue. I'll give one maybe small example. They've got strengths in the area of cyber test range. Cyber test ranges an area where there are some quite advanced tools and processes, which can be relatively easy to transfer across borders with the right government approvals. And it's an example that within the Orcus arrangement that certainly would give us an opportunity to leverage our skills and capabilities, for instance, between Australia, UK, and US. So whilst you're right, historically there has been no non-US revenue, we certainly see that as an opportunity in the pipeline going forward. So Sash, I hope those three answers address your three questions, but I'll give you the opportunity to clarify or come back as well.

Sash Tusa: Yeah. No, thank you. It seems to me based on the comments that Shawn made, that as well as the re-compete rate ... 90 cents is extremely encouraging. We need to be looking at staff turnover rates as well, because keeping your staff is going to be very, very important to maintaining your re-compete rate.

Steve Wadey: So staff retention is industry leading. Shawn, I think the figure is 86%. So it's got a hugely attractive retention rate. And it's the same for the rest of QinetiQ, by the way Sash. This is a company that has got a very similar ... I think I said it in my presentation. It's got a very similar capability and risk profile to the rest of QinetiQ, which is why this is such a great strategic fit. And I think Shawn also mentioned a methodology that they have embraced and developed, which I would also describe as industry leading, that supports that retention by focusing on the employees, creating a really attractive place to work, is that ITM program, integrated talent management program. And this is all about empowering, creating teams focused on the customer, that really does drive value add in and is differentiated, compared to some of our peers. Hence, the really high retention rate and also high attraction rate, in terms of recruitment in this business.

Steve Wadey: So those sort of questions that you are raising, clearly we've diligence exceptionally thoroughly and are very confident in how we will work with the team as we combine to keep those rates high going forward.

Sash Tusa: Okay, great. Thank you very much.

Steve Wadey: Okay. Thanks, Sash.

Call Operator: Thank you. As there are no other questions in the queue, I'd like to hand the call back over to our speakers for any additional or closing remarks.

Steve Wadey: Okay. Well, great. Thank you everybody for joining today's call. As we said, we're really delighted with the acquisition. Strong, strategic fit, compelling economics, and a major step forward in our global growth strategy. If you have any further questions at any point, please do come through our IR team and we'll be happy to answer them. Thank you very much everybody and have a great day. Thank you.