QINETIQ

Preliminary results for the twelve months ended 31st March 2021

Call Transcript

Key:

Steve Wadey – Chief Executive Officer
David Smith – Chief Financial Officer
John Haworth – Group Head of Investor Relations

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Thank for joining, and welcome to the Full Year Preliminary Results Presentation with QinetiQ Group PLC, for the twelve months ended 31 of March 2021. Fifth year of growth - accelerating our global ambition.

I'm John Haworth, Group Head of Investor Relations for QinetiQ. The session will be led by Steve Wadey, Group's CEO; and David Smith, Group CFO. Your videos have been automatically disabled and your audio is muted. Steve and David will run through their presentation after which they'll be an opportunity for you to ask questions. Steve, over to you for the presentation.

Steve Wadey – Chief Executive Officer

Great. Thank you, John. So good morning, everybody, and welcome. Thank you for joining. This morning we will present our full-year results for FY '21 and share more about our exciting and accelerating global ambition. I'm extremely proud of the outstanding way our people have adapted and pulled together over the last year to deliver an incredible fifth year of growth against the most challenging backdrop of COVID-19. This picture represents our largest contract win of the year to provide engineering services for the Typhoon combat aircraft and is symbolic of our company vision coming to life. We are becoming the chosen partner delivering mission-critical solutions innovating for our customers advantage. Building on our success, we have a clear strategy to drive the next five years of global growth.

So the agenda this morning is as follows, I'll start by giving you the headlines. David will provide you with a commentary on our financial results. I will come back and give you a strategic update, and we'll then open up for questions.

So, let's start with the headlines. We've had an outstanding year with strong operational performance, despite COVID-19. Orders are up 18% representing our largest order intake in a decade. Revenue is up 19%. 10% on an organic basis. Profit is up14%, 6% on an organic basis. Cash performance remains strong with a 131% cash conversion, pre-CapEx, returns are healthy with EPS up 11% and we reinstated are progressive dividend.

Through disciplined execution of our customer focused strategy we have driven 70% growth in five years. During the year, we successfully transitioned the new long-term partner agreement signed in April 2019 to an output based contract, won a number of major long-term contracts in the UK, U.S. and Australia. Actively managed our portfolio, with the acquisition of Naimuri and three disposals, grown the international share revenue to GBP420 million, adapted our ways of working and increased employee engagement by 6%.

Looking forward, we have increased our ambition and evolved our strategy to meet the changing needs of our customers and deliver a further 70% growth over the next five years. Our priorities are to deliver consistent operational performance, pursue global campaigns and win further competitions. Drive disruptive innovation by leveraging our capabilities globally, supported by investment in new services and products and strategic acquisitions.

With a redefined addressable market worth more than GBP20 billion per year, our evolved strategy will drive focus for our next phase of global growth and deliver even greater returns for our shareholders.

Our strong financial results have been underpinned by a number of operational highlights across our global company. In the UK, performance remains strong with 16% growth in the year. Beyond the LTPA success, our engineering delivery partner contract is growing rapidly with GBP360 million of new orders and we secured an GBP18 million defence intelligence contract, bringing together our existing QinetiQ capabilities with our recent acquisitions of NSC, Inzpire and Naimuri.

Whilst our business in the United States was impacted by COVID-19, momentum is now growing and we are focused on winning larger longer term programs. We delivered four demonstrators ahead of schedule for our Robotic Combat Vehicle program and the first prototype next generation bomb suit using advanced sensing technology to protect the US war fighter.

In Australia, we achieved another record year of growth and committed $8 million investment to build a sovereign, engineering and integration center to leverage our target robotic capability from Canada, the UK and the US.

After a challenging start to the year, target systems business recovered during the second half, and achieved a major milestone with the delivery of the 8,000 Banshee target.

Likewise in Germany, our team performed well to recover flying activity in the second half, but unfortunately, new orders were lower than planned, and we have needed to re-baseline the business. However, we do expect to drive long-term growth.

Finally, our space business in Belgium delivered a record year of growth, winning a number of significant contracts from the European space agency.

So, as we step back, FY '21 has truly been an outstanding year, and these are just some of many operational highlights across the company, making a difference for our customers. I'll now pass over to David for an overview of our financial performance. David.

David Smith – Chief Financial Officer

Thank you, Steven. Good morning everybody. As usual, I'm going to begin with a summary of fiscal '21 financial performance before going into more detail on the drivers. As Steve's already mentioned, we delivered a strong performance resulting in our fifth year of growth.

We've increased revenue by 19% to GBP1.278 billion, 10% on an organic basis. And we've grown underlying operating profit by 14% to a GBP152 million and our margin of 11.9% was at the upper end of our short-term guidance of 11% to 12%. Underlying earnings per share grew by 11% to 22.1 pence despite an increase in tax rates. And our order intake was excellent increasing by 11% organically and 18% overall, which supported our strong order backlog of GBP2.9 billion. We delivered a strong cash performance with a 131% underlined cash conversion and our balance sheet is strengthened further with net cash of GBP164 million. We are therefore proposing a four-year dividend of 6.9 pence, an increase of 5% on fiscal '20 and in line with our progressive dividend policy. On ESG, we've now delivered a 28% reduction in scope one and two greenhouse gas emissions versus our 2019 baseline. In summary, we delivered a strong performance despite COVID-19.

So moving on to some detail. I'm going to start with orders performance. We made strong progress on orders with 11% organic growth, and 18% growth, overall. The key driver of that strong order performance was Naimuri Services, which grew orders by GBP173 million in the year. And that included GBP158 million of Typhoon phase one orders under the engineering delivery partner contract as Steve already mentioned.

Organic growth in Naimuri Services was partially offset by an organic reduction of 72 million in global products. Primarily due to the significant EUR75 million Altius contract for the space business we got in fiscal '20 and lower contracting in the U.S. And that reflected some disruption from COVID and the change in administration. The contribution from prior year acquisitions MTEQ, NSC and Naimuri -- collectively contributed a GBP103 million of orders in the reported number. And at the start of fiscal '22, we have GBP800 million of fiscal '22's revenue under contract.

So now turning to revenue, despite experiencing COVID related disruptions at the beginning of the year, we delivered a strong performance with organic revenue growth of 10%, or 19 % on our reported basis. In EMEA Services, we grew revenue by 15% organically, primarily due to EDP and growth in our cyber and information business, and in Australia. That was partially offset by 16% organic decline in global products due to COVID related impacts on QTS and OptaSense and lower robotic sales in the U.S.

The contribution from our acquisitions, including MTEQ, NSC and Naimuri was GBP117 million and that resulted in the reported revenue growth of 19%. So whilst our U.S. business experienced some COVID-19 and change of administration delays that impacted performance, MTEQ, that we acquired in December 2019 has delivered revenue growth compared to the previous 12 months on a like-for-like basis, and positive momentum is growing with continued growth in key sectors, strong delivery and cost efficiencies.

While not shown in this slide, international revenue has continued to grow and now represents GBP420 million of grown revenue with strong growth in the U.S. and Australia.
Although notably our UK business also grew by 16%.

Now turning onto operating profit. Overall reported operating profit was a 14%, and 6% on an organic basis. In EMEA Services profit grew by GBP13.5 million organic basis with strong performance on our core contracts and that was offset by a GBP6 million organic decline in global products, due to the impact of COVID-19 on QTS and OptaSense. MTEQ, NSC and Naimuri collectively contributed GBP14 million to operating profit in the reported number and that resulted in that group margin of 11.9% at the top end of a short term margin guidance of 11% to 12%.

So overall a strong performance with good growth in orders revenue and operating profit despite a challenging environment. But also two specific items that aren't on the bridge, but are in the box that I'd like to draw your attention to this year. We realized a gain on the sale of Boldon James, Commerce Decisions, and OptaSense of 28 million and we made a goodwill impairment of the QinetiQ Germany business of 25 million following the end of a significant contract and losses on a couple of new bids. The new management team are growing the pipeline in all areas, however and we do expect future growth from this key market.

So, turning now to EMEA Services first. The chart here shows the split by business within the EMEA Services division. The 29% increase in orders that we saw was primarily due to that £158 million Typhoon order under EDP. We continue to make excellent progress on EDP with an additional £362 million orders in EMEA bringing the total, since inception to over £600 million. As a single source contract and given its minimum capital requirements, the margin we make on ESP and other similar contracts is lower than the average group margin. However, we actually improved margins by around a point, as we successfully moved our mix up the value chain and delivered appropriate return on capital. We expect EDP to continue to be a core component of our UK business in the medium-term.

Revenue increased by 18%, 15% organically largely driven by new work through EDP and the ongoing growth in Australia, particularly under the MSP contract. Underlying operating profit increased by 18%, assisted by £4 million contribution from NSC and Naimuri, organic revenue growth and significant cost savings. And that resulted in operating margins of 12.6%, reflecting disciplined execution on long-term contracts, cost control measures and the impact of the acquisitions. Excluding LTPA amendments, we have grown order backlog by 18%, following the strong orders performance that gives us very good forward visibility.

Turning next to global products. This division is a shorter cycle business and performance varies more greatly due to the timing and mix of product sales and the impact of COVID in this particular year. Order intake was down 6% and an organic decline of 26%, following that EUR75 million Altius contract in the space business in the previous year. And also lower contracting in the U.S., outweighing the contribution from MTEQ.

Reported revenue was up 23%, reflecting the contribution from MTEQ, but on an organic basis, it was down 6% due to COVID disruption on QTS and OptaSense and the lower robotic sales in the U.S. Underlying operating profit increased by 2%. Giving us an operating margin of 9.8%. Organic profit, however, was down 6 million again, primarily OptaSense and QTS, more than offsetting the 9.4 million contribution from METQ. While there has been some COVID related disruption at the QTS business, longer term, we believe that the business remains well positioned, and they had a stronger second half offering advanced target systems with complete integration into test and evaluation at an attractive price point.

So moving now to our cash flows, overall our cash conversion of 131% was strong. We saw a small working capital unwind of GBP13 million primarily due to high contract receivables. Cash flow associated with CapEx was GBP80 million as we continue to invest both in our core contracts such as the LTPA and digital. After CapEx, we had an underlying net cash inflow of GBP120 million from operations. And it's worth re-emphasizing that given the cash generative nature of our business we continue to expect to be able to fund that CapEx in organic investment from our operating cash flows.

The next slide shows the movement in our net cash balance. So I already talked about the 120 million inflow from operations. We had a 15 million tax charge and a small net interest charge, which resulted in free cash flow of GBP103 million. The disposals of Boldon James, OptaSense and Commerce Decisions generated net cash proceeds of GBP54 million and we recycled some of this capital acquiring the high growth and more strategically align business of Naimuri for a GBP25 million cash flow and then an additional GBP4 million for one payment for the remaining 15% ownership of Inzpire Limited that we didn't buy a couple of years back. After the dividend repayments of finance leases we ended the year with a GBP164 million of net cash. Obviously, this net cash balance and committed facilities of GBP275 million, that gives us a robust balance sheet with a capacity to support our growth plans for the business and proactive strategic acquisitions.

Overall our financial strategy is to drive revenue growth at stable margins with appropriate return on capital. And as part of that, we maintain a rigorous approach to evaluate the deployment of our capital, scrutinizing both organic and inorganic opportunities in the same manner to ensure returns to shareholders are appropriate for the risks that we're taking. Our return on capital employed at 28% was consistent with the prior year.

Turning now to some technical factors. I've updated these for your forecasts. With a positive cash balance, our underline net finance costs are expected to remain minimal. Our effective tax rate last year was 15.9%, and our tax cash outflow was GBP15 million. I think this is going to remain relatively stable in fiscal '22, although we will see an increase in the next couple of years as we see UK tax rates increased. And we continue to benefit from R&D grants in the UK.

Working capital outflows of 13 million last year. I do anticipate that we may see a further unwinding of working capital this year, depending on trading performance. And in terms of capital expenditure, that's expected to increase to 90 million to 120 million over the next two years as we invest in our digital transformation and continue investing in our long-term contracts.

So finally, now to our outlook and the financial year-to-date, we enter fiscal '22 with confidence with a strong order book GBP800 million revenue under contract and growing positive momentum. And we remain confident to deliver in line with our expectations for fiscal '22 with mid-single digit organic revenue growth, and 11% to 12% operating margin, lower than our midterm target guidance driven by increased investment on our digital transformation program, and by the evolution of our business mix. Capital expenditure is expected to be in the region of GBP90 million to a GBP120 million for the next two years as I've said.

Taking a longer term view, beyond fiscal '22, our ambition is to deliver a similar level of growth in the next five years, as we have in the last five years. And that means, we're targeting compound organic revenue growth of mid single digits percentage over the next five years, with strategic acquisitions further enhancing this growth. We are also targeting to increase the international share of revenue to over 50% with the UK still delivering good growth supported by accelerated growth, particularly in the U.S. and Australia. Also targeting operating profit margin at 12% to 13% in the medium to long term and our return on capital employed is forecast remain strong probably at the upper end of the 15% to 20% range.

I'll hand back now to Steve to take you through our strategic progress.

Steve Wadey – Chief Executive Officer

Great. Thank you, David. So in 2016, I launched our vision based strategy to reverse decline and drive growth by focusing on our customer needs and improving our competitiveness. We developed our strategic business plan to create the first step change, five years on we have built a company delivering strong operational performance as shown from the left to the middle of this slide, growing by 70% to GBP1.3 billion of revenue, growing operating profit by 40% and doubling our order book to GBP3 billion to increase forward visibility.

Building on our strong track record and the changing needs of our customers. We have reached an inflection point in our growth strategy. Moving from the middle to the right of this slide, we've increased the scale of our ambition to grow the company to more than GBP2 billion revenue over the next five years. A company with a clear purpose, protecting lives, defending sovereign capability and securing the vital interests of our customers. A company renowned for delivering mission led innovation making a difference to global and national security. To achieve a second step change, we've evolved our strategy to accelerate our next phase of global growth. This will be driven by continued customer focus and delivery of our strategic business plan underpinned by our capital allocation and rigorous financial discipline. By continuing to grow an integrated global company, we will deliver even greater returns for our shareholders.

So, let's look more specifically at how we've delivered our first five years of successful growth. Driven by disciplined execution of our vision-based strategy, we've created a culture of partnering to meet our customer's needs. We've up scaled our business winning capability resulting in us consistently winning larger longer term programs, tripling our order pipeline to more than GBP6 billion. We've committed GBP400 million of capital investment into our core contracts, such as the LTPA and to leverage our capabilities globally. We've strengthened our portfolio by investing in seven strategy-led acquisitions and disposing of three non-core businesses. And we've developed a platform for growth in the U.S. with our new special security agreement.

Our people are passionate about our company purpose to support our customers mission. Successful delivery of our strategy has been underpinned by developing our high-performance, inclusive culture, and introducing a new rewarding for performance framework. We've improved our employee engagement by 16% in two years and incentivized delivery of our strategy with more than 80% of our employees now being shareholders. We continue to mature our culture by learning from the pandemic to adapt our ways of working and harness the strengths of diversity. As a result, we have delivered our first step change in performance, 70% revenue growth, including 43% in the UK and grown the international share of revenue from 21% to 33%. I'm incredibly proud of the maturity that we have achieved changing our culture to focus on our customers and creating a strong foundation for our future success.

The second step change in our performance, starts by understanding the changing needs of our customers. In the UK, the integrated defence and security review underpinned by a significant budget increase, signals a major shift to operational independence and technology-led modernization of UK defence capability. In the United States, the new administration is committed to maintaining focus on capability modernization against the near peer threat through next generation technologies. The Australian government continues to focus on the regional threat and the development of sovereign industrial defence ability including test and evaluation. More broadly, we see other countries focusing on capability modernization and a shift to greater national protectionism.

Given we are not a platform prime the dynamics of this new world play to our unique strengths, as our customers seek a major shift in agility and pace to respond to the evolving threat and their budget priorities. Our close customer relationships, domain knowledge and deep technical capabilities, enable us to co-create cost-effective solutions at pace. In summary, our distinctive capabilities and strategy make us increasingly relevant and extremely well positioned to benefit of the dynamics of this new world.

To drive our next phase of global growth, we have redefined our addressable market. We are creating even greater focus on our six home and priority countries, and pursuing opportunities across these nations to support their shared defence and security mission.
We've increased our addressable market from GBP8 billion to more than GBP20 billion per year. We see greater opportunity in the UK and Australian markets, based on their evolving needs. For the first time we've added our target segments in the U.S. market and we've reduced the rest of the world market opportunity to reflect our reprioritization. We are targeting global growth through execution of our strategy and careful investment decisions to build distinctive offerings that provide high value solutions focused on high priority growth segments. With an addressable market worth more than GBP20 billion per year, our increased ambition to grow the company to GBP2 billion of revenue over the next five years is more than achievable.

To deliver this ambition, we have evolved our vision-based strategy to provide even greater focus for our business decisions and our investment choices to accelerate our next phase of global growth. Our customer value proposition is mission-led innovation, co-creating cost-effective solutions to meet our customers needs across the capability life cycle at pace. Our strategy is a multi-domestic strategy with a clear focus on the where, the what and the how, we deliver value for our customers.
Where - Building an integrated defence and security company through global leverage of our unique capabilities into six priority countries.

What - Sharpening our focus on co-creating and delivering distinctive offerings that add value to our customers differentiated from competitors; and

How - Applying disruptive innovation to accelerate solutions for our customers with greater agility and pace. Underpinning our strategy is our culture, where we live by straightforward values and behaviors and adhere to the highest environmental, social and governance standards. Throughout the company including a board level, we take our ESG responsibility seriously. And it's at the heart of our great strategy as we discussed earlier in the year at our Investor Seminar. We are committed to delivering responsibly, sustainably and to the benefit of all of our stakeholders.

Looking forward, we've developed our next strategic business plan to create the Second Step change in our performance. With a strong balance sheet, we continue to execute our strategy, developing our capability by investing in both organic opportunities and strategic acquisitions to realize our ambition. On largest market opportunity is in the United States, where our goal is to double the size of our business to more than $600 million per year. Following the acquisition of MTEQ, a new governance model and a new leadership team. We are building a disruptive mid-tier defence business and leader of advanced sensing robotics and autonomy in the largest defence and security market in the world, adding value to the U.S. war fighter.

To ensure we can respond to the changing character of warfare and evolving threats, we continue to invest in our ongoing transformation to stay ahead for our customers advantage. A major part of our transformation is our investment in digital test and evaluation to support the rapid development of next-generation products and services. We are creating a suite of new digital tools and techniques to compliment our physical capabilities, and create an integrated live virtual constructive environment to add greater value and pace for our customers. Our strategic business plan underpinned by our investment in our capabilities, technology, and people will drive a further 70% growth in the next five years.

So, as we continue to build on our success, our company vision is coming to life. We are a company that focuses on partnering with our customers to deliver mission-led innovation through six distinctive offerings shown on this slide. We optimize our capabilities internally through leveraging our technology and engineering solutions globally, so that we can maximize growth opportunities externally through single routes to market in six home and priority countries. By applying this operating model, we are scaling our company and accelerating our global growth.

Let me give you one example of how this approach is driving growth from our distinctive offering of tests and evaluation. In the UK, we committed GBP400 million of capital investment to modernize the LTPA's key capabilities. This week, these capabilities are delivering bring formidable shield 21, NATO’s biggest biggest air defence training exercise, testing our response to the world's most challenging ballistic missile threats. Our Australian business has leverage these world-class skills to build local capability and win new contracts to design, build and operate, a new unmanned air systems test range in Queensland, are shown in the middle left picture. Based on this success, we've chosen to invest 8 million to create a sovereign engineering and integration center in Australia, which will leverage our target or robotic capabilities from Canada, the UK, and the U.S. to drive even further growth.

As we continue to create a world leader in high value solutions to national defence and security challenges, I'm confident that we will realize our increased ambition.

So, in summary, I'm extremely proud of how our people have adapted and pulled together to deliver strong operational performance despite the challenges of COVID-19. We achieved 18% orders growth, 19% revenue growth, and 14% profit growth and maintain good visibility with a healthy order book of GBP3 billion. Through disciplined execution of our customer focus great strategy, we have driven 70% growth in five years and our momentum is building. The changing character of warfare and evolving threats are changing our markets and presenting us with major opportunities for our distinctive capabilities. Having built a strong foundation and learned from the pandemic, we have reached an inflection point. We are accelerating our global ambition and evolved our strategy to drive a further 70% growth over the next five years. Our strategy will continue to be underpinned by rigorous capital allocation with investment in both organic capabilities and strategic acquisitions. I'm focused on driving growth into our redefined addressable market worth more than GBP20 billion per year. I'm incredibly excited about our future by continuing to grow an integrated global defence and security company at stable margins, we will deliver even greater returns for our shareholders.

Thank you. David and I will now be happy to take any of your questions.

John Haworth – Group Head of Investor Relations
Thank you, Steve. (Operator Instructions) First question is from the line of Sash Tusa.

Sash Tusa – Agency Partners
Great. Good morning. Thank you very much indeed. Sorry, good morning. Thank you very much. I've got a couple of questions, they're all international ones. The first one, clearly the performance in Germany is disappointing. Should we read into this that your refocusing and your effective downgrading of your growth in the rest of the world reflects the fact that you just don't think Germany is the market that you can continue to penetrate at the same level that you had hoped a couple of years back and the refocusing is effectively an anglophone refocusing?

Steve Wadey – Chief Executive Officer
Okay. I'll take that one first. Sash, I'll make some comments and I'll hand over to David.
Look, I mean, we had a tough year and clearly it is disappointing. And yeah, we've had to re-baseline the business. During the course of the year, the business did perform well, it recovered from the first impact of COVID-19 and finished in a good place. And as David said, unfortunately, we did lose some orders. But no, don't read that into it. We do see the German market being a good market, there are good opportunities and we still see long-term growth. And acquisitions more broadly remains central to the overall strategy. I mean, we've completed seven during the course of this phase of the strategy. And overall, we are performing in line with our overall expectations. So yeah, disappointing. Please don't read into that specifics about the German market, it's a rebase lining on not winning some orders and still seeing long-term growth. But David, you want to add a few comments.

David Smith – Chief Financial Officer
Well, I think I just had a couple of other points. I think we have a fresh management team there who are very active. In fact, they've been adding some smaller contracts, in the last month or so outside of Germany also. So that's developing the business, and we're still investing there. Actually, I have a paper on my desk about investing further in terms of their aircraft fleet as well. So, we're still investing there. We still intend to grow that business. They were being more realistic, I think about the growth rates that we can expect.

Sash Tusa – Agency Partners
That's great. Thank you. And then if I could ask about the U.S. I wonder if you could explain what you think the SSA will give QinetiQ and to what extent investors will notice the difference in you having an SSA as opposed to a proxy board? I mean, you were able to acquire MTEQ, you won the robotics contract. So, it's not that the US has been impossible for you to access, but how would we, as external observers, see a step change from the SSA?

Steve Wadey – Chief Executive Officer

Well, I think the SSA was really about, we worked probably for two to three years to get to the point to establish our relationship with the U.S. government to be able to secure the SSA and then proceed with the acquisition of MTEQ. I think what it gives us, first of all, as a management team, it gives us a board, where we've got alignment between the key stakeholders. We're focused not just on their obligation, which is to ensure national security to the U.S. government, but we've got a board of high-calibre, experienced business leaders that are helping us with our strategy. So I think it starts there. It allows us to have established a really high-calibre local leadership team. And it allows us to have access to broader management performance, to drive our decisions and align our strategy with the rest of the group.

And I think the ultimate measure, Sash, is really what you'll see come through in the performance, because I think that we have the right governance and management model now that allows us to manage the business pretty much in the same way that we would manage our business in Australia or in Canada or the other countries as a global company. And ultimately, I think you'll see the benefits of that come through in our performance over the months and years to come. I think they're the main drivers.

Sash Tusa – Agency Partners
Okay. So I mean, just to be as clear then, are there contracts that you could not have won with a proxy board that you think you can win now with an SSA or indeed businesses that you would not have been allowed for approach with a proxy board that you would now be allowed for approach for acquisition?

Steve Wadey – Chief Executive Officer
So, it's a bit of a chicken and egg question, to make sure that I'm answering clearly. I think because of our management environment that we have created, we can go after other business and be more successful. That's not a specific security issue. It's because of the environment that we've created in leading and managing the business.

Sash Tusa – Agency Partners
Okay. Thank you. And then just a very quick final one. I wonder whether you could just give some sort of indication of what do you think the percentage of revenues that come from your testing facilities in Scotland are? Because clearly, the issue of Scottish independence is likely to raise its head again over the next couple of years, and you've got some pretty important synergies there.

Steve Wadey – Chief Executive Officer
Yeah. Maybe I'll say a couple of words about Scotland, whilst David does some sums in his head. I think overall, I mean, that we've got some great capabilities in Scotland. And I think whatever happens here, I think that a sensible solution will emerge from what is clearly a political question. And whatever happens in that, I mean, we remain committed to the UK armed forces. So, we're very proud of what we do in Scotland. But David, have you got any color that you could give on our revenues in the long-term partner agreement?

David Smith – Chief Financial Officer
Yeah. I think I'm not really fast enough on my feet to give you a percentage, but I'll give you a couple of examples. So we've just recently invested very significantly in our capability on underwater tracking ranges and that's now really delivering us, a really strategic asset for the UK. So, a very important asset there. And as Steve has already mentioned, the formidable shield exercise, which is a NATO exercise from the UK, is really using those air ranges and the broader capability that we have in the Hebrides area, so they are important. It's tens of millions. I can't give you a precise number, Sash, but it's very strategic and important.

Therefore, your question is relevant and one that we're thinking about. But these are strategic assets, and we hope that would be part of any Sovereign-based decision going forwards.

John Haworth – Group Head of Investor Relations
Thank you, Sash. So the next question is from the line of Charlotte Keyworth.

Charlotte Keyworth - Barclays
Good morning, guys, and thanks very much for taking my questions. And I just start with the fairly broad strategic question actually on value creation as a theme. So David mentioned margin expansion, deliveries on EDP are moving up the value chain. And Steve, you mentioned longer term contract larger in value in the U.S. Could you guys just comment on how you're achieving this and how you are better positioned to capture value worth more generally?

Steve Wadey – Chief Executive Officer
No. Let's take them one by one, because you probably have a long list. David, do you want to pick up on the first point about the margin expansion and the EDP example?

David Smith – Chief Financial Officer
Yeah. I mean, I think EDP is a great example and actually it's an example that you can go back into QinetiQ's history and say, actually that's really what we've been trying to do.
Because you go back a few years, most of QinetiQ was essentially on a cost-plus, delivering on a specific outputs basis and increasingly they're delivering capability over a period of time. And this is particularly important on the engineering services that we're delivering into the MOD through a very broad supply chain. And as we do that, as we move up the value chain from sort of labour substitution into your higher complexity capability cast, and then it's right that we get a higher margin and because there's more risk involved in that. So, it is a definitely strategic decision. And one I think that actually this plays into our strengths, because our strengths really are in bringing together complex collaborative partnerships to solve difficult customer problems. And therefore, it is all about for us moving up that value chain.

Steve Wadey – Chief Executive Officer
And Charlotte, my build upon that would be taking you right back to the origin of the strategy that we launched five years ago. And if you can remember, there were four huge change levers that we focused: one was around leadership and organization, one was around strategic planning; the third was around business development; and the fourth was around investment. And I think our focus on moving to higher value, larger longer term contracts directly relates to the third of those, where we fundamentally upskilled our business winning capability. Because as we've moved away from pure transactional work into more strategic value added programs, it allows us to take a longer term perspective and design solutions, but add more value to the customers help them on savings as David has just been saying on EDP. And that clearly benefits us from an order book point of view. And to a degree means that we're taking on more risk for our customers, so we can execute it. But we've also been building our capability as a company, so that we can manage that risk and successfully execute it, hence you can see that in our performance. So, I would go back to, this has been a conscious drive for the company for five years, and I think we will continue to do that and that's what's giving us the visibility and the ability to keep to those long-term margin projections that we've described. Hopefully that answers your question.

Charlotte Keyworth - Barclays
Yeah. That's helpful. Thank you. And I've only got two more questions, don't worry. And the next one is just on the LTPA amendment. Just wondering if you could comment on how international capture is tracking since the '19 change to the contract and your expectations going forward?

Steve Wadey – Chief Executive Officer
Yeah. overall it's been a great success story. It's been a success story of partnering between the UK MOD and ourselves. I mean, it was a huge transition program, we achieved all the milestones either early or on schedule. We formally signed off the full operational capability at the end of March. So, we've really transitioned from what was previously this availability contracts, this event-based output contract. So it's been hugely successful with the UK MOD. So, we're very pleased with that. And as you point out, the origin of the concept was always, not just to modernize it as to make it more attractive and more relevant to the UK armed forces, but to become even more attractive to then draw in further international throughput. I mean, this week as I mentioned, we've got the Formidable Shield '21 exercise and we got 10 allies up in Scotland undertaking the most challenging ballistic missile training exercise that's ever been undertaken, that's bringing significant throughput. We also in the last 12 months won, for the first time in there decade, a contract to bring the U.S. Air Force in Europe back onto the LTPA test ranges both in Wales and in Scotland, and we're continuing now with the support of the UK government to raise the profile of these modernized capabilities around the world with other key allies, so that we can bring more throughput into them and then share the benefits accordingly. So, the international throughput of the LTPA I think is tracking well and has got a lot more to come.

Charlotte Keyworth - Barclays
Okay. Great. Thank you. And then just finally, for David on the exciting terms of the tax. I know you've commented on the direction of travel and for the big clear [ph] that the effective tax rate was raising. And can we just talk about timing of super deductions and mix as well, you've upgraded your target on international revenue today... So, are we looking at a material tax step-up from 2024 for example?

David Smith – Chief Financial Officer
Yes. Sure. We will get benefits from the super deductions on capital investments essentially in the UK. So that will I think mean from the modelling side that our tax rate maintains in the sort of 15% to 16% range over the next couple of years. But once we get to '24 that runs out and therefore we'll be faced both with the higher UK corporate tax rate and also I think the U.S. tax rates also are probably going to go up. So, my anticipation is by the time we get to 2024, our tax rate will be in the low-20%. We'll still get a benefit from RDEC, our research and development grants. So when we think about the full year tax rate, it will probably be in the low-20s by then.

John Haworth – Group Head of Investor Relations
Thank you, Charlotte. The next question is from the line of Richard Paige.

Richard Paige – Numis
Hi. A couple of questions from me, please. I'll do them one by one as before. First one is on the addressable market, obviously, you've now involved the U.S. RDT&E market. I think back at the CMD, there was a feeling that that might be a slower burn in terms of being able to translate that sort of more product based activities you do there. Is any change in your thinking or sort of what sort of timeframe should we be looking to you to make progress, please?

Steve Wadey – Chief Executive Officer

Well, I mean I'm pleased you've noted, it's quite an important message that we've shared that over the last six months really we've been reflecting, learning from the pandemic, looking at the success of the first five years, looking at the changes in the market, that we stood back and strategically assessed our addressable market. And yeah, I think as the strategy has evolved and we've got now greater focus on the six home and priority countries. It was absolutely right to do our strategic analysis on the U.S. And the GBP15 billion that we've included for the U.S. is still a relatively small share of the GBP700 billion that goes to market. So it was absolutely right to include it, but I think we've chosen a figure that is a modest value based on looking in quite some detail of the segments, where over the next five years, we believe that we can start to add value and clearly sensing robotics and autonomy.

But ultimately, as we build and it links back to the previous conversation about the SSA, starting to apply our global leverage model, where we can start to take in some of our test and evaluation and training experience to add value to the U.S. war fighter. So I think that's a strategic orientation that we've given. And I think that you'll start to see progress not in months, but certainly over the coming one to three years as we sort of really start to build momentum on the platform that we built around MTEQ and look forward to the next strategic acquisitions that we have in the U.S. to build that mid-tier disruptive player that I've described before. So I'm pleased you noted. Because I think it is a strategic way point in the way that we're describing our next five years of growth, Richard. Then, if that answers your question.

Richard Paige – Numis
No, it does. Yeah. Absolutely. Thank you. And I'm going to probably stay with the U.S. business and just understand the dynamics around the robotics business. Because obviously you've pointed that out as an influence in the order book this year, but we obviously have the longer term programs to come in. And what happens over the next 12, 24 months there, please?

David Smith – Chief Financial Officer
Yeah. Why don't I kick off. I mean, we're in a bit of a transition phase just at the moment, because a small robotics program CRS(I) or SPUR it's called as a brand is really just getting into full production. So our revenue and orders have been muted on that over the last year. And while we get ready for that, we're getting very close to that now. And then the Talon Ranger has been very successful product and still selling, is coming sort of closer to the end of its lifetime. And clearly, as Steve showed on one of his illustration, one of those photographs, the RCV-Light program in terms of larger robotic vehicle systems is also in a prototype phase. So I think this is a timing issue. Robotics will still be an important part of our growth story here, but we're just doing a little bit of a phase of the actual customer sales and deliveries being lower as we go through these prototype phases.

Steve Wadey – Chief Executive Officer
And I think more broadly, Rich, I mean, I'm really excited about what we're doing in the U.S. and what our future is. I mean, it's a very interesting market, its focused heavily on capability modernization. We're being very focused on the segments that we're targeting within the market, around robotic sensing and autonomy, which are without doubt key to future defence capability and we're making progress. I mean, even in the early part of this year, at a generic level, I can say I mean, we've just won a $25 million ISR program. It's a really significant win for us and that gets the U.S. business off to a really good start in fiscal '22.

And as David mentioned on the RCV program, it goes straight in line with our overall strategy of mission-led innovation. We're partnering with Pratt & Miller. Yeah. This is next generation capability. It's about keeping the U.S. war fighter out of harm's way. And it really is -- it's a really good example of what we mean by being a mid-tier disruptive defence player in the U.S. And I think that we've got a lot more that we can do in the U.S. by really building on what we're doing and accelerating the strategy. So I think the U.S. is a very important part of QinetiQ's future story.

Richard Paige – Numis

Awesome. Thank you. And one last question, if I may sneak in. Numbers one, always love to hear. For David, just could you help us a bit more with the building blocks into next year, obviously, with the influence of the digital investment FX and the M&A you've done?
Could you just give a little bit more flavor to the influence of all of those, please?

David Smith – Chief Financial Officer
Yeah. I mean, if I start with revenue, so we were GBP1,278 million of revenue, it was about GBP17 million within that for the disposals, which takes us down to about GBP1,260 million roughly. And we add this single-digits on to that, we're getting to GBP1.325 billion, that sort of level of revenue. I think that's a reasonable expectation as a baseline for us for next year.

And as I said, I think we are going to see margins in the mid-11% to 12%, and there's two things really going on there. We do obviously have a little bit of recovery in some of the business, at QTS business for instance. We probably won't enjoy quite as much of a cost saving on things like travel that we did last year. Those are sort of netting off effects I think. And then we've got the increased investment that we're making on digital, which will have both an OpEx and the CapEx impact, but roughly about a GBP5 million headwind from an OpEx point of view on PBT. So, these are sort of the main dynamics, which will keep us I think in about that mid-11s in terms of our margins for the year.

John Haworth – Group Head of Investor Relations
Thank you. So, the next question is from the line of Joseph Ayoola.

Joseph Ayoola – Morgan Stanley
Great. Yeah. So, it's Joseph Ayoola here from Morgan Stanley. Thanks for taking my question. I just had one actually on -- (Technical Difficulty) -- and it was a bit of a follow-up actually on the Charlotte's question around EDP. The first piece of the question is just around growth rates, and so clearly you've grown stronger here in the last two or three years to a degree you'll see that level of growth is not sustainable into longer term. But as you've built out that business, how do you think of normalized growth rates from here?

And the second piece is just coming up until your comments on moving up the value chain there. Could you maybe give us a bit of insight into some of -- (Technical Difficulty) - you've had this year and sort of how you think of the mix of all those orders? Thank you.

Steve Wadey – Chief Executive Officer
So maybe I'll start with some more general comments about the UK market first, and then maybe David could just sort of build upon that. I mean, the first thing to say, I mean, I think it's a really good outcome, the integrated review both from a policy point of view but also the support from the incremental budget. And for us as a company, the focus on science and technology that leads straight into technology-led capability modernization. That's a really positive change for us as a business. Certainly, test and evaluation, you've seen that test and evaluation being declared as such a critical and pivotal part of the future UK defence capability. I mean, the long-term partner agreement and our partnering approach was called out specifically.

And then as David's already touched on the ongoing modernization of that and blending our physical strengths with the virtual world of digital test and evaluation. I think a combination of these big principles that are reinforced in the integrated review and underpinned by budget, are really strong for us. And therefore, I think our strategy and the policy is converging. And ultimately, that's why we're also seeing more opportunity to add value to our UK customer and move up that value chain and see the benefits for our customers and the business. So I think those are my sort of macro views Joseph about the UK market. But David, do you want to go into a little bit more against Joseph on the value chain and maybe EDP again?

David Smith – Chief Financial Officer
Yeah. I mean, if I tackle EDP specifically. I mean, I think we have been really pleased with the take-up of this. And as we outline we had over £360 million of orders which takes cumulatively to over £600 million of orders on EDP. Our revenue last year actually pretty well doubled to about GBP150 million which was a large part of our growth on U.S. services. I don't think it's going to grow by anything like that over this year. I think we're getting towards the plateau. I think it'd be more in the 10% to 15% growth this year. But we'll still see growth.

And the very important thing is the one that we've discussed already, which is as we do it we are trying to change the mix of contract. So, you mean, actually a great example is the Typhoon contact, we're really providing through life and engineering support, some capability on things like safety assurance work for that. And that's where we think that we can really add value and help the MOD to take cost out by leveraging both our own and border supply chains capability into delivering those services. And therefore, we do take on more risk as Steve said and we get a higher margin on that. So that's still -- both of those things are still part of the strategy, and I think EDP will still continue to be a strong contributor for the medium-term in terms of the business.

Steve Wadey – Chief Executive Officer
I think the other thing that comes to mind, Joseph, that is relevant to the UK, and other markets, is the really exciting and emerging area of data intelligence, and you may have noticed the story that I shared in the operational highlights about winning a GBP18 million order which happen to be contracted actually through the EDP framework and it really does bring together our QinetiQ capabilities with the capabilities of the three acquisitions that we've made in the last two years of Inzpire, NSC and Naimuri, and that is a really growing segment, not just in the UK market but all of the markets that we are focused on. It's a growing segment in terms of both their budget and priority for these customers.

And building AI, cyber, data analytic capability, how we can take best practice from Naimuri in the intelligence world and pivot it into your value-add solutions for our defence customers, this sort of -- it brings together a number of the questions that we've had from Charlotte on longer term programs, margin, and how we can add value on emerging areas, not just more efficient areas for what we currently do. So yeah, it's a really exciting area and we're probably in the foothills of making progress towards that part of our overall growth and expansion. Hopefully, that answers your first question, Joseph.

John Haworth – Group Head of Investor Relations
Thank you. Next question comes from the line of Sean Stewart.

Sean Stewart - JPMorgan
I just had one more question. Hi there. Just -- yeah, just one question for me. I wondered if you could perhaps slash out the working capital expectations for this coming year just in terms of the moving parts there, please?

David Smith – Chief Financial Officer
Yeah. I mean, working capital is always a difficult thing, because you do get just timing trading flows going on between the customer and ourselves and our supply chain. We saw roughly GBP13 million outflow last year. We are still in a significant net negative working capital position and that GBP13 million was really just timing around contractor receivables and payables. I am anticipating that we may see a little bit further degradation this year, maybe up to GBP20 million. Do I have a very specific reason for that? No. Do I think that we'll see quite a stronger close to years as we saw last year? I think that would be very fortunate, if we did

that. But so I'd rather plan on that more conservative basis, which is why we've given that as guidance, but it is something, it's difficult to predict because it really does depend on flows in the last couple of months of the year primarily.

John Haworth – Group Head of Investor Relations
Thanks Sean. Steve, that concludes the questions for this morning's event. If you do have any further questions, please do feel free to reach out to me and my details are on our website on the Investor page. Steve?

Steve Wadey – Chief Executive Officer
Great. Well, thank you for everybody joining. I hope you really found the presentation useful as always. Some great questions. And as John said, we'll be happy to follow up any other questions offline. So, thanks for joining and we'll see you again soon. Thanks everyone.