Ultra Electronics Holdings plc

# Interim results presentation and script

for the six months ended **30 June 2018**

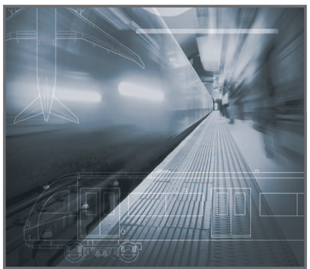
**Douglas Caster,** Chairman
**Simon Pryce,** Chief Executive Officer
**Amitabh Sharma,** Group Finance Director

6 August 2018

The **Ultra Electronics** Group manages a **wide range of specialist capabilities**, generating **highly-differentiated** solutions and products in the **Defence & Aerospace**, **Security & Cyber**, **Transport** and **Energy** markets.

**DEFENCE & AEROSPACE**

**SECURITY & CYBER**



**TRANSPORT**

**ENERGY**

We meet **customer needs** by applying **electronic** and **software technologies** in **demanding environments** and meeting **critical requirements**.


## Douglas Caster, Ultra's Chairman provided an overview of the interim results.

Good morning and welcome to the 2018 Interim Results Presentation.

Last November when I stepped in as Executive Chairman I had a number of priorities. The first one was to deliver the revised forecast for the 2017 year-end. The second was to set a budget for 2018 that I believed would be achievable at the time and I concluded that modest progress could be achieved in 2018. Thirdly, I conducted a strategic review during January, meeting with all of the Group's businesses to understand the key drivers, opportunities and issues they faced and I shared this with our City audiences in March.

What I concluded from this review was that despite the "reset" in performance expectations that we made last November, there was nothing fundamentally wrong with the Group's businesses and that there was no reason why the Group would not be able to make good progress into the future from there but under the right leadership. However this is not to say that I discovered several areas where improvements could be made and these are being pursued by our new Chief Executive Officer whom you'll hear more from later.

Turning now to, the first point on the slide, overall we are experiencing improved market conditions. This is particularly so in the US Defence market where Defence Investment Outlays in 2017 were up 5.6% on the previous year and are expected to be up by about the same amount in 2018. In the UK Defence market however, in common with other companies, we have continued to experience fiscal tightness as the UK MoD focuses on what I would call big ticket items where expenditure is already committed. In the civil aerospace market this continues to be buoyant for us, driven by aircraft production programmes.

As a result of the currently prevailing market conditions we have achieved a very strong order intake across the Group with the order book up 18% on the same period last year and 6% higher than at the 2017 year-end. Ami will be giving more detail but this level of order winning provides good order cover for the second half.

For the first time in a while we are reporting underlying organic growth. Unfortunately, this is masked by currency exchange headwinds but it is a welcome indicator that Group performance is turning around. Specific engineering problems at Herley, however, have impacted profit performance so that we are unable to report the matching organic growth in profits which would have occurred without these charges. I'd like to assure you that much management attention has been given to the Herley issues, including full engagement with the customer, to ensure that they are contained and that a satisfactory outcome will eventually be arrived at.

One of my other priorities last November was to find and appoint a new Chief Executive Officer. I'm glad to report that on 18 June we appointed Simon Pryce who is here before you and later he will give you his initial impressions of the Group.

With that brief introduction I'll hand over to Ami to take you through the detail of the results.

INTERIM RESULTS 2018
SLIDE 3

## Key metrics

| | 2018 H1 | 2018 H1 (Excl. development contract impact) | 2017 H1 (IFRS 15) | Growth | Organic Growth[3] (Excl. development costs and FX) |
|---|---|---|---|---|---|
| Order book | £969.2m | | £821.1m | +18.0% | |
| Revenue | £350.5m | | £365.8m | -4.2% | +1.3% |
| Operating profit[1] | £47.9m | £54.0m | £56.5m | -15.2% | +1.4% |
| Operating margin[1] | 13.7% | 15.4% | 15.4% | | |
| Profit before tax[2] | £43.6m | | £51.2m | -14.8% | |
| Earnings per share[2] | 45.1p | | 57.0p | -20.9% | |
| Dividend per share | 14.6p | | 14.6p | - | |

(1) *before the S3 programme, amortisation of intangibles arising on acquisitions, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, and significant legal charges and expenses.*
(2) *before the S3 programme, amortisation of intangibles arising on acquisitions, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, significant legal charges and expenses, fair value movements on derivatives, unwinding of discount on provisions, defined benefit pension finance charges, and for EPS before related taxation.*
(3) *the annual rate of increase or decrease in revenue or profit that was achieved at constant currencies and when compared to the prior period results prepared on an IFRS 15 basis. Adjustment is also made for any acquisitions or disposals to reflect the comparable period of ownership.*

Ultra ELECTRONICS making a difference



### Amitabh Sharma, Group Finance Director, presented the details of Ultra's first half financial performance.

Thank you Douglas and good morning.

I am pleased to present our interim results for the period ended 30 June 2018.

We are reporting for the first time under IFRS 15 and in this presentation all the percentage movements quoted will be against IFRS 15 adjusted comparatives.

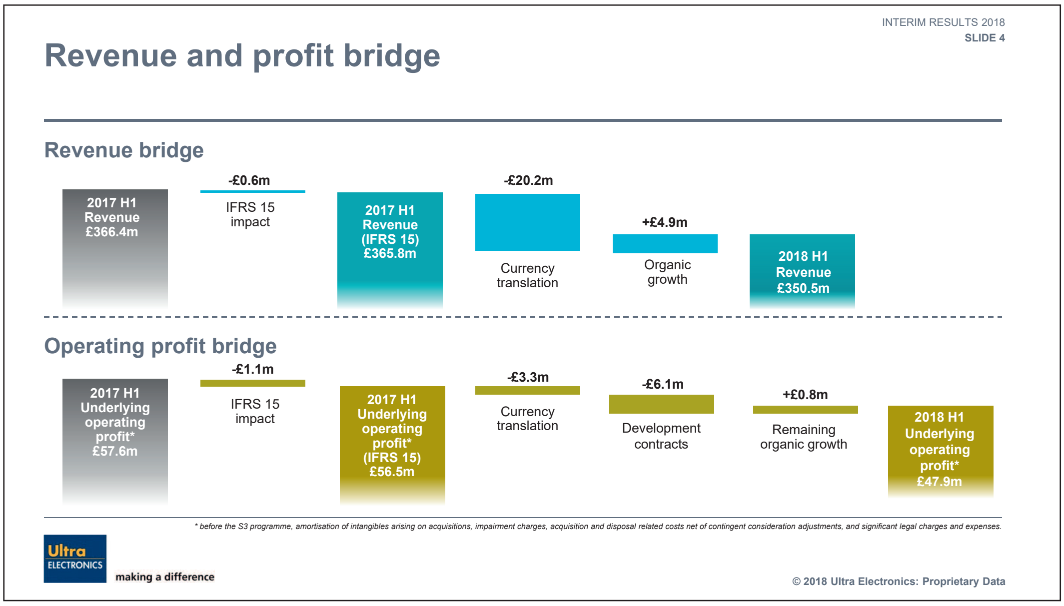
The Group closed June with a strong order book reflecting improved order intake over the period. At constant currencies, the order book grew 4.9% organically compared to December 2017 and 19% organically compared to June 17. This is encouraging and reflects our improving major end market. Looking at order intake, this improved 6.6% organically compared to H1 2017.

As expected, FX movements provided a headwind to our key indicators. Sterling strengthened 9.5% against the US Dollar, with the average rate moving to 1.38 in the first half of 2018 from 1.26 in the comparable period last year.

For the first time since December 2011, the Group achieved organic revenue growth, with a constant currency increase of 1.3%. Operating profit reduced organically by 9.4%, which includes £6.1m development cost overruns at Herley. Operating profit grew organically when excluding this.

Margins as a result were lower at 13.7%. Excluding the cost overruns, margins were in the customary range at 15.4%. Earnings per share declined by 20.9% due to foreign exchange, lower profits and the 2017 equity raise. The share buyback commenced over the period, with 3.5m shares re-purchased for just under £50m.

Reflecting these factors, the interim dividend of 14.6p per share is unchanged compared with H1 2017.




Moving to the revenue bridge.

This is self-explanatory and highlights the organic growth and currency impact on the half year.

Similarly the profit bridge shows the impact of currency and development contract overruns on the half year.

INTERIM RESULTS 2018
SLIDE 5

## Operating cash flow

| | 2018 H1 | 2017 H1† |
|---|---|---|
| Operating profit* | £47.9m | £56.5m |
| Depreciation and disposals (incl. IT licences) | £5.5m | £6.6m |
| Capital expenditure (incl. IT licences) | (£8.1m) | (£4.8m) |
| Net capitalised R&D | (£0.4m) | - |
| Working capital increase | (£33.3m) | (£26.4m) |
| Pension contribution and other | (£5.1m) | (£1.4m) |
| Operating cash flow | £6.5m | £30.5m |
| **Cash conversion** | **14%** | **54%** |
| **Net debt to EBITDA** | **1.39x** | **1.79x** |

| Working capital increase | |
|---|---|
| Inventory | (£13m) |
| Debtors | £3m |
| Creditors | (£23m) |

* before the S3 programme, amortisation of intangibles arising on acquisitions, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, and significant legal charges and expenses.
† 2017 has been re-presented as if under IFRS 15.

making a difference



Turning to cash.

Operating cash flow of £6.5m represented cash conversion of 14%, compared to 54% last year. I will take you through the key elements of this.

Capital expenditure increased to £8.1m. This included spend on equipment required for our London Heathrow Terminal 5 contract. Our Montreal military radio production site required investment to help execute the order book. As you may remember, we are undertaking a number of ERP implementations. Six are in progress. These will go live over H2 2018 and H1 2019.

Working capital increased by £33m over the first half of the year. A breakdown is included in the box on the right hand side of the slide. This is larger than the working capital outflow last half year so let me give you some detail.

Inventories represented £13m of the increase in working capital, with a number of businesses increasing stock levels. The largest increase was at our Ocean Systems business where inventories grew by £7m for deliveries across a number of underwater warfare projects in H2. Most of the rest is due to smaller inventory increases ahead of H2 deliveries as a result of the larger order book.

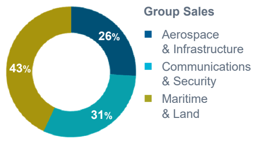
Creditors decreased by £23m overall due to a reduction in trade creditors from year end. £12m of this was due to supply chain constraints requiring us to make faster payments to suppliers and this is included in the 70-75% full year cash conversion guidance. In order to normalise working capital flows and improve business and financial performance, the Group intends to review its working capital levels for future years.

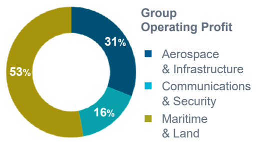
Moving onto net debt. Significant movements include the share buyback which resulted in a cash outflow of nearly £50m over H1 and, as previously advised, the closure of the Sparton forward foreign exchange contract resulted in an £11m outflow. The net debt to EBITDA ratio reduced from 1.79x at the end of H1 2017, which was before the Sparton related equity raise, to 1.39x at the end of June. A slide with more detail is included in the Appendices.

INTERIM RESULTS 2018
SLIDE 6

## Divisional performances

| **Aerospace & Infrastructure** | 2018 H1 | 2017 H1† | Growth |
|---|---|---|---|
| Order book | £319.1m | £269.6m | +18.4% |
| Revenue | £91.9m | £94.0m | -2.2% |
| Operating profit* | £14.8m | £14.4m | +2.8% |
| Operating margin* | 16.1% | 15.3% | |
| **Communications & Security** | | | |
| Order book | £282.6m | £234.7m | +20.4% |
| Revenue | £110.2m | £110.5m | -0.3% |
| Operating profit* | £7.9m | £13.3m | -40.6% |
| Operating margin* | 7.2% | 12.0% | |
| **Maritime & Land** | | | |
| Order book | £367.5m | £316.8m | +16.0% |
| Revenue | £148.4m | £161.3m | -8.0% |
| Operating profit* | £25.2m | £28.8m | -12.5% |
| Operating margin* | 17.0% | 17.9% | |

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† 2017 has been re-presented as if under IFRS 15.

Ultra ELECTRONICS making a difference



Moving on to how the three divisions performed, we start with Aerospace and Infrastructure.

Revenues grew organically at constant currencies as activity increased on our aerospace contracts, notably the Joint Strike Fighter programme. This was partially offset by reduced contract manufacturing revenues. Profit margins increased to 16.1% due to lower research and development costs at our aerospace business.

The Communications and Security division also saw organic revenue growth at constant currencies. Increased military radio, air defence systems and electronic warfare deliveries contributed, but this was offset by slower crypto revenues and a strong comparative period for forensic equipment sales.

The cost overruns at Herley caused margins to reduce to 7.2%, but when excluding the £6.1m charge, margins were 12.7% compared to 12.0% in 2017.

Looking at the Maritime and Land division, revenues declined organically over the first half. Demand for legacy sonobouys remains healthy, but there have been some maritime system programme delays leading to revenues moving into the second half. Margins reduced to 17% principally due to additional costs of redesign on certain programmes.

All three divisions saw significant increases in their order books compared to June last year. The largest increase was experienced by the Communications & Security division, whose 20% order book growth was driven by military radios, security equipment wins and strong order intake at Herley. Joint Strike Fighter related orders boosted the Aerospace & Infrastructure division order book, which grew by 18%.

The Maritime & Land order book grew 16%, following a significant Indian Navy contract win and a maritime propulsion order.

INTERIM RESULTS 2018
SLIDE 7

## S3 return on investment

| Workstream | 2018 H1 costs | Total costs to date | 2018 H1 savings | Total enduring savings from 2019 |
|---|---|---|---|---|
| Property/facility management | £0.1m | £9.3m | £3.3m | £6.7m |
| Consolidation | £nil | £4.6m | £3.4m | £6.8m |
| Sourcing | £0.1m | £3.3m | £1.5m | £4.5m |
| HR | £nil | £0.6m | £0.2m | £0.9m |
| ERP related | £0.2m | £1.9m | £0.2m | £1.1m |
| **Total** | **£0.4m** | **£19.7m** | **£8.6m** | **£20.0m** |

2018 workstreams:

- Six ERP implementations commenced and on track for completion during H2 '18 & H1 '19
- Further 2% reduction in property footprint
- Five out of seven UK payrolls transferred to GBS – transfer of UK accounts payable to GBS underway

**S3 cost savings realised as project concludes: further opportunities for efficiencies**

Ultra ELECTRONICS making a difference



The S3 programme is now reaching its final six months. The S3 initiative was launched in late 2015 with an aim to reduce complexities within our group so that management can focus on growing their businesses rather than managing the back office processes.

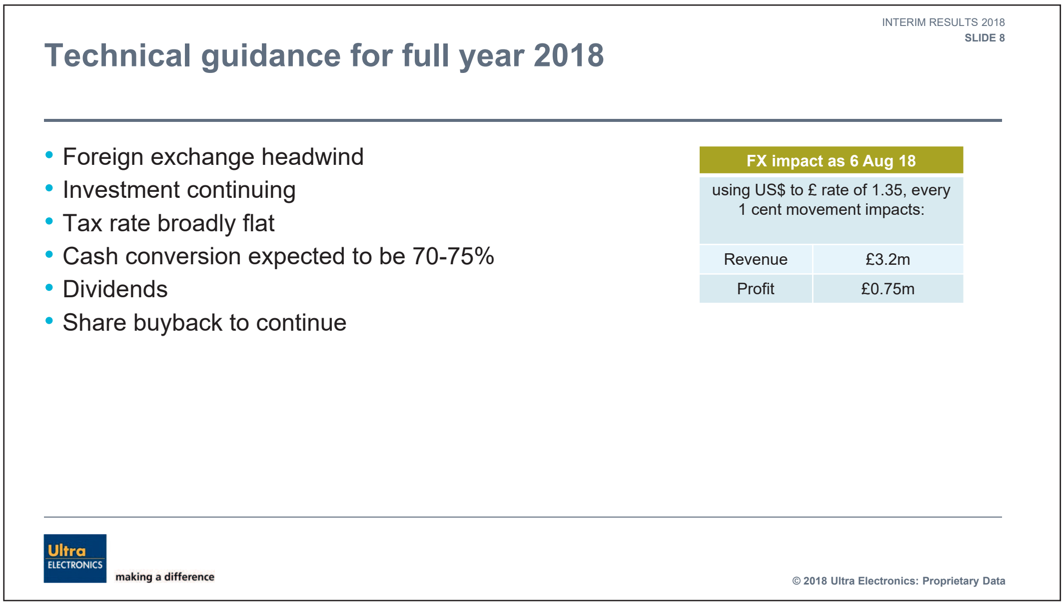
From left to right, column 1 shows the programme has cost just under £0.5 million in 2018 and column 2 shows that cumulatively we have spent £19.7 million.

The costs to date comprise project costs, together with onerous lease provisions, consolidation costs and the costs of some headcount reductions owing to property closures. S3 costs are anticipated to be around £25 million in total as the project concludes at the end of 2018.

Column 3 shows that S3 has generated savings of £8.6 million in 2018 so far, and we expect the savings will be £20 million from 2019.

Notable successes so far in 2018 include further progress on the ERP rollout, a further reduction in our property footprint and the consolidation of UK payroll services.

While the S3 project will end this year, there remain opportunities for further operational improvements in the future.




Let me provide you with some technical guidance for 2018. The strengthening of Sterling will provide a FX headwind. At present, each one cent movement in the US dollar represents a movement of £3.2 million in revenues and £0.75 million in profits.

In respect of our investment plans our current guidance is for capital expenditure to be around £20 million, the largest element being the IT system rollouts.

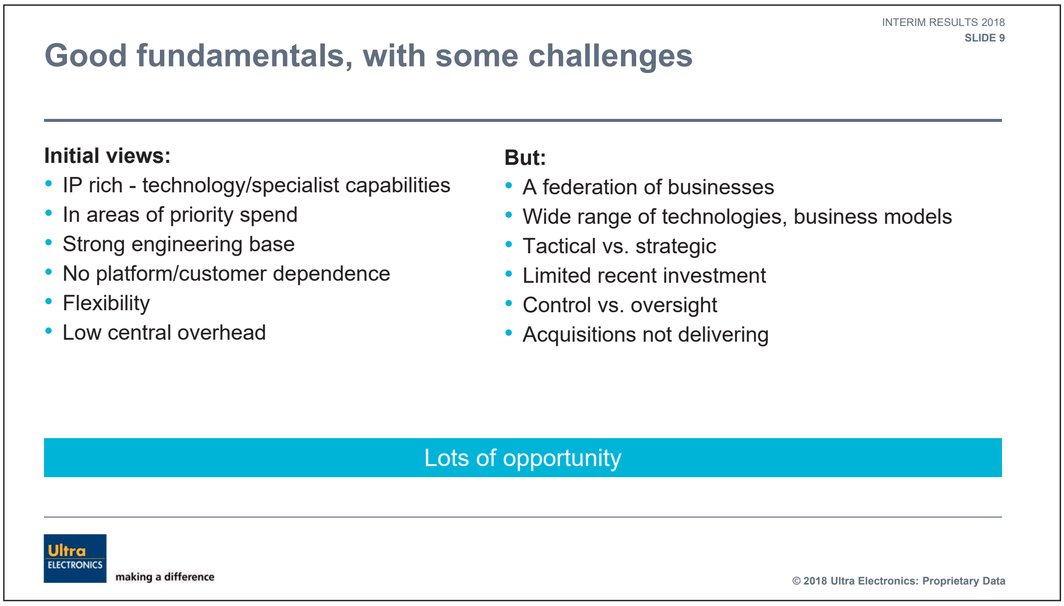
The Group's effective tax rate is currently expected to be broadly flat.

As previously guided, full year cash conversion is expected to be in the 70-75% range.

In terms of the total dividend for the year, we will look at this in the context of the full year performance.

The balance sheet remains strong and we will continue the share buyback, particularly when we see good value in the shares.

Thank you. I will now hand over to Simon.




### Simon Pryce, Ultra's Chief Executive Officer, continued covering future performance and the market outlook.

Good morning everybody, thank you Ami, thank you Douglas. What I'm going to go through in the next couple of slides is what I've been doing for the last six weeks. I have spent most of my time familiarising myself with the Ultra businesses, the Ultra leadership and the working processes and practices that go on within the organisation. My initial impressions very much support the due diligence I did before I joined and what Douglas' has highlighted at the beginning of this presentation.

In common with a number of other companies with significant defence exposure, constrained defence spending both in the UK and particularly in the US created a challenging environment for Ultra, which has particularly impacted the Group over the last two or three years.

But, it shouldn't detract from the underlying strengths of Ultra: What I've found here is an IP rich group of businesses with a very solid technology base and wide range of specialist capabilities.

As the US moves into a period of increased defence spend, Ultra's world leading technology in areas such as anti-submarine warfare and secure communications is particularly relevant in helping to address the perceived threats that our major customers are trying to prioritise.

And these technologies and capabilities are supported by good people who are well connected with their customers and a particularly strong and flexible engineering capability.

We support a wide range of platforms, programmes and customers with generally, although not always, relatively small shipset values, and importantly from a risk management perspective, has no major platform or customer dependency.

Our federated structure allows both agility and flexibility in providing solutions that customers need in the most technologically effective and cost efficient way.

And finally, we do all this with a pretty lean central overhead.

But, it does feel, even after six weeks, like there is lots more we can do:

As our performance over the last few years has demonstrated, there are significant strengths associated with being a federation of autonomous businesses. However, I'm not sure that we have sufficiently robust underlying processes particularly around risk assessment and management and resource allocation, nor necessarily all of the right capabilities, to consistently deliver the best possible outcome for all of our stakeholders.

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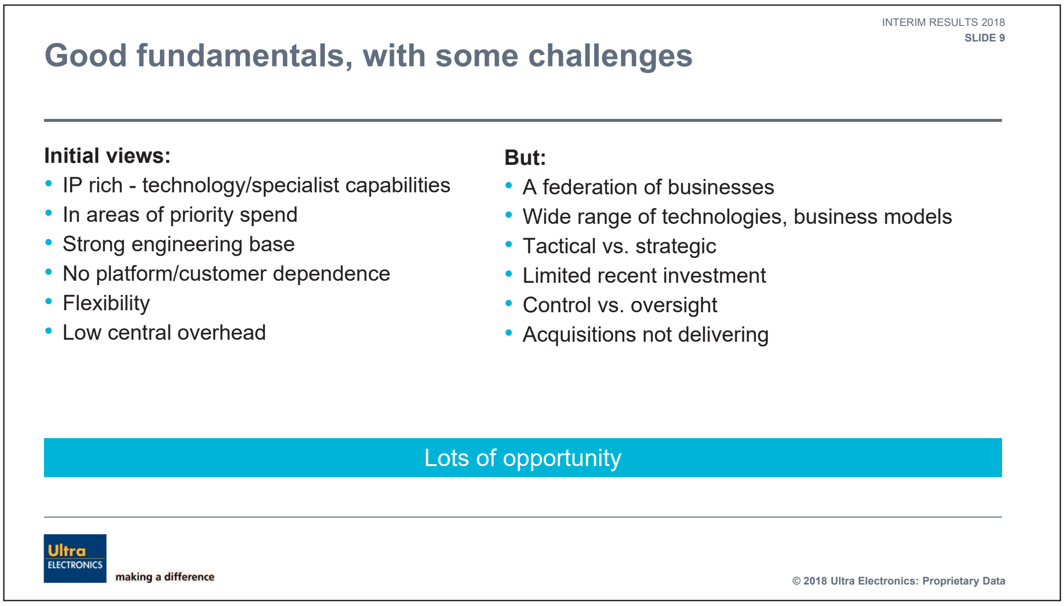


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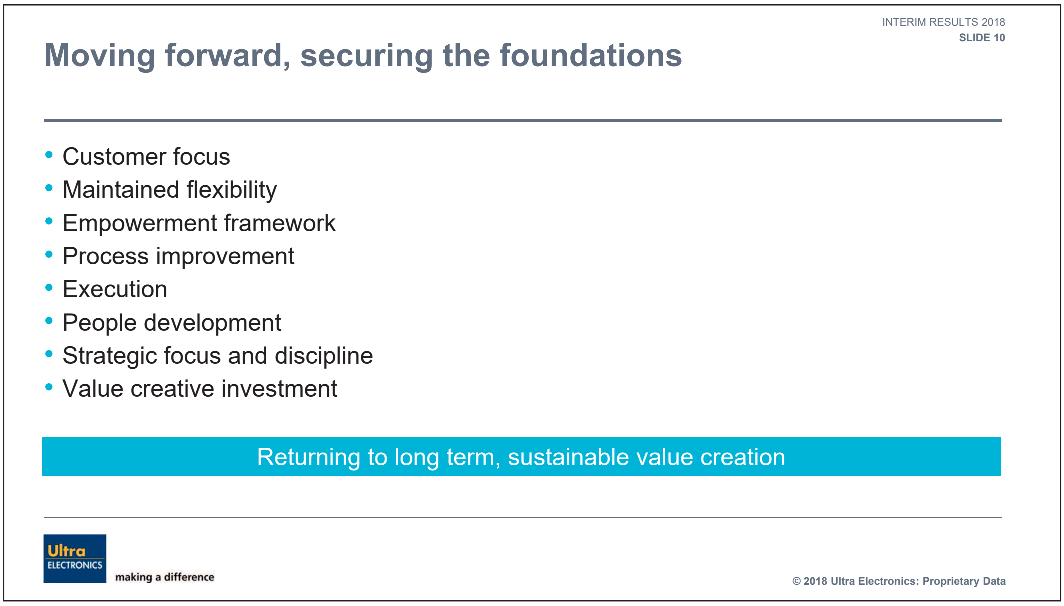
I am not sure that we have an optimised structure and set of management processes that supports the delivery and maximisation of long term and sustainable value creation across the wide range of technologies, capabilities and business models within the Group.

Whether it is to do with the market, or for internal reasons, it feels like Ultra at the moment is rather tactical, and that there are greater opportunities in a long-term business like this, from taking a more strategic approach to the way we make decisions.

And the challenges the Group has faced in recent years and the pressure to achieve profits growth, despite a challenging market, has led to a focus on cost cutting and a tendency to hold back on investment together with greater central control over expenditure, perhaps at the expense of a more pragmatic approach to risk, contracting and effective oversight.

And finally, as a number of you will be aware, one or two of the acquisitions we made recently are not delivering against the strategic investment cases that were made at the time the investment was entered into.

But importantly, all of these issues feel like opportunities rather than problems. They are fixable and build on Ultra's traditional strengths, with its extensive specialist capabilities and differentiated technologies, its talented people and strong balance sheet. In short, it feels like there is lots of medium and long term opportunity at Ultra.




So what we are going to think about over the next six to 12 months moving forward, it's all about securing the foundations for the next phase of Ultra's development:

We will be looking at things that continue to put the customer first, focusing not just on meeting our commitments to them, but exceeding their expectations; delivering effective solutions to them, on time, to cost and at a price they are prepared to pay;

We'll be looking at ways of maintaining that agility and flexibility in finding effective solutions to meet our customer's needs, not just through direct strategic and tactical relationships, but also through mutually beneficial teaming and partnering arrangements.

We'll be working to ensure we have the right empowerment framework that allows decision making to take place at the right level and that people are empowered and have the resources to deliver their plans in the context of aligned longer term strategic goals.

Whilst the S3 programme was a start, as Ami flagged, we will continue to look at opportunities for process improvement, commonisation and standardisation that supports us being more effective in the way we do business whilst maintaining our independent customer focus.

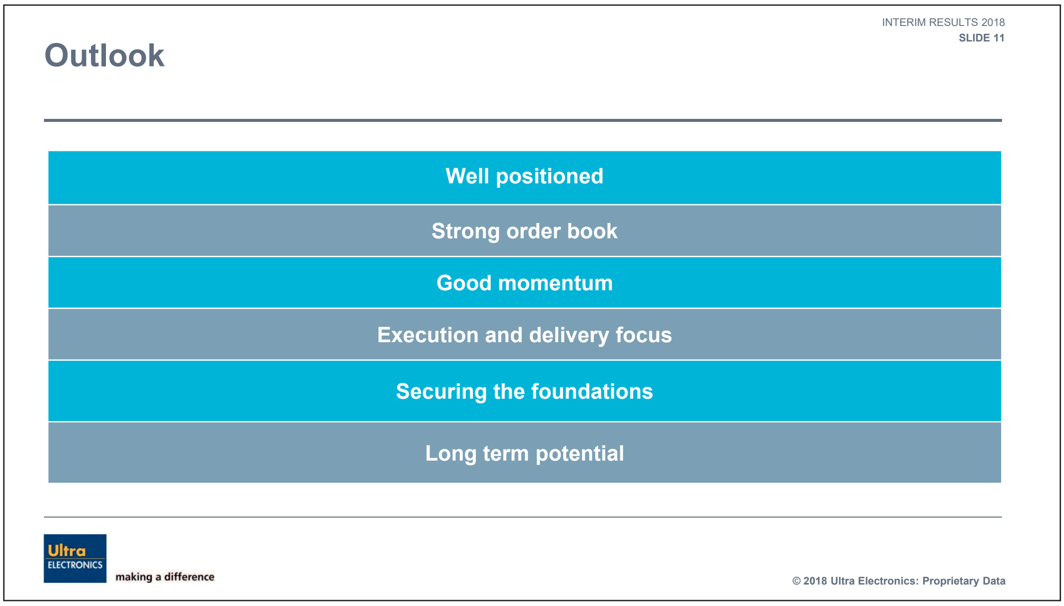
We will apply the same execution discipline I see for some of our businesses more broadly across the whole Group, and also on our cross business and cross functional projects.

We will focus on the more effective and structured development of our already talented, and our most precious resource, our people.

And we will be working on clarifying our strategic objectives and ensuring that in our resource allocation and in our investment process, we are aligning them and are disciplined in delivering against those aligned objectives.

Our investment process is going to be very disciplined, and will always support the longer term Group strategic goals.

Ami and I will provide you with preliminary thoughts on these areas and where we have got to at the time of the prelims in March. These feel like the areas we are going to focus on as we enter into Ultra's next phase of development as we focus on returning to long term and sustainable value creation from this Group.




So in summary, six weeks into the role, and admittedly with much still to learn and see, I very much concur with Douglas' view, despite a difficult few years and in no small part due to his recent efforts, Ultra is well positioned as we enter the second half.

The order book is strong, indeed as strong as it has been for a number of years.

We have got good, positive momentum as we exit the first half, and with good order cover for the remainder of the year, and it certainly feels like risks to H2 are mainly around execution and effective delivery.

In parallel we will be looking at securing and strengthening Ultra's foundations, and I'm extremely excited to be part of Ultra and I thank Douglas for giving me the opportunity as we take Ultra into the next phase of its development where it feels that there is a lot of potential for this Group in the medium to long term.

That is the end of the formal presentation and I'd now like to open the session up for questions. It would be helpful, certainly to me as I am relatively new to this audience, if you could raise your hand and state your name and the institution or firm you are representing followed by your questions. If we do not manage to get to your questions during the course of this presentation, please feel free to get hold of Ami or me outside this session and we will do all we can to answer any concerns or questions that you have got. So with that, I will open the floor.

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