

## Operating review

# Modest but positive progress



Andrew Thomis  
Chief Executive

**“2021 has been a year of modest but positive progress for Cohort, with the impact of COVID-19 added into the mix of factors affecting business. It has been a pleasing year for order intake, and cash performance was also good. In terms of revenue and profit, strong performance at EID and Marlborough Communications (MCL), together with a maiden contribution from ELAC, have been partly offset by reduced profits at Chess and SEA. Overall, performance has been in line with our expectations for the year.”**

### 2021 highlights

- ▶ The Group’s adjusted operating profit of £18.6m (2020: £18.2m) on revenue of £143.3m (2020: £131.1m) represented a net return of 13.0% (2020: 13.9%).
- ▶ MASS remained the strongest contributor to the Group’s adjusted operating profit, despite a slightly reduced level of revenue and profit.
- ▶ ELAC made an initial contribution to revenue and profit following completion of the acquisition in December 2020.
- ▶ EID had a much stronger year, as did MCL.
- ▶ Chess saw a reduction on profit despite strong revenue growth.
- ▶ SEA’s performance was lower than in 2020 in terms of revenue and profit.

### Operating review

2021 has been, overall, another year of progress for Cohort, with the Group reaching a record level of revenue and adjusted operating profit but with mixed results from the underlying businesses. Revenue grew by 9.3% and adjusted operating profit by 2.2%. Both revenue and adjusted operating profit benefited from a maiden contribution from ELAC, which joined the Group in December 2020.

EID improved its performance again as a result of increased export sales, including some deliveries that had been delayed from the previous year. MCL returned strongly after a disappointing year in 2020 with some good wins and successful deliveries. These improvements were offset by weaker performances at Chess and SEA. Chess achieved good revenue growth, but margins were affected by the need for competitive pricing and a small number of problem projects. SEA was hit by delays to expected order intake, resulting in lower revenue and profit despite the cost base reduction implemented during the year.

The COVID-19 pandemic and resultant lockdowns continued to have an impact on many of our markets, with international travel restrictions still in place in many regions. The resulting barriers to interaction with customers have not had a short-term impact on our ability to win new business. The Group achieved an order intake of over £180m, resulting in a closing order book of £242m and order cover of just under £100m for 2022. Nevertheless, we have continued to see deliveries of products and services impacted by customer site closures and restrictions. With vehicle traffic volumes falling drastically over the pandemic period and plenty of competing priorities, local authority spending on SEA’s traffic enforcement systems has reduced and is only just now showing signs of recovery. Overall, for 2021 we estimate that the impact of COVID-19 has been a reduction in revenue of around £6m across the Group but that savings in overheads, especially on travel and business development, including exhibitions, has offset most of the margin slippage with a net impact on adjusted operating profit of £0.2m.

The Group’s adjusted operating profit grew by 2.2% to £18.6m (2020: £18.2m) on revenue of £143.3m (2020: £131.1m), a net operating return of 13.0% (2020: 13.9%). The Group’s statutory operating profit of £7.8m (2020: £10.7m) reflects the significant effect of the amortisation of other intangible assets, a £10.1m non-cash charge in 2021 (2020: £7.4m charge). In this review, therefore, the focus is on the adjusted operating profit of each business, which we consider to be a more appropriate measure of performance year on year. The adjusted operating profit is reconciled to the operating profit in the Consolidated Income Statement and by business in note 1.

## Operating review continued

### Operating review continued Adjusted operating profit by subsidiary

	Adjusted operating profit			Adjusted operating margin	
	2021 £m	2020 £m	Change %	2021 %	2020 %
Chess	3.0	3.9	(0.9)	10.5	15.6
EID	4.8	3.1	1.7	23.1	17.2
ELAC	1.2	—	1.2	14.1	—
MASS	8.7	8.9	(0.2)	22.1	21.7
MCL	2.1	1.7	0.4	11.5	11.0
SEA	2.4	3.5	(1.1)	8.4	11.1
Central costs	(3.6)	(2.9)	(0.7)	—	—
	18.6	18.2	0.4	13.0	13.9

EID's performance improved markedly compared to 2019/20 with a significant increase in export revenue, partly the result of a substantial delivery being delayed from the end of the previous year. Its operating margin was enhanced by improved production efficiency.

ELAC made a welcome initial contribution to revenue and profit from its five months in the Group in 2020/21. Its revenue was derived from a combination of specialist sonar products and a surface ship sonar suite.

MCL delivered increased revenue and profit after a disappointing 2020. Strong demand for hearing protection systems from the British Army made a major contribution to performance.

Following a record year in 2020, as expected MASS delivered a slightly weaker trading performance in 2021 with a reduction in revenue (mostly in its Digital Services and Electronic Warfare Operational Support divisions) and the corresponding gross margin. MASS's service deliveries faced a considerable headwind from COVID-19, and we were pleased that it nevertheless managed to deliver a satisfactory result.

After a good result in 2020 Chess delivered increased revenue, following strong order intake. Disappointingly, profit and consequently operating margin were significantly reduced, a result of tighter margins on some larger contracts and cost overruns on a small number of problem projects.

SEA's result was disappointingly behind our expectations and last year's performance. Order intake during the year was very strong, but contract awards were in many cases later than expected and it was not possible to realise the planned revenue from them. The Transport business also suffered as COVID-19 diverted local authority expenditure and priorities elsewhere.

### Our people

All the Group's capabilities and customer relationships ultimately derive from our people, and the success we have enjoyed is a result of their efforts. Their adaptability and perseverance in the face of the challenges of the pandemic have been exemplary. I would like to take this opportunity to express my sincere thanks to all employees of Cohort and its businesses.

Over the year we have made several changes to our subsidiary senior management. Steve Hill stepped down as Managing Director of SEA in July 2020. Martin Kelly, SEA's Head of Complex Systems, took over on a temporary basis, with Richard Flitton appointed as permanent Managing Director in January 2021. My thanks go to Steve for his contribution to SEA and to Martin for his willingness to step up at short notice. At EID, António Marcos Lopes retired after over 37 years of service and was replaced as Managing Director by Frederico Lemos. I thank António for his contribution to EID's development, and I am delighted to welcome both Richard and Frederico to the Cohort Group. Just after the financial year end, Graham Beall who founded Chess and has led the business since 1993, stepped back from the role of Managing Director to lead the business's US market development. His deputy, David Tuddenham has taken over as Managing Director from 1 June 2021 following a competitive selection process.

As the COVID-19 pandemic has waxed and waned across Europe, our infection control measures have remained effective and we have not witnessed any confirmed transmission of COVID-19 in the workplace. That has not prevented the disease affecting many of our colleagues, either directly or through family connections. We experienced one tragic loss of life of an employee at EID, and many more have lost close family members to the disease. It has been a sad time for many of our workforce, but their resilience and commitment has been remarkable.

Our policy towards the UK's furlough scheme has developed as the pandemic and the Government response has evolved. We made some use of the scheme initially where lockdown restrictions had a direct impact on employees' ability to carry out their roles, as the alternative would have been to make the individuals concerned redundant. Avoiding redundancy and unemployment in these circumstances was exactly what the scheme was intended to do, and the net saving to Cohort compared to the redundancy option was small or even negative. However, we elected not to make use of the furlough scheme simply to match resources to demand, even when demand has been affected by COVID, an option we could have taken advantage of. We took the view that such resource management, and the associated costs, are for us and not the UK Government. We subsequently ceased use of the scheme completely in October 2020. Receipts from the scheme for the Group over 2019/20 and 2020/21 were £0.3m in total.

As governments and health services begin to bring the pandemic under control, we expect gradually to increase the numbers of people working regularly on-site at our facilities in the UK, Portugal and Germany. The experience of remote working has had some very positive aspects, and our businesses all intend to make use of the flexibility and efficiency it can offer in future. Nevertheless, as we have begun to resume face-to-face meetings with colleagues, suppliers, partners and customers, the importance and value of these interactions have become clearer than ever. Currently our workforce is split roughly 50:50 between those who are primarily home-based and those who are site-based. If the current lockdown measures continue to be eased, we expect that balance to be around 25:75 between home and site-based by October of this year.

### Operating strategy

#### Organic growth

Despite the difficulties in customer communications thrown up by the COVID-19 pandemic, we have had a good year for new orders, and we end it with a significantly increased order book. That is a positive indicator for future organic growth. However, although we did see some organic revenue growth in 2021, the modest level of net profit growth was driven by the acquisition of ELAC.

Cohort currently operates as a group of six small and medium-sized businesses, operating primarily in defence and security markets, and with a strong emphasis on technology, innovation and specialist expertise. Within our markets we have sought to identify niches where prospects are attractive and where we have some sustainable competitive advantage. Growth strategies and opportunities vary around the Group:

- ▶ MASS uses its extremely high reputation, its rare or unique technical capabilities and its experience at building long-lasting customer relationships to win long-term service contracts, gradually adding new building-blocks to its revenue stream.
- ▶ EID combines a low cost-base by international standards with access to Portugal's extremely strong technical education system to create high-performance low-cost communications products that can win in a highly competitive marketplace.

## Operating review continued

### Operating strategy continued

#### Organic growth continued

- ▶ Chess makes use of its innovative engineers, customer-focused culture and ability to source sensors from the best international providers to win against more vertically-integrated larger competitors.
- ▶ SEA has used its close long-term relationship with the Royal Navy to build confidence with that important customer, which in turn creates a strong platform for export orders. It is also investing in new technologies where there is an opportunity to build a strong competitive position, for instance in lightweight towed-array sonars.
- ▶ MCL has a unique business model, combining a small but innovative engineering team with a wide range of international partnerships to provide highly specialised equipment and services to the UK armed forces and security services.
- ▶ ELAC, the newest member of the Group, has built on almost a century of hydro-acoustic knowledge to create a new architecture for sonar systems on a scale that only a few international providers can match. Its systems combine world-class performance with an ability for customers to tailor analysis techniques and data libraries to their own specific needs.

Our businesses have continued to be active in finding new customers, and 2021 has seen some notable successes for Chess, MCL and SEA in particular. Discussions with potential customers have opened up some major longer-term opportunities for all of our businesses.

Being part of the Cohort Group brings some material advantages to small and medium-sized defence technology businesses. The Group's strong balance sheet gives customers the confidence to award large or long-term contracts that we are well able to execute technically but which might otherwise be perceived as risky. Recent examples include the award of the €49m order to ELAC for sonar systems for the Italian Navy's new class of submarine, the £25m support contract recently awarded to SEA for the Royal Navy and the £16m of orders awarded to Chess, announced in October 2020.

The Group's Directors have long experience of operating in the defence sector and have contacts and working relationships with senior customers in the UK and internationally that would be hard for independent smaller businesses to establish. Our six operating businesses, while remaining operationally independent, have formed close working relationships and benefit from sharing technical capabilities, customer relationships and market knowledge within the bounds imposed by our various confidentiality obligations. We will continue to work to promote the Group's services and products in wider markets, including through business development visits as and when government restrictions allow.

These strategies have generated long-term customer relationships and good opportunities that give us confidence that we can continue to win substantial new business in the year ahead. Overall, the organic profit performance of the business in the year (i.e. excluding the effect of ELAC's initial contribution) was slightly behind that achieved in 2020 with improved results at MCL and EID being offset by weaker performance at Chess and SEA.

#### Acquisitions

Alongside our organic growth strategy, we continue to see opportunities to accelerate our growth by making further targeted value enhancing acquisitions. We believe that there are good businesses in the UK and overseas that would thrive under Cohort ownership, whether as standalone members of the Group or as "bolt-in" acquisitions to our existing subsidiaries.

The most likely candidates for bolt-in acquisitions are businesses with capabilities and/or customer relationships that are closely linked to one of our existing subsidiaries. We would expect to integrate an acquired business

of this nature fully within the relevant subsidiary. This could lead to both cost savings and benefits from shared access to markets and technologies.

For standalone acquisitions we are looking for agile, innovative businesses that have reached a stage of development where there will be mutual benefit in joining Cohort. It is likely that candidates will be operating in the defence and security markets either in the UK or internationally, as that is where the Group can add most value. Growth prospects, sustainable competitive advantage and the ability to operate as part of a publicly quoted UK group will all be important.

On 3 December 2020, we announced the completion of our agreement to acquire 100% of Wärtsilä ELAC Nautik GmbH (now renamed ELAC Sonar GmbH) for a consideration of €16.2m on a debt free, cash free basis. ELAC, a leader in sonar systems technology for naval surface ships and submarines, has joined the Group as Cohort's sixth standalone business. The agreement was first announced in December 2019, completion taking longer than expected as a result of COVID-19 restrictions and the need for German Federal Government approval.

The acquisition of ELAC fits well with our acquisition strategy. Importantly, it increases the Group's exposure to scalable product and systems and export customers, particularly in the naval market. ELAC shares highly complementary expertise, capabilities, and technologies with SEA, providing a significant cross-selling opportunity. This has already begun, with SEA offering its towed-array sonar to customers being supplied with ELAC's complementary sonar products. The acquisition will increase the Group's reach and potential in new international markets and adds Germany as a new home market.

We acquired 81.84% of Chess in December 2018 for an initial consideration of just over £20.0m. The acquisition includes an earn-out clause and an option for acquiring the minority interest (18.16%), both based on Chess's performance for the three years ended 30 April 2021. The performance period for determining the value of the earn-out and option ended on 30 April 2021, and we now expect to pay £2.8m (2020: £4.0m) in total on or before 31 October 2021.

#### Maintain confidence

Cohort's management approach is to allow its subsidiary businesses a significant degree of operational autonomy to develop their potential fully. At the same time we provide light-touch but rigorous financial and strategic controls at Group level to manage and control risks and ensure legislative and regulatory compliance. Our experience is that our customers prefer to work with businesses where decision making is streamlined and focused on solving their immediate problems. This model provides us with a degree of competitive advantage over some larger rivals where the decision-making process can be more extended. It is also cost-effective as it avoids the need for additional layers of management involved in coordination activities and for a large headquarters team. High-calibre employees find our business model attractive and more rewarding as it allows them to be involved in decisions affecting the business, even at a relatively junior level, rather than being constrained to a narrow or purely technical role. This positions us well with customers where such attributes are highly valued.

Although the degree of autonomy our subsidiary businesses enjoy is high, and we believe that this is an effective operational strategy, we take a practical view of the best way forward when circumstances change. When the operational situation is such that a merger, restructuring or even sale is necessitated, we will act and have acted in the best interests of the wider Group and its shareholders.

**Andrew Thomis**  
Chief Executive