Cohort Plc

Full Year Results | Video Webcast

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Transcript

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Andrew Thomis: Good morning, everyone. Nice to see you. For anyone who doesn't know me, I'm Andy Thomis. I'm the Chief Executive at Cohort, and I'm here with Simon Walther, who's our Finance Director, to take you through the final results for the financial year that ended in April this year. So, I'm going to start by giving you the highlights of the results we're announcing today. Simon is going to provide more detail, including a divisional breakdown, and then I'm going to come back with some comments about the outlook, about the demand drivers and about our future prospects. And the big picture, of course, is that we've seen a very strong performance this year: record operating profit, record revenue, and a record closing order book.

So here are the numbers. As I say, revenue and profit, both up very strongly. Revenue up by a third to £182 million. Adjusted operating profit and earnings per share both grew strongly to just over 19 million and 36 pence per share, respectively. And those also are new record numbers. And it was a very strong period for new orders to, order intake of £220 million, significantly exceeding the revenue that we recognised. And so the total order book grew to nearly £330 million at the year end. And that meant that 80% of our consensus forecast revenue for the current year was already on order at the end of April.

And that strong run of order wins has carried on since then, because at the end of June, the order book had grown to £360 million, and that gives us now 90% revenue cover for the year. And finally, the cashflow was strong as well, the end of year cash position, much better than we'd been expecting. Net funds of £15.6 million. And so against that backdrop, the board is very pleased to be recommending a final dividend of 13.4 pence, and that represents an increase of 10% for the year as a whole.

Now, before we get into the detail, I wanted to let you know about some changes that we've made to the way that we present our results this year. We've grouped our six businesses into two divisions, reflecting the two main areas that we operate in, and we think that that will make for a clearer and simpler way of reporting while still providing the detail that you need.

So our Communications and Intelligence division includes EID, MASS and MCL, and you'll recall that EID is our Portuguese naval and land communications business. MASS provides specialist technical services to customers in the intelligence and electronic warfare worlds. And MCL provides both communications and intelligence equipment for customers in the UK government. Our Sensors and Effectors division comprises of Chess, ELAC SONAR, and SEA. And Chess, as you'll remember, specialises in integrated optical and radar sensors for land and naval users.

ELAC SONAR provides complete sonar systems for surface ships and submarines. And SEA provides its own special purpose sonar, as well as effectors, including torpedo launch systems and decoy launches for surface ships. And the charts on the right-hand side show the recent revenue, operating profit and order book contributions of the two divisions. You'll see that both divisions achieved similar revenue last year, with Sensors and Effectors in fact, slightly ahead. But Communications and Intelligence made much the larger contribution to group profitability. And that's primarily down to MASS, which has the highest operating margin of our businesses.

Conversely, Sensors and Effectors makes the largest contribution to the group order book, and SEA in particular, has been building its order book very strongly, and that provides long-term stability for the group. Continuing the growth trajectory for this division is going to help us push up margins closer to the level that we're achieving in communications and intelligence.

Now, one thing I should emphasise in all this is that this new way of reporting doesn't mean that we've changed the way that we manage the group. Simon and I continue to have direct and close relationships with all of the operating company managing directors, and they have the same high degree of autonomy within our light touch, but rigorous framework of financial and governance controls.

So, Simon's going to give a more detailed breakdown of the divisional performance in a moment, but this slide shows the main factors behind the group's performance improvement. In Sensors and Effectors, one major factor was a return to a solid profit at Chess after a disappointing net loss last year. Now, Chess still has some way to go to achieve its potential, but we're increasingly confident it's on the right track. And alongside that, we saw steady progress at ELAC SONAR and SEA. And SEA, as I've said in particular, made a big contribution last year to the group's order book.

Communications and Intelligence, we saw a remarkably strong performance at MCL, a business with less than 50 employees actually delivered the second largest annual revenue of all our businesses. Sorry, the largest annual revenue of all our businesses, and the second largest contribution to profit after MASS. And that was a result of increased UK defence spending on certain types of equipment, as well as growth in the longstanding hearing protection line.

MASS made its usual significant contribution, but slightly lower than last year. EID’s performance though, was the most disappointing in that division. A result of delays to domestic orders and some supply chain issues, but that didn't detract from what was overall a really very positive picture. So with that, let me hand over to Simon who's going to take you through those results in a little bit more detail.

Simon Walther: Thank you, Andy. Good morning, everybody. It's good to see us all back in a room together again. Let me just check this. Thank you. As Andy's already said, I'd like to reiterate that the record revenue and trading profit performance of the group was, obviously very welcome, and a very good performance. You'll notice that the weaker gross margin percentage this year as compared to last year, now, that was a result of a mix of change, with lower relative contribution from MASS within the communications and intelligence division.

It also reflects some weaker specific project margins. You're well aware that we've got this large project down through ELAC on the Italian Sonar project. We are trading that at the moment at lower margins as it progresses through its development phase. It should start to enter into production during late ‘24 and into ‘25. We also had the sale of some older product at Chess, which was at lower margin, but that did have a very good beneficial impact on the cashflow, which you'd have seen.

However, we do expect the gross margin for the group to move back up towards nearer historical levels. Probably not as high as 21/22 in the coming year, but that's the plan, to get those margins coming up. Again, that will improve as a result of mix, but also we expect improved performances both for EID, and continuing improvements at Chess.

Moving on to the individual divisions, in Communications and Intelligence, you can see a strong operating performance from this division with revenue and trading profit up by 26% and 21% respectively. The improvement has come from a very strong MCL performance driven by the MOD demand during the year, especially for communications equipment, hearing protection and drones.

Sadly, EID had another disappointing year of continued delay to large naval orders from Portugal. These are now expected to be secured in the current financial year, with the procurement process now underway in Portugal. Once secured, we do expect EID’s performance to recover, albeit slowly at first. For this division, the order cover now stands at the end of June at around 75% for our expected revenue for the coming year. This is typically lower than Sensors and Effectors with the short-term nature of some of the work at MASS and especially at MCL.

For the coming year, a recovery at EID, improvement at MASS will be offset by MCL reverting back to more historical levels. And overall, we expect this division to trade roughly in line with the current year. Moving to Sensors and Effectors, again, a very strong performance with revenue and trading profit up 39 and 24%, respectively. The improvement was continued growth at ELAC and SEA, and an improved performance at Chess. We did close out some legacy issues at Chess, in part explaining the weaker net margin for this division. I'd also add here that we've acquired some land in the north of Kiel, for a new facility for the ELAC factory. That building work will start in the next quarter. We've had to take this on because ELAC's current facility is due to be torn down in 25/26, to be taken over by the University of Kiel. We've ensured that the timing of this building completion is ready for the delivery of the first Italian Sonar product, which is towards the back end of '25. The order cover for this division at the end of June, now stands at near to 95%, which is typical for a business which is dominated by long-term naval programs. And it's this division with the order book going out to the early 2030s. We do expect this division to grow in the coming year, and that will grow, drive the overall revenue growth for the group and the profit growth.

Finally, net funds bridge. Net funds ended a lot stronger than I expected, and many of you, I know. This was despite a networking capital outflow. There were a number of reasons for the working capital outflow. At EID, it was due to timing, with sales slipping from April into May. We should get that recovered. MCL had a similar issue, unusual for MCL to actually have quite high working capital. ELAC has started its large build on the Italian project. Obviously its development work, early buyers. SEA also had builds for naval and traffic camera systems. We also invested over £5 million in CapEx, which is almost double our usual run rate. This was mostly in Germany, to fund the land purchase and also equipment for the Italian Sonar project.

We do expect the group's CapEx for the next two years to be over £10 million per year, as we go through the build program on the German facility, before returning in 25/26 to probably around three to 4 million per annum. I'm guiding net funds to reduce in the current year to around about £8 million, before growing again in the next two years after that. But I would reiterate, overall a record trading year, a strong funding position, which should enable us to invest in technology and targeted acquisitions. Thank you very much. I'll hand back to Andy.

Andrew Thomis: Thank you, Simon. So, in this final section, I'm going to talk about the outlook. I'll start with a bit about the broad market position. I'll talk about some of the investments that we're making in new products and technology to maximise our opportunities in that market. Then I'll show you how the existing order book runs off over the coming years, and I'll round up with a summary.

So, let's start with the main forces that affect demand for our products and services. The global picture has two main driving forces at the moment. The continuing conflict in Ukraine, of course, is one. The influence of growing Chinese assertiveness from the Indian Ocean to Australasia is the other. Now, in Europe, this is primarily but not exclusively a land-based challenge. Russia's foreign policy has grown more assertive over many years, but the transition to armed aggression was a step change. Now, I don't expect that Russia's going to win in any meaningful sense in Ukraine, but a long term armed standoff is likely, when the conflict comes to a close. Russia's revitalised defence industry and reconstituted armed forces will pose a standing threat to the West. So, Russia's European neighbours will need to adapt to the new reality of that.

In Asia, Chinese assertiveness has not yet manifested itself in the same way, but the naked threat is there. Of course, Taiwan is at risk, but there's also aggressive behaviour and maritime claims in the South China Sea. Those are having a major regional impact on defence postures and equipment spending. Also, Chinese behaviour in the region has driven the creation of the tripartite AUKUS alliance between Australia, the UK, and the US. Now, that naturally leads onto the domestic picture as AUKUS is one of the major factors having an effect on UK defence and the UK defence industry. Yesterday we saw the release of a new defence command paper, which announced initiatives to make UK defence a science and technology superpower, and to develop a new strategic relationship with industry. Those very positive developments complement the integrated review refresh that the government released earlier this year, that confirmed the need to invest in responding to challenges both from Russia and from China.

In our other domestic markets, well, in Germany to start, we're starting to see the impact of the step change in defence spending that's been promised there. Our German business is already supplying specialist hydro acoustic equipment for new German surface ships and submarines. In Portugal, the long list of domestic opportunities for EID is really finally starting to gather some momentum, with bids being invited for several major programs and a new military procurement law now having been approved by the Portuguese Parliament. In our export markets, most NATO countries have pledged to increase defence spending since February last year, and we've seen a direct impact from that in some of our markets, with new opportunities emerging and existing orders being increased in scale and scope.

Further East, we see strong demand in the Asia Pacific region as well. Australia has continued to commit to strong growth in defence spending under the Albanese government. Japan remains committed to doubling its expenditure on national security, as a share of GDP by 2027. It's also joining the new Anglo Italian Next Generation Combat Aircraft project. Elsewhere in the region, spending has also grown strongly, notably in the Philippines and in Taiwan. Now, NATO and Asia Pacific are the regions we supply most, although we're also active I should say, in South America. So, overall, the international demand picture for Cohort is positive.

Against that encouraging background, we're maintaining our spend on technology development to meet the evolving needs of our customers. So many of these projects, of course, are sensitive, but I wanted to share some examples that I can with you. So, one of the key lessons of the Ukraine conflict is the importance of battlefield awareness, awareness of friendly forces, hostile forces, objectives, and threats. Now, EID is invested in a Dismounted Soldier System Integrator that provides power, communications and an accurate battlefield picture to every infantryman. It's an advanced system that will match that of the leading multinational defence primes at a much lower cost, and is now in service with the Portuguese Armed Forces.

Chess has developed an artificial intelligence based technology to track small and elusive targets in challenging environments. Now, I'm not sure if you can see the drone that's hiding behind the tree in that particular picture, but I can assure you that the Chess system can. That capability is being combined with other technologies to create genuinely effective counter drone systems. Again, the Ukraine conflict has shown those to be absolutely vital. Looking to Asia Pacific, one of the greatest security challenges is driven by the large and growing submarine fleets of China and North Korea. SEA is developing technology to allow non-expert users to detect submarines and to build and share an accurate picture of the undersea battle space. That's known as the Multi-Environment Display.

Another key technology in that domain is underwater communications, which will become more and more important as unmanned underwater vehicles become a vital part of naval inventories. ELAC SONAR is developing new technology to enable these vessels to be controlled, and to enable them to share data without surfacing and without that communication being intercepted. Finally, and no less importantly, we maintain our strategy of seeking and investing in value-adding acquisitions. We are very selective and we won't acquire a business unless we know it will add value and growth in the long term. But we have an experienced acquisition team, and I can say we have no shortage of opportunities to review.

So I've talked in broad terms and about markets and capabilities, but this slide shows the tangible results of the demand picture that I've described. At nearly £330 million, Cohort's year-end order book is the strongest that we've ever announced. It includes a very substantial element that will feed directly into revenue this year and next. But it also includes over £100 million of order cover for 2025, '26, and beyond, guaranteeing a solid flow of revenue for a decade or more. Now, as I mentioned earlier, since the year end, the order book has grown further, and it reached £360 million at the end of June, giving us 90% revenue cover for the year. The larger part of our order book, as I've said, sits with the Sensors and Effectors division. SEA makes a very strong contribution to this number, and it's received a further strong boost to its order book since the year end. And it also has opportunities to win new and large long-term orders this year. ELAC and Chess also add significantly to the total.

In Communications and Intelligence, MCL tends to operate naturally on a relatively short-term order book so its contribution to the order book total is modest. MASS's total is substantial, but it tends to only increase significantly in those years when its large long-term contracts are renewed.

EID's order book reduced in 2022/23. But it does also, as I've said, see some attractive opportunities with its domestic, naval, and military customers. And with that new Portuguese military procurement law now approved by Parliament, we're much more optimistic that those are going to be converted in a firm contract in the years ahead.

So, here, you can see the first column of the chart that I've just shown, the order book, in numbers, together with a comparison against the same position last year. And the growth in the total order book from £291 million to £329 million, and that's a 13% increase, is a strong indicator of the potential for future growth. And those two shaded columns show the revenue already on order for the year ahead, compared to the same position in 2022.

Now, in Communications and Intelligence, we can see that the underpinning is broadly similar to last year. MCL's ability to win and deliver new business in year is going to have a big impact on the division's actual performance in the course of the year. But the big change is in census and effectors, where the underpinning for the year has increased from £69 million to almost £84 million. And that's an increase of over 20%. And that positions us well in that division for further growth this year.

So that brings me almost to the end of what we wanted to say to you this morning. To summarise, it's been a record year in terms of performance. We're not resting on our laurels, of course, but we're very pleased to be growing the size and strength of the group in this way. Maybe more importantly, we've achieved a record order book. And we see an excellent pipeline of further orders ahead. As I mentioned, I'll say it again, that order book has now increased to £360 million at the end of June. The markets we're operating in are growing. We expect to see those higher levels of spending maintained in the longer term. We're investing in the products and the capabilities that customers will need as they look to keep themselves safe in what is a more challenging global security environment. If we can, we'll accelerate our growth through targeted acquisitions of additional businesses. Our immediate expectation is that we will continue to grow in the year ahead. And I've tried to explain what's behind and what supports that view in this presentation.

Beyond next year, based on the order book and on the opportunities that we can see, we expect that growth to accelerate. And as a result of our performance and our prospects, the board has felt confident to increase the dividend by 10% again. And we've grown the dividend, I should remind you, every year since our IPO in 2006. So, overall, it's been a positive year. Unfortunately for us, there's no time to sit back and admire it because we're already on to the next one.

But in closing, I wanted to take the opportunity to say thank you to our management teams and to all of our employees for their continued hard work. And I wanted to leave you with this snapshot of how we see ourselves developing. We've made considerable progress towards achieving this vision from the earliest days on the market back in 2006. Our strategy continues to generate growth, both organically and through acquisitions, while paying a dividend that reflects our successful financial performance. And we believe that this offers the best long-term returns for investors, while creating high value employment in the UK and our other operating countries, and enhancing the security of the UK and its allies. That's what I wanted to say. Thank you all very much for your attention. If you have any questions, we'll be delighted to try and answer. Thank you.

So please, questions. Ben?

Ben Bourne: Andy and Simon, thank you very much for that. I have three questions for you, Andy, please, and two for you. Good morning, all. It's Ben Bourne from Investec. Three questions for you, Andy, please, and two for you Simon. Firstly, Andy, you mentioned the defence command paper published yesterday. What are your thoughts on the direction of travel domestically, and was it as expected? Do you want all three or one at a time?

Andrew Thomis: We'll do one at a time, Ben, if that's okay. Yeah, I think it was a further step in the strategic direction that was set out originally by the integrated review in 2021. And was continued in the integrated review refresh that happened earlier this year. I think the importance of technology for defence, the high importance as far as keeping platforms up to date by improving and replacing the systems that sit on those platforms. So, for example, not necessarily replacing frigates and destroyers, but upgrading the capabilities that they've got regularly. That's a really important capability, I think. The importance of a strategic relationship with industry, I think, is really important. So it's good to see these things being emphasised. It suggests to me that the UK is on a very sensible and rational strategic track in responding to the changes in the security environment that we've seen since last year. And that's certainly something that I feel contributes to the positive backdrop in our home UK market.

Ben Bourne: Thank you. Secondly, any thoughts on Ben Wallace's successor, and have the right foundations been laid?

Andrew Thomis: I would hesitate to comment on the likely successor to our Defence Secretary, but I think strong foundations have been laid. I think the UK MOD, and perhaps this can't always have been said of it, has behaved in a strategic, thoughtful, and rational way in responding to what has been an extraordinary challenge that we've seen over recent years. And I hope very much that that can continue. It would certainly be nice to see some stability in the post of Defence Procurement Minister which, regrettably, is something that we haven't seen in recent years.

Ben Bourne: Thank you. And then, lastly for you, Andy, it appears that prospects look pretty strong in naval and ground-based air defence. Which countries are offering the best opportunities at the moment?

Andrew Thomis: Well, again, I have to hesitate to name individual countries. But I can certainly talk about particular opportunities on the naval side in Southeast Asia and around the South China Sea, where we see a significant challenge from Chinese assertiveness, obviously, across the Straits of Taiwan. But there's a maritime claim for pretty much all of the South China Sea. Navies in that region tend to operate with relatively large fleets of relatively small vessels. And responding to that, we're providing the kind of system that will enable them to limit the options available to Chinese submarine commanders, for example, in that region. I would hope that the UK's accession to the CPTPP, if that's the right collection of Ts and Ps, will be a positive step towards continuing to develop our relations with countries in that region. And I think that will continue to be important market for us.

And of course, as I've mentioned already, we're seeing a significant increase in defence spending around the NATO countries too, from the new members and from the old members alike.

Ben Bourne: A new acronym. I thought I knew them all after 20 years. Thank you.

Simon, two quick ones. Any tax credits to take advantage of in the year ahead? And then secondly, please, could you expand on what products have caused MCLs recent success?

Simon Walther: Yes. On the first one, yes, we continue to attract R&D tax credits in the UK. They are also available in Portugal. They are not currently available in Germany, although I think the German government is looking at this.

In the UK, we generally are quite prudent in how we recognise these credits and the nature of what we do between, it's a bit of a technical question, but between how when work stops being R&D and when it becomes production, when you're making one-offs, it's quite difficult to define. And so we are quite careful and how we do that.

And likewise in Portugal, the regime's slightly different in that it's recognized on almost a cash basis rather than in the UK on accrual basis. But no, I do expect to continue to get credits. And as you know, we've always been very prudent on our tax forecasting, so we tend to do better than what we normally put out.

In terms of the second point, remind me, on product.

Ben Bourne: Yeah, MCL outperformance.

Simon Walther: Yeah. Okay. MCL, obviously, it's in the communications and intelligence division. Therefore, much of what it does is in that field. It's had a very good year in terms of communications, particularly on intercoms for the UK MOD.

Here in protection has really ramped up, particularly on they've got going on armoured fighting vehicles, particularly including the Ajax. And then drones, there's been quite a demand for drones. And there is also, not at the moment we've got any orders, but there's also a sort of increase in counter drone systems as well, which MCL are looking at both for Army and Navy users.

Ben Bourne: Thank you.

Andrew Thomis: Other questions, please?

Yeah, Jamie.

Jamie Murray: Good morning, chaps. So, yeah, obviously the trends in defence spending across Europe is very high. How do you see the new entrants, the new NATO entrants, do you have any business in Sweden, Finland? Have you been making any contacts there?

Andrew Thomis: We have some very strong relationships in Sweden, primarily with Saab of course, which has been a business partner in a number of important areas for us over many years. Sweden has a strong defence industry and they're both customers and suppliers to us in many areas. So I would hope to see those relationships deepen with the acquisition, sorry, accession of Sweden to NATO.

Finland, not so much. I would hope to see more opportunities as a result of their accession to NATO. They also have a strong defence industry with companies such as Patria, and I think moving towards a much more Western orientated approach from Finland will be a welcome development from our perspective too.

Jamie Murray: Thank you.

Rohan Dabasia: Hi, good morning to you both. Just two questions. One on CapEx first. Where is the focus for the 10 million CapEx spending over the next couple of years?

Simon Walther: Yes. Well, obviously it will be on a new factory in Germany. That's where the majority of the CapEx spend will be. We estimate the overall cost for the facility to be around about 20 million euros, of which we've only just acquired the land, just under two million.

There is also some investments still to be done on machinery and other equipment for the Italian program. These sonars, I think I wouldn't be given much away, but the full sonar suite is tens of tons in weight, and it's very large. Imagine the size and these run down in each flank of the submarine. So there's quite a bit of equipment. This is bigger than anything that ELAC have ever produced. So there's some equipment, down to basics like ovens for curing things all the way up to more heavier equipment.

So that's where the investment primarily is. Elsewhere in our other businesses, they'll run at the usual run rate, which is many equal depreciation.

Rohan Dabasia: And lastly, on Chess, what do you think the timeline is when you expect the business to get back to expected margin potential?

Andrew Thomis: We'll certainly see an improvement this year, and I would hope to see perhaps in the year after that, getting up towards its full potential. We'd be looking for order of 15%, around that region, plus and minus a bit for our product type businesses. And Chess is no exception to that.

Rohan Dabasia: Very good. Thank you.

Andrew Thomis: Further questions?

No. Emily?

Emily McBride: I've got a question online from Robin Speakman from Shore Capital Markets. He said, "Well done on a great set of results. First question, are there any significant contract renewals due this year?"

Andrew Thomis: Good question, are there any this year?

Simon Walther: No, there aren't. The big contract renewals mostly are at MASS. And as we've said in the statement, there are no significant renewals at MASS until 2026. We've had literally in the last quarter of the financial year, MASS had a number of extensions, renewals to exist in MOD support programs.

SCA also won a long support program on work that it's been carrying out for many years. Interestingly, MASS's service contracts now, I think for some of them we are running into 25 plus years of work for the MOD. So they clearly like what we're doing and we continue to deliver well.

Emily McBride: Second question from Robin. "There's visibly higher margins in services. They seem to have been diluted by success in OE orders and revenues. Will we see a rebound in service revenue growth through FY24 and beyond?"

Andrew Thomis: You want to take that one?

Simon Walther: Yeah. Again, obviously the service element of our revenue is dominated by MASS. The other five businesses, they do have an element of service, SCA particularly, but they are mostly product, whether it's off-the-shelf type product almost, or design and deliver.

We probably will see a small recovery in the services in the coming year. But actually, you can see as Andy's already talked about net margin, the objective is to drive our product businesses to achieve a net margin.

MASS's market, it has an export market, which we are looking to grow, but its domestic market is fairly niche. There is not a huge amount of growth in it. There's some, but this is one of the reasons why MASS is a relatively solid business in terms of both revenue, profit and particularly cash generation. But it's not one that, I don't see MASS growing at double-digit growth for the next three or four years.

So, overall, I expect as the group develops and the order book increases, we will see service revenue as proportion of our business over time come down. Obviously, M&A may change that. We may find a service orientated business. But overall, we are moving more and more towards product and technologies that are product based.

Andrew Thomis: Thanks. Okay. If any further questions? No. Okay. Well, with that, I'll say thank you to all of you. Thanks very much for coming. I hope you found it useful, and you know where to find us if you do have further questions. Thank you.