Interim Results Transcript – 4 June 2024 – Analyst presentation and webcast

1. Title slide - Investing to grow

2. Introduction - Michael Ord, Group CEO

Good morning and welcome to the presentation of the company's results for the half year to the 30th of April 2024.

I'm delighted to be joined by James Mortensen, our Chief Financial Officer, who started in-role on the 1st of January this year.

For this morning's presentation I will begin with some of the highlights from the first half of the year and some comments on the company's strong long-term prospects. I'll then hand over to James who will take us through the financial results in more detail. I'll then comment on our market environment and how we are matching our strategy to these significant opportunities for future growth.

3. H1 2024 GOOD PROGRESS ACROSS KPI's

Turning now to the first half. There has been heightened activity in both sectors, and we have achieved results in line with our expectations. This is a solid performance given the impact of the weather-related challenges that we updated you on in February.

Revenue grew 8% to £223 million, earnings per share was 6.6 pence, and cash conversion improved significantly from 64% to 83% demonstrating the cash generative nature of the business and our continued focus on productivity improvement and cash management.

The stand-out result is the continued growth in order intake, which is up 2% to £345m, even against our H1 record intake last year. This has delivered a record order book of £1.04 billion, which is up 13% since the end of FY23, and up 39% since this time last year.

We have also continued to make good progress on our Safety and ESG strategies, in line with our commitment to building a safe, inclusive and sustainable company; and from an industry perspective it was pleasing to read the joint statement issued in April by the Treasury and the Investment Association which stated that 'investing in good, high-quality, well-run defence companies is compatible with ESG considerations'.

4. Significant long-term visibility - Positive outlook unchanged

With 93% of 2024 revenue covered by the order book, the Board's expectations for the current financial year are unchanged, and I believe that the company is very well positioned to continue to deliver sustainable performance and growth.

Moving to the longer term, I concluded the results presentation in December with the message that the outlook for the defence sector was increasingly robust, and that momentum has continued, and if anything may well be increasing.

I believe that we are at the beginning of a fundamental defence and re-armament upcycle that will last at least the next decade and likely well beyond. I'd point to the company's record order book as a measure supporting this forecast.

Clearly, this presents opportunities for our businesses operating in the areas of specialist energetic and propellant materials, high-precision devices for space and missile applications, active-cyber defence, software engineering, electronic warfare, and data science. As you know these are niches where we hold market leading, and often sole source positions, and where there are significant barriers to entry.

Our long-term order-book, programme, and contract visibilities, together with the support of grant funding and our customers wanting to move to longer-term partnering agreements, gives us confidence to invest in additional productive capacity, further reinforcing our position as a key supplier to NATO.

Against that background, our ambitious goal is to increase the Group's annual revenue to c.£1bn by 2030. This is illustrative of the confidence we have in our ability to deliver against our commitment to balance near-term performance with longer-term growth and value creation.

I'll now hand over to James who will take you through the financial results.

5. Financial Review – James Mortensen - CFO

Thanks Mick, it's great to be here. And I'm very fortunate to be joining Chemring when we are playing such an important role in the world today.

6. Initial Observations

I've now visited the majority of our sites, so before I dive into the numbers I'd like to share some initial observations.

It's clear there are very strong market fundamentals which Mick has already touched on. This is reflected in our record order book giving us growing confidence in the delivery of our plan.

I've really enjoyed my time visiting our sites and talking to some of our very talented people. I've learnt a massive amount, and these are the key things I've found:

1. **Demand is long term.**
   Because of the critical nature of our products, customers are pushing us to commit to longer term contracts. On many of our applications we have to be qualified to get a place on a particular platform, (and remember qualification often takes years, which creates extremely high barriers to entry) and that means we are sole source in over 60% of cases. With our customer programs ramping, they are placing longer term orders to secure their production schedules – and so we are seeing long term demand for the capacity we are building. What I take from this is that the risk to executing our plan relates to building and commissioning the additional capacity, not in then selling that capacity to our customers
2. **Chemring is more than just countermeasures**
   The proportion of countermeasures has fallen from about 45% of revenue six years ago to about 30% today because of the growth in space, missiles, active-cyber defence, electronic warfare and AI & autonomy. Over the next few years the proportion of those business areas will continue to grow (currently about 45% up from about 30% six years ago). In the future they will make up a significant proportion of our business – we expect more than 50%; and all of this business is high quality – in growing end markets, and with rich engineering content. The kind of businesses that I saw trade for very high multiples when I was in the M&A team at Smiths.
3. **We have unique manufacturing capabilities**
   We are specialists in operating facilities in high hazard environments. And these facilities are very hard to replicate and much in demand. As you know, we've recently modernised our facilities to increase safety and automation, and so there's a strong foundation from which to build. What you

should take from this is that production is currently limited by our capacity, and adding additional capacity takes time and so growth comes later. But once they do come online, they are unique, in demand and highly cash generative.

So when I think about the business it is clear that:

- we are underpinned by the strong cash generative annuity of our countermeasures business and our programs of record
- Roke will continue to deliver near term growth
- And, our energetics business will deliver longer term growth once the capacity we are building comes online, with much of that capacity already sold

And so **I** can see why we have growing confidence in the delivery of the plan and the outlook.

So now onto the half year, where we made good progress with that record order book and saw strong cash generation.

7. Financial Highlights

- As I said, a record order book of over £1bn, up 39%
- Good momentum in revenue, up 8%
- Lower operating margin and H1 weighting, as we flagged in the trading update, with much of that driven by bad weather disruption and operational and legacy contract challenges at our Countermeasures business in Tennessee.
- EPS down 11% impacted by lower profits and higher tax and finance costs
- Strong cash conversion at 83%
- And so, the Board has declared an interim dividend of 2.6p. This is up 13%, which continues the progression towards our target of 2.5x cover, and is supported by our growing confidence in the outlook for the business.
- And, of course, underpinning that confidence is the strength of our order book, so let's turn to that:

8. Order Book

We've got a record order book of over £1bn, which has grown 39% since the last half year. So we've now got 93% coverage for the remainder of the year.

Within Sensors & Information we've seen strong order intake in National Security and Defence, which Mick will expand on later. The order book grew 3% and we've now got 83% coverage of H2 revenue.

Within Countermeasures & Energetics we've seen significant growth in order intake, with the order book growing 48% and now covering 99% of H2 revenue. To give you a sense of the long term nature of the order book, we've also got significant coverage in FY25 and FY26. And customers are pushing to secure that capacity – giving us great confidence that the capacity we are installing will be sold.

That strong order book is driving solid delivery in the period.

9. Group and Segmental Performance

Strong momentum continued in Sensors and Information with revenue up 15% and operating profit up 16%. Within that Roke grew revenues 19%, showing the continued strong momentum there. Operating margin was slightly up on last year at 20.4% despite the continued investment in people, product development and infrastructure to position Roke well for future growth.

Countermeasures and energetics revenue grew 3%. Growth in niche energetics was offset by a weaker period for countermeasures, caused by operational issues at our Tennessee business which I'll cover on the next slide. So operating profit was down 22%, and margin decreased 330 bps to 10%.

Group revenue was up 8%, despite an FX headwind of £2m. Group operating profit was down 5%, and operating margin down 150bps to 11.2%.

Our first half weighting of operating profit was around 35% this year, when normally it has been about 40% in the first half; but we see a clear path to make that up in the second half especially given our 99% H2 coverage in Countermeasures and Energetics.

You can see the operating profit bridge on this next slide.

10. Group Operating Profit Bridge

We have seen good momentum across the majority of the business, with year on year profit growth. Countermeasures and energetics was held back by our Tennessee business, which was impacted by three things:

- In January temperatures fell to -27c, which meant plant operations had to be halted and the plant winterised for a week followed by a gradual resumption of operations
- We also experienced a slower ramp in production in the new automated facility than expected following the decision to install higher specification pipework throughout the facility to further reduce Electro-Static Discharge risk
- And, we also have a legacy contract from 2016 that has been a drag on profitability. This contract, which is with the US DoD, will be completed in full within the second half.

We've made significant progress resolving the operational issues, and we expect the facility to continue to ramp in the second half.

11. Group Net Debt Bridge

As you can see, this remains a strongly cash generative business, with cash conversion up 190bps in the period to 83%. We are using our strong balance sheet:

- To invest in additional capacity, with £24m spent in the period on the Energetics expansion projects. Mick will go into more detail, but we're increasing the size of our investment in Norway taking our total energetics investment to £200m. This will be offset by £90m of grant funding, and we now understand about £30m of this will be received up front. So we expect that in the second half. Subsequent grant funding will be received annually based on completion of work packages. This means that net spending on Energetics expansion will be about £10m this year, £65m next year and then £30m and £5m in '26 and '27 respectively; to which I would add about £20-30m a year for maintenance CAPEX. We have included detailed guidance in the appendix.

- We have also returned over £40m to shareholders, through our progressive dividend and the £50m share buyback. We have £13m remaining, and if the share buyback hasn't completed by July, the Board intends to extend the completion date of this previously announced buyback to the announcement of our full year results.

We had closing net debt of £75m, well within our £166m headroom and below 1x leverage. We forecast a moderate reduction in net debt in the second half upon receipt of £30m of grant funding, offset by continued investment in energetics expansion.

12. Capital Allocation

Next, I wanted to set out how we think about capital allocation. Overall we want to maintain a resilient balance sheet and will target leverage of less than 1.5x.

First, we see lots of opportunity to invest in the business, to increase capacity to meet demand, or to introduce automation.

Second, we'll continue to target an annual dividend cover of 2.5x

Third, we intend continuing to execute focused M&A – within our core or close adjacencies in particular Roke and US space and missiles. We'll remain disciplined and I've seen a healthy pipeline of opportunity.

We recently signed an asset purchase agreement for the sale of our explosive hazard detection business, which is now subject to CFIUS approval.

And finally, we'll return surplus capital to shareholders.

13. Guidance and Financial Summary

So let me tell you how I see the rest of the year. You've seen the good progress we've made in H1 which was in line with our previous expectations. The market conditions and record order book give us continued confidence in our full year outlook.

There are also some external factors, including the strengthening of sterling, the potential UK and US government transitions and increased raw material cost we are seeking to recover from the US DoD.

And so that means we see no basis to change our full year outlook.

Thank you, and with that I'll hand back to Mick.

14. Strategy update and outlook

Thanks James.

I'll now look at the broader market environment, how our strategy is aligned with current and future trends, and the opportunities we are seeking to capture and deliver.

15. Market Environment

Turning first to the market environment.

Whether it's the ongoing conflict in Ukraine, the conflict between Israel and Hamas in the Middle East, or an increasingly assertive China in the Asia-Pacific region, the elevated level of geopolitical uncertainty and tension is prompting governments to re-assess their defence and national security assumptions and spending plans.

The UK, the US and European allies are increasing spending on defence and on increasing sovereign industrial manufacturing capacities to fill their elevated stockpile and readiness levels, and to an extent provide military aid to Ukraine.

All NATO countries are moving towards the target threshold of 2% GDP spend on defence, and 18 member nations will reach that level in 2024. Also in 2024 European NATO allies will invest a total of US$380Bn in defence, which for the first time amounts to 2% of their combined GDPs.

Against this heightened threat environment, which will drive a fundamental re-armament upcycle over at least the next decade, the company's diverse and niche technologies and manufacturing capabilities position us well to support our customers' growing critical needs.

As a key supplier to NATO we are seeing increased long-term demand for our Countermeasures & Energetics products and engineering capabilities. This is particularly prevalent in our three Energetics businesses where we are seeing unprecedented demand for specialist energetic and propellant materials, and high-precision devices for space and missile applications.

Our customers are moving to longer-term contracting arrangements to secure their supply chains, and in parallel some governments are providing grant funding to bolster their sovereign manufacturing capabilities, as evidenced by the £57m award from the European Commission and the £32m award from the Government of Norway to boost production levels of energetic materials at our Norwegian facility.

Maintaining strategic advantage against adversaries in an increasingly digitised defence and security environment, will demand rapid, large-scale, data exploitation and multi-domain integration. This is providing increased demand for Roke's cutting-edge technologies.

We also continue to maintain and build upon our world leading position in the addressable air and naval countermeasures market, with robust and steady demand expected over the coming years. This is evidenced by £94m of order intake by our Countermeasures businesses in the first half of the year. Absent a force deployment we anticipate this market may remain broadly flat with low, single digit growth.
In summary, the changes that we are seeing in customer budget priorities present significant long-term opportunities for our Group.

16. Strategic Framework

As you would expect, with this market environment we've evolved our strategic framework to recognise the improved visibility and increased opportunities available to the Group. However, our approach remains evolution not revolution, and therefore our core values of safety, excellence and innovation remain the company's foundations, along with the management fundamental of balancing near-term performance with longer-term growth and value creation.

Our strategy has three imperatives:

The first imperative is to grow the company by investing in our businesses and the development of our people, our intellectual property and our infrastructure.

Central to this is our investment in increasing the capacity of our three energetics businesses, and our investment in Roke's portfolio of products, services, and intellectual property.

The second imperative is to seek opportunities where we can further accelerate growth through bolt-on acquisitions to the Group.

As James has already mentioned, we will continue to focus our attention on bolt-on acquisitions to grow Roke and our Chicago business in the US Space and Missiles market.

And our third imperative is to protect and strengthen our sole source and market leading positions, with a rigorous focus on safety, operational excellence, and the development of new products that meet our customers ever evolving critical needs.

If we deliver these three imperatives, we will be our customer's preferred supplier across the niche sectors in which we operate.

As I outlined earlier, our ambitious goal is to increase the Group's annual revenues to c.£1bn by 2030. This makes certain assumptions regarding growth rates and does include some bolt-on acquisitions, but the overall point is clear: it underlines the confidence we have in our ability to deliver growth and value creation over the long term.

So now let's turn to some of the actions we are taking to deliver that growth.

17. Growth and long-term demand in Energetics

In December I said that demand for propellants, energetic materials, and mission critical components was continuing to grow, with many governments and customers seeking to increase the capacity and resilience of sovereign industrial supply-chains and nothing in that sentiment has changed in the past six months, which is reinforced by the H1 order intake across our energetics businesses being up 3% to £155m. Clearly that gives us excellent medium and longer term visibility for planning and investment decision making.

A key highlight in the first half was in March when the European Commission and the Government of Norway awarded grants totalling £90m to boost production at our Norway facility.

Given this grant funding, and the ever-growing demand for energetic materials, we have decided to invest a further £80million in increasing the capacity of our Norwegian business.

Our overall Capex investment plan for these three businesses therefore rises from the £120 million we announced in December, to £200 million. This investment is expected to deliver incremental revenue of £100m per annum and incremental operating profit of £30 million per annum in FY28.

With almost half of this Capex being grant funded the return on invested capital is compelling and will deliver strong returns to our shareholders once the manufacturing facilities are built and commissioned.

18. Growth and long-term demand in Energetics (2)

Good progress has been made by our Energetics businesses during the first half of the year.

In Norway, the business is operating at full capacity while in parallel delivering expansion programmes which, when complete, will increase site productive capacity by circa 275%. As a reminder the business supplies HMX, RDX, NTO and MCX materials to prime contractors on both sides of the Atlantic.

In our Chicago business, the acquisition and expansion of manufacturing operations into an adjacent facility has progressed well, with the new facility fitted out, and operations are already up and running. This new facility significantly enhances our ability to maintain continuous flow manufacturing operations which is essential in delivering against customer programme requirements, and is a key enabler of future growth ambitions.

And in Scotland, construction of our new propellants manufacturing facility is progressing to plan. Concrete pours have been completed on most buildings and steelwork and frames also installed. This new facility will provide increased capacity and throughput in a safe and modern manufacturing environment.

19. Maintaining Roke's growth

Turning now to Roke which continues its track record with another period of strong performance.

Order intake and customer demand across all of Roke's markets remains robust, driven by the global threat environment.

There has been sustained demand for Roke's core capabilities in support of our national security customers. Orders totalling £33m were received under framework agreements in the first half, demonstrating the sustained demand we see from these customers.

In line with our focus on increasing revenue from the products side of Roke, we have seen growing interest in our range of defence capabilities, where the Ukraine conflict has reinforced the need for tactical electronic warfare, information advantage, autonomy and counter-drone technologies. The request for quotation pipeline for defence products is now in excess of £200m, and Roke remains well positioned to win several multi-year orders.

We have continued to win new Electronic Warfare customers, most notably securing an order in Japan, the first into the East-Asia region. Roke also received a £10m increase to the Project ZODIAC award received in September last year. In total Roke's ZODIAC contract awards now stand at £50m which will be delivered over the next two years. Future phases of Zodiac could be in excess of £100m, presenting a significant opportunity to Roke as the incumbent supplier.

Current conflicts, especially in Ukraine, are demonstrating the operational effectiveness of Unmanned Air Systems, and presents an opportunity for Roke.

The acquisition of Cubica in 2021, provided unique technology that, when combined with Roke's existing capabilities, delivers a software platform on which to build advanced AI capabilities delivering autonomy in the battlefield. This includes the autonomous supervision of intelligent sensors, drones and counter-drone systems.

Roke is currently working with MOD's around the world in the development of sensor and disrupter technologies that can be integrated on to Unmanned Air Systems to both counter the threat and provide invaluable surveillance and tracking capabilities.

Roke will continue to focus on growing across all business areas, and we remain on track to organically grow revenue to £250m per annum by 2028.

20. Driving innovation

Across the Group we have over one thousand engineers, scientists, and subject-matter experts, and as a specific insight, Roke has over one hundred Artificial Intelligence engineers and scientists actively engaged in cutting edge AI programmes to a number of customers as well as a number of our internal R&D programmes.

Group-wide we continue to invest in Research and Development to ensure our products, services and technologies remain highly relevant to the ever evolving threats faced by our customers. To provide perspective, we spend around £115m a year on R&D through a combination of self and customer-funded programmes.

One area that I thought I would spend a few moments on is our work in support of the strong demand we are seeing in the space launch market.

Having for many years been the sole supplier to NASA for their NASA Standard Initiator, we have leveraged this pedigree with other space launch providers including the United Launch Alliance (ULA), SpaceX and Blue Origin.

An excellent example being that following a competitive tender process, Chemring was selected to provide the Blue Origin Standard Initiator (BSI) and our Chicago business is now the sole provider for these mission-critical devices which will be common to all Blue Origin launch vehicles including the upcoming New Glenn.

Our Chicago business is also a key supplier to ULA, supporting both ATLAS and Vulcan heavy-lift launch vehicles, and by the end of 2025 ULA plans to launch a Vulcan every other week to meet US Government and commercial launch demands. On every launch we supply multiple products including solid rocket booster separators, rocket motor igniters and self-destruct safety devices. With Chemring providing significant content for every launch, this is illustrative of the significant opportunity we see for growth in the space and missiles market.

22. Summary and Outlook

So, in conclusion, we have continued to make good progress in the first half of the year as we continue to strengthen our high quality and resilient business, and as we invest for future growth.

Current geo-political uncertainty has highlighted the need for increased defence expenditure, particularly across NATO, and more broadly it has highlighted the need for countries to re-equip and modernise their defence capabilities to meet the threat of peer-on-peer competition and conflict. This has led to record H1 order intake and the highest order book in the Group's history.

With ninety three percent (93%) of our expected H2 revenue in the order book as of 30th April, the Board's full year expectations are unchanged.

Looking to the medium and longer term, the outlook for the Group is increasingly robust. Strong growth is expected in the areas of specialist energetic and propellant materials, space and missile devices, and across our Roke business. Our investments in these areas will deliver significant returns, particularly when the new manufacturing capacity expansion projects come on-line.

With market-leading products, technologies, and services, that are critical to our customers, and with a strong and deployable balance sheet that enables us to consider inorganic opportunities, I am confident that Chemring will continue to deliver on our commitment to balance near-term performance with longer-term growth and value creation.

If anyone has any questions we will be happy to take them. Could I please ask you to state your name and the organisation that you represent before asking your question.

Thank you for joining us today everyone, we look forward to presenting the full year results to you in December.