



SSRO

Single Source
Regulations Office

SSRO's baseline profit rate, capital servicing rates,
and SSRO government owned contractor
rate recommendation: 2025/26 Supporting analysis

January 2025

Contents

This pack sets out details of the SSRO's rates recommendation to the Secretary of State:

- Baseline profit rate
- Capital servicing rates
- Government-owned contractor rate

It includes sensitivity and other analyses, including:

- Analysis of the changes to the baseline profit rate since last year
- Changes in the comparator groups since last year
- Defence sector representation in the benchmark
- Geography

Baseline profit rate (BPR): introduction

The baseline profit rate is step 1 of the 4-step process to calculate the contract profit rate of a contract that falls under the Single Source Contract Regulations.

The Procurement Act 2023 introduced the 4-step process and, as of 01 April 2024, replaces the previous 6-step process in place since the start of the current regime in 2015.

The baseline profit rate is the average of the underlying rates for the last three years.

The underlying rate for a single year is based on the financial performance of a group of companies whose activities are comparable to those that contractors might be expected to perform for single source contracts.

Full details on the approach are set out in the SSRO publication *Single source baseline profit rate and capital servicing rates methodology*.

Baseline profit rate approach and methodology



Objective

OECD: Transfer Pricing principles

Replicable



Reliable

Actual profit on actual cost

IFRS / GAAP numbers



Predictable

Stable approach

3 year rolling average



Calibrated

Stakeholder feedback (including QA of accounting data)

Completed contracts

Company selection process



Databases:
Orbis, Bloomberg,
Bank of England



Active
companies



Limited liability
companies



Latest year
of accounts



Consolidated
accounts



Independence



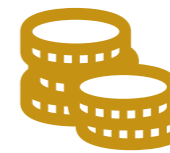
Geographic
location



Turnover



Operating
Profit



Assets /
liabilities



Functions
NACE code
Text terms



Activities



MOD
supplier
lists



Defence
keyword



Average



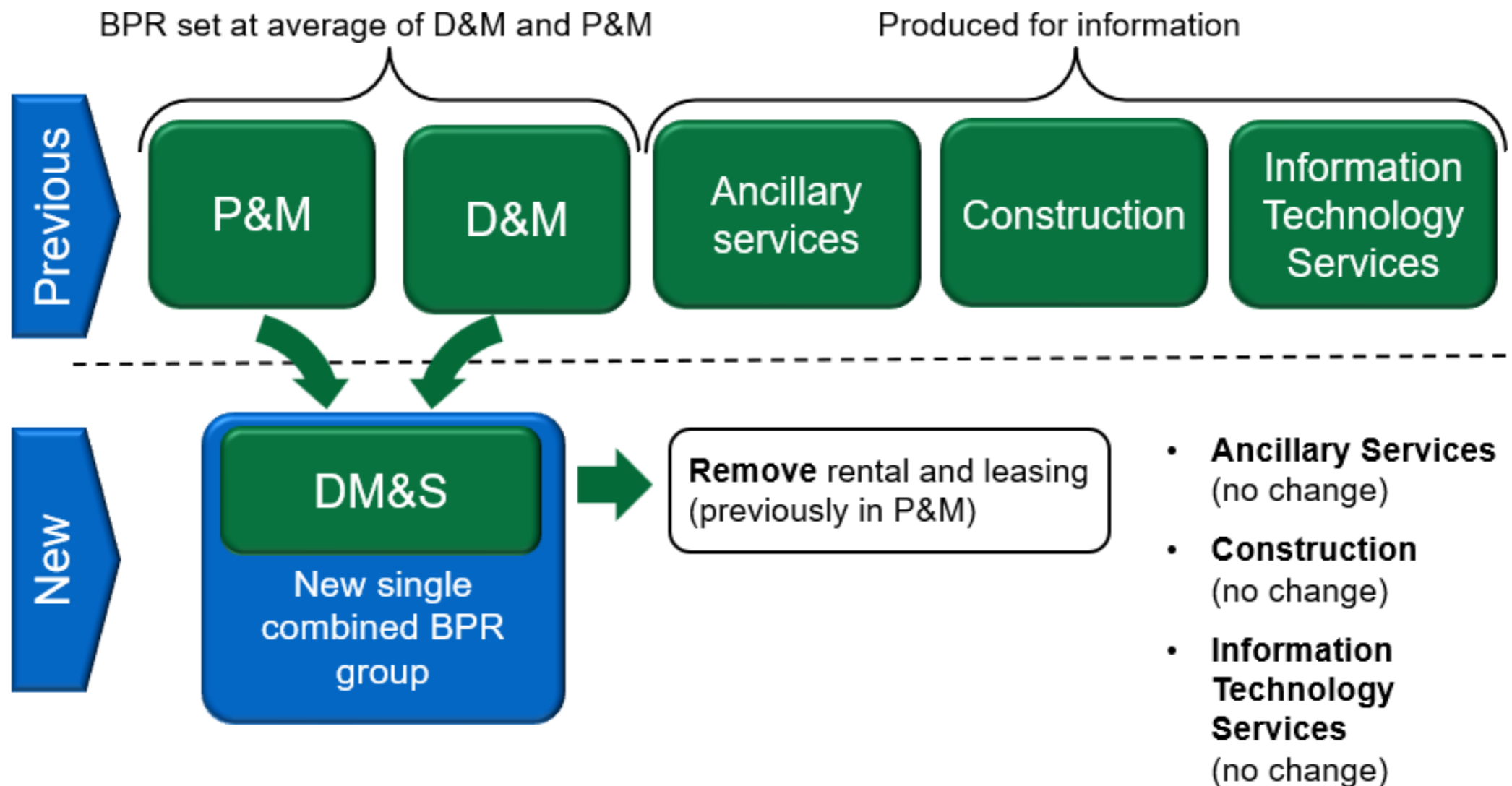
Automated search



Manual review

Baseline profit rate: Methodology changes this year

Following the outcomes of a [public consultation](#), changes have been made to the methodology for calculating the underlying BPR rate. The changes are summarised below, and Q11 & Q12 of the published questions and answers document provides further explanation of these changes and the impact.



Baseline profit rate and other activity group rates: Overview

The below tables show the current and historic BPR recommendations and activity group rates. For further information about the new ‘Develop, Make and Support’ activity group which forms the BPR recommendation, please see Q11 and Q12 of the published questions and answers document.

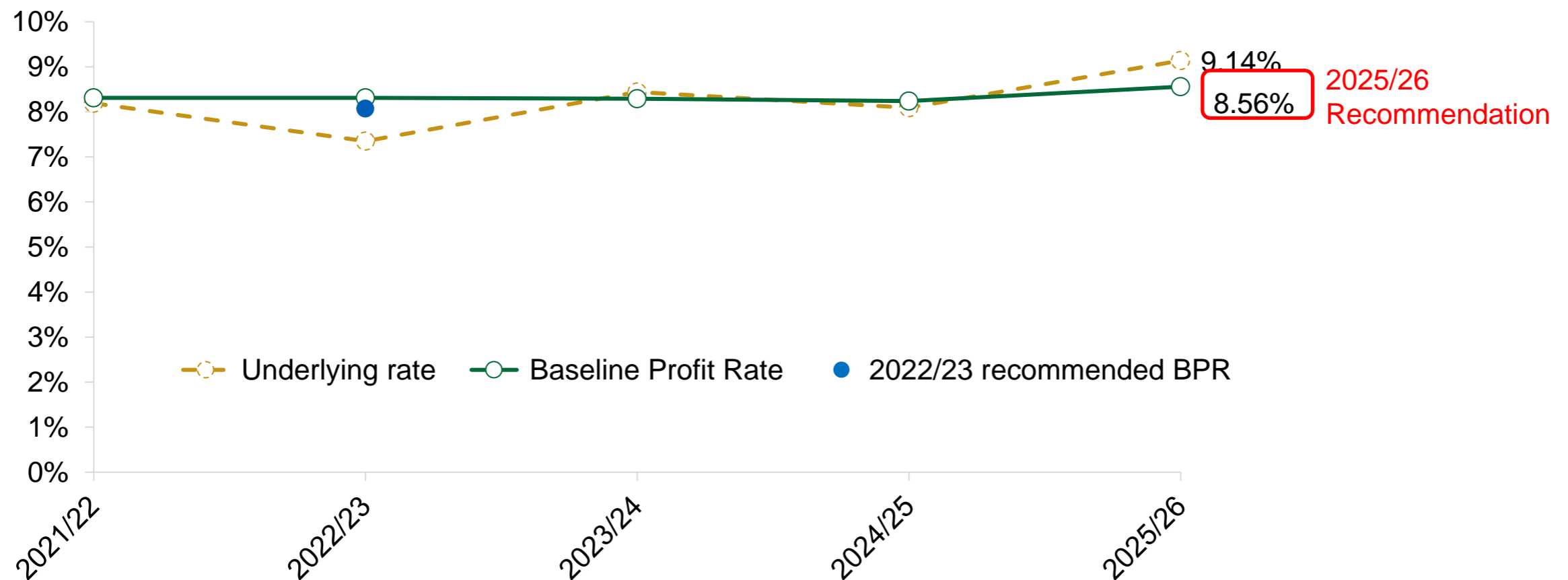
Current and historic BPR recommendations

BPR rates	2019/20	2020/21	2021/22	2022/23*	2023/24	2024/25	2025/26
Underlying rate (unadjusted for capital servicing)	9.85%	9.80%	9.59%	8.24%	9.50%	9.31%	10.60%
Capital servicing adjustment	-1.35%	-1.57%	-1.40%	-0.89%	-1.06%	-1.22%	-1.46%
Underlying rate	8.50%	8.23%	8.19%	7.35%	8.44%	8.09%	9.14%
Three-year rolling average (BPR recommendation)	7.63%	8.22%	8.31%	8.07%	8.29%	8.24%	8.56%

* The Secretary of State determined that the 2022/23 BPR rates would be fixed at the level of the prior year. The numbers shown here are SSRO’s recommendations.

Baseline profit rate

The baseline profit rate is a three-rolling average of the underlying rate. The 2025/26 recommended baseline profit rate is 8.56 per cent.

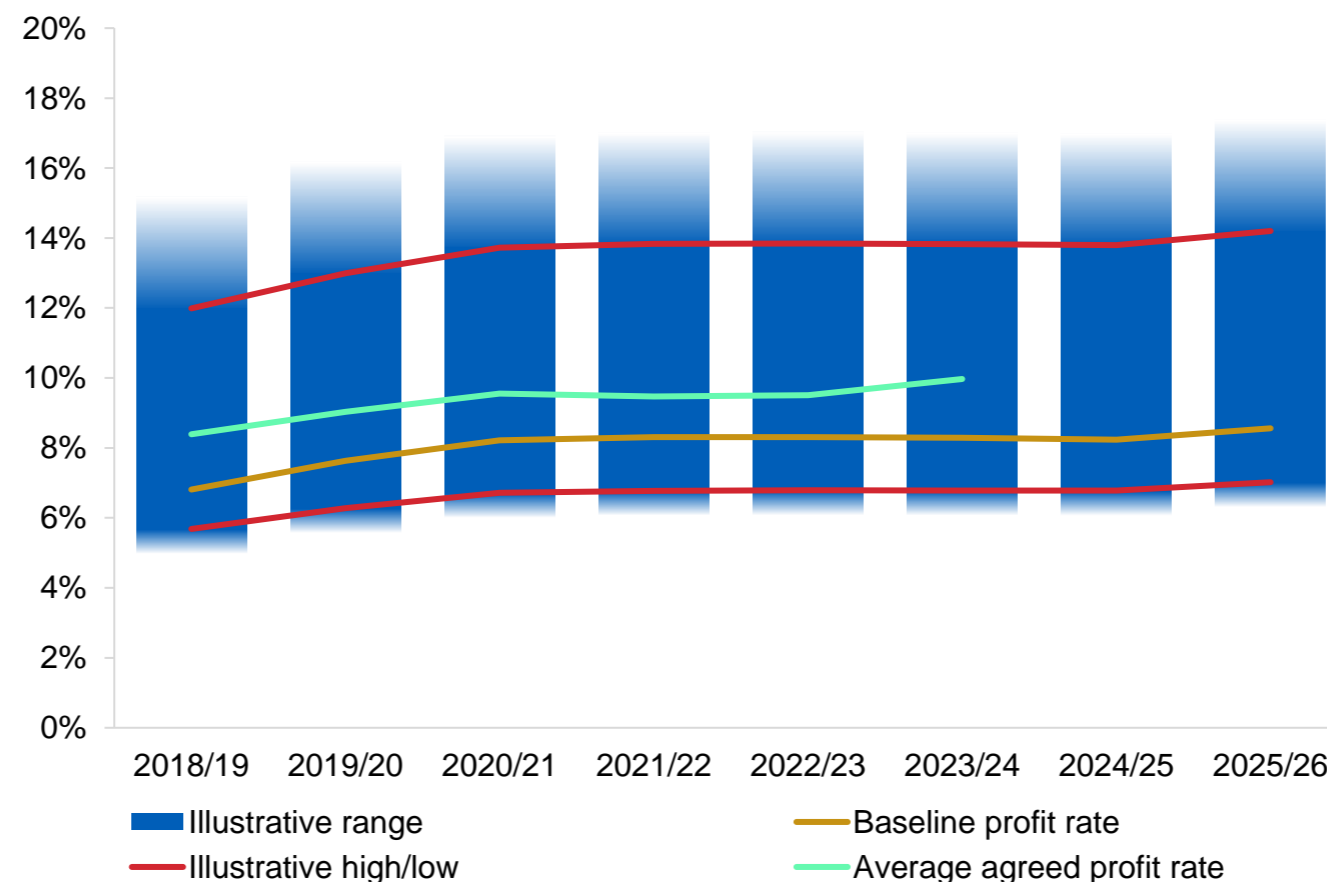


Note: Historical baseline profit rates are shown as they were determined by the Secretary of state. The SSRO's recommended rate for 2022/23 is shown as a floating dot. The underlying rate for each year is shown as calculated by the SSRO. The 2020/21 to 2024/25 underlying rates are based on the composites of the 'Develop and Make' and 'Provide and Maintain' activity groups; while those for 2025/26 are calculated from the 'Develop, Make and Support' activity group.

Source: Orbis, Bloomberg and SSRO calculations

Illustrative high and low contract profit rate

The baseline profit rate is combined with the other profit rate steps to arrive at the contract profit rate (CPR). There is a range available, depending on the application of these steps. Full details on the calculation are set out in the SSRO publication [*Guidance on the baseline profit rate and its adjustment*](#). Details of the calculation for 2025/26 are presented on the next slide.



Notes: The solid area is an illustrative low/high for a standard contract, applying assumptions about the typical values of certain components of profit. The gradient areas end at a theoretical minimum and maximum, applying reasonable limits where a profit component is unbounded. The capital servicing adjustment (step 4) is dependent on the characteristics of the contract in question therefore, for illustrative purposes, we have applied to all the periods presented, the average of capital servicing adjustments agreed for contracts entered into for 2018/19 to 2023/24. The latest published data available is up to 2023/24.

Illustrative high and low contract profit rate: detail

Contract profit rate step		Value/Adjustment			
	Unadjusted rate	9.80%			
	Capital servicing adjustment [†]	-1.24pp			
Step 1	Baseline profit rate	8.56%			
+ Step 2	Cost risk adjustment*	-2.14pp to +2.14pp			
+ Step 3	Incentive adjustment**	up to +2.00pp			
	Range before capital servicing	Low: 6.42%		High: 12.70%	
+ Step 4	Capital servicing adjustment (CSA) [†]	Minimum	Lower quartile	Upper quartile	Maximum
	Illustrative observations from 2023/24 *** :	-0.1%	+0.6%	+1.5%	+4.7%
=	Contract profit rate	Minimum 6.32%	Low 7.02%	High 14.20%	Maximum 17.40%



Notes:

The four-step process is set out in the SSRO's publication *Guidance on the baseline profit rate and its adjustment*

[†] See Q19 of the Q&A document for an explanation of how the two 'capital servicing adjustments' interact.

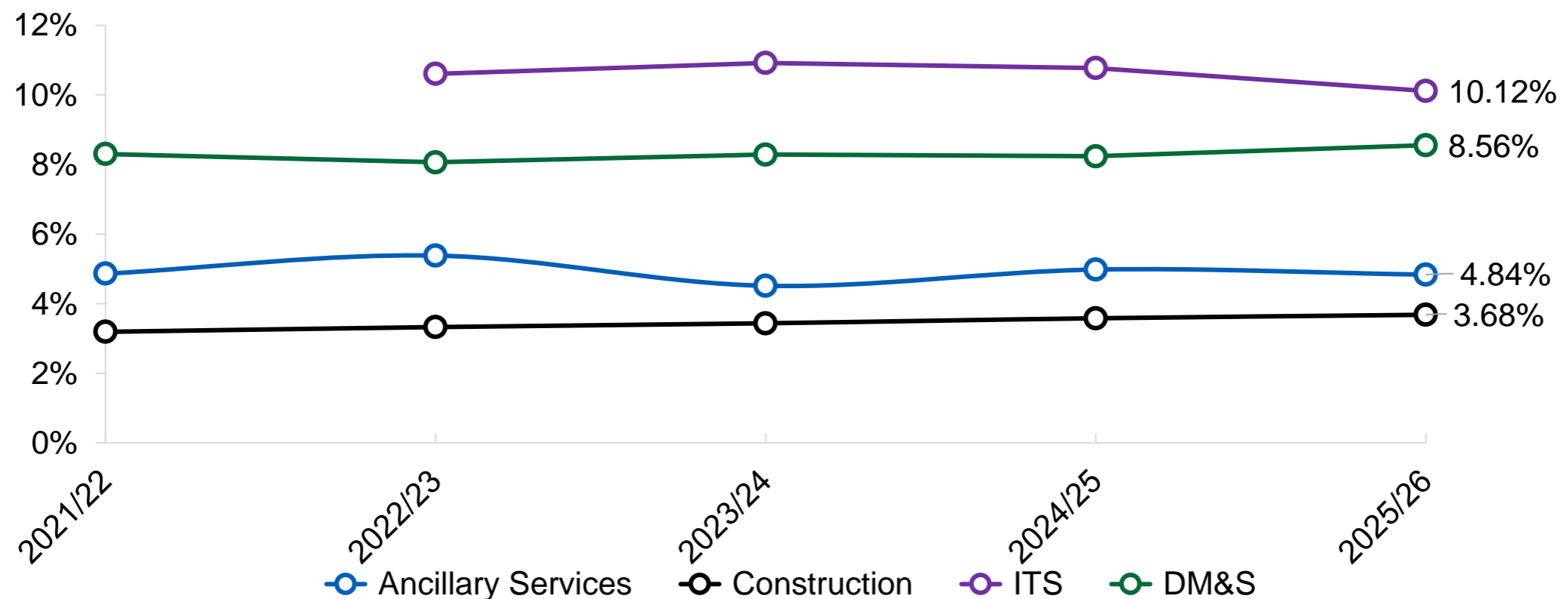
* An adjustment of between -25 and +25 per cent of step 1.

** A positive adjustment of up to two percentage points may apply to incentivise the achievement of enhanced performance.

*** These figures are the average of actual values reported to the SSRO for contracts priced between 2018/19 to 2023/24. The actual adjustment may be higher, lower or negative. **Source:** *Annual qualifying defence contract statistics: 2023/24* (SSRO)

Summary of activity groups

The baseline profit rate is a three-rolling average of the underlying rate. Rates for three other groups, Ancillary Services, Construction and Information Technology Services (ITS) are presented for information.



Notes: The chart shows results for three year (four year for 2022/23) rolling average of underlying rates. The 2022/23 rates were determined at the 2021/22 levels, but the above chart shows the rates that the SSRO recommended. The ITS group was introduced for 2023/24. Its historical numbers are based on the historical data for the 2023/24 set of comparators. The 2020/21 to 2024/25 underlying rates are based on the composites of the 'Develop and Make' and 'Provide and Maintain' activity groups; while those for 2025/26 are calculated from the 'Develop, Make and Support' activity group.

Source: SSRO calculations

Capital servicing rates: introduction

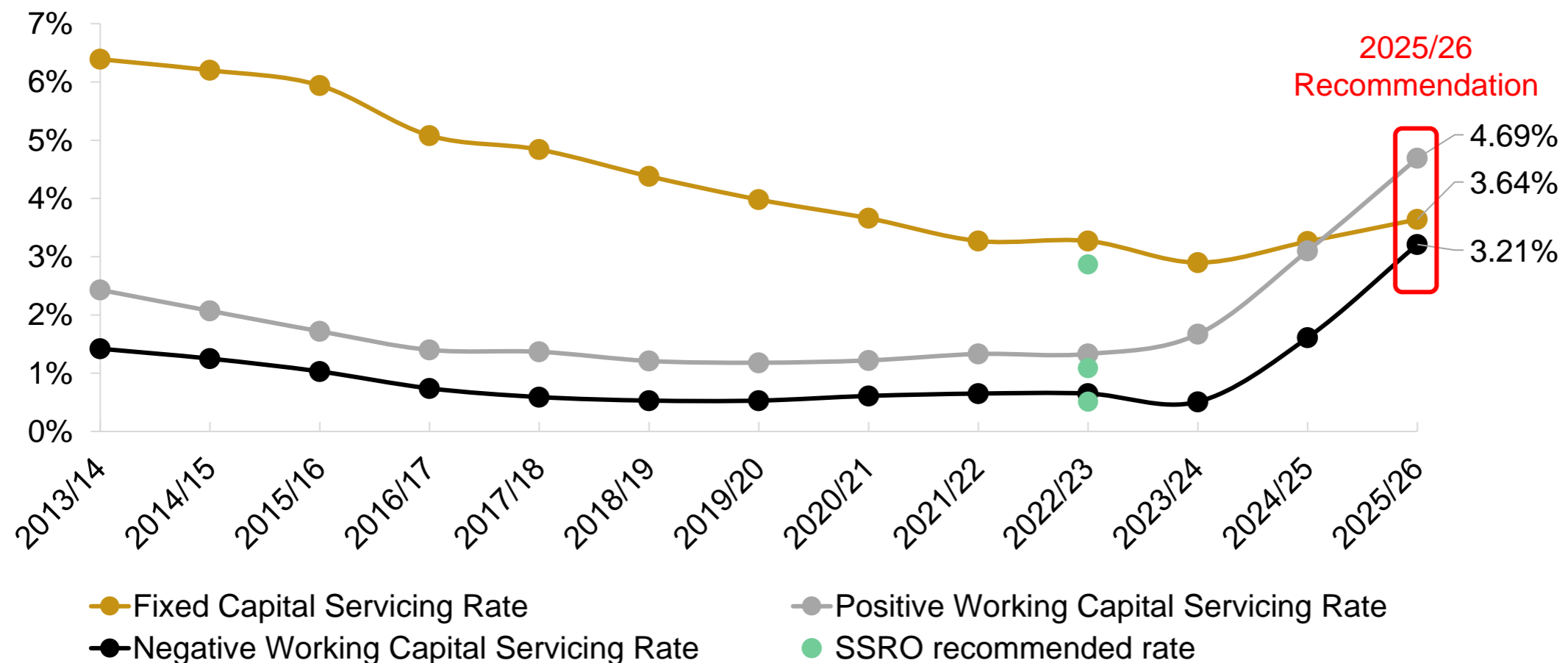
Each year the SSRO calculates the following three capital servicing rates based on averages of bond yields and interest rate data published by Bloomberg and the Bank of England:

- Fixed capital
- Positive working capital
- Negative working capital

Full details on the approach are set out in the SSRO publication *Single source baseline profit rate and capital servicing rates methodology*.

Capital servicing rates

Rate	Description	Recommendation
Fixed capital servicing	15 year BBB GBP bond index – 7-year average	3.64%
Working capital (positive)	1 year BBB GBP bond index – 3-year average	4.69%
Working capital (negative)	Monthly interest on short term deposits – 3-year average	3.21%



Note: The Secretary of State determined that the 2022/23 rates would be fixed at the level of the prior year. The floating data points shown for 2022/23 are the rates as recommended by the SSRO.

Source: Bloomberg, Bank of England and SSRO calculations

Government owned contractor rate: introduction

The government owned contractor rate is a baseline profit rate that can be used to deliver a contract profit rate (CPR) of zero on QDCs between the Secretary of State and companies wholly owned by the Secretary of State.

The government owned contractor rate must only apply to qualifying defence contracts where:

- a) the contract is between Secretary of State and a company incorporated under the Companies Act that is wholly owned by the UK Government; and
- b) both parties to the contract agree that it should apply.


Full details on the approach are set out in Appendix D of the SSRO publication *Single source baseline profit rate and capital servicing rates methodology*

Government owned contractor rate

For 2021/22 to 2023/24 the government owned contractor rate was set at a level that was opposite to the application of the SSRO funding adjustment. This approach delivered a contract profit rate of zero when steps 2, 5 and 6 of the then 6-step contract profit rate formula was determined to be zero.

From 2024/25 onwards, Schedule 10 of the Procurement Act came into force removing the SSRO funding adjustment from the six-step process. The approach remains the same for the four-step process now in force, such that it delivers a contract profit rate of zero if steps 2, 3 and 4 are determined to be zero.

Recommendation	2021/22	2022/23	2023/24	2024/25	2025/26
Government-owned contractor rate	0.057%*	0.046%	0.038%	0.00%**	0.00%

 Previously published figures

- Notes:** The Government-owned contractor rate was first introduced for 2021/22.
 * The SSRO did not recommend a government owned contractor rate for 2021/22 and the rate was assessed by the Secretary of State. The reason for doing so is set out in the London Gazette: <https://www.thegazette.co.uk/notice/3760612>
 ** Had Schedule 10 of the Procurement Act 2023 not come into force the rate would have been 0.036% for 2024/25

Understanding the changes in the baseline profit rate

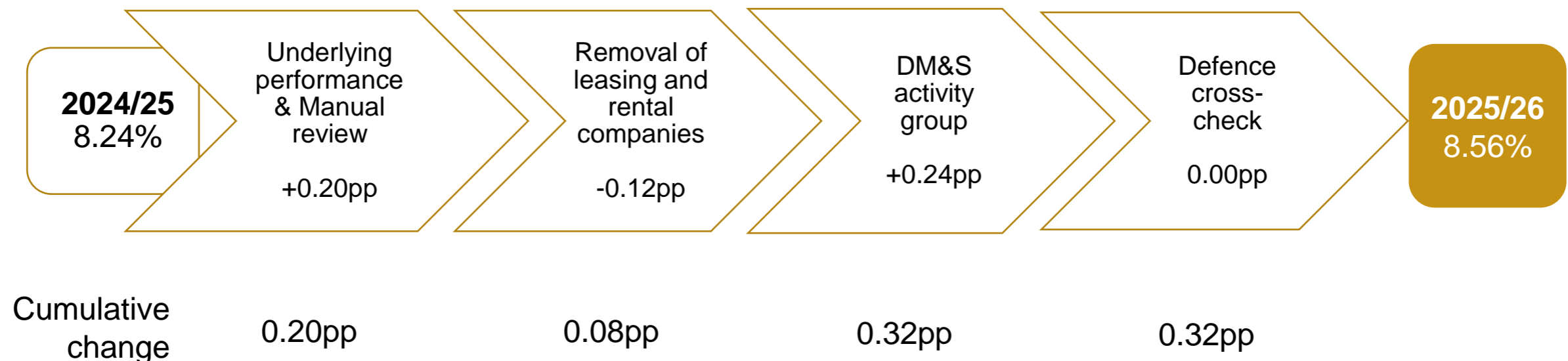
The following slides set out an analysis of the changes in the baseline profit rate since the prior year, including:

- changes to the companies in the comparator groups
- changes to the underlying rate and the baseline profit rate

2025/26 Underlying rate: explaining the change from 2024/25

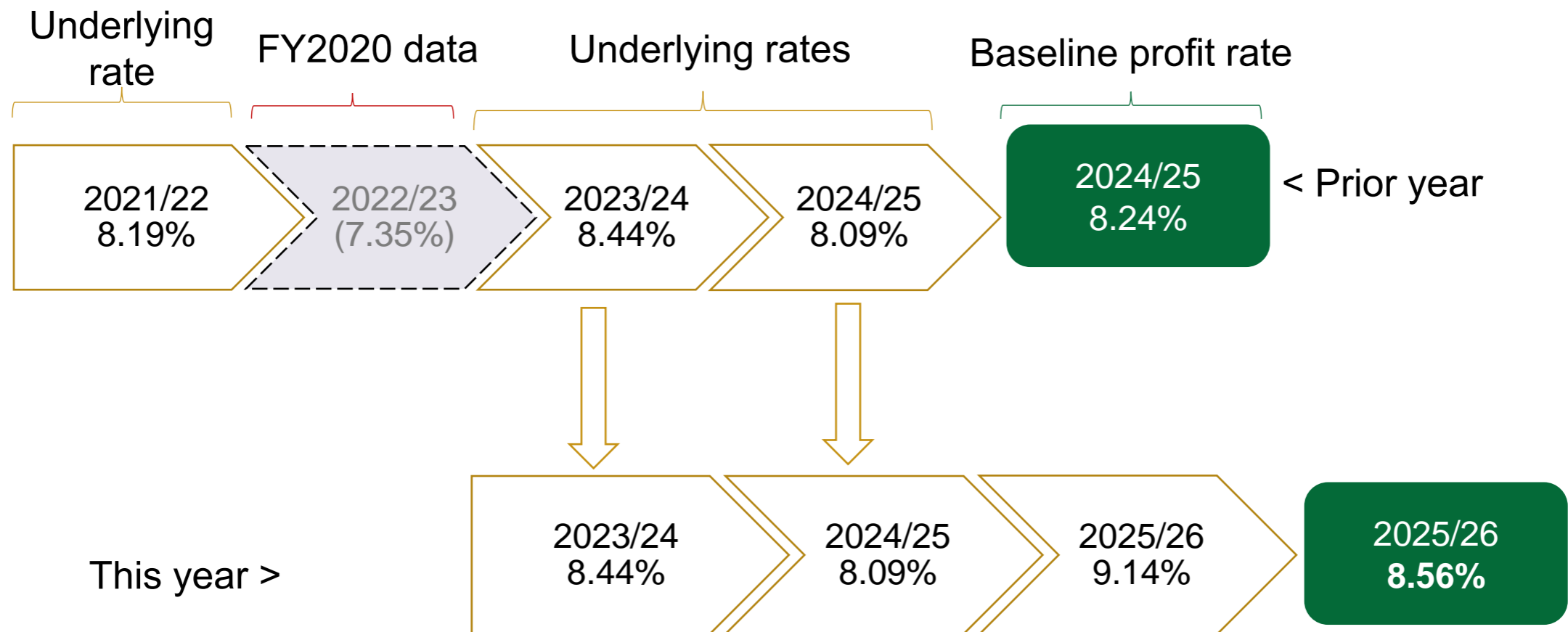
The change in the underlying rate this year (see slide 6) is a product of:

- 1. Underlying performance:** Changes in the financial performance of the prior year's comparator companies and the effect of updated capital servicing rates. Additionally, this also includes companies removed from the comparator groups or moved between groups as a result of the detailed re-validation of company activities and geography. Based on the composite rate.
- 2. Removal of leasing and rental companies:** Excluding 23 leasing and rental companies from the P&M activity group. Based on the composite rate.
- 3. DM&S group:** Combining the D&M and P&M activity groups (after excluding 23 leasing and rental companies) to calculate one underlying rate rather than averaging the groups.
- 4. Defence cross-check:** Companies from the MOD supplier lists added to the DM&S activity group comparators identified through the Orbis search.



2025/26 Baseline profit rate: explaining the change from 2024/25

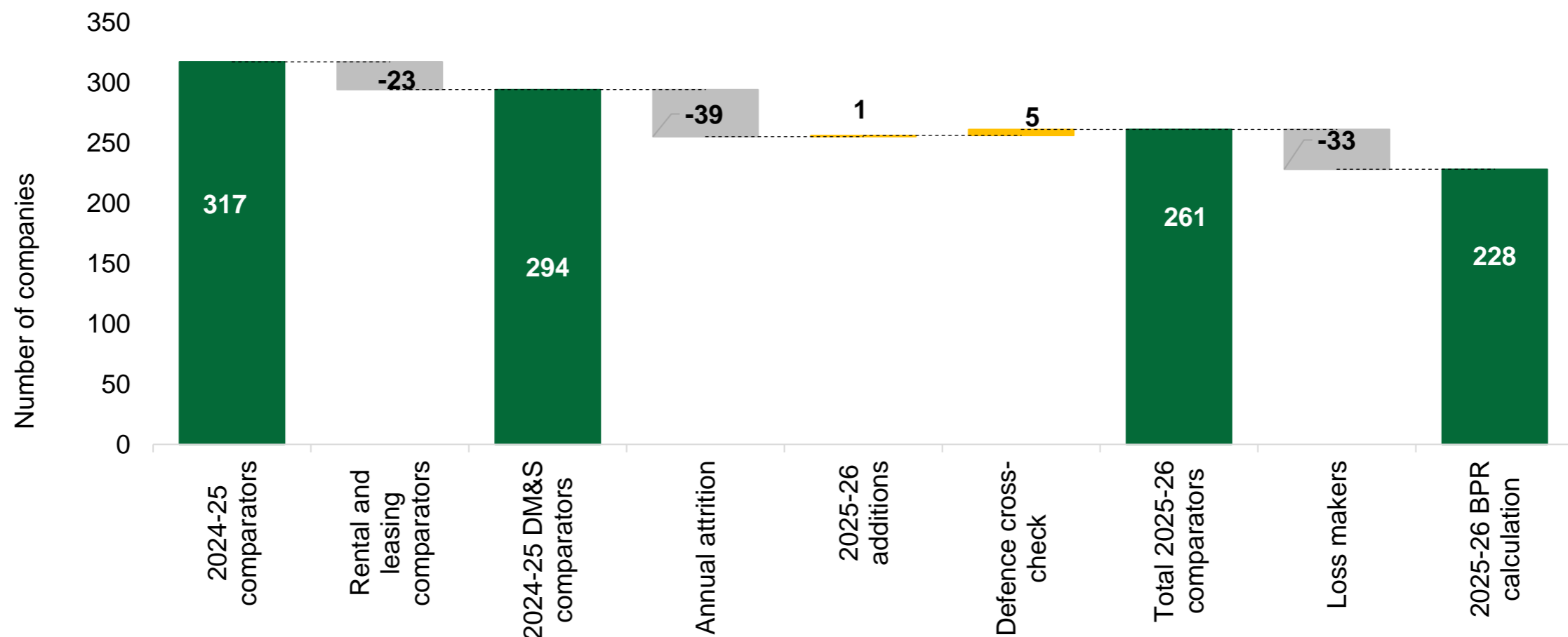
The baseline profit rate is the three-year average of the underlying rate of the most recent years excluding data for FY2020. The 2021/22 underlying rate of 8.19% has been replaced by the 2025/26 underlying rate of 9.14%, resulting in a baseline profit rate of 8.56%. The 2023/24 and 2024/25 used composite underlying rates for the D&M and P&M activity groups, while the 2025/26 underlying rate is based on the DM&S activity group.



Joiners and leavers to the comparator groups

Maintaining an adequate number of comparator companies ensures the underlying rate is robust.

As an annual update year, we rolled over the prior year’s comparator group. We downloaded last year’s 317 companies (including loss makers) accepted in last year’s assessment and excluded 23 companies engaged in leasing and rental activities and the 39 that failed the Orbis search criteria. 6 companies were added to the group, of which 1 was transferred from the ITS activity group and 5 through the defence cross-check process. We identified 261 suitable comparators of which 33 were loss makers, leaving 228 comparators that were used to calculate the BPR.



Source: SSRO calculations

Note: Question 15 in the published Q&A document explains why some companies join/leave the groups

Comparisons and benchmarking

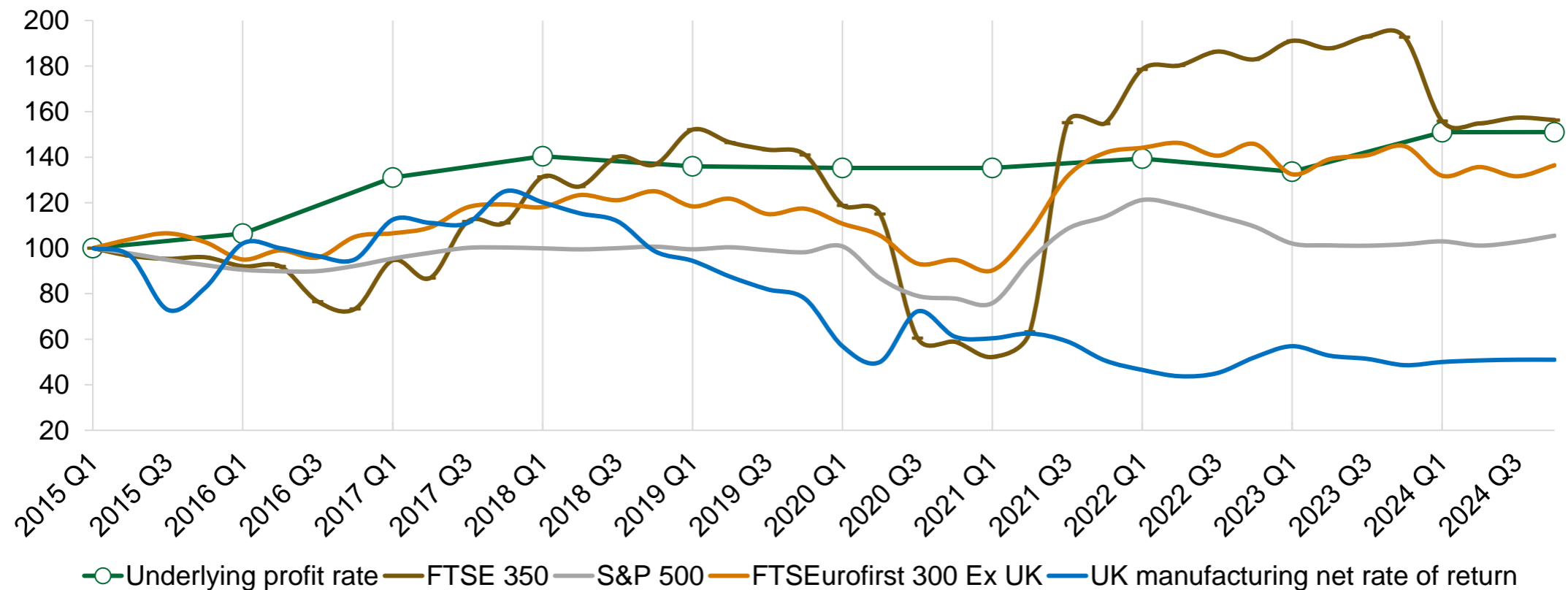
The following compare the trend in the baseline profit rate to the trend in macro-economic indicators and benchmark the range available in the UK regime to those available elsewhere:

- Profitability of major UK, US, and European share indices
- ONS data on UK manufacturing rate of return

Trends in the performance

This chart compares the trend in the underlying profit rate to the trend in profitability of companies included in major UK, US, and European share indices; and in the UK manufacturing sector.

Note that the ONS' UK manufacturing rate of return is a measure of return on capital for UK companies. Profit on cost and return on capital are not directly comparable, but we can use this data to compare trends in the underlying profit rate assessment to trends in the wider UK economy.



Notes: The underlying profit rate, the operating margin of the companies in the indices, and the ONS measure of profitability (net operating surplus divided by net capital employed) are based to 100 in March 2015. Increases and decreases in those rates are shown over time relative to that starting point.

Source: Bloomberg, ONS Dec 2024 release of *Quarterly net rate of return of manufacturing private non-financial non-UK continental shelf corporations* (series LRYC)

Defence sector representation

It is not the SSRO's intention that the comparator groups contain only companies from the defence industry, but we expect them to be represented because we are benchmarking activities that those companies typically perform.

The following slides set out analysis of defence sector representation within the comparator groups and their influence on the result, including:

- an explanation for the presence, or otherwise, of the MOD's largest private sector suppliers;
- an explanation of the cross-check against MOD supplier lists to ensure that MOD's actual suppliers are represented in the comparator groups; and
- the proportion of defence keyword companies in the analysis and their results compared to non-defence keyword companies.

Presence of the top 20 MOD suppliers in the comparator groups

Company name	Activity Type	Company name	Activity Type
BAE Systems PLC	Develop, Make and Support	Serco Group PLC	Ancillary Services
Babcock International Group PLC	Develop, Make and Support	Saab AB	Develop, Make and Support
Rolls-Royce Holdings PLC	Develop, Make and Support	General Atomic Technologies Corporation *	Not Included
Airbus Group SE	Develop, Make and Support	Volkswagen AG	Not Included
Leonardo SpA	Develop, Make and Support	RTX Corporation	Develop, Make and Support
The Boeing Company ***	Develop, Make and Support	L3Harris Technologies Inc.	Develop, Make and Support
Thales	Develop, Make and Support	Skanska AB	Construction
QinetiQ Group PLC	Develop, Make and Support	BT Group PLC**	Not Included
Rheinmetall AG	Develop, Make and Support	Northrop Grumman Corporation	Develop, Make and Support
Lockheed Martin Corporation	Develop, Make and Support	Advent International Corporation*	Not Included

Explanation for companies not included in an activity group:

* Companies that failed the Orbis search criteria: Advent International Corporation, General Atomic Technologies Corporation failed data availability criteria.

** Companies that sell products predominantly to the general public: BT Group PLC and Volkswagen AG

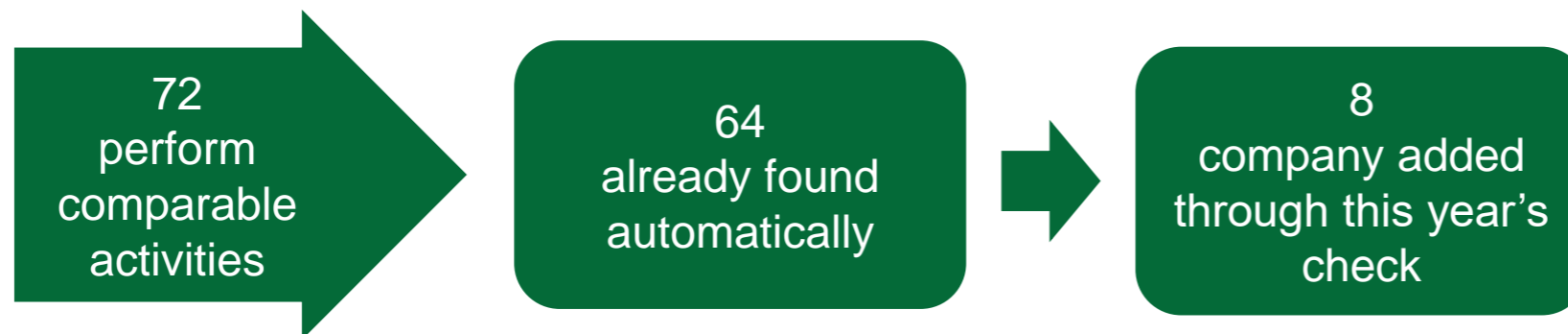
*** Comparable company that was a loss-maker for the current year, as measured by the adjusted underlying profit rate, failing the criteria for inclusion in the BPR calculation.

Notes: Source of companies are MOD statistics of private sector holding companies paid £50 million or more in 2023/24, *Table 4a MOD trade, industry and contracts: 2024 (MOD)*. The table is both compiled and ordered by value of non-competitive spend in 2023/24.

Defence cross-check

The SSRO inspects MOD statistics on the organisations that the MOD contracts with for more than £5 million and uses DefCARS data to identify any additional comparators that were not found through the search process.

8 additional companies are included in the comparator groups as a result of the defence cross check process, representing 3% of the group. The majority of MOD suppliers performing comparable activities were already identified by the search process.

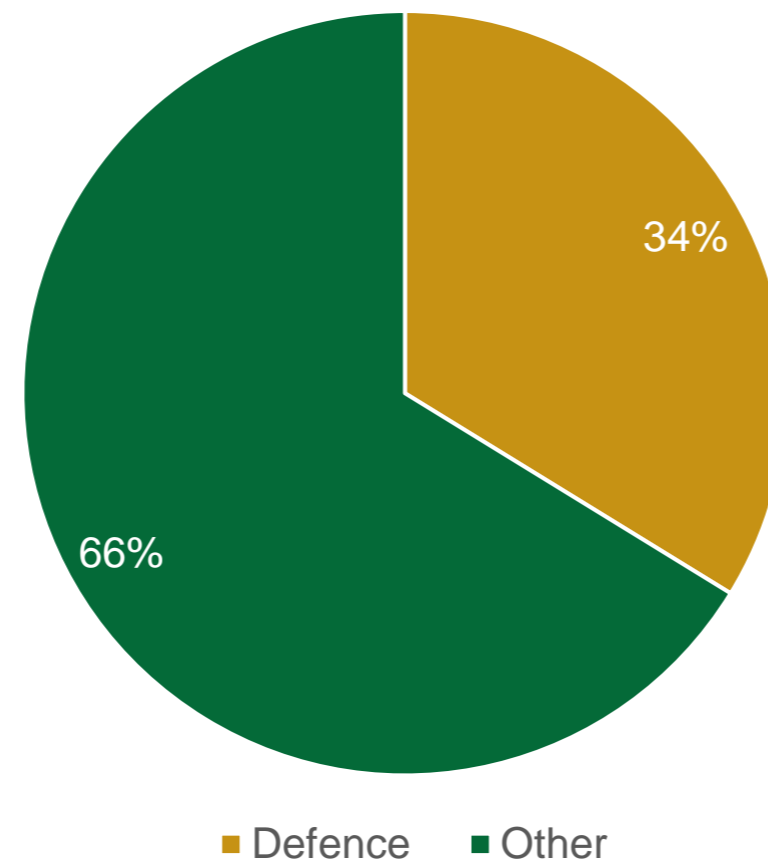


Company name	Accepted Activity group
Bouygues	Construction
Corpay INC	Ancillary Services
Forum Energy Technologies, Inc.	Develop, Make and Support
Cicor Technologies LTD	Develop, Make and Support
Marshall of Cambridge (Holdings) Limited	Develop, Make and Support
Ascent Flight Training (Holdings) Limited	Develop, Make and Support
Solid State PLC	Develop, Make and Support
Akhter Group Limited	Information Technology Services

Source: DefCARS, *Table 3a MOD trade, industry and contracts: 2024* (MOD), DefCARS, Orbis, SSRO calculations

Proportion of 'defence keyword' companies in the BPR calculation

Companies that either have the word 'defence', 'defense' or 'militar*' included in their Orbis text description account for 34% of the composite comparator group.

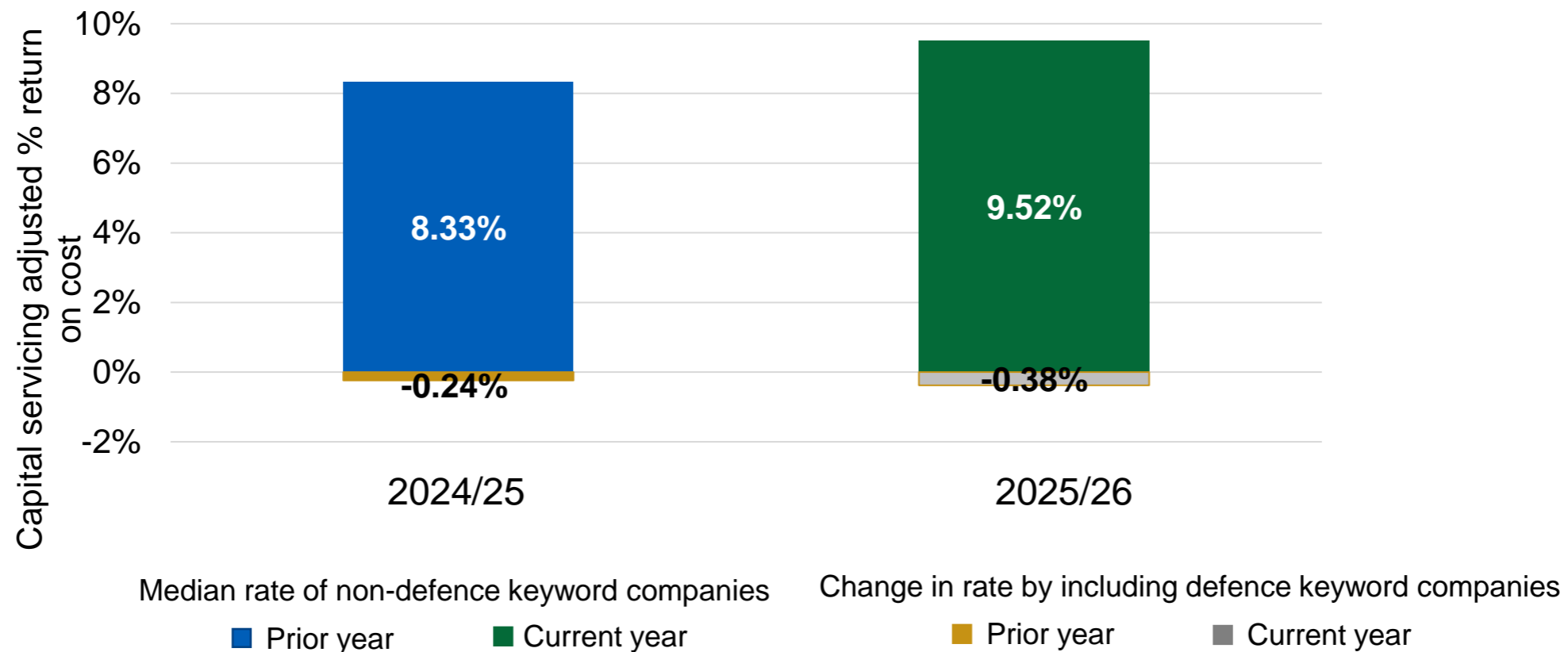


Notes: A company is considered to be a 'defence keyword' company if either the word 'defence', 'defense' or 'militar*' is included in their Orbis text descriptions. The '*' indicates that all words starting with those letters, for example 'military' and 'militarised', are included.

Source: Orbis and SSRO calculations

Impact of ‘defence keyword’ companies on the result

The chart shows the underlying rate of each comparator group excluding defence keyword companies and the corresponding impact of adding those defence keyword companies back to get to the final result.



Notes: A company is a ‘defence keyword’ company if the word ‘defence’, ‘defense’ or ‘militar*’ is included in their Orbis text description. ‘Current year’ is the current year comparator group. ‘Prior year’ is the prior year comparator group and definition, which did not include ‘militar*’ as a keyword.

The 2020/21 to 2024/25 underlying rates are based on the composites of the ‘Develop and Make’ and ‘Provide and Maintain’ activity groups; while those for 2025/26 are calculated from the replacement ‘Develop, Make and Support’ activity group.

Source: Orbis and SSRO calculations

Geography

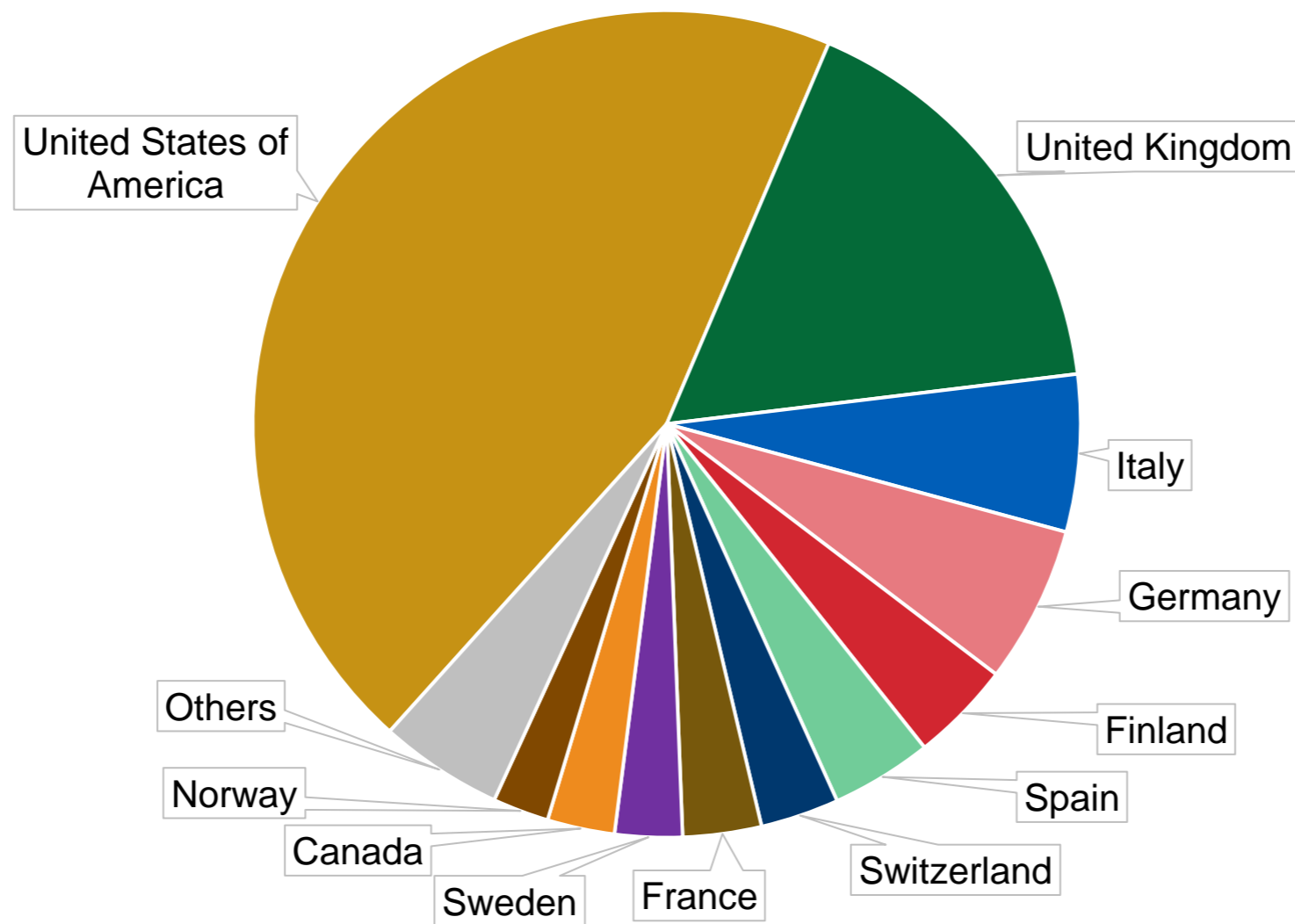
Only companies located in Western Europe and North America are included in the comparator groups.

The following slides set out analysis of the geographical characteristics of the comparator groups, including:

- the proportion of companies in the comparator groups from each country,
- the profitability of companies from each a selection of countries; and
- the impact of those countries on the baseline profit rate analysis.

Geographical distribution of the comparator group

There is wide representation across Western Europe and North America.

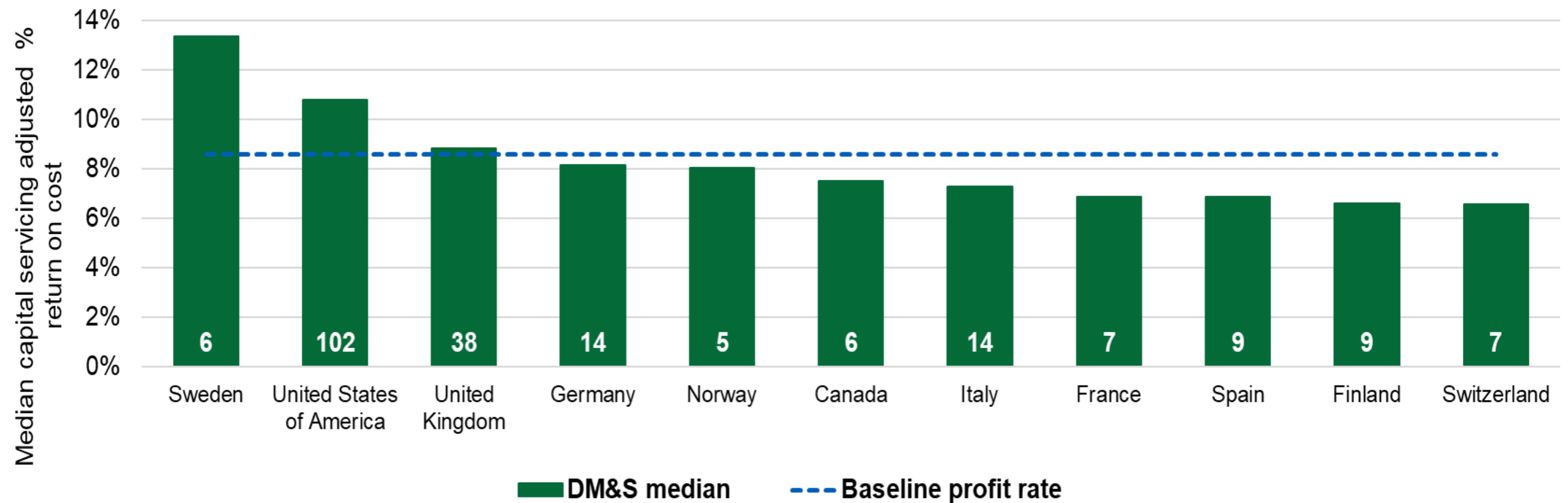


Notes: Countries with < 5 number of companies are merged in to 'Others', which includes : Austria, Belgium, Denmark, Ireland, Iceland, Netherlands, Portugal.

Source: Orbis

Profitability by country

This chart shows the 2025/26 composite underlying rate for each country individually compared to the baseline profit rate. The number of companies is shown at the bottom of each bar.

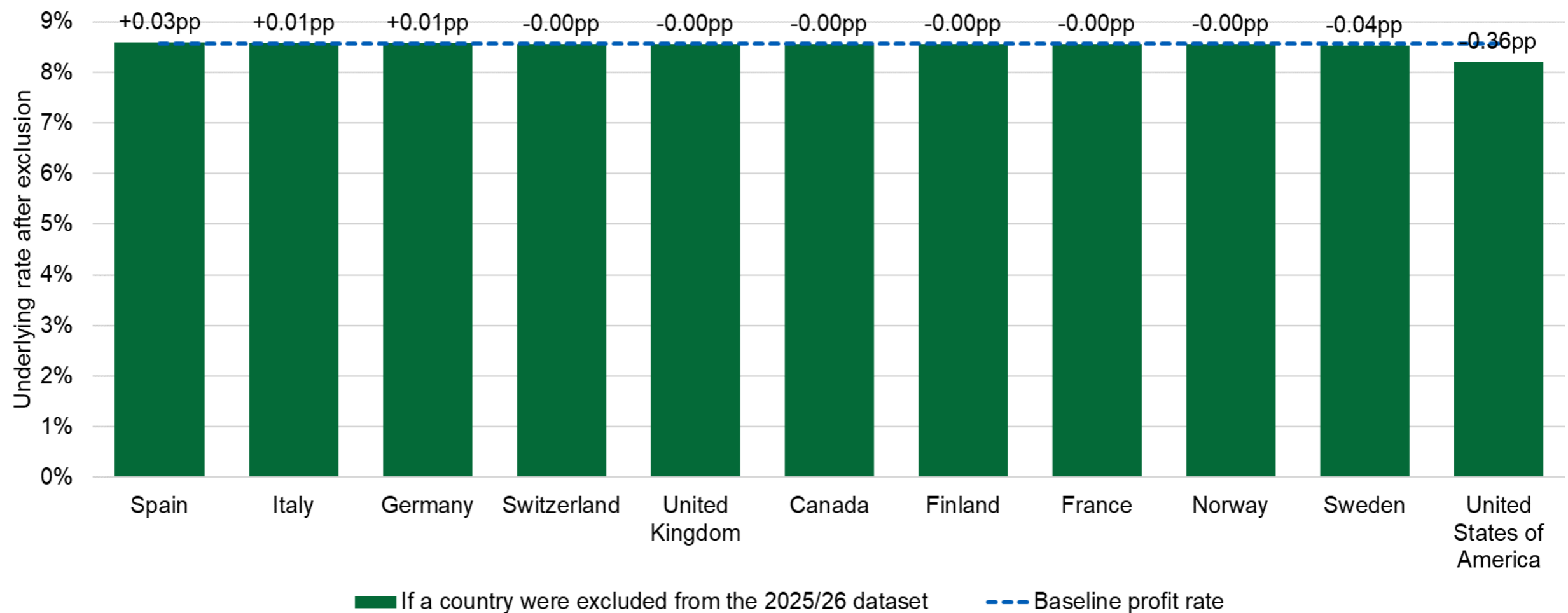


Notes: Only countries with ≥ 5 number of companies are shown.

Source: Orbis, SSRO calculations

Sensitivity to the exclusion of a particular country

This chart shows what the baseline profit rate calculation would have been had a particular country been excluded from the analysis of the 2025/26 composite underlying rate. The figures shown are the differences to the actual baseline profit rate recommendation.



Notes: Only countries with ≥ 5 number of companies are shown.

Source: Orbis, SSRO calculations