Engineered systems and services

Babcock International Group PLC

Interim Report 1999

First half 1999/2000

Babcock International is a multinational engineered systems and services group, headquartered in the UK. It executes business worldwide from its operations in 16 countries. BES provides engineering and technology support services to the defence, rail, marine and 'secure facilities' sectors. BMH delivers materials processing technologies and engineered systems to a range of industries.

£234m

Group turnover from continuing operations (1998/99: £250m Full year: £495m)

£11.1m

Profit before tax excluding exceptional items (1998/99: £11.0m Full year: £25.3m)

£68.9m

Net cash (1998/99: £35.8m Full year: £82.1m)

5.6p

Earnings per share excluding exceptional items (1998/99: 5.0p Full year: 11.4p)

Chairman's statement

Results I am pleased to report that the Group has had another successful first half year with good progress being made by both Divisions. Group operating profit, excluding £2.2m of exceptional costs for a redundancy programme in Railcare, its rail venture with Siemens, increased strongly by 14.5% compared with the first half of the previous year.

Group operating profit before goodwill and the exceptional item referred to above increased in the half year to £10.0m (1998: £8.4m) resulting in an operating margin of 4.3% (1998: 3.4%) on turnover of £233.6m (1998: £250.3m). The credit from goodwill amortisation in the period was £1.0m (1998: £1.2m).

Group profit on ordinary activities before tax was £11.9m (1998: £11.0m) after including the exceptional costs of redundancy and the exceptional profit on disposal of fixed assets of £0.8m (1998: £nil) and interest receivable of £2.2m (1998: £1.0m).

Earnings per share excluding the above exceptional profit was 5.6p (1998: 5.0p) and after including it was 6.1p (1998: 5.0p). An interim dividend of 0.9p per share has been declared by the Board (1998: 0.8p).

The Group order book has remained strong and was £382.3m at September (1998: £270.5m) compared with £353.2m at March 1999.

The operating cash outflow during the first half was £6.2m compared with an inflow of £11.0m in the corresponding period last year and the Group's net cash at the end of September was £68.9m (March: £82.1m).

Review of operations

BES BES achieved a good trading performance during the first half and increased operating profits before the cost of the redundancy programme at Railcare, by £0.6m or 9.6% compared with the corresponding period last year. Turnover was lower than for the same period last year due principally to weaker demand for rail wheelset and bogey overhaul, a lower level of refit man hours following the delayed arrival of the aircraft carrier HMS Ark Royal and the completion last year of the Ministry of Defence ('MoD') funded nuclear dock infrastructure improvements at Rosyth.

In the Division's naval refitting activities there were further improvements in performance both in the UK and New Zealand as a result of continuing cost reduction and efficiency improvement initiatives. The two-year refit contracts for the nuclear submarine HMS Spartan and aircraft carrier HMS Ark Royal that began in the period are progressing well. In New Zealand the deployment of the Royal New Zealand Navy's ships in response to the situation in East Timor has led to a temporary reduction in naval work.

Within Railcare, performance improvement measures have been pursued to protect future margins. Information in connection with the UK Government's public/private partnership plans to modernise and upgrade the London Underground system was released recently and is now being studied and evaluated. Railcare is also now responding to enquiries regarding its capability to convert 'swing door' railway rolling stock to a 'sliding door' configuration for which a prototype has already been completed.

In the Division's modest sub-sea engineering and supply activities challenging market conditions continued to prevail although the more recent substantial increase in oil prices has generated an improved medium term outlook.

Good progress was made during the period in the Division's strategy of leveraging off its substantial facilities and skills at Rosyth with a view to accessing new customers and alternative business streams. Initiatives underway to exploit our nuclear engineering skills include the recent formation of a joint venture between BES and Studsvik AB, a leading Swedish company in the field of nuclear waste clean up, to apply the joint skills of the partners to civil nuclear decontamination and decommissioning opportunities in the UK.

BES' rail freight wagon (Mega 3), with its ability to handle megatrailers, tank trailers and swap bodies, successfully completed its UK certification programme which has confirmed its ability to operate at high speeds of up to 140 kph. BES will now seek approval for the wagon to operate in Europe and remains confident that this concept is being factored into the forward plans of rail freight and logistics operators as the way ahead to reduce road congestion and improve the speed of freight movements.

Babcock Defence Systems' bid in February 1999 to supply a new towed array sonar to the UK Royal Navy for its Type 23 Frigate fleet has been recently resubmitted following a number of technical changes required by the MoD. Further clarifications are being processed and a final round of revisions is expected before the successful bidder, from a short list of two, is announced towards the end of the current financial year.

The consortium bidding for the ten year management contract of the UK Government's Atomic Weapons Establishment at Aldermaston led by Babcock and including W S Atkins and Scientific Applications International Corporation (SAIC) has completed several tough rounds of bidding and evaluation in the course of the last six months. No final decision has been announced by the MoD although this is expected before the end of the calendar year. Regardless of the outcome this contract demonstrates our credentials to participate in such sophisticated facility management bids to the MoD. There are a number of other major facility management opportunities with the MoD which the Group will pursue over the coming years. Furthermore BES will shortly establish a new specialist facilities management company to exploit a range of skills and software that can be spun out from Rosyth. It will aim to serve the more sophisticated end of the growing facilities management market including in the civil sector.

BMH The Division continued to make very good progress with turnover and operating profits growing by 11.5% and 32.5% respectively compared with the corresponding period last year. Total order book at September was 13.8% higher than a year earlier at £115.6m.

The importance of BMH's balanced portfolio of businesses and a flexible and global operating structure was again evident as the Division responded to new opportunities. Improved trading performances were recorded in the period by the Division's pipeline engineering and marine businesses although the Nordic bio-energy activities were more subdued. The South Africa business achieved modest profitability despite facing depressed markets particularly in equipment distribution.

Market conditions in some parts of the world are still challenging, particularly in Latin America and South Africa, and both sales and order intake in the first half have continued to be led by Europe and North America. In Asia, which remains an important market for BMH, there have been encouraging signs of a revival in demand from certain of the troubled Asian economies. Similarly the prices of certain commodities that are important drivers in BMH's businesses have shown significant recovery, including crude oil prices which influence investment levels in pipeline activity.

Key elements of BMH's strategy for organic development include accessing new business opportunities in adjacent markets and new product development. The Division has secured contracts in adjacent markets for grain terminals, grinding and refined building materials. In new product development there has been a particularly strong emphasis on packing and despatch systems, port terminals and technologies in support of engineered building products. In addition the product portfolio has been enriched through license agreements for special tubular conveying technology. The Division has reached agreement to acquire radio frequency drying plant technology in the USA to enable it to access new markets in veneer and board drying. BMH is also placing greater emphasis on long-term customer support services including modern telecommunications techniques to monitor plant installations remotely in real time.

Strategy and prospects The Group continues to evaluate potential acquisitions which have a good strategic fit with our existing businesses and which utilise the Group's international market expertise and in depth knowledge of a wide range of industrial sectors. We are confident that in due course we will complete strategic acquisitions at acceptable prices.

Over the past two years we have transformed the risk profile of the Group and its portfolio of businesses. We have made excellent progress on improving operating margins and returns on capital employed. Increased focus is now being placed upon adding new revenue streams through organic growth and acquisition. Where appropriate these will be geared to utilising the Group's sizeable pool of overseas tax losses. The Group's strategy has the potential to continue delivering future improvements in shareholder value.

T. John Parker

Dr T John Parker Chairman
18 November 1999

Group profit and loss account

For the six months ended 30 September 1999

Year ended 31 March 1999 £'000		Six months ended 30 September 1999: Before operating exceptionals (unaudited) £'000	Six months ended 30 September 1999: Operating exceptionals (unaudited) £'000	Six months ended 30 September 1999: Total (unaudited) £'000	Six months ended 30 September 1998 (unaudited) £'000
509,413	**Turnover including share of joint ventures**	**233,600**	**–**	**233,600**	259,805
13,092	Less: share of joint ventures turnover	**–**	**–**	**–**	9,467
494,990	Continuing operations	**233,600**	**–**	**233,600**	249,861
1,331	Discontinued operations	**–**	**–**	**–**	477
496,321	**Group turnover**	**233,600**	**–**	**233,600**	250,338
19,786	Continuing operations	**9,953**	**(2,152)**	**7,801**	8,270
109	Discontinued operations	**–**	**–**	**–**	178
19,895	**Group operating profit before goodwill amortisation**	**9,953**	**(2,152)**	**7,801**	8,448
2,337	Goodwill amortisation	**1,038**	**–**	**1,038**	1,150
22,232	**Group operating profit**	**10,991**	**(2,152)**	**8,839**	9,598
569	Share of operating profit of joint ventures and associates	**–**	**–**	**–**	404
22,801	**Trading profit including share of joint ventures and associates**	**10,991**	**(2,152)**	**8,839**	10,002
6,142	Profit on sale or termination of operations			**–**	–
–	Profit on disposal of fixed assets			**798**	–
28,943	**Profit on ordinary activities before interest**			**9,637**	10,002
2,501	Interest			**2,223**	968
31,444	**Profit on ordinary activities before taxation**			**11,860**	10,970
(5,295)	Tax on profit on ordinary activities			**(2,205)**	(2,304)
26,149	**Profit on ordinary activities after taxation**			**9,655**	8,666
(637)	Minority interests			**612**	(200)
25,512	**Profit for the financial period**			**10,267**	8,466
(3,725)	Dividends paid and proposed			**(1,524)**	(1,355)
21,787	**Retained profit for the financial period**			**8,743**	7,111
15.07p	**Earnings per share – Basic**			**6.06p**	5.00p
14.99p	**Earnings per share – Diluted**			**5.94p**	4.97p

Group balance sheet

As at 30 September 1999

As at 31 March 1999 £'000		As at 30 September 1999 (unaudited) £'000	As at 30 September 1998 (unaudited) £'000
	Fixed assets		
	Intangible assets		
183	Development costs	**64**	329
	Goodwill		
21,842	– Goodwill	**20,935**	23,074
(22,593)	– Negative goodwill	**(20,648)**	(24,576)
(751)		**287**	(1,502)
(568)		**351**	(1,173)
47,824	Tangible assets	**45,135**	50,234
	Investments		
	Investments in joint ventures		
–	– Goodwill	**–**	1,518
–	– Share of gross assets	**–**	8,503
–	– Share of gross liabilities	**–**	(4,952)
–		**–**	5,069
558	Investments in associates	**558**	526
126	Other investments	**684**	134
684		**1,242**	5,729
47,940		**46,728**	54,790
	Current assets		
25,835	Stocks	**26,187**	23,704
105,741	Debtors – due within one year	**122,712**	124,862
77,144	Debtors – due after more than one year	**74,285**	73,191
182,885		**196,997**	198,053
6,618	Investments	**7,574**	–
89,928	Cash and bank balances	**76,336**	58,674
305,266		**307,094**	280,431
(182,430)	Creditors – amounts due within one year	**(178,304)**	(178,937)
122,836	Net current assets	**128,790**	101,494
170,776	Total assets less current liabilities	**175,518**	156,284
(2,016)	Creditors – amounts due after more than one year	**(2,058)**	(8,767)
(32,186)	Provisions for liabilities and charges	**(30,002)**	(25,867)
136,574	Net assets	**143,458**	121,650
	Capital and reserves		
84,660	Called up share capital	**84,685**	84,656
67,112	Share premium account	**67,118**	67,111
(25,017)	Profit and loss account	**(16,539)**	(39,489)
126,755	Equity shareholders' funds	**135,264**	112,278
9,819	Minority interests	**8,194**	9,372
136,574		**143,458**	121,650

Summarised Group cash flow statement

For the six months ended 30 September 1999

Year ended 31 March 1999 £'000		**Six months ended 30 September 1999 (unaudited) £'000**	Six months ended 30 September 1998 (unaudited) £'000
56,136	Cash flow from operating activities	**(6,177)**	10,971
1,350	Dividends from joint ventures	**–**	1,350
1,615	Returns on investments and servicing of finance	**1,075**	584
(798)	Taxation	**(644)**	(796)
(5,506)	Capital expenditure and financial investment		**(1,419)**
(2,880)			
16,941	Acquisitions and disposals	**(1,994)**	4,829
(3,235)	Equity dividends paid	**(2,370)**	(1,880)
66,503	Cash (outflow)/inflow before management of liquid resources and financing	**(11,529)**	12,178
884	Management of liquid resources	**(956)**	886
(6,240)	Financing	**244**	(6,223)
61,147	(Decrease)/increase in cash in the period	**(12,241)**	6,841

The principal component of the cash flow from acquisitions and disposals is the settlement of the litigation against the Group that arose following the disposal of a business that was formerly part of the Group.

This matter was referred to in the Group's 1999 annual report and financial satatements. The Group has also paid deferred consideration following the Group's acquisition of AKI Dryer Manufacturers (now renamed BMH AKI Dryers Inc.) in September 1998. Returns on investment and servicing of finance inlcudes the payment of a dividend of £1.0m to the minority shareholder in the Group's Railcare operation.

Reconciliation of net funds

For the six months ended 30 September 1999 (unaudited)

	At 1 April 1999 £'000	Cash flow £'000	New finance leases £'000	Exchange movement £'000	**At 30 September 1999 £'000**
Cash in hand and at bank	89,928	(12,962)	–	(630)	**76,336**
Overdrafts	(6,462)	721	–	(16)	**(5,757)**
	83,466	(12,241)	–	(646)	**70,579**
Debt	(1,399)	(289)	–	5	**(1,683)**
Finance leases	(757)	76	(382)	2	**(1,061)**
	(2,156)	(213)	(382)	7	**(2,744)**
Liquid resources	6,618	956	–	–	**7,574**
	87,928	(11,498)	(382)	(639)	**75,409**

Group results by Division

For the six months ended 30 September 1999 (unaudited)

	Group turnover Sept 1999 £'000	Group operating profit before operating exceptional items Sept 1999 £'000	Group operating exceptional items Sept 1999 £'000	Group operating profit after operating exceptional items Sept 1999 £'000	Share of operating profit of joint ventures and associates Sept 1999 £'000	Trading profit including joint ventures and associates Sept 1999 £'000
Continuing operations						
BES	**123,878**	**6,886**	**(2,152)**	**4,734**	**–**	**4,734**
BMH	**109,722**	**4,012**	**–**	**4,012**	**–**	**4,012**
Unallocated costs and other income	**–**	**(945)**	**–**	**(945)**	**–**	**(945)**
	233,600	**9,953**	**(2,152)**	**7,801**	**–**	**7,801**
Goodwill amortisation	**–**	**1,038**	**–**	**1,038**	**–**	**1,038**
Total continuing operations	**233,600**	**10,991**	**(2,152)**	**8,839**	**–**	**8,839**
Discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**
Goodwill amortisation	**–**	**–**	**–**	**–**	**–**	**–**
Total discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**
	233,600	**10,991**	**(2,152)**	**8,839**	**–**	**8,839**

	Group turnover Sept 1998 £'000	Group operating profit Sept 1998 £'000	Share of operating profit of joint ventures and associates Sept 1998 £'000	Trading profit including joint ventures and associates Sept 1998 £'000
Continuing operations				
BES	151,421	6,280	–	6,280
BMH	98,440	3,027	–	3,027
Unallocated costs and other income	–	(1,037)	–	(1,037)
	249,861	8,270	–	8,270
Goodwill amortisation	–	1,158	–	1,158
Total continuing operations	249,861	9,428	–	9,428
Discontinued operations	477	178	601	779
Goodwill amortisation	–	(8)	(197)	(205)
Total discontinued operations	477	170	404	574
	250,338	9,598	404	10,002

Group statement of total recognised gains and losses

Year ended 31 March 1999 £'000		**Six months ended 30 September 1999 (unaudited) £'000**	Six months ended 30 September 1998 (unaudited) £'000
25,512	Profit for the financial period	**10,267**	8,466
(710)	Currency translation differences on foreign currency net investments and related loans	**(265)**	(506)
24,802	Total recognised gains and losses relating to the period	**10,002**	7,960

Reconciliation of movements in shareholders' funds

Year ended 31 March 1999 £'000		**Six months ended 30 September 1999 (unaudited) £'000**	Six months ended 30 September 1998 (unaudited) £'000
105,673	Shareholders' funds at start of period	**126,755**	105,673
5	Shares issued in the period	**31**	–
24,802	Total recognised gains and losses relating to the period	**10,002**	7,960
(3,725)	Dividends	**(1,524)**	(1,355)
21,082	Net movement in shareholders' funds	**8,509**	6,605
126,755	Shareholders' funds at end of period	**135,264**	112,278

Notes

1) The statement of results for the year to 31 March 1999 is an extract from the Group's full accounts for the year which have been filed with the Registrar of Companies and on which the Group's auditors gave an unqualified report. The accounting policies are as stated in the Group's full accounts for the year ended
31 March 1999.

2) The charge for taxation has been based on the estimated effective tax rate, before (non-operating) exceptional items and goodwill, for the year ended 31 March 2000.

3) Earnings per share is based on the profit attributable to shareholders for the half year to 30 September 1999 and an average of 169.3 million shares in issue in the period.

4) Based on the first half trading results, the Board has approved the payment of an interim dividend amounting to 0.9p per share (compared to 0.8p in 1998). The dividend will be paid on 28 January 2000 to shareholders registered on 6 January 2000.

Circulation note: Copies of this interim report are being sent to shareholders on 24 November 1999. Further copies are available at the Company's registered office: Badminton Court, Church Street, Amersham, Bucks HP7 0DD.

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