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The future of defence outsourcing

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Babcock International Group



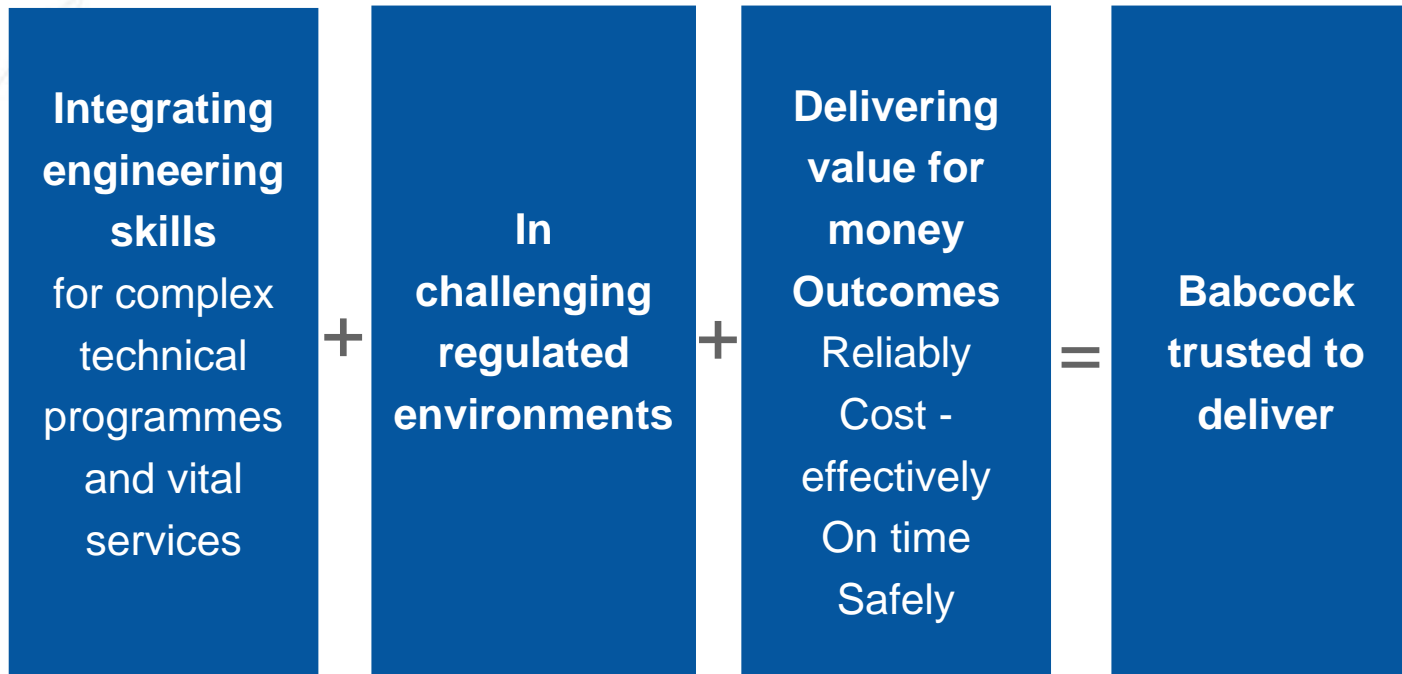
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- FTSE 250 engineering support services company
 - Group revenue 2010 £1.9 billion
- Our customers
 - are **government departments**, public bodies or private companies operating in **highly regulated** environments
 - operate strategically important assets which require **long-term** maintenance and upgrade where spend is **non-discretionary**
 - seek innovative, **cost effective** engineering solutions
- Our key strengths
 - highly **technical** engineering skill base (17,000 people)
 - **complex** project management capability
 - **long-term** relationships with our customers

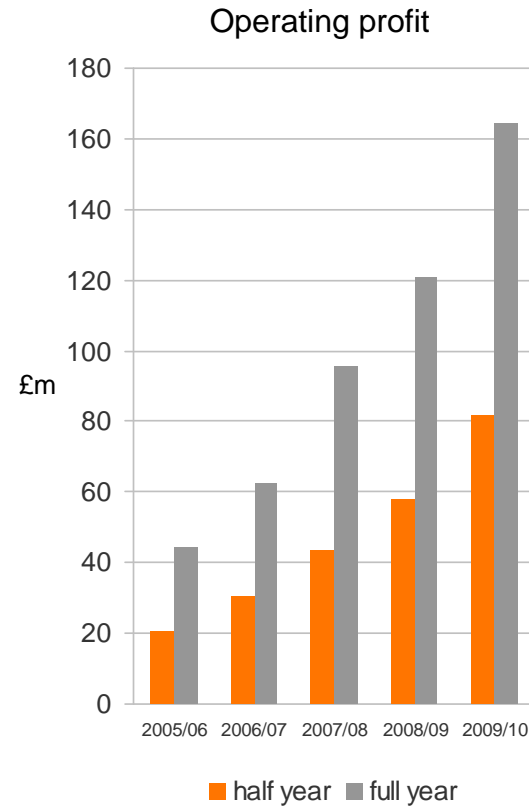
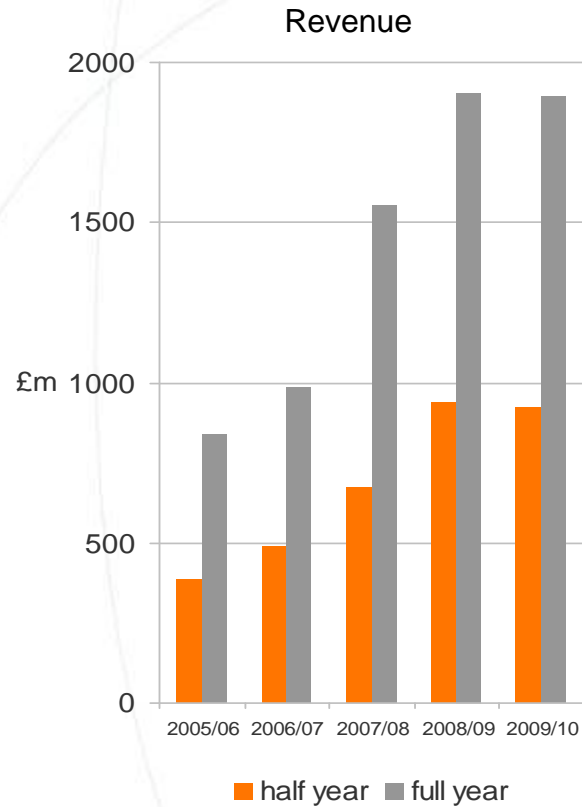


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Our business model



Sustained track record of growth



- By establishing leading positions in markets with strong growth potential: defence, public services and critical infrastructure



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UK defence market



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Defence under Labour

- MoD's annual spend £38 billion*
- Top priority equipment and support for Afghanistan
- Whilst ensuring Armed Forces are fit for the “challenges of tomorrow”
- Strategic Defence Review deliberately delayed until post election

**includes ~ £11bn on personnel, ~ £4bn equipment support, ~ £4bn property management, ~ £5.4 bn major procurement programmes*



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Defence under the Coalition

- Strategic Defence Review underway
 - will report this Autumn as part of overall Comprehensive Spending Review (to be a top down settlement)
- Defence budget protected this financial year only
 - MoD will be expected to deliver some early savings
- MoD priorities likely to remain the same – assuming no fundamental rethink of UK strategic posture!
 - Afghanistan and front line
 - best value for every pound spent
 - budget brought under control
- Coalition team
 - Liam Fox – Secretary of State
 - Nick Harvey - Minister of State for the Armed Forces (Lib Dem)
 - Gerald Howarth/Andrew Robatham – Junior Ministers
- Will Grimstone and Defence Support Reviews continue?



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The underlying challenges still the same

- The MoD have some difficult challenges ahead
 - **cost savings** in both revenue and capital budgets
 - the **release of resources** for the front line
- Their focus will be on ensuring that every pound spent has an **operational effect**
- Ideally cost reductions should not reduce levels of service, equipment or facilities
 - in short, their desire is the **same for less**
- An area for close scrutiny is likely to be the capital equipment programme, which could result in
 - more **life extensions** of current platforms
 - more **off-the-shelf solutions**
 - more focus on **through-life cost**
- Reducing administrative overhead likely to be a key focus



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Babcock and the MoD: highlights

- Babcock is currently one of the **top 6** providers to MoD
 - c 65% of Group revenue comes from MoD
- Sole provider of support for the Royal Navy's submarine fleet
- Undertake 75% of surface ship refit work
- Integrator for 2 new aircraft carriers (CVFs)
- Manage 2 of the Royal Navy's 3 naval bases
 - includes fleet time maintenance and engineering support
- Manage 2 of Defence Estates' 5 Regional Prime Contracts
- Deliver training and training support for the Royal School of Military Engineering
- Provide equipment support and base support to the Royal Air Force's Hawk fleet

Babcock's approach - the same for less



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- Outsourcing produces **cost savings**
 - target cost incentive contracts drive efficiencies
 - not afraid to take the 'difficult' decisions
 - flexibility of resource levels
- Outsourcing releases military **resource for the front line**
 - many support tasks do not need to be done by military personnel
- Outsourcing needs **trusted partners**
 - understanding their systems and processes
 - knowing what's important to the customer



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Defence infrastructure

Regional Prime contract market

- Outsourced primes represent approximately £1.5 billion of Defence Estates' budget of £4 billion
- Babcock Primes
 - two regional
 - one functional prime
- Trends
 - significant budget issues
 - estate size reducing
 - further outsourcing opportunities





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Defence Estates – Prime contracts

Five regional prime contracts

- | | |
|--------------|--------------------|
| – South West | Babcock/Bovis JV |
| – East | Babcock/DynCorp JV |
| – Central | Carillion JV |
| – South East | Interserve JV |
| – Scotland | Turner FM |

Three functional prime contracts

- | | |
|--------------------------------------|-------------------------|
| – Single Living Accommodation (SLAM) | Babcock/Bovis JV |
| – Married quarters | Carillion/Enterprise JV |
| – Army Training Estate | Interserve/SEC JV |

Benefits of Regional Prime contracting

- Prime contracting aims to achieve **long-term value**
 - improved management information
 - incentivised payment mechanisms
 - life-cycle management of estate
 - economies of scale = reduced overheads
 - same for less
- Approximately **30% cost saving** at award
 - **+ 2%** savings each year
 - **incentivised** gain share with customer
- **Growth in scope**
 - 35% since start



Project SLAM (Single Living Accommodation Modernisation)



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- Functional Prime contract
 - to construct and maintain new en-suite single living accommodation
 - Phase 1 – 5 year
£450 million programme
9,000 units
 - Phase 2 – 5 year
£600 million programme
10,000 units
- Delivered by JV with Bovis Lend Lease
- 12,969 bed spaces now in compliance
 - 2,557 bed spaces to be added in coming year
- Team co-located with Defence Estates across the UK
 - delivering Phase 2
 - developed supply chain model
 - now approaching key life cycle





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Defence equipment support



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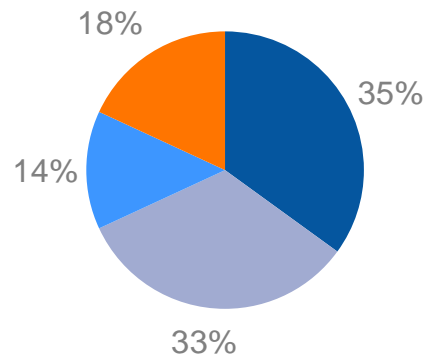
Equipment support - market factors

- Afghanistan remains the key priority
- Short to medium-term pressure on budgets for new equipment
 - capital spending likely to be rationed
- Postponement or cancellation of new platforms could lead to life extensions of current equipment
- New platforms will increasingly be contracted on a through-life capability basis
- The key issue facing MoD for next five years will be cost of capability leading to
 - life extension of legacy programmes
 - through-life support of new and legacy programmes

Military air equipment support market

- MoD and OEM self performance >80%
- Babcock share <5%
- Opportunity to reduce costs
- Opportunity to provide integrated base and equipment support
- Opportunity for growth

Estimated market size
c £900 million



■ Jets ■ Rotor wing ■ Transport ■ Other



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Our role on Hawk fast jet trainers



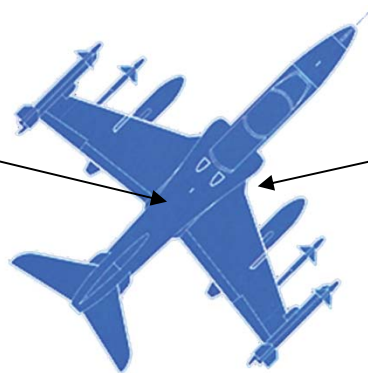
Airframe – BAE Systems

Flight line maintenance, scheduled maintenance, repair, overhaul and test



Adour Engine – Rolls-Royce

Maintenance, repair, overhaul, test



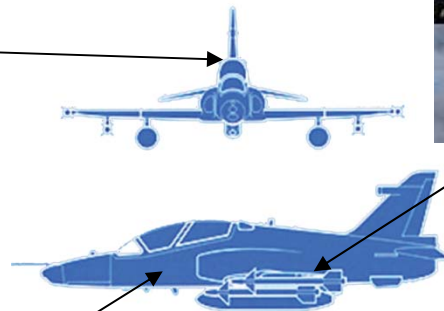
Ejection Seat – Martin Baker

Maintenance, repair, overhaul, test



Training Weapons

Configuration, loading, maintenance



Avionics – Smiths Industries

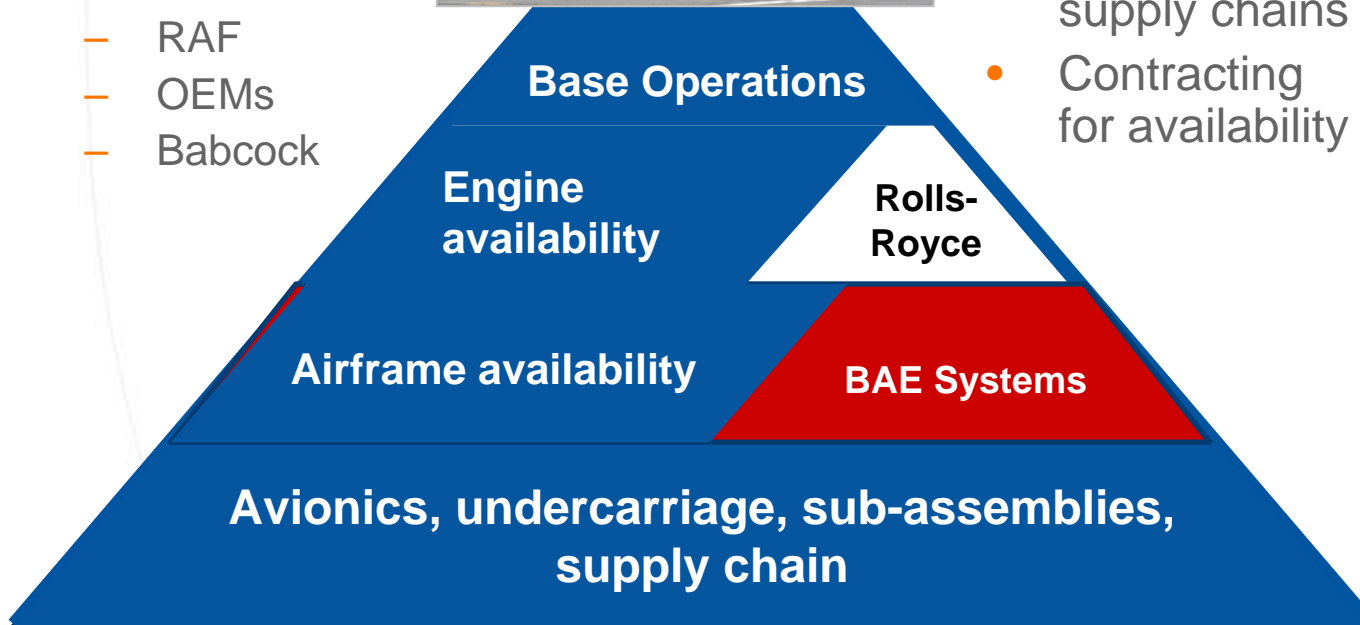
Maintenance, repair, overhaul, test

Integrating capabilities at RAF Valley

- Complex operational mix
- Complex inter-dependencies
 - DE&S
 - RAF
 - OEMs
 - Babcock



- Complex contracting structures
- Inter-dependent supply chains
- Contracting for availability





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Defence training



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Outsourcing defence training

- MoD seeking to **increase outsourcing** in training market
 - **cost savings** a key driver
 - **release of personnel** for operational duties
- MoD recognises that **training transformation** will not happen without industry involvement
 - partnering approach
 - transfer of training risk increasingly required
 - outsourced infrastructure upgrades
 - consolidation across cap badges and trades
 - increasing requirement to use technology and distributed training
 - agility and relevance key to support current and future operations



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Defence training current opportunities

- Royal Navy training
 - 6 year contract with options to extend
 - teamed with Raytheon
 - total value c £200 million, work share to be determined
 - expected contract start 2011
- Defence Training Review Package 2
 - existing programme currently under review
 - opportunities for separate tri-service training packages
- Military Flying Training System (MFTS)
 - tier 2 contract for fixed wing training
 - tier 2 contract for rotary wing training
 - total value £700 - £1,000 million



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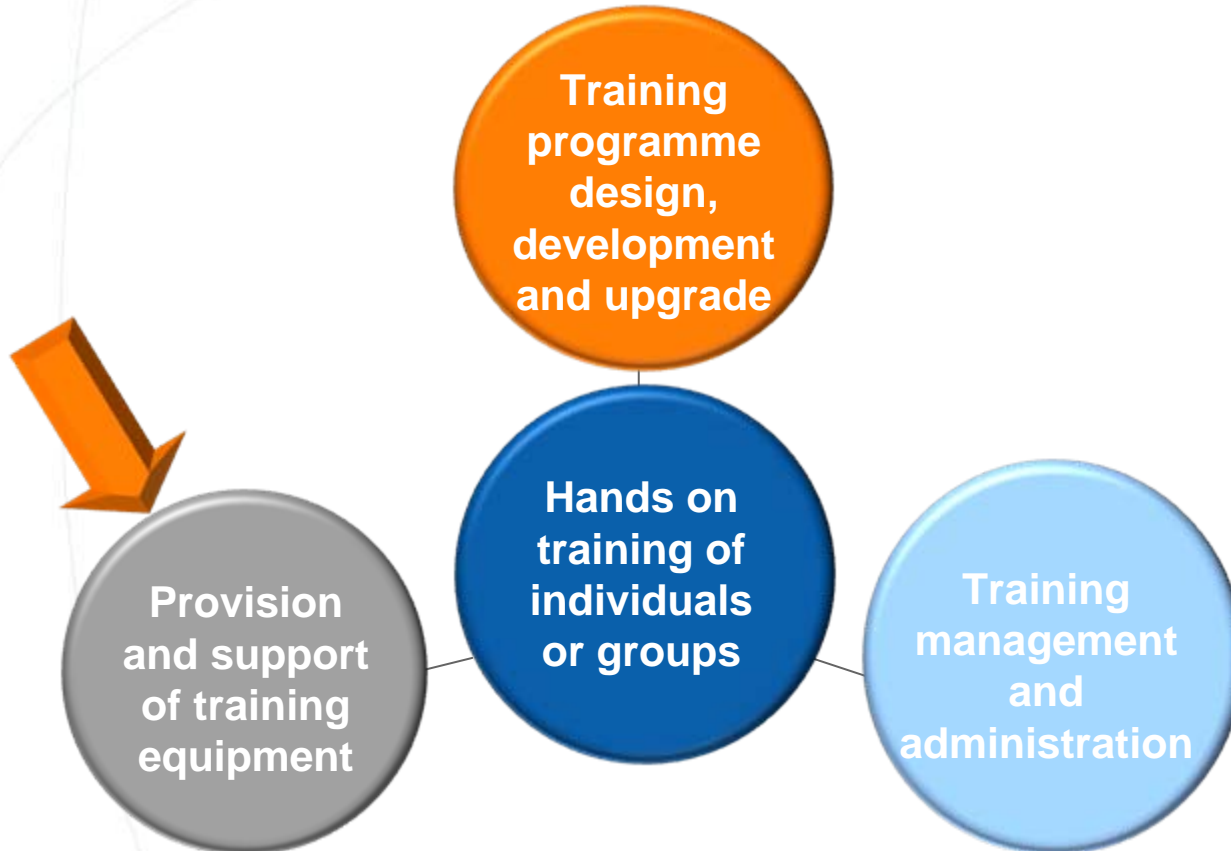
Royal School of Military Engineering

- Achieved financial close September 2008, commenced January 2009
 - contract value £2.9 billion (£1.5 billion to Babcock) for 30 years
- First PPP to deliver training support for the Army
 - skill and craft training from NVQ to foundation degree
- Significant **investment programme** of refurbishment and construction
 - upgrade of accommodation at Chatham and Minley
 - new training facilities to be built at both sites
 - rationalisation of other training sites
- Focus on delivering **greater efficiency** through improved
 - levels of service
 - training programme velocity
 - matching of training to Army requirements
- Released over **300 military personnel** for front line duties
 - equivalent of a new regiment of Engineers

Capability before RSME



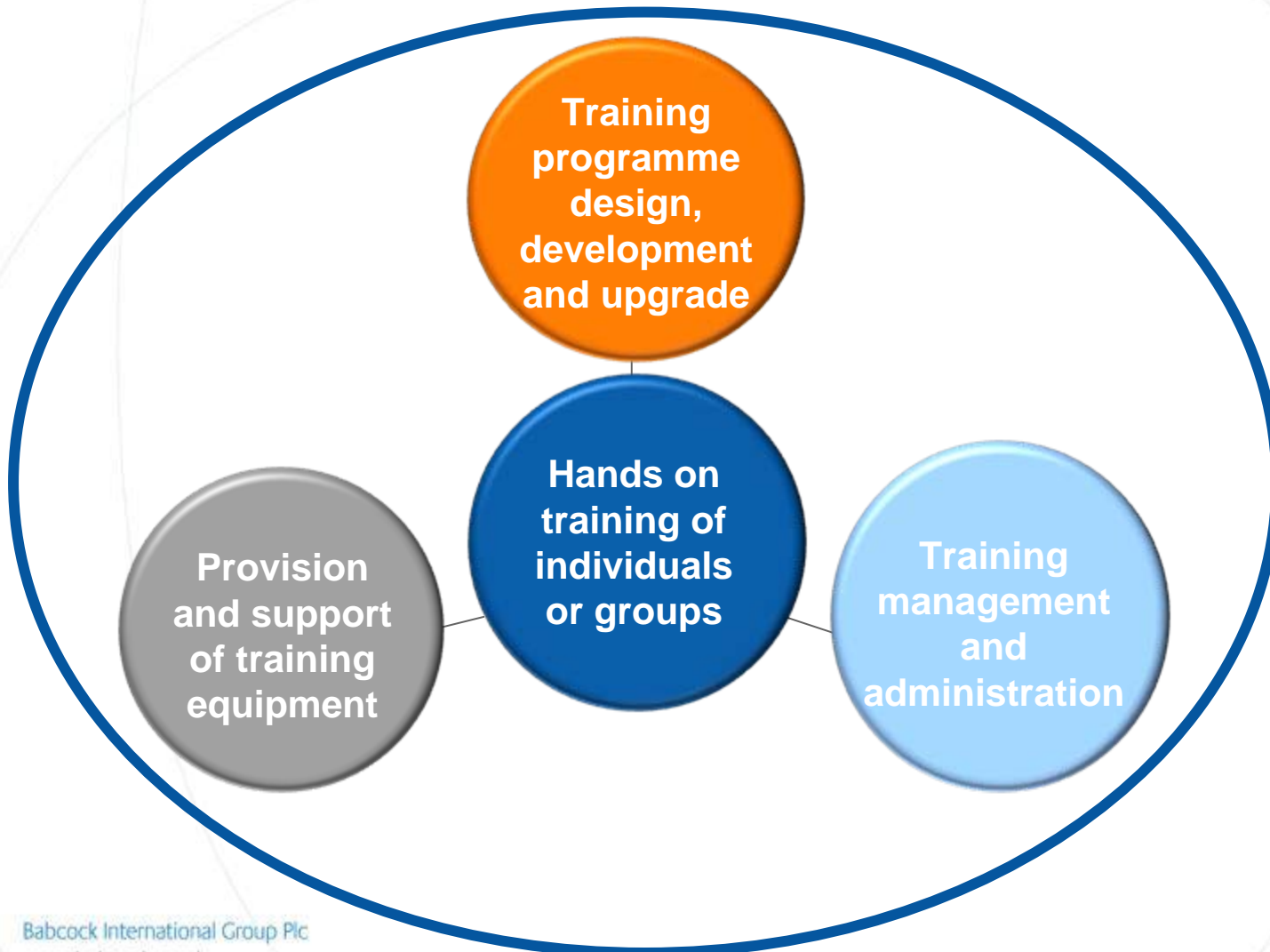
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Capability today integration



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Marine



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Naval support market

- **Most advanced** of three Services in terms of outsourcing
 - through-life engineering support
 - naval base management and fleet time engineering support
 - critical infrastructures owned by industry partners
 - some procurement outsourced
- Royal Navy benefit from
 - **close and embedded** relationships with partners
 - **innovative** commercial models
 - **guaranteed** level of **savings**
- We benefit from
 - **visibility** of work streams
 - opportunity to **share in savings**



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Royal Navy key support partner

Babcock's current position

- **75%** of surface fleet upkeep undertaken at Rosyth/Devonport
- **50%** of surface fleet base ported at Devonport
- Own or operate **unique** facilities and infrastructure
- Support for **all** current classes of ships
- **Tier 1** partner in Queen Elizabeth Class Aircraft Carrier Alliance
- **Tier 1** partner in Surface Ship Support Alliance
- **Tier 1** partner in Naval Design Partnership

Warships

Key activities and capabilities



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- In-service engineering support
- Major maintenance and re-build
- Capability insertion and upgrades
- Platform and equipment support
- Design Support Alliance



Surface Ship Support Alliance – SSSA



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- **15 year** alliance between MoD, Babcock and BAE
- Through-life support for **all** current and future classes of surface warships
 - including new Type 45 destroyers, QE class carriers and Future Surface Combatant
- **Upside reward** for superior performance with element of joint risk sharing
- Long-term upkeep schedule gives **visibility** and **certainty**

Submarines

Key activities and capabilities



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- In-service engineering support
 - major maintenance and rebuild
 - capability insertion and upgrade
- Platform and equipment support
- Through-life engineering support
 - Submarine Engineering Support Contract (SESC)
- Laid up submarine support
- Decommissioning and disposal



Submarine Enterprise Performance Programme



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- Cooperation **agreement** MoD, Babcock, BAE and Rolls Royce
- Covers full **CADMID** cycle for existing and future submarines
- **Lead** on through-life, in-service support, decommissioning and disposal
 - platform design and manufacture - BAE lead
 - Nuclear Steam Raising Plant - Rolls Royce lead
- Concept, appraisal and detailed design
 - joint work teams
- Bilateral agreements to avoid duplication and maximise use of key resources
- Babcock **major involvement** in new Astute Class and Future Deterrent concept development

Terms of Business Agreement highlights



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- **Pivotal role** as leading through-life support partner
 - Centre of Excellence Deep Maintenance
 - Centre of Excellence Amphibiosity – Royal Marines
 - Through Life Support partner for **all** submarines
 - Through Life Support partner for Surface Warships
 - Submarine Centre of Specialisation
 - Warship support partner through SSSA including Aircraft Carriers
- **15 year programme** of work delivering
 - improved availability of platforms
 - lower overall through-life costs
- Naval base management contracts **extended** to 2025
- **Tier 1 partner** for Submarine Disposal



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Outlook for defence outsourcing

Opportunities



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- SDR could be an opportunity
 - **through-life** support solutions for new platforms
 - **life extension/upgrade solutions** for legacy systems
 - **outsourcing** of MoD self delivered operations
- Integration capability key in contracting for availability and through-life support
- Benefits from Strategic Defence Review and trend towards outsourcing in
 - defence infrastructure
 - defence training
 - equipment support
 - engineering solutions
 - life extension
 - decommissioning



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Summary – same for less!

- We already deliver much of what the MoD is seeking to achieve
 - **cost savings**
 - by delivering services more efficiently
 - by Improving availability of assets and troops to the front
 - **improved availability of equipment**
 - through-life platform support
 - life extensions
 - fewer “banana skins” for MoD through **risk transfer** and outcome style contracts
- We have a **proven** track record and are a **trusted** partner



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