Babcock International Group PLC
Preliminary results
for the year ended 31 March 2011

17 May 2011

Successful integration of VT Group plc and excellent financial results create a strong platform for future growth

Financial Highlights

Underlying	March 2011	March 2010	Change
Revenue*	£2,894.5m	£1,923.4m	+ 50%
Operating profit**	£286.9m	£164.7m	+ 74%
Profit before tax***	£228.2m	£145.2m	+ 57%
Basic earnings per share****	55.03p	51.37p	+ 7%
Statutory			
Revenue	£2,755.8	£1,895.5m	+ 45%
Operating profit	£157.5m	£148.1m	+ 6%
Profit before tax	£115.4m	£129.2m	- 11%
Basic earnings per share	31.28p	46.29p	- 32%
Year end net debt	£729.0m	£302.3m	-
Net debt:ebitda (per financial covenants)	2.4 x	1.6 x	-
Full year dividend	19.4p	17.6p	+ 10%
Order book	£12bn	£8bn	+ 50%

*Underlying revenue includes the Group's share of joint venture revenue

**Underlying operating profit includes IFRIC 12 investment income and joint venture operating profit but is before amortisation of acquired intangibles and exceptional items

***Underlying profit before tax is inclusive of pre-tax joint venture income but before amortisation of acquired intangibles and exceptional items

****Underlying basic earnings per share is before amortisation of acquired intangibles and exceptional items, before the related tax effects and before the effect of UK tax rate changes.

Operational Highlights

- Successful integration of VT Group plc supports future growth in UK and overseas
- Underlying business performance remains strong
  - 5% organic growth in underlying revenue and operating profit
  - underlying group operating margin 9.9%,
- Economic environment continues to support outsourcing opportunities; bid pipeline increased to £8.5 billion
- Cash conversion of 146%, net debt reduced to £729 million
- Continued focus on creating value for shareholders; proposed full year dividend of 19.4p, up 10%

Peter Rogers, Chief Executive commented

"These strong results reflect the value Babcock is now generating as the UK's leading engineering support services group. The successful integration of VT Group into our existing business has created a powerful operational and financial platform for us to capitalise on our increasing opportunities for growth both in the UK and internationally.

"We have entered the new financial year with the excellent visibility conferred by a large and long-term order book and with an expanding bid pipeline. The Board is confident in the outlook for the group and we look forward to making further good progress this year and thereafter."

Contact:

Babcock International Group PLC

Peter Rogers, Chief Executive — Tel: 020 7355 5300

Bill Tame, Finance Director

Terri Wright, Head of Investor Relations

Financial Dynamics

Andrew Lorenz — Tel: 020 7269 7291

Nick Hasell

A meeting for investors and analysts will be held today at 9:00 am at RBS, 250 Bishopsgate, London EC2M 4AA. A webcast of the presentation will be available at www.babcock.co.uk from mid afternoon on 17 May 2011.

Introduction

2010/11 has been an important year for Babcock. The acquisition of VT Group plc (VT) has established us as the UK's leading engineering support services company and has enabled us to create a strong platform for future growth. The integration of VT has progressed speedily and smoothly and delivery of the £50 million cost synergies is on schedule.

The excellent financial results for the year reflect the new size and structure of the Group. The underlying strength of our business has delivered underlying organic revenue and underlying operating profit growth of 5% in a period when public sector activity has been relatively low and pressure on budgets has increased. Positive financial momentum has been maintained in a year of substantial change. Our strong focus on cash has enabled us to rapidly reduce net debt to £729 million, with an operating cash conversion rate of 146% the successful refinancing of the £400 million acquisition bridge facility, achieved a net debt to ebitda ratio of 2.4 times.

Our acquisition of VT has enabled us to strengthen our positions in our principal markets. We now have a broader range of skills and capabilities and in the current economic climate, where many of our customers are operating under tight financial constraints, we are better placed to help them achieve the financial and operational efficiencies they require. We believe there are three ways we can continue to grow our business

- **Grow existing contracts**. We have a number of large, long-term contracts and agreements, such as our training and support contract at the Royal School of Military Engineering and our Terms of Business Agreement (ToBA) with the Ministry of Defence, where we can use the existing arrangements to deliver additional services whilst focusing on driving efficiencies.
- **Grow existing customers**. The new and complementary skills VT has brought to the Group have enabled us to build on the strong relationships we have with our existing customers to offer them a broader range of services.
- **Grow new customers**. Babcock seeks to be a leader in all its chosen markets. We believe the Group's enlarged platform provides many opportunities to create new outsourcing opportunities in our current markets, transferring existing capabilities and knowledge to new customers in both the UK and overseas.

During this year the Government's Comprehensive Spending Review (CSR) and UK Strategic Defence and Security Review (SDSR) were completed and published in October 2010 and, despite many commentators' concerns were seen as broadly positive for the Group. As part of the CSR and SDSR process, as well as the Cabinet Office efficiency programme, throughout the year we have been engaged in a broad range of discussions with Government and our major customers within the MoD. These have identified: the level of savings already being achieved through arrangements such as our ToBA; areas where we can assist on delivery of additional savings on existing contracts, by increasing the scope of work being carried out; and how new outsourcing initiatives could deliver significant benefits. Discussions with the Cabinet Office concluded positively with signature of a Memorandum of Understanding (MoU), which will have no net impact of the Group's financial expectations. In collaboration with our customers, we are now seeking to progress some of the initiatives identified.

In the current economic environment and as a result of the strength of the enlarged Group, we believe we are well placed to benefit from new public and private sector outsourcing initiatives as well as the significant long-term growth opportunities that already exist within our markets, both in the UK and overseas.

Dividend

The Board remains committed to ensuring our shareholders share in the ongoing success of our business. Reflecting our confidence in the strength of our business and the opportunities for future growth, we are therefore recommending a final dividend of 14.2 pence per share. This will give a total dividend for the year of 19.4 pence per share an increase of 10% (2010: 17.6 pence per share, comprising two interim dividends of 12.8 pence per share and 4.8 pence per share). The dividend will be paid on 9 August 2011, to shareholders on the register at close of business on 8 July 2011.

Order book

Since the completion of the VT acquisition, the order book has remained stable at around £12 billion (2010: £8 billion). The ongoing strength of our order book reflects the constant flow of rebids and contract extensions as well as new contracts from the bid pipeline. This provides us with excellent visibility. We currently have over 65% of revenue contracted for 2011/12 and over 40% for 2012/13.

In a tough economic environment and in common with peer companies, in the first half we experienced some slowdown in the number of contracts coming out to tender. This trend started to reverse in the second half of the year and since the time of our half year results in November 2010 we have seen our pipeline of bids at PQQ (pre-qualification questionnaire) or ITT (invitation to tender) stage increase from around £5 billion to £8.5 billion (2010: £3.4 billion).

Outlook

We remain confident that, in the current economic climate, our markets continue to provide excellent long-term growth prospects with potential for significant further outsourcing opportunities. In this environment, strengthened by the acquisition of VT, the scale of our operations, the breadth of our expertise and our track record of delivering both operational and financial efficiencies place us in a strong position from which to benefit.

The Board remains confident in the outlook for the Group. We have excellent long-term visibility through our order book and our bid pipeline, which is growing as new outsourcing opportunities are created, and our involvement in long-term programmes delivering critical support for our customers. We look forward to making further good progress this year and thereafter.

Financial Review

Statutory to underlying reconciliation

	Statutory	jv	jv tax	IFRIC 12	Amortisation of acquired intangibles	Change in tax rate	Exceptional	Underlying
2010/11								
Revenue	2,755.8	138.7						2,894.5
Operating profit	157.5	9.3		16.0	83.4		20.7	286.9
Share of profit from jv	6.1	(1.0)	4.1	(13.8)	4.6			0
Investment income	2.2			(2.2)				0
Net finance cost	(50.4)	(8.3)						(58.7)
Profit before tax	115.4	0	4.1	0	88.0	0	20.7	228.2
Tax	(10.7)		(4.1)		(25.4)	(2.7)	(3.9)	(46.8)
Profit after tax	104.7	0	0	0	62.6	(2.7)	16.8	181.4
2009/10								
Revenue	1,895.5	27.9						1,923.4
Operating profit	148.1	0.5			16.1			164.7
Share of profit from jv	(0.5)	0.6	(0.1)					0
Investment income	0							0
Net finance cost	(18.4)	(1.1)						(19.5)
Profit before tax	129.2	0	(0.1)	0	16.1	0	0	145.2
Tax	(20.8)		0.1		(4.5)			(25.2)
Profit after tax	108.4	0	0	0	11.6	0	0	120.0

In this review, unless otherwise stated, revenue, operating profit, operating margin, net finance costs, profit before tax and earnings per share refer to results before amortisation of acquired intangibles and exceptional items. Revenue, operating profit, operating margins and net finance costs also include the Group's share of equity accounted joint ventures (jv). Operating profit and operating margin include investment income arising under IFRIC12 (Accounting for Service Concession Arrangements) which is presented as financial income in the Income Statement. Collectively these adjustments are made to derive the underlying operating results of the business. All numbers are stated before the effect of tax rate changes.

The underlying figures provide a consistent measure of business performance year to year thereby enabling comparison and understanding of Group financial performance.

Income statement

Revenue at £2,894.5 million increased by £971.1 million, a growth rate of 50% compared to 2010, of which £856.0 million arose from the VT acquisition in July 2010. Adjusting for the effect of acquisitions and disposals and for the effect of movements in foreign exchange rates, organic growth was £89.3 million or 5%.

Operating profit was £286.9 million, an increase of £122.2 million or 74% (2010: £164.7 million). Former VT businesses contributed £112.2 million and after adjusting for this and the effects of foreign exchange rate movements, the Group's organic growth in operating profit was £8.4 million or 5%. Cost synergy benefits arising as a result of the combination with VT totalled £11.6 million in the year and we had achieved an annualised run rate of c £15 million by 31 March 2011.

The improvement in operating return on revenue, which increased to 9.9% (2010: 8.6%) was primarily driven by growth in higher margin businesses in Support Services and Defence and Security but also through the delivery of the cost synergy benefits which particularly benefited the Support Services and Defence and Security divisions.

The integration of VT has progressed smoothly and as planned throughout the year. As expected, the costs associated with the acquisition and integration have increased exceptional items to £20.7 million (2010: £nil). The principal drivers were reorganisation costs of £10.8 million, and the costs of the acquisition transaction of £12.8 million, offset by a profit of £2.9 million on the sale of subsidiaries. Further charges will be incurred on the VT integration over the course of 2011/12.

The charge for amortisation of acquired intangibles increased significantly to £88.0 million (2010: £16.1 million) following the capitalisation of acquired intangible assets arising from the acquisition of VT and incorporates the Group's share of amortisation in joint ventures (jv) of £4.6 million (2010: £ nil).

Net finance costs**,** including the Group's share of jv net interest expense of £8.3 million, totalled £58.7 million (2010: £19.5 million). Immediately following completion of the acquisition of VT, net debt increased to c £890 million (31 March 2010: £302.3 million) and included a £400 million acquisition bridge facility designed to provide short-term funding for the acquisition. This debt has now been successfully refinanced through the issue of $650 million of loan notes in the US private placement market. The Group's share of jv interest largely arises in respect of long-term, non-recourse debt provided for Private Finance Initiative (PFI) contracts and, typically for this type of contract structure, is likely to be high in the early years through the construction phase and decreasing through the contract term, which can exceed 20 years.

Profit before tax increased to £228.2 million (2010: £145.2 million). Taxation totalled £46.8 million (2010: £25.2 million) including the Group's share of jv income tax of £5.4 million (2010 £0.1 million credit). The effective rate of income tax, which is calculated by reference to the Group's underlying profit before tax and the associated tax charge (excluding prior year items), was 20.5% (2010: 19%).

Earnings per share for the year was 55.03 pence per share (2010: 51.37 pence per share) an increase of 7%. Excluding the effect of the prior year tax credits in 2009/10, growth was 9%. Basic earnings per share as defined by IAS33 was 31.28 pence per share (2010: 46.29 pence per share).

Group operating profit after amortisation of acquired intangibles and exceptionals was £157.5 million (2010: £148.1 million) with increased underlying profits offset by an increase in amortisation of acquired intangibles of £67.3 million, the increase in amortisation arose from VT acquired intangibles of £465 million. Profit before tax and after amortisation of acquired intangibles and exceptionals was £115.4 million (2010: £129.2 million).

Cash flow and net debt

In a long-term contracting environment the Group's focus on cash is of paramount importance and the level of cash generated is a key indicator of the financial position of its contracts as well as the business as a whole. This year, with the acquisition of VT and the consequent increase in debt on the balance sheet, the benefits of ensuring optimal cash generation have been demonstrated in the rapid reduction of debt.

Cash generated from operations was £308.5 million representing a conversion rate of 146% (2010: £170.3 million and 121%), the highest rate within the last five years for the Group. Tight control of working capital and capital expenditure contributed significantly to this although payments received ahead of turnover were somewhat higher than we would normally experience and have also contributed to the high conversion rate. Consequently, we anticipate that there will be some unwind of the absolute level of these payments over the course of the next financial year which could reduce the overall conversion rate for 2011/12.

Capital expenditure (net) was £33.2 million (2010: £23.7 million) and the principal areas of expenditure were for dockyard infrastructure upgrades in Marine and Technology and the commencement of a major information technology (IT) project to upgrade and integrate the systems of the enlarged group post the acquisition of VT. This is expected to cost in the order of £25 million of which £4 million was spent in 2010/11 with the balance expected to be spent in 2011/12.

Cash interest (net) was £50.0 million (2010: £18.5 million) reflecting the additional interest expense incurred on the debt raised for the acquisition of VT. Cash interest excludes that paid by joint ventures except where payments are made to the Group on loans to joint ventures.

After taxation payments of £19.3 million (2010: £1.7 million), free cash flow was £206.0 million (2010: £126.4 million) an increase of 63% year on year.

Within acquisitions and disposals the most significant cash event during the year was the acquisition of VT for a net cash outflow of £570 million. There were in addition, two minor transactions in the year: the disposal of Acetech, a non-core supplier of agency labour, for £2.2 million net and the acquisition of Evergreen Unmanned Systems, a supplier of technical support to users of unmanned aerial vehicles (UAVs) for £8.9 million (US$14 million).

The Group acquired VT on 8 July 2010 for a total cost of £1.5 billion, financed by the issue of equity shares (129.0 million Babcock ordinary shares) valued at £806 million. (including the costs) of issuance and from cash resources. The cash element of the consideration was sourced from the Group's existing £600 million revolving credit facility and a new £400 million bridge finance facility.

In the early part of 2011, the Group issued US$650 million of seven and ten year loan notes in the US Private Placement market. This comprised US$150 million of seven year notes and US$500 million of ten year notes. The proceeds from these notes were swapped into sterling and used to repay the £400 million acquisition facility taken out by the Group in 2010 as part of the financing of the VT acquisition.

Cash dividends paid in the year totalled £48.0 million (2010: £34.7 million) being the second interim dividend in respect of financial year 2009/10 and the interim dividend in respect of 2010/11, plus minority dividends of £3.5 million (2010: £2.2 million).

The Group's net cash outflow was £426.7 million (2010: inflow £49.2 million) leaving net debt at the year end of £729.0 million (2010: £302.3 million). Leverage ratios, whilst higher than at the end of 2010 as a result of the VT acquisition, remain comfortable and well within covenanted levels. The debt service ratio represented by EBITDA/net interest coverage, as calculated for covenant purposes, was 5.3 times (2010: 9.7 times) against a covenanted level of over 4 times and the net debt to EBITDA ratio was 2.4 times (2010: 1.6 times) compared to a covenant level of less than 3.5 times. Overall, the Group's gearing ratio at 31 March 2011 was 59% (2010: 74%). Whilst these ratios will inevitably 'peak' at the time of significant acquisitions they should demonstrate a clear downward trend post the acquisition as we continue to focus on reducing net debt.

VT acquisition

At the time of the acquisition we identified £50 million per annum of merger benefits plus £8 million of financial synergies (post tax) which would accrue as a result of the combination. The integration of VT is progressing well and we had achieved an annualised run rate of merger benefits of c £15 million as well as the total £8 million of financial synergies by 31 March 2011. This is ahead of our original planning assumptions although we expect to deliver the total £50 million of merger benefits in line with the timescale published at the time of the acquisition.

The costs of delivering the merger benefits were estimated at £45 million at the time of the acquisition. By 31 March 2011 £10.8 million had been incurred and has been included in exceptional charges in the income statement.

During the year we have been undertaking a review of our business portfolio as part of the strategic planning process, which may lead to further changes in the structure of the Group when it is concluded later this year. As part of this process the Waste operations have been identified as non-core and exit options have been considered.

Pensions

The Group provides a number of defined benefit and defined contribution schemes for its employees. The largest defined benefit schemes are the Babcock International Group Pension Scheme, the Devonport Royal Dockyard Pension Scheme and the Rosyth Royal Dockyard Pension Scheme whose combined assets of £1.8 billion represent 70% of the total assets. All the schemes are closed to new members except where defined benefit pension provision is mandated for former public sector employees transferring into the Group in relation to specific contracts.

The valuation dates for the three largest schemes are set so that only one scheme is revalued each year in order to spread the impact of market movements in assets and liabilities. A valuation of the Babcock Group scheme was completed by an independent actuary as at 31 March 2010, based on a market value of the assets and a prudent approach to the setting of the assumptions, as agreed with the company, to assess and value the expected benefit payments from the scheme. The valuation revealed a funding deficit of £44 million to be recovered by additional contributions paid by the employer over eight years.

Defined benefit pension schemes taken on as a result of the VT acquisition had funding deficits at 31 March 2011 totalling £119 million and requiring cash contributions of £29 million in 2011/12.

The total funding deficit on all schemes, including the former VT schemes, as at 31 March 2011 was £298 million. The total cash contributions expected to be paid by the Group into the pension schemes during 2011/12 are £98 million of which £30 million was paid prior to 31 March 2011. £8 million of the contributions are in respect of longevity swaps executed in 2009/10 and £59 million in respect of future service accrual. Recoveries of contributions for future service accrual in Marine and Technology via contractual commercial terms represent c £34 million per annum leaving £34 million to be funded from other Group contracts.

The IAS19 pension valuation for accounting purposes showed a market value of the assets of £2.6 billion in comparison to a valuation of the liabilities using a discount rate based on AA corporate bond rate of £2.8 billion, representing a 93% funding level. The total accounting deficit, pre-deferred tax, at 31 March 2011 was £225 million (2010: £324 million) and the expected IAS19 service cost in 2011/12 is £47 million (2010: £46 million). The net IAS19 charge to profit and loss after allowing for interest on scheme liabilities and expected returns on scheme assets for 2011/12 is £20 million (2010: £29 million).

During 2011/12, the Group expects to complete the merger of three of the schemes operated by the VT Group into the Babcock scheme which will add a further £367 million to the assets of that scheme. The largest three schemes will then account for 85% of the total assets of all the schemes.

Operational review

Introduction

We continue to grow our position as the UK's leading engineering support services company. In an environment where engineering knowledge and skills are scarce, and strengthened by the acquisition of VT, we have a workforce of significant scale and depth of knowledge that is highly regarded by our customers. Across our businesses, in both the UK and overseas, we will seek to build on this position to deliver sustainable and profitable growth for our shareholders.

UK Defence Market

In the current economic environment, the requirement of our major customer to reduce costs whilst maintaining operational efficiency is entirely consistent with our business model in both the Marine and Technology and the Defence and Security divisions. We believe this requirement will lead to opportunities for increased outsourcing of support activities as a key driver to achieve its goals.

All three of the UK's armed forces face a reduction in manpower numbers over the next five years although world events continue to make significant operational demands on them. This dynamic is already leading to considerable structural reform and a requirement within the Ministry of Defence (MoD) to maximise efficiency and optimise support to front line operations. The introduction of the Defence Reform Unit reinforces this change as the MoD seeks to maximise output with reducing resources.

Following the General Election in May 2010, the government announced it would be carrying out a Strategic Defence and Security Review (SDSR). The SDSR was published in October 2010 and sought to balance the current and future needs of the UK's armed forces in response to increasing budgetary pressure.

For Marine and Technology, the SDSR included a number of positive decisions and removed uncertainty around some of the key projects we are involved in.

The commitment to complete the build of the two new Queen Elizabeth (QE) class aircraft carriers was welcomed as was the decision to retain all three naval bases in the UK. These decisions provide certainty of work for our Rosyth facility through to completion of the two new carriers in 2016 and 2018, at the earliest, and a continuation of our role at HMNBs Clyde and Devonport.

The Government committed to retain the current submarine-based nuclear deterrent. This provides a stable base for our submarine support operations and a key role for the division in the Vanguard life-extension project, which has been estimated at a cost of £1.3 billion for three additional long overhaul and refuelling periods.

For the Defence and Security division the cancellation of the Defence Training Rationalisation (DTR) project provides significant opportunities for us to expand our position as the leading military trainer in the UK for all three services. In addition, there is a significant pipeline of opportunities in the equipment support market where we believe we can build on our expertise.

Marine and Technology

		31 March 2011	31 March 2010	Change + / -
Revenue	total	£1,019.5m	£973.8m	4.7%
Operating profit	total	£119.3m	£116.5m	2.4%
Operating margin	total	11.7%	12.0%	

The Marine and Technology division has been largely unaffected by the VT acquisition with only the New Zealand naval base, submarine communication and Astute training contracts additionally included.

Revenue increased by 4.7% benefiting from international submarine support activities in Australia, Canada and Spain as well as from increasing activity in the QE class aircraft carrier programme. Equipment Support continued to benefit from further supply chain contracts for the provision of minor equipment to the UK MoD. Naval communications contracts contributed £29 million in the year. These improvements were offset by the completion of the Jackal all-terrain, high mobility vehicle contract which generated c £55 million in 2009/10 and some change of phasing within the submarine programme.

Operational review

Our Terms of Business Agreement (ToBA) with the MoD provides the framework for the strategic development of our core naval businesses. In return for certainty of our naval support roles through to 2025, we have committed to deliver savings of over £800 million to the MoD while sustaining or improving our overall margins. In the first reporting year we have already delivered savings which are greater than anticipated. Through our naval base management roles at both Devonport and Clyde, now confirmed through to 2025, in partnership with the MoD we will be seeking to drive further efficiencies. The ToBA also provides the opportunity for us to identify additional outsourcing opportunities which can both enhance the service that we already provide and deliver additional cost savings to the MoD. The ToBA is a significant contribution to the MoD's overall cost reduction challenge but it also provides us with certainty and the potential for growth.

In the last 12 months in our role as the Royal Navy's major warship partner, we have undertaken critical deep maintenance on a number of surface warships. The amphibious assault ship HMS Bulwark completed its first major docking period at Devonport and work on HMS Northumberland is underway, whilst at Rosyth maintenance and upgrade work has been carried out on the aircraft carrier HMS Illustrious, the frigate HMS Argyle and the mine warfare vessel HMS Blyth and work is underway on the frigate HMS Kent.

The QE class aircraft carrier project has made significant progress in the last 12 months. The new 1,000 tonne Goliath crane arrived in Rosyth as planned and will play a crucial role in the assembly programme for the two vessels. As well as having responsibility for constructing some of the sections, we continue to play a major design role. At our Appledore facility we are making excellent progress on the sections we are building with a number already delivered to Rosyth. We expect the first major hull section from the other UK build yards to arrive in late 2011. We have also completed the delivery of major weapons handling systems for both carriers in readiness for installation. We expect to benefit from the decision to reconfigure the vessels for non-STOVL aircraft, which will require significant extra packages of engineering work to be undertaken.

We have now completed the first full year of the long-term Submarine Engineering Support Contract, where we have a key role developing a full 'flotilla output' availability-based support arrangement. This will ensure the Royal Navy has the most cost-efficient through-life support.

Work continues on the Long Overhaul Period (Refuelling) (LOP(R)) of HMS Vigilant. With the reactor refuelling process now complete the project is expected to conclude in late 2011. Planning and preparation work is underway for the LOP(R) on HMS Vengeance. We already have a role in the development of the new deterrent submarines but we believe the strength of our expertise in submarine support and our ownership of unique naval nuclear infrastructure will provide opportunities for enhancing our long-term role in this programme.

During the year we have also undertaken a number of in-service maintenance packages on the UK submarine fleet including the first in-service maintenance package for HMS Astute. The SDSR confirmed that seven Astute class submarines will be built and we already have a key role in this programme to design and deliver the weapons handling and discharge systems. To date, we have completed systems deliveries to the fourth Astute Class submarine and have an early order placement for systems for the fifth boat. This keeps our work programme ahead of the overall Astute programme timetable.

In both Canada and Australia we are engaged in markets that remain strong. Both countries are progressing with gradual reform programmes for naval support that will lead to long-term incentivised arrangements of interest to Babcock.

In Canada, progress continues on the major refit of HMCS Chicoutimi and good progress is being made at our facility in Victoria. In Australia, we continue to develop relationships with the Australian Navy and are developing our involvement in their current submarine programme through our weapons handling and discharge systems. In both countries we have pre-qualified to tender for initial packages of long-term support work for surface ships. We expect further progress on these and subsequent contracts during the next financial year.

In other international markets our activities are focussed on specific long-term naval programmes. In Spain, the S-80 submarine programme is key to future naval capability and is unaffected by broader economic pressures. To date, we have delivered major sub-systems for this programme and have successfully completed testing of the Air Turbine Pumps, built at our Submarine Pumps Centre of Excellence in the UK. We have also completed the concept design for weapons launch and handling systems for the South Korean indigenous submarine programme and we have been approved as a local partner for future phases of work.

Our equipment support operations continue to provide engineering support for a number of key assets, as well as procurement and logistics support to all three services. During 2010/11 we were down selected as sole industry bidder for the MoD's Maritime Equipment Transformation programme. This contract is expected to be worth in the order of £300 million over 10 years and is the first part of the MoD's extensive programme to improve overall procurement and supply chain management.

During the year, the MoD has continued to progress the Submarine Dismantling Project and has identified our facilities at Rosyth and Devonport as the two potential sites to carry out dismantling work. We are actively involved in the development of this project and would expect to see further opportunities resulting from the strength of our naval nuclear engineering capabilities.

Divisional outlook

In the UK, as a result of our ToBA and through our positions on a number of key naval programmes, we are well positioned to assist the MoD and Royal Navy as they seek to reduce costs and improve operational efficiency. In addition, there are a number of new opportunities where our skills, know-how and infrastructures will play a significant role. Overseas, we are seeking to build on our existing submarine positions in Canada and Australia to contribute further to their submarine programmes as well as into surface ship support. We believe the strength of our business model will also provide significant opportunities in a number of other international naval markets.

We believe the outlook for the Marine and Technology division is extremely secure in the UK and we are well placed to deliver significant long-term growth overseas.

Defence and Security

		31 March 2011	31 March 2010	Change + / -
Revenue	group	£381.9m	£74.1m	
	jv	£87.3m	£13.8m	
	total	£469.2m	£87.9m	433.8%
Operating profit	group	£54.4m	£9.2m	
	jv	£18.8m	£0.7m	
	total	£73.2m	£9.9m	639.4%
Operating margin	group	14.2%	12.4%	
	jv	21.5%	5.1%	
	total	15.6%	11.3%	

The Defence and Security division comprises predominantly former VT activities as well as Babcock's former defence services businesses and the RSME contract. Underlying growth on former Babcock continuing businesses was £19 million, or 22%, largely arising from significantly higher activity levels in the Royal School of Military Engineering (RSME) contract, partly through scope increases and partly through programme mobilisation.

The two major Private Finance Initiative (PFI) joint ventures (jv) for the Future Strategic Tanker Aircraft (FSTA) and UK Military Flying Training Systems (UKMFTS) saw the completion of the Main Operating Base (MOB) phases of both sub-contracts with associated revenue of £26 million. As both contracts move into the service delivery phase in 2011/12, the Group's share of revenues from the jvs, which totalled £37 million in 2010/11, is expected to increase while sub-contract revenues and margins decline. RAF multi-activity contract revenues remained broadly stable.

In addition to the extra activity at RSME, the division benefited from good performance on the Royal Navy Flagship Training contract and the MoD 'green fleet' and 'white fleet' management contracts, where additional volume supported revenue. In general, contract performance was excellent and this is reflected in the division's margin performance.

Operational review

Activities on our two key joint ventures, UKMFTS and FSTA have continued to make good progress and are performing in line with our expectations.

The UKMFTS effort has been in support of Advanced Jet Training and Rear Crew Training. Following the practical completion of the construction phase in August 2010, the Advanced Jet Training (AJT) programme based at RAF Valley, Anglesey, has successfully achieved its 'Ready for Training Use' milestone sign off thus allowing occupation of the facility and the start of operations in support of fast jet pilot training. Our responsibility has now moved to focus on the delivery of through-life maintenance for the remaining 22 years of the PFI contract. Similar success has been achieved with the Rear Crew Training element of the UKMFTS programme. The project involved the refurbishment of facilities at two sites: RAF Barkston Heath in Lincolnshire and RNAS Culdrose, Cornwall. The facilities were certified as 'Ready for Training Use' in March 2011 and were occupied from April 2011 when long-term support for the facility began.

The construction phase for the MOB in support of the FSTA programme was completed at the end of March 2011 and AirTanker Services and the RAF teams occupied the facility in May 2011. A key component in the delivery of the service is the Communications Information System (CIS) at the heart of the operation. Development, delivery and integration of the CIS to support occupancy of the MOB was completed in May 2011 and the programme has continued to meet the delivery milestones.

The airfield and operational support contracts continue to perform well. Under the Hawk IOS and AJT contracts we supported 88 aircraft to deliver over 17,000 flying hours. At RAF Linton-on-Ouse we supported 52 Tucano aircraft to deliver over 10,000 flying hours and our own fleet of 119 Grob 115e Tutor aircraft delivered over 39,000 flying hours to the Light Aircraft Flying Task contract.

New business activity has focused on the next generation of contracts to deliver fixed wing flying training capability to UKMFTS. We have formed a consortium with BAE Systems, Pilatus and GAMA to bid this programme. As our RAF customer looks to find efficiencies arising from the impact of SDSR we anticipate further opportunities to support aircraft and equipment capitalising upon our existing position within the military flying training system.

Our training and support operations continue to deliver high levels of service across all contracts and this year the MoD's Supplier Relations Team (SRT) have evaluated contract performance as 'excelling'.

Our contract for the provision of construction vehicles to the Royal Engineers now delivers over 2,000 vehicles on demand across the world in support of training and operational activities. During the year we won a service extension to provide maintenance and repair of those vehicles on operations through a permanent maintenance unit based in Camp Bastion, Afghanistan.

We also manage some 15,000 white fleet vehicles and a further 600 armoured and patrol vehicles on behalf of the MoD. This experience leaves us well placed as the MoD reviews outsourcing options to deliver efficient support across its entire fleet of vehicles numbering around 80,000 assets.

At RSME we have concluded the second year of operation with a number of significant milestones being achieved. Three new buildings have been delivered and we have also begun transformation of student training using modern learning techniques and are working closely with the customer to implement these improved processes. Initial pilots have demonstrated that we can deliver additional value to our customer by leading their training transformation.

We have recently been awarded a contract extension to provide army training services at Bordon and Arborfield, through to 31 March 2012 at a value of c £19 million, and have also been selected as Preferred Bidder for the Training Establishment Support Contract for Bordon and Arborfield, which is worth c £22 million over four years starting on 1 August 2011 and will provide support to training at both sites. At Bovington we have continued successfully to deliver training for tracked vehicle drivers and maintainers alongside fleet availability management of over 300 of the armoured and patrol vehicles.

Operational review continued

Further outsourcing of individual training offers the MoD a proven route to achieving improved service delivered at reduced cost and we therefore expect the MoD to bring a number of competitions to market. Our extensive footprint in this area, combined with our understanding of our customer's ethos, positions us well for future MoD training opportunities.

Our Flagship training and facilities management contract with the Royal Navy continues to perform extremely well, customer relations remain strong and we continue to achieve high standards, with an 'excelling' SRT score this year. Similarly, our International Training contracts continue to perform in line with the expectations of our customers. Significant investment has supported the development of thought leadership programmes with the Royal Navy to ensure a modern training environment is maintained. This has also been supported by the installation of Learning Content Management Systems, Coaching Programmes, and Capability Management Systems across all contracts.

Building upon our extensive knowledge and success of delivering crew training to international navies, we have secured a multi-million pound training contract from STX OSV Brattvaag who are contracted to build three special purpose vessels for an international client. The package will provide training for the crews and base maintainers of each vessel. The training being delivered by Flagship includes English language, salvage, rescue, towing, fire fighting and pollution prevention.

We are pleased to announce that Flagship has been selected as Preferred Bidder by the Royal Navy for the Fleet Outsourced Activities Project (FOAP). The contract is for an initial period of six years and requires the provision of a variety of activities including training delivery, design and support. The contract has an initial value of c £90 million.

Discussions with our customer on alternative solutions for the Defence Training Rationalisation (DTR) project are progressing well, and we expect to see further interim extensions to our training and FM contracts awarded whilst a sustainable and long-term solution is formulated.

The SDSR and CSR are forcing the Royal Navy to make tough spending decisions and we are focussed on offering solutions and potential training scenarios, which will leave us well placed to secure future outsourcing business.

Divisional outlook

The MoD has already started major outsourcing initiatives that align with Babcock's core capabilities and we believe we are well placed to benefit from these. Following SDSR and the cancellation of DTR, the MoD is finalising its approach to training and support solutions for both its vehicle fleets and aircraft, areas where we have a demonstrable track record of delivering efficiencies.

In addition, these programmes will encompass estate rationalisation as the MoD seeks to reduce the number of sites on which it operates. This will provide further opportunities for us to leverage our current infrastructure projects.

Support Services market

The current economic climate continues to constrain public and private sector budgets. The Comprehensive Spending Review (CSR) was broadly positive for the Support Services division and has highlighted a number of areas where spending will be protected and prioritised, focussing on achieving greater efficiencies or improvements in service. As a result we believe our capabilities will be in increasing demand as our customers seek greater support. We remain confident that there is substantial scope for the division to grow within its chosen markets.

Support Services

		31 March 2011	31 March 2010	Change + / -
Revenue	group	£895.2m	£673.4m	
	jv	£51.4m	£14.1m	
	total	£946.6m	£687.5m	37.7%
Operating profit	group	£75.3m	£35.9m	
	jv	£4.3m	£(0.1)m	
	total	£79.6m	£35.8m	122.3%
Operating margin	group	8.4%	5.3%	
	jv	8.4%	-0.7%	
	total	8.4%	5.2%	

The Support Services division represents the most significant combination of former Babcock and VT businesses. The division provides technical expertise to support and manage a range of critical assets and infrastructures. It is responsible for managing the Group's regional Prime contracts for the Defence Infrastructure Organisation, has operations in the rail, nuclear and high voltage power transmission and emergency services fleet and mobile asset markets as well as providing training to a wide range of customers.

Across our business we have a keen focus on delivering value for our customers, supporting them to deliver more against a constrained funding background, and focusing on activities with technical demands and a clear need for client partnering to succeed. We can achieve this in three ways: through continued enhancement of existing contracts, by extending our customer relationships offering a broader range of services and by seeking to create new opportunities in five key growth markets.

Energy

After some years of financial constraint, the UK nuclear decommissioning market is now starting to ease with a good pipeline of opportunities becoming visible. The Nuclear Decommissioning Authority (NDA) achieved a positive outcome from the Government's recent Spending Review and secured an average of £3 billion funding for the next 4 years. This work involves the dismantling of redundant nuclear reactors and the clean-up of radioactive waste at sites across the UK, is an essential stage ahead of the new nuclear build programme. Through the acquisitions of both UKAEA Ltd and VT our skills have been enhanced and we now execute some of the most challenging decommissioning projects in the UK. We estimate our current project work along with our site management work totals around 9% of the addressable market in the UK.

Babcock is one of two leading service providers in the UK power transmission sector. In a market where specialist skills and knowledge are rare and in high demand, we have a team of highly skilled engineers and technicians able to deliver the design, construction and refurbishment of high voltage overhead power lines and related infrastructure.

The UK's electricity networks are undergoing a substantial period of investment to meet challenging climate change targets and address a potential significant increase in energy demand. Current projections indicate investment of up to £3.2 billion will be required to upgrade and renew the current ageing infrastructure and provide connections for renewable generation and smarter grids to ensure that the demand for electricity can be met.

National Grid, is leading this investment programme and during 2010/11 completed a rights issue, raising £3.2 billion to fund its UK capital programme which will total £22 billion over five years. As a key partner in the National Grid's Energy Alliance West, this increased investment will create good opportunities for the division.

Mobile Assets
Babcock works with customers in both the public and private sector to provide comprehensive support for the management and operation of large, complex mobile asset fleets, vital to their core operations. As our customers face increasing pressure to lower costs and minimise disruption to essential activities, we have established a track record of improving the availability of assets whilst reducing total through-life costs. Our independence and desire to actively support and integrate with our customers' primary business activities enables us to differentiate from traditional competitors such as leasing companies and equipment manufacturers.

Education
Large scale changes are taking place across the education landscape, creating opportunities for our education business. Service providers have to respond to cuts in local authority funding and increased devolvement of powers to individual schools. We have developed a good track record, developing an innovative way of working with schools and local authorities to deliver outstanding educational results at significantly reduced costs. The appetite for outsourcing is increasingly strong and the pipeline for schools improvement services is growing.

Training
The UK apprenticeship training market remains strong. As part of Budget 2011, the Chancellor of the Exchequer announced a £180 million package for 50,000 extra apprenticeship places: this equates to the delivery of at least 250,000 more apprenticeships over the next four years. This is in addition to the existing c 270,000 apprentices on programme per annum.

Babcock delivers around 10% of all UK apprenticeships and is the largest provider of training in the UK. In 2010 we accessed over £42 million of government funding on behalf of clients and learners, making us the second largest direct contract holder with the Skills Funding Agency. Our core areas of operation are the engineering and service sectors. Training suppliers in both sectors remain fragmented which combined with Central Government focus on improving the skill base within the UK economy highlights this sector for continued growth.

To complement our apprenticeship training delivery, we have developed a broader training capability and are now trusted by a number of major customers to provide not just basic job skills but training for key business capabilities. Focussing on the Aerospace & Defence, Automotive, Energy, Nuclear and Rail sectors, we aim to capitalise on synergies with Babcock's core operating sectors.

Central and local government property
Babcock has significant experience in strategic asset management, estates and property management, hard and soft facilities management and supply chain management, working extensively with government agencies, local authorities and the education sector. Our public sector customers have severely constrained budgets so to drive efficiency and raise standards they are increasingly looking to outsource services.

A number of significant strategic government property opportunities are coming to the market which include the consolidation of contracting arrangements within central and local government as well as further outsourcing of services. With an established position in MoD estate management, we are seeking to increase our market share in this sector.

Operational review
The integration of VT businesses and subsequent restructuring has progressed rapidly and smoothly, and as a result the distinction between revenue from pre-acquisition activities has become less precise. However, of total Support Services revenue, including the Group's share

of joint ventures, of £946.6 million for the year, approximately £269 million was from former VT businesses, leaving approximately £(9) million or (1)% representing a year-on-year reduction in the old Babcock businesses. Operating return on revenue at 8.4% continued to improve during the second half of the year as merger benefits were captured and good contract performance was recognised.

After a slow start to the year in Nuclear, there were clear signs of an increase in activity during the second half of the year with a number of contract awards at Sellafield and AWE contributing. Infrastructure saw lower overall volume in the Regional Prime contracts as the customer cut back on its programme of extra-to-contract works, however, facilities management activity at RSME and also on the Building Schools for the Future contracts increased. Revenue declined slightly in Critical Assets from programme slippage in non-National Grid power transmission operations but activity levels remained high on both the emergency services fleet management and communications contracts. Rail revenue declined year on year as the High Output track renewals contract ended in 2009/10. Profits for the division benefited from ongoing improvement in profitability in Rail, amidst signs of an overall improvement in the commercial environment. Profitability in the nuclear operations has also remained strong.

There is a broad political consensus in support of the Government's response to the devastating effects of the recent earthquake and tsunami in Japan. The UK nuclear industry also believes the Government's response steers the right course by not rushing to judgement while ensuring that the lessons learned through an independent and comprehensive report of the facts, which is being drawn up by the Chief Nuclear Inspector over the next six months, are fully applied in a proper way. The utility companies involved in the UK nuclear new build programme expect this to be achievable and continue to develop their plans. Over the past 12 months Babcock has built strong relationships with members of EdF's existing supply chain and together we have positioned ourselves to support EdF Energy's planned new builds at Hinkley Point C and Sizewell C.

In the nuclear decommissioning market, our ability to demonstrate one of the widest and deepest nuclear capabilities in the market is beginning to show with the recent award of the B41 contract at Sellafield with Bechtel, expected to be in the order of £120 million for all three phases through to March 2017, supporting the earlier BEPPS win, £140 million for Phases 1 and 2 also through to 2017. The nuclear business is heavily committed to securing the Dounreay PBO contract to deliver the decommissioning of a site that we have been involved with since its original commissioning.

The Regional Prime contracts have continued to perform in line with our expectations with additional works only starting to come through in the second half of the year. Both the South West and East Prime Contracts have now been formally extended through to 2014 as the Defence Infrastructure Organisation develops the replacement Next Generation Estates contracts. Building on our position as the leading facilities management partner for the MoD, in February 2011, we were awarded the £170 million, 5 year contract to provide services to the British Forces' establishments in Germany.

The Education and Training business has continued to perform well. Our apprentice training operations have made good progress growing their footprint in the automotive sector with key contract wins with Hyundai, Fiat, Alfa Romeo and Ferrari Europe.

Our Alliance with Amec and Mott MacDonald delivering overhead line engineering services to National Grid performed strongly in the year and we are working closely with National Grid as it positions itself for major capital investment programme through the coming regulatory control period. Our Power business achieved zero major accidents through the year with over 3.3 million man hours worked

As previously reported, we have decided to exit our Waste operations and have signed a teaming agreement with Shanks to progress the Wakefield contract to financial close. Once this has been achieved, the agreement provides a mechanism for Shanks to acquire the business. We expect this will be achieved later in this year.

In addition to new contracts mentioned above, we have secured significant elements of our existing contract base with an extension to our UK Power Networks contract and successful rebids for the BAA baggage handling contract (£120 million over 6 years) and Radiometrics and Calibration services at Sellafield (£86 million over 12 years). Further, we are now in sole source negotiations with the BBC for the rebid of the World Service contract effective from 2012. Throughout this year we have not lost any rebids.

Divisional outlook

We remain confident that our markets provide significant long-term growth opportunities. The current economic climate is driving our customers to seek greater value and innovation and our broad technical capability and customer focus places us in a strong position from which to benefit.

Operational review continued

International

		31 March 2011	31 March 2010	Change + / -
Revenue	total	£459.2m	£174.2m	163.6%
Operating profit	total	£27.4m	£10.8m	153.7%
Operating margin	total	6.0%	6.2 %	

Operational review

With the addition of the former VT US business revenues of £196 million, total International divisional revenues increased by 164%. The South African equipment business saw a significant rebound in sales of Volvo equipment to the mining sector which drove a 51% increase in revenue year on year. Power station outage support work and high voltage line installation for Eskom were also more buoyant in the second half of the year helping to push total revenue from South Africa to £251 million (2010: £166 million), a 51% increase.

The US business had good success in its rebids on two major contracts but competitive pressure on margins for US Department of Defence (DoD) business remains. The oil and gas pipeline design and construction market was active, driving a 50% increase in revenues from Eagleton to £12 million (2010: £8 million).

Foreign currency translation gains on like for like revenues were £26 million (2010: £29 million).

South Africa

In South Africa, the aftermath of the global economic crisis of 2008/09 continued to be felt throughout most of 2010, however for our business this was offset by world demand for commodities. Ongoing commitment to excellence through service to customers has ensured that the division maintained its prominent position in markets served and as a result, during the year we were awarded 'Silver' partnership status with Volvo Construction Equipment, one of only three international dealers to achieve this. In 2010 we also added the DAF truck franchise to our operations and launched the heavy vehicle range.

We have continued to experience a good level of enquiries into 2011 which is encouraging for the year ahead. Many new mining projects are coming on stream and existing mining operations are being expanded. This helped our Equipment business in the latter part of 2010 and should continue to provide opportunities. The relatively high cost of finance and the very conservative approach by banks to lending has hampered local demand. Parts and service revenue has grown during the year as customers chose to run their fleets for longer than normal, but it is likely that, in a number of these instances, customers will need to start replacing older machines, driving further increase in demand.

Southern Africa's critical shortage of power creates large opportunities for power station support services in an effort to provide continuous supply through planned outage maintenance and breakdown services. This is likely to continue unabated for the next 15 to 20 years. The demand for power has driven the need for expansion of the transmission line networks and, in spite of stiff competition from foreign importers, we have won significant powerline orders.

Throughout the downturn we have taken the opportunity to review and reshape our business, to strengthen our skills base and generally to prepare ourselves to take full advantage of the recovery.

The business will be entering 2011/12 with a strongly improved order book. Low interest rates and the current global demand for commodities are likely to stimulate investment in new mining projects. The need for infrastructure investment in southern Africa remains a priority for economic growth in the region and we remain confident that such projects will come to fruition. The outlook for the year ahead is encouraging.

USA

In the US, the defence business has continued to perform in line with our expectations, despite the competitive trading environment. The DoD is reviewing its spending requirements and, as publicly stated, there is a definite desire and trend to do more with less. We have responded to these conditions by developing more innovative contracting techniques and integrating solutions using key partners and suppliers.

There has been further impact from the DoD's move to use small local businesses rather than large corporates to deliver contracts and, unlike the UK, its move to insource. While insourcing has abated, the small business preference has increased. We expect this will drive a further shift toward value added services and our customer will be looking for ways of mitigating risk.

In January 2011 we were selected as one of four contractors for installation of Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems for the US Navy. The contract includes a three year base period with an additional two year option. The base contract we could expect to share in has a maximum value of $840 million and, if the option is exercised, the maximum contract value could be $1.3 billion.

In July 2010, we were awarded a task order by the Naval Sea Systems Command (NAVSEA) to provide support for the Program Management Office for Naval Special Warfare (PMS NSW). This Indefinite Delivery Indefinite Quantity (IDIQ) contract has a potential value of around $50 million over five years. We have been providing professional engineering services and strategic planning support to NSW and other government agencies.

The Evergreen Unmanned Systems business acquired in the first half of the year has integrated into the US operations successfully, and has enabled us to offer a broader range of services to a range of government and commercial customers.

Middle East
Despite the political unrest in many areas of the Middle East, we remain confident about the security of our current operations in Oman and Kuwait and believe our target markets continue to offer significant opportunities.

Over the past year, through our management team in Abu Dhabi, we have been involved in active dialogue with a number of government departments and private organisations to introduce Babcock and the range and scale of the activities we are involved in as well as the strength of our track record. Building on current contracts in the region and our significant expertise in the UK, we are looking at the following key areas of opportunity: military training, particularly flying training to complement our aircraft support roles; facilities management, both in the civil and defence markets, building on our extensive experience as a Prime Contractor to the Defence Infrastructure Organisation; Education and training, again in both civil and defence markets.

Peter Rogers
Group Chief Executive

Bill Tame
Group Finance Director
16 May 2011

Principal risks

The specific risks and uncertainties mentioned below are those we believe to be of most direct relevance and significance to Babcock today: its key business risks. We do not include in this section those risks which are likely to affect businesses generally or that are in the nature of our day-to-day operations. Instead, we focus on those that potentially can materially and adversely impact our growth and strategic development.

Under each key risk we give a general description of our approach to managing them.

1. Reliance on large contracts with a relatively limited number of major clients

Our chosen business model is that we work principally for large, complex customers, typically government departments, public sector bodies or commercially owned entities in sectors typified by regulation. Many of our important customers rely, to a greater or lesser extent, on public funding. The contracts we enter into are typically intended to last for five to seven years and many for much longer than that. We understand these clients and this business model very well and our success in this is, we believe, amply demonstrated by our strong track record to date. There are many benefits to such a business: strong cash flow; lower customer credit risk, good visibility of order book and pipeline development, relative lack of volatility, scope for innovative pricing and contracting models that allow for revenue and margin growth over the lifetime of the contracts.

Inevitably, though, reliance on a relatively limited number of large customers and contracts carries risks:

- government policy changes and public spending constraints are potentially material risks for the Company if they lead to delays in placing work, pressure on pricing and margins, withdrawal of projects, early termination of contracts, lower contract spend than anticipated or adoption of less favourable contracting models, but they can also be sources of material opportunity ;
- a loss of reputation, either generally or with a specific major customer, could lead to a significant loss of existing or future business;
- key reputational dependencies include health and safety record (a subject of great importance in and of itself to Babcock as many of our businesses require employees and contractors to work in inherently dangerous or high-risk environments); business ethics, and our record of contract delivery and performance
- our bid success rate is critical to our success and growth; bids for large and complex contracts are expensive to compete and, by their nature, large, longer terms contracts are irregularly and less frequently available;

Being unsuccessful in a new bid, therefore, can represent a significant missed opportunity for growth, and losing re-bids could mean the loss of a significant existing revenue and profit stream. In addition, an unsuccessful bid or re-bid can involve the writing-off of significant wasted bid costs.

What we do

At the strategic level, we make it a top priority to maintain an ongoing general dialogue with our key customers, making sure that we stay close to them to gain a full and appreciative understanding of their thinking, the plans they may have, the direct and indirect influences on them and the pressures and constraints under which they must operate. In this way we aim not only to be able to look ahead to see what risks there might be for us and how that might affect our strategy, but we also seek to ensure that both we and they understand what we can do to help them meet their changing needs and challenges and how we can, if necessary, adapt or innovate to meet them. We strive to be proactive in this regard. The Company's Chief Executive and our Divisional Chief Executives, along with other members of our senior management team, are personally and closely involved in ensuring the strength of customer relationships.

At the operational level, we aim, where we can, to structure our contracts with a view to fostering long-term co-operative working relationships with our customers, that share fairly with them the financial success or failure of contracts so that they can measure the benefits of their working with us and our commitment to them.

For matters that affect our reputation, such as contract delivery, health, safety and environmental performance and our ethical conduct, we have specific internal controls and risk management mechanisms, that seek to reduce the likelihood of these risks materialising and/or their impact if they do. We are fully aware of the potential implications of the new Bribery Act in the UK and are updating and refining our policies in the light of its associated guidance.

As regards bid success rate, all bids are subject to governance requirements, according to size, at Group or Divisional management level with continuous monitoring and review by senior Group and/or Divisional executives to ensure resources are appropriately focused on worthwhile bids that we stand a realistic chance of succeeding in, the chances of success are maximised and the financial returns will be acceptable. The final submission of any significant bid or re-bid requires formal approval from Group centre.

2. Some of our operations carry significant health and safety or environmental risks

The safety and wellbeing of our employees and minimising the risk of our activities to third parties and the environment are core Babcock values and objectives. It is, however, in the nature of some of our operations that, if not properly managed and conducted, they could cause significant harm to employees, third parties or the environment. Apart from the adverse impact this could have on our reputation and the willingness of customers to deal with us (see Risk 1 above) this could lead to significant financial loss and claims for damages.

What we do

We manage and mitigate these risks through specific governance and management arrangements involving Group Senior management as well as operational staff that underpin the great importance we attach to them in all our operations. In addition, we carry, to the extent it is available in the market on reasonable commercial terms, insurance cover (subject to compensation limits and deductibles) relating to such risks, but no insurance can be certain of recovery. We benefit from statutory or customer indemnities in some of our operations (for example our nuclear engineering businesses).

3. We require skilled employees, who can sometimes be in short supply

A number of our businesses (for example, our nuclear, technology and engineering businesses and those with high project management content) are complex and demand skilled personnel to deliver them. The continuing success of these businesses relies on our ability to recruit, train and retain qualified and experienced professionals, technicians, engineers and project management staff. In recent years industry demand for employees with these skills has been high and the numbers of suitable candidates limited. This can lead not only to increasing costs but also potential problems with resourcing contracts and bids, which could in turn threaten growth and reputation.

What we do

We aim to make our businesses attractive places to work and offer competitive remuneration packages with long-term employee retention in mind. We place a great deal of emphasis on and devote significant resources to apprentice and graduate recruitment, training and development, succession planning and on talent management generally.

4. We rely on complex information technology arrangements

Like any modern business, Babcock's performance depends to a significant extent on having reliable IT systems. Many of our contracts require us to operate our contract-supporting IT either entirely within secure customer networks or to be able to interface reliably and securely with such systems. Cyber-security presents an increasing risk to us and to our customers. The challenge for Babcock is to ensure that we integrate and run our IT systems in a way that both meets demanding customer requirements and enables Babcock as a group to operate as securely and efficiently as possible. This is against a background of several major acquisitions over recent years of businesses each with its own specific IT needs and systems. To this end, and following a complete review of our IT needs after the acquisition of VT Group in 2010, a major IT transformation programme is underway to update, integrate and rationalise our IT systems, which will roll out over the coming months. Any such programme carries an element of operational and implementation risk.

What we do
We have a Group Chief Information Officer responsible for the integrity and development of the Group's IT systems and resources. Businesses have detailed disaster recovery plans in place. The IT transformation project now underway represents a major investment by the Company and aims to establish a rationalised, updated and standardised system across the Group, with independent systems as may be required under customer contracts, with a view to enhancing the reliability, security and efficiency of the those systems and how they are supported. It involves the establishment of a new group data centre and centralised IT service overseeing and implementing IT strategy, procurement, support and management, with locally distributed services as appropriate. The project has been devised in association with external expert support and is being monitored and implemented under formal governance procedures designed to foresee and minimise implementation risk so far as possible.

5. The Group has significant defined benefit pension schemes

Defined benefit schemes deliver a specified level of pension benefit to members, the cost of which is met from member and employer contributions paid into pension scheme funds and the investment returns made in those funds over time. The level of contributions required to meet pension obligations is actuarially determined based on various assumptions, which are subject to change, as to life expectancy of members, investment returns, inflation etc. If, based on the assumptions being used at any time, assets in the pension scheme are judged to be insufficient to meet the calculated cost of the pension obligations there can be a significant shortfall, which the scheme trustees may require to be made up or secured by increased contributions from employers and/or employees, additional cash payments from employers and/or guarantees or other security to be provided by employers. This may reduce the cash available to meet the Group's other obligations or business needs. The most significant differences between assets and liabilities of the schemes can occur due to differences between the actual and assumed investment returns and changes in the assumptions as to for life expectancy.

Also, the Group must comply with IAS 19 when accounting for its defined benefit schemes. IAS 19 requires corporate bond related discount rates to be used to value the pension liabilities. This is likely to lead to valuation variations from year-to-year due to a mismatch with the investments held in the pension schemes and because of variations in the yields available on corporate bonds and inflationary expectations. This in turn can materially affect the pensions charge in the [income statement] in the Group's accounts from year-to-year as well as the value of the difference between the assets and the liabilities shown on the Group's balance sheet, leading to significant accounting volatility.

What we do
We aim to have constructive and open relationships with the schemes' trustees and to work with them to follow appropriate investment policies for the profile of their members as well as seeking other means of eliminating or mitigating risk. For example:

- "longevity swaps" are in place for our three largest schemes to reduce our exposure to the impact of increasing life expectancy;
- a consistent long-term investment strategy has been agreed with the trustees of the schemes, intended to mitigate investment risk.
- a pan-scheme investment sub-committee is tasked with implementing the agreed Investment strategy efficiently.
- the strategy provides the necessary framework to hedge the schemes' exposure to changes in inflation and interest rates with a view to stabilising the impact on the Group's cash requirements and accounting entries.
- a governance committee operating across the schemes aims to ensure the trustees follow a strong governance regime in running the schemes.
- the Group maintains suitable ongoing funding rates based on prudent assumptions agreed with the trustees of the schemes.
- a Group Pensions Manager, who reports to the Group Finance Director, keeps strategic pension matters under close review and reports regularly to the Board.

6. Risks arising from acquisitions

The Group has made a series of significant acquisitions over recent years, the most recent being the acquisition of VT Group plc. There is a risk that expected benefits from acquisitions might not be fully realised. There is also a risk of acquiring unknown or understated liabilities.

What we do
Before we make acquisitions we carry out a detailed valuation exercise using various valuation criteria and scenarios to assess potential returns, sensitivities and price. We also carry out as thorough a due diligence exercise as we can based on information available and in the context of the transaction concerned. Where possible, we seek to obtain commercially acceptable warranties and indemnities from vendors, though such protections may be restricted in time and/or amount and in some cases, such as public takeovers, are essentially not available.

Income statement

For the year ended 31 March 2011

	Note	£m	2011 Total £m	£m	2010 Total £m
Total revenue	2		2,894.5		1,923.4
Less: joint venture revenue			138.7		27.9
Group revenue			2,755.8		1,895.5
Group					
Operating profit before amortisation of acquired intangibles and exceptional items		261.6		164.2	
Amortisation of acquired intangibles		(83.4)		(16.1)	
Exceptional items		(20.7)		–	
Group operating profit	2, 3		157.5		148.1
Joint ventures					
Share of operating profit	2	9.3		0.5	
Investment income		13.8		–	
Amortisation of acquired intangibles	3	(4.6)		–	
Finance costs		(8.3)		(1.1)	
Income tax expense		(4.1)		0.1	
Share of results of joint ventures			6.1		(0.5)
Group and joint ventures					
Operating profit before amortisation of acquired intangibles and exceptional items		270.9		164.7	
Investment income		16.0		–	
Underlying operating profit*		286.9		164.7	
Amortisation of acquired intangibles		(88.0)		(16.1)	
Exceptional items		(20.7)		–	
Group investment income		(2.2)		–	
Joint venture finance costs		(8.3)		(1.1)	
Joint venture income tax expense		(4.1)		0.1	
Group operating profit plus share of joint ventures			163.6		147.6
Finance costs					
Investment income		2.2		–	
Finance costs		(59.0)		(21.8)	
Finance income		8.6		3.4	
			(48.2)		(18.4)
Profit before tax			115.4		129.2
Income tax expense	4		(10.7)		(20.8)
Profit for the period			104.7		108.4
Attributable to:					
Owners of the parent			101.1		106.0
Non controlling interest			3.6		2.4
			104.7		108.4
Earnings per share	5				
– Basic			31.28p		46.29p
– Diluted			31.17p		46.10p

*Including IFRIC 12 investment income but before exceptional items and amortisation of acquired intangibles

Statement of comprehensive income

For the year ended 31 March 2011

	2011 £m	2010 £m
Profit for the period	104.7	108.4
Other comprehensive income		
Currency translation differences	(7.7)	10.7
Fair value adjustment of interest rate and foreign exchange hedges	7.3	–
Tax on fair value adjustment of interest rate and foreign exchange hedges	(1.5)	–
Fair value adjustment of joint venture derivatives	8.8	–
Tax on fair value adjustment of joint venture derivatives	(2.4)	–
Net actuarial gains/(loss) in respect of pensions	103.5	(403.5)
Tax on net actuarial (gains)/loss in respect of pensions and hedges	(34.0)	113.0
Other comprehensive income, net of tax	74.0	(279.8)
Total comprehensive income/(loss)	178.7	(171.4)
Total comprehensive income attributable to:		
Owners of the parent	175.0	(174.4)
Non controlling interest	3.7	3.0
	178.7	(171.4)

Statement of changes in equity

For the year ended 31 March 2011

	Share capital £m	Share premium £m	Capital redemption £m	Retained earnings £m	Hedging reserve £m	Translation reserve £m	Shareholder equity £m	Non controlling interests £m	Total equity £m
At 1 April 2009	137.7	148.2	30.6	(16.0)	(10.7)	(1.4)	288.4	4.4	292.8
Total comprehensive income	–	–	–	(184.6)	–	10.2	(174.4)	3.0	(171.4)
Shares issued in the period	0.1	0.1	–	–	–	–	0.2	–	0.2
Dividends	–	–	–	(34.7)	–	–	(34.7)	(2.2)	(36.9)
Share-based payments	–	–	–	2.7	–	–	2.7	–	2.7
Tax on share-based payments	–	–	–	0.5	–	–	0.5	–	0.5
Own shares and other	–	–	–	(2.1)	–	–	(2.1)	–	(2.1)
Net movement in equity	0.1	0.1	–	(218.2)	–	10.2	(207.8)	0.8	(207.0)
At 31 March 2010	137.8	148.3	30.6	(234.2)	(10.7)	8.8	80.6	5.2	85.8
At 1 April 2010	137.8	148.3	30.6	(234.2)	(10.7)	8.8	80.6	5.2	85.8
Total comprehensive income	–	–	–	170.6	12.2	(7.8)	175.0	3.7	178.7
Shares issued in the period	77.5	724.5	–	–	–	–	802.0	–	802.0
Dividends	–	–	–	(48.0)	–	–	(48.0)	(3.5)	(51.5)
Share-based payments	–	–	–	5.8	–	–	5.8	–	5.8
Tax on share-based payments	–	–	–	0.5	–	–	0.5	–	0.5
Minority interest acquired	–	–	–	–	–	–	–	3.5	3.5
Own shares and other	–	–	–	(2.2)	–	–	(2.2)	–	(2.2)
Acquisition costs	–	–	–	(2.0)	-	-	(2.0)	–	(2.0)
Net movement in equity	77.5	724.5	–	124.7	12.2	(7.8)	931.1	3.7	934.8
At 31 March 2011	215.3	872.8	30.6	(109.5)	1.5	1.0	1,011.7	8.9	1,020.6

Balance sheet

As at 31March 2011

	Note	2011 £m	2010 £m
Assets			
Non-current assets			
Goodwill		1,614.8	548.3
Other intangible assets		473.4	80.2
Property, plant and equipment		205.8	149.3
Investments in joint ventures	7	64.9	1.0
Loans to joint ventures	7	22.1	13.3
Retirement benefits		12.2	–
Other financial assets – IFRIC 12		38.2	–
Trade and other receivables		1.9	0.4
Deferred tax asset		3.3	84.9
		2,436.6	877.4
Current assets			
Inventories		96.6	84.2
Trade and other receivables		540.3	330.9
Income tax recoverable		2.7	1.9
Other financial assets		1.8	1.1
Cash and cash equivalents		104.3	189.6
		745.7	607.7
Total assets		3,182.3	1,485.1
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital		215.3	137.8
Share premium		872.8	148.3
Capital redemption and other reserves		33.1	28.7
Retained earnings		(109.5)	(234.2)
		1,011.7	80.6
Non controlling interest		8.9	5.2
Total equity		1,020.6	85.8
Non-current liabilities			
Bank and other borrowings		799.0	329.1
Trade and other payables		13.6	12.3
Deferred tax		23.2	–
Income tax payable		–	0.2
Retirement liabilities	11	237.3	324.0
Provisions for other liabilities		124.4	37.1
		1,197.5	702.7
Current liabilities			
Bank and other borrowings		35.3	162.8
Trade and other payables		877.8	498.1
Income tax payable		17.3	6.9
Other financial liabilities		4.1	15.7
Provisions for other liabilities		29.7	13.1
		964.2	696.6
Total liabilities		2,161.7	1,399.3
Total equity and liabilities		3,182.3	1,485.1

Cash flow statement

For the year ended 31 March 2011

	Note	2011 £m	2010 £m
Cash flows from operating activities			
Cash generated from operations	8	308.5	170.3
Income tax paid		(19.3)	(1.7)
Interest paid		(58.6)	(22.3)
Interest received		8.6	3.8
Net cash flows from operating activities		239.2	150.1
Cash flows from investing activities			
Disposal of subsidiaries and joint ventures		2.2	–
Proceeds on disposal of property, plant and equipment		1.0	1.3
Proceeds on disposal of intangible assets		0.2	–
Purchases of property, plant and equipment		(30.2)	(16.8)
Purchases of intangible assets		(4.2)	(3.2)
Investment in and loans to joint ventures		0.2	–
Acquisition of subsidiaries net of cash acquired	12	(486.2)	(37.9)
Net cash flows from investing activities		(517.0)	(56.6)
Cash flows from financing activities			
Dividends paid		(48.0)	(34.7)
Finance lease principal payments		(12.9)	(1.4)
Bank loans repaid		(457.5)	(130.5)
Loans raised		845.1	100.0
Dividends paid to minority interests		(3.5)	(2.2)
Net proceeds on issue of shares		–	0.2
Movement on own shares		(2.2)	(2.1)
Net cash flows from financing activities		321.0	(70.7)
Net increase in cash, cash equivalents and bank overdrafts		43.2	22.8
Cash, cash equivalents and bank overdrafts at start of period		29.0	6.3
Effects of exchange rate fluctuations		0.5	(0.1)
Cash, cash equivalents and bank overdrafts at end of period	10	72.7	29.0

Notes to the consolidated financial statements

For the year ended 31 March 2011

1. Basis of preparation

The financial information has been extracted from the Annual Report, including the audited financial statements for the year ended 31 March 2011. They should be read in conjunction with the Annual Report for the year ended 31 March 2010, which has been prepared in accordance with IFRSs as adopted by the European Union. The accounting policies used and presentation of these consolidated financial statements are consistent with those in the Annual Report for the year ended 31 March 2010, except that on the acquisition of VT Group plc IFRIC 12 'Service concessions arrangements' is now a significant accounting policy for the Group and IFRS 3 'Business combinations'.

IFRS 3 (revised), 'Business combinations': as a consequence of which £12.8 million of acquisition costs are included in exceptional costs which would have previously been a cost of investment and included in goodwill.

IFRIC 12 'Service Concession Arrangements' addresses the accounting by private sector operators involved in the provision of public sector infrastructure assets and services. For all arrangements falling within the scope of the Interpretation (essentially those where the infrastructure assets are not controlled by the operator), the infrastructure assets are not recognised as property, plant and equipment of the operator. Rather, depending on the terms of the arrangement, the operator recognises:

- a financial asset – where the operator has an unconditional right to receive a specified amount of cash or other financial asset over the life of the arrangement; or
- an intangible asset – where the operator's future cash flows are not specified (e.g. where they will vary according to usage of the infrastructure asset); or
- both a financial asset and an intangible asset where the operator's return is provided partially by a financial asset and partially by an intangible asset.

As a consequence of this treatment the operator recognises investment income in respect of the financial asset on an effective interest basis and amortisation of any intangible asset arising.

The other standards, amendments and interpretations effective in 2010 with minimal or no impact on the Group:

- IFRS 2 (amended), 'Share based payments'.
- IAS27 (revised), 'Consolidated and separate financial statements'.
- 2009 Annual improvements.

2. Segmental analysis

Following the acquisition of VT Group plc the segments have changed to reflect the new business structure announced on 12 July 2010. The segments reflect the accounting information reviewed by the Chief Operating Decision Maker (CODM). The Marine & Technology segment includes the Group's UK and International marine business, the Defence & Securities segment is the remainder of the UK defence business with the exception of certain defence infrastructure contracts which fall within Support Services. Support Services includes Education and Training, Nuclear, Rail, Infrastructure and Critical Assets. International includes the US, South African and Middle East businesses.

2011	Marine & Technology £m	Defence & Security £m	Support Services £m	International £m	Unallocated £m	Group total £m
Continuing operations						
Total revenue	1,019.5	469.2	946.6	459.2	–	2,894.5
Joint venture revenue	–	87.3	51.4	–	–	138.7
Group revenue	1,019.5	381.9	895.2	459.2	–	2,755.8
Operating profit – group	119.3	52.8	74.7	27.4	(12.6)	261.6
IFRIC 12 investment income – group	–	1.6	0.6	–	–	2.2
Operating profit – share of joint ventures	–	8.5	0.8	–	–	9.3
IFRIC 12 investment income – share of joint venture	–	10.3	3.5	–	–	13.8
Underlying operating profit	119.3	73.2	79.6	27.4	(12.6)	286.9
Joint venture share of interest	–	(4.7)	(3.6)	–	–	(8.3)
Joint venture share of tax	–	(4.0)	(0.1)	–	–	(4.1)
Acquired intangible amortisation – group	(10.1)	(13.9)	(52.6)	(6.8)	–	(83.4)
Acquired intangible amortisation – share of joint ventures	–	(4.3)	(0.3)	–	–	(4.6)
Net finance costs	–	–	–	–	(50.4)	(50.4)
Exceptional items	–	–	–	–	(20.7)	(20.7)
Group profit before tax	109.2	46.3	23.0	20.6	(83.7)	115.4

2010	Marine & Technology (restated) £m	Defence & Security (restated) £m	Support Services (restated) £m	International (restated) £m	Unallocated (restated) £m	Group total (restated) £m
Continuing operations						
Total revenue	973.8	87.9	687.5	174.2	–	1,923.4
Joint venture revenue	–	13.8	14.1	–	–	27.9
Group revenue	973.8	74.1	673.4	174.2	–	1,895.5
Operating profit – group	116.5	9.2	35.9	10.9	(8.3)	164.2
Operating profit – share of joint ventures	–	0.7	(0.1)	(0.1)	–	0.5
Underlying operating profit	116.5	9.9	35.8	10.8	(8.3)	164.7
Joint venture share of interest	–	(1.0)	(0.1)	–	–	(1.1)
Joint venture share of tax	–	0.1	–	–	–	0.1
Acquired intangible amortisation – group	(7.5)	–	(8.6)	–	–	(16.1)
Net finance costs	–	–	–	–	(18.4)	(18.4)
Group profit before tax	109.0	9.0	27.1	10.8	(26.7)	129.2

Notes to the consolidated financial statements continued

3. Exceptional items and acquired intangible amortisation

	Group		Joint venture		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Exceptional items						
Profit on disposal of subsidiaries	(2.9)	–	–	–	(2.9)	–
Reorganisation costs	10.8	–	–	–	10.8	–
Acquisition costs	12.8	–	–	–	12.8	–
Exceptional items	20.7	–	–	–	20.7	–
Acquired intangible amortisation	83.4	16.1	4.6	–	88.0	16.1
	104.1	16.1	4.6	–	108.7	16.1

Exceptional items are those items which are exceptional in nature or size. These include material acquisition costs and reorganisation costs.

Acquisition costs above relate to the acquisition of VT Group plc (see note 12). Reorganisation costs relate to the integration of Babcock international Group PLC and VT Group plc.

4. Income taxes

The Group's effective rate of tax on underlying profit before tax for the year to 31 March 2011 was 20.5%. (2010: 19%). For effective tax rate purposes, a tax credit of £24.1 million in respect of acquired intangible amortisation, a tax credit of £3.9 million in respect of exceptional items, a tax credit of £2.7 million in respect of UK tax rate changes and a tax credit of £1.3 million in respect of JV amortisation of intangibles have been excluded.

5. Earnings per share

The calculation of the basic and diluted EPS is based on the following data:

	2011 Number	2010 Number
Number of shares		
Weighted average number of ordinary shares for the purpose of basic EPS	323,193,144	228,890,548
Effect of dilutive potential ordinary shares: share options	1,144,410	936,028
Weighted average number of ordinary shares for the purpose of diluted EPS	324,337,554	229,826,576

Earnings

	2011 Earnings £m	2011 Basic per share pence	2011 Diluted per share pence	2010 Earnings £m	2010 Basic per share pence	2010 Diluted per share pence
Earnings per share from continuing operations	101.1	31.28	31.17	106.0	46.29	46.10
Add back:						
Amortisation of acquired intangible assets, net of tax	62.6	19.39	19.32	11.6	5.08	5.06
Exceptional items and other, net of tax	16.8	5.20	5.18	–	–	–
Impact of change in UK tax rate	(2.7)	(0.84)	(0.83)	–	–	–
Earnings before amortisation, exceptional items and other	177.8	55.03	54.84	117.6	51.37	51.16

Notes to the consolidated financial statements continued

6. Dividends

The Directors have proposed a final dividend of 14.2 pence per 60 pence ordinary share (2010 second interim dividend: 12.8 pence per 60 pence ordinary share) after the balance sheet date and which will be paid on 9 August 2011 to shareholders registered on 8 July 2011, Subject to approval at the Annual General Meeting on 7 July 2011.

7. Investments in and loans to joint ventures

	Investment in joint ventures		Loans to joint ventures		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
At 1 April	1.0	1.5	13.3	12.0	14.3	13.5
Acquisition of joint ventures	51.2	–	8.1	–	59.3	–
Investments in joint ventures	0.2	–	–	–	0.2	–
Loans repaid	–	–	(0.4)	–	(0.4)	–
Fair value adjustment of derivatives, net of tax	6.4	–	–	–	6.4	–
Share of profit/(losses)	6.1	(0.3)	–	–	6.1	(0.3)
Interest accrued	–	–	1.1	1.5	1.1	1.5
Interest received	–	–	–	(0.2)	–	(0.2)
Impairment of goodwill	–	(0.2)	–		–	(0.2)
At 31 March	64.9	1.0	22.1	13.3	87.0	14.3

8. Reconciliation of operating profit to cash generated from operations

	2011 £m	2010 £m
Cash flows from operating activities		
Operating profit before exceptional items	178.2	148.1
Exceptional items	(20.7)	–
Group operating profit	157.5	148.1
Depreciation of property plant and equipment	31.2	22.3
Amortisation of intangible assets	87.3	18.9
Investment income	2.2	–
Equity share-based payments	5.8	2.7
Profit on disposal of subsidiaries	(2.9)	–
Loss/(profit) on disposal of property, plant and equipment	0.4	(0.4)
Loss on disposal of intangible assets	0.2	–
Operating cash flows before movement in working capital	281.7	191.6
Decrease in inventories	3.5	22.7
(Increase)/Decrease in receivables	(83.0)	23.6
Increase/(Decrease) in payables	123.1	(72.4)
(Decrease)/increase in provisions	(16.8)	4.8
Cash generated from operations	308.5	170.3

9. Movement in net debt

	2011 £m	2010 £m
Increase in cash in the period	43.2	22.8
Cash flow from the (increase)/decrease in debt and lease financing	(374.7)	31.9
Change in net funds resulting from cash flows	(331.5)	54.7
Loans acquired and disposed of with subsidiaries	(90.3)	–
New finance leases	–	(5.0)
Foreign currency translation differences	(4.9)	(0.5)
Movement in net debt in the period	(426.7)	49.2
Net debt at the beginning of the period	(302.3)	(351.5)
Net debt at the end of the period	(729.0)	(302.3)

10. Changes in net debt

	At 1 April 2010 £m	Cash flow £m	Acquisitions and disposals £m	New finance leases £m	Exchange movement £m	At 30 March 2011 £m
Cash and cash equivalents	189.6	(278.1)	193.8	–	(1.0)	104.3
Bank overdrafts	(160.6)	127.5	–	–	1.5	(31.6)
Cash, cash equivalents and bank overdrafts at end of period	29.0	(150.6)	193.8	–	0.5	72.7
Debt	(325.1)	(387.6)	(79.7)	–	(6.3)	(798.7)
Finance leases	(6.2)	12.9	(10.6)	–	(0.1)	(4.0)
	(331.3)	(374.7)	(90.3)	–	(6.4)	(802.7)
Net debt before derivatives	(302.3)	(525.3)	103.5		(5.9)	(730.0)
Net debt derivatives	–	–	–		1.0	1.0
Net debt including derivatives	(302.3)	(525.3)	103.5	–	(4.9)	(729.0)

11. Pensions

Analysis of movement in the Balance Sheet

	2011 £m	2010 £m
Fair value of plan assets		
At 1 April	1,979.8	1,702.9
Acquisitions	432.5	–
Expected return	152.6	113.1
Actuarial gain	7.8	375.5
Change in reimbursement rights	36.1	(157.7)
Employer contributions	82.5	46.0
Employee contributions	7.1	5.9
Benefits paid	(118.1)	(105.9)
Exchange differences	(0.4)	–
At 31 March	2,579.9	1,979.8
Present value of benefit obligations		
At 1 April	2,303.8	1,652.2
Acquisitions	483.6	–
Service cost	46.0	23.3
Interest cost	135.6	107.2
Employee contributions	7.1	5.9
Actuarial (gains)/loss	(63.3)	621.3
Benefits paid	(118.1)	(105.9)
Exchange differences	(0.1)	(0.2)
At 31 March	2,794.6	2,303.8
IFRIC 14 adjustment	(10.4)	–
Net deficit	(225.1)	(324.0)

Analysis of charge to Income Statement

	2011 £m	2010 £m
Service cost	(46.0)	(23.3)
Expected return on assets	152.6	113.1
Interest on obligations	(135.6)	(107.2)
At 31 March	(29.0)	(17.4)

As at 31 March 2011 the key assumptions used in valuing pension liabilities were:

Discount rate	5.6% (31 March 2011: 5.5%)
Inflation rate	3.1% (31 March 2011: 3.4%)

12. Acquisition

On 8 July 2010 the acquisition of 100% of the share capital of VT Group plc was completed for a cash and share consideration of £1,471.3 million. On 27 September 2010 the acquisition of the assets and trading of Evergreen Unmanned Systems (Evergreen) in the USA was completed for a cash consideration of £8.9 million (US$14 million).

The goodwill arising on the acquisition derives from the experience, knowledge and location of the workforce, the market position of the entities involved and expected synergies.

Details of assets acquired and the goodwill are as follows:

	VT Group plc £m	Evergreen £m	Total £m
Cost of acquisition			
Cash paid	665.7	8.9	674.6
129,034,886 shares issued	805.6	–	805.6
Purchase consideration	1,471.3	8.9	1,480.2
Fair value of assets acquired (see below)	405.0	2.2	407.2
Goodwill	1,066.3	6.7	1,073.0

Net assets and liabilities arising from the acquisition are as follows:

	VT Group plc		Evergreen		Total	
	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m
Goodwill	302.9	–	–	–	302.9	–
Intangible assets	13.3	8.3	–	–	13.3	8.3
Acquired intangibles*	115.9	464.9	–	4.5	115.9	469.4
Property, plant and equipment	74.6	59.6	0.9	0.9	75.5	60.5
Investment in and loans to joint ventures	16.0	59.3	–	–	16.0	59.3
Retirement liabilities	(84.8)	(58.1)	–	–	(84.8)	(58.1)
Deferred tax	(11.5)	(86.9)	–	–	(11.5)	(86.9)
Income tax	(1.8)	(1.2)	–	–	(1.8)	(1.2)
Cash, cash equivalents and bank overdrafts	193.6	193.6	0.4	0.4	194.0	194.0
Bank loans	(80.9)	(81.5)	–	–	(80.9)	(81.5)
Finance leases	(10.6)	(10.6)	–	–	(10.6)	(10.6)
Inventory	14.7	14.3	–	–	14.7	14.3
Current assets	178.6	165.3	0.2	0.2	178.8	165.5
Current and non current liabilities	(175.4)	(201.6)	–	–	(175.4)	(201.6)
Provisions	(55.7)	(116.8)	(3.8)	(3.8)	(59.5)	(120.6)
Minority shareholders	(2.9)	(3.6)	–	–	(2.9)	(3.6)
Total	486.0	405.0	(2.3)	2.2	483.7	407.2

* Acquired intangibles are: customer relationships, order book and know-how.

Cash outflow to acquire businesses net of cash acquired:

	VT Group plc £m	Evergreen £m	Total £m
Purchase consideration	1,471.3	8.9	1,480.2
Cash, cash equivalents and bank overdrafts	(193.6)	(0.4)	(194.0)
Acquisition costs accrued in prior year	2.0	–	2.0
	1,279.7	8.5	1,288.2
Less: issue of shares net of costs	802.0	–	802.0
Cash outflow this period	477.7	8.5	486.2

12. Acquisition (continued)

The revenue and operating profit of the acquired businesses since the date of acquisition and as if they had been acquired on 1 April 2010 are:

	Since date of acquisition £m	For full year £m
Group revenue		
VT Group plc	758.4	1,035.6
Evergreen	2.7	4.7
	761.1	1,040.3
Total revenue (including share of joint venture)		
VT Group plc	856.0	1,178.2
Evergreen	2.7	4.7
	858.7	1,182.9
Operating profit (before amortisation of acquired intangibles)		
VT Group plc	90.3	100.2
Evergreen	0.1	0.3
	90.4	100.5
Underlying profit (including investment income and share of joint venture underlying profit)		
VT Group plc	112.2	125.7
Evergreen	0.1	0.3
	112.3	126.0

13. Related party transactions

Related party transactions in the year are sales to and purchases primarily from joint ventures. The year end receivables balance was £24.0 million (2010: £7.7 million) and the payables balance was £2.8 million (2010: £0.1 million). In addition, there were transactions with the Finmeccanica UK Group, a related party by means of common directors. Revenue of £6.2 million in the year and a year end debtor balance of £2.1 million.

14. Financial information

The financial information in this preliminary report does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006.

Statutory accounts for 2010 have been delivered to the Registrar of Companies and those for 2011 will be delivered following the company's Annual General Meeting.

The Annual Report for the year ended 30 March 2011 and these financial statements were approved by the Directors on 16 May 2011. The auditors have reported on the Annual Report for the year ended 31 March 2011 and 31 March 2010 and neither report was qualified and neither contain a statement under section 498(2) or (3) of the Companies act 2006.

Annual General Meeting 2011

This year's Annual General Meeting will be held on 7 July 2011 Details of the resolutions to be proposed at that meeting will be included in the Notice of Annual General Meeting that will be sent to shareholders at the beginning of June 2011.

At our Annual General Meeting in 2007 our shareholders unanimously agreed to proposals to allow us to use electronic communications with them as allowed for under the Companies Act 2006. For shareholders who agreed, or who are treated as having agreed, to receive electronic communications, the Company website is now the main way for them to access shareholder information. These shareholders will be sent a 'notice of availability' notifying them when the Annual Report is available (which will be early in June) on the Company website www.babcock.co.uk. Hard copies of the Annual Report will be distributed to those shareholders who have requested or subsequently request them. Additional copies will be available from the Company's registered office 33 Wigmore Street, London, W1U 1QX.

Forward-looking statements

Certain statements in this announcement are forward looking statements. Such statements may relate to Babcock's business, strategy and plans. Statements that are not historical facts, including statements about Babcock's or its management's beliefs and expectations, are forward-looking statements. Words such as 'believe', 'anticipate', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', and variations of these words and similar future or conditional expressions are intended to identify forward-looking statements but are not the exclusive means of doing so. By their nature, forward-looking statements involve a number of risks, uncertainties or assumptions, some known and some unknown, that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements, many of which are beyond Babcock's control. Please see pages 12-14 which set out some of these risks and uncertainties. These risks, uncertainties or assumptions could adversely affect the outcome and financial effects of the plans and events described herein. Forward-looking statements contained in this announcement regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Nor are they indicative of future performance and Babcock's actual results of operations and financial condition and the development of the industry and markets in which Babcock operates may differ materially from those made in or suggested by the forward-looking statements. You should not place undue reliance on forward-looking statements, which speak only as of the date of this announcement because such statements relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements reflect Babcock's judgement at the date of this announcement and are not intended to give any assurance as to future results. Except as required by law, Babcock is under no obligation to update (and will not) or keep current the forward-looking statements contained in this announcement or to correct any inaccuracies which may become apparent in such forward-looking statements.

Statement of Directors' responsibilities

The responsibility statement below has been prepared in connection with the Group's full Annual Report for the year ended 31 March 2011. Certain parts thereof are not included within this announcement.

We confirm that to the best of his knowledge:

- the Group financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group taken as a whole and the Company; and
- the Directors' report (which includes the Business review) includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that it faces.

The responsibility statement was approved by the Board of Directors on 16 May 2011.

Peter Rogers
Group Chief Executive

16 May 2011

W Tame
Group Finance Director

16 May 2011