babcock group

Babcock International Group PLC
Interim report 2001

Highlights

Profit improvement compared to the previous six months driven by Babcock's core support services divisions: BES and HCS

Operating profit before goodwill and exceptional items of £7.1m on turnover of £227m (£1.8m and £228m in second half of 2000/2001 and £7.8m and £213m in the first half of 2000/2001);

Earnings per share before goodwill and non-operating exceptional items of 2.39p as compared with a loss of 0.35p per share for the full year 2000/2001;

Interim dividend of 1.1p per share (1.1p per share on the same basis for the first half of 2000/2001)

Continued implementation of the strategy to transform Babcock into a support services group:

Integration of recently acquired Hunting Defence Services business completed and performing ahead of expectations;

Order book for continuing operations increased over last six months;

Initial progress with sale of the materials handling businesses;

Stabilised majority of underperforming BMH businesses

Strong financial base:

Ungeared balance sheet;

Secure order book with circa 60% business based on long-term government contracts

Overview

The first half of the current financial year saw a recovery in operating profits compared to the previous six months. This stemmed from good performances in the BES and HCS Divisions and was assisted by the sale of the loss-making Railcare business. These performances more than offset the expected deterioration in the BMH Division. Interest costs increased due to the acquisition of HCS and the return of cash to shareholders.

This was an encouraging recovery from the previous six months, and despite the deterioration of the BMH Division, the order book for continuing operations has increased. Two-thirds of the business is in defence related activities and, with an ungeared balance sheet, the company is well placed to weather any economic downturn and, indeed, to continue with the expansion in support services.

The six months saw the continued implementation of the strategy to move the business more firmly into the support services sector. HCS, which was acquired in March 2001 for £60.9m, was fully integrated into the Babcock Group and delivered the performance anticipated at the time of the acquisition. In addition to establishing Babcock as a leading supplier of support services to the Armed Forces, it will also provide a base for expansion into the civil sector.

HCS performed slightly ahead of expectations and is currently bidding for a number of major MoD contracts, details of which are described later in this report.

BES turned in a strong performance, with additional work being demanded on both HMS Ark Royal and the two S-Class submarines. HMS Ark Royal was completed on time and has now been replaced in the dockyard by HMS Invincible. Further contracts were secured for the refitting of 5 Type 23 frigates and a number of orders were booked for new vessel builds.

The sale of the BMH operation commenced, with the disposal of the wood handling business, albeit at a loss to the net asset value. The deteriorating market conditions, allied to uncertainty created after the 11 September events, has inevitably made the sale of the remaining businesses in the BMH Group more difficult. The deteriorating market conditions also meant disappointing results from BMH but, with the exception of the Marine division, results have now been stabilised. The management are, however, continuing to actively restructure the underperforming parts of this division; consequently, restructuring costs were incurred in downsizing the operation and these will continue into the second half.

Review of operations

BES:
Engineering and technology support services for the defence, transport and 'secure facilities' sector

The division performed particularly well in the first half, with turnover and profits growing, compared to the previous six months and the first half of 2000/2001. This was primarily due to an increased workload on HMS Ark Royal and S-Class submarines. The final programme on HMS Ark Royal amounted to £135m compared to an original programme of £80m. Despite this increase in workload, the original timetable was met and the vessel delivered on time. HMS Ark Royal has now been replaced at Rosyth by HMS Invincible, and various other refits were confirmed during the period. The division's order book increased from £128m to £168m over the six months.

Additional commercial orders were received during the period, based largely on the design capability of FBM which had been acquired in March 2000. The first fast passenger ferry was delivered in August, and contracts for 16 military landing craft were booked, in addition to 6 vessels for the RNLI. Orders were also confirmed for 22 mega-3 rail freight wagons and delivery is expected to commence in the second half.

The New Zealand dockyard operation made further progress in its commercial activities as well as exploring the potential for service support to the Australian Navy.

Work continued throughout the period with the Warship Support Agency to conclude the contract to manage the naval bases at Faslane and Coulport. It is still expected that this proposal will be submitted to the Minister by the end of the year, with the contract commencing in the spring of 2002.

HCS:
Multi-skilled organisation offering technical support, training and facilities management for the Royal Air Force and the Army

The acquisition of HCS was completed in March 2001. It has been rapidly assimilated into the Babcock Group and has met fully the expectation at the time of the acquisition.

HCS has strong relationships with all its customers and the Multi-Activity contract at Cranwell and FSAST Simulator Maintenance contract have been extended during the first half. Further renewals are anticipated as a consequence of the excellent reputation which HCS enjoys with its customers in the Armed Forces.

In addition, HCS are in the bidding process for some major new PPP/PFI contracts, including the Royal School of Military Engineering, Armoured Vehicle Training Service and the Airfield Support Services Project, in conjunction with partners.

HCS will also provide the basis for expansion into the civil sector of support services, but this move would be accelerated by prudent acquisitions and a number are under review. The areas upon which we would concentrate would be those areas of strength within HCS, viz training, maintenance and facilities management.

Gordon Campbell
Gordon Campbell Chairman

BMH:
Leading supplier of materials processing technologies and engineered systems

BMH's performance was adversely affected by very difficult trading conditions. Action was taken to significantly restructure the business in response to poor demand but further will be necessary in the second six months. However, with the exception of the marine business, the other businesses have been stabilised.

The order book at 30 September 2001 was similar to that at 31 March 2001 but turnover (excluding Africa) fell by 29% compared to the previous six months. In the circumstances, to contain the losses, before exceptional items, to only £1.2m more than in the previous six months, was a respectable achievement.

The market environment undoubtedly hindered our attempts to dispose of the BMH businesses, but we are currently in negotiations to sell two of the remaining businesses. The wood handling business in Finland was sold to the management, but at a book loss of £3.3m.

Babcock Africa
Babcock Africa continues to refocus its business on support services, but still has some dependency on contracting which causes some lumpiness in the results. Thus, whilst the turnover in the first six months matched the previous half-year, profits were somewhat lower.

There is, however, potential for transferring some of the BES/HCS skills into South Africa as the government reviews its outsourcing policy, and our base there is a crucial marketing advantage over other support services groups.

Prospects
With two-thirds of the business based on long-term government contracts and an ungeared balance sheet, Babcock is well placed to weather the current uncertain economic circumstances, and to pursue its strategy of expansion in support services.

Group profit and loss account

For the six months ended 30 September 2001

Year ended 31 March 2001 (as restated) £'000		Note	**Six months ended 30 September 2001** Before exceptional items (unaudited) £'000	Exceptional items (unaudited) £'000	Total (unaudited) £'000	Six months ended 30 September 2000 (as restated) Before exceptional items (unaudited) £'000	Exceptional items (unaudited) £'000	Total (unaudited) £'000
	Group turnover							
382,776	Continuing operations		**212,930**	**–**	**212,930**	184,719	–	184,719
58,265	Discontinued operations	4	**14,060**	**–**	**14,060**	28,198	–	28,198
441,041		3	**226,990**	**–**	**226,990**	212,917	–	212,917
(6,135)	**Group operating profit/(loss) before goodwill amortisation**		**7,139**	**(1,677)**	**5,462**	7,828	(1,190)	6,638
1,473	**Goodwill amortisation**		**(1,098)**	**–**	**(1,098)**	761	–	761
	Group operating profit/(loss)							
5,391	Continuing operations		**5,863**	**(1,677)**	**4,186**	10,421	–	10,421
(10,053)	Discontinued operations	4	**178**	**–**	**178**	(1,832)	(1,190)	(3,022)
(4,662)		3	**6,041**	**(1,677)**	**4,364**	8,589	(1,190)	7,399
(163)	Share of operating loss of joint ventures and associates		**(246)**	**–**	**(246)**	(89)	–	(89)
(6,200)	Loss on sale of operations	6	**–**	**(3,348)**	**(3,348)**	–	–	–
(11,025)	**Profit/(loss) on ordinary activities before interest**		**5,795**	**(5,025)**	**770**	8,500	(1,190)	7,310
3,715	Net interest and similar charges				**(655)**			2,711
(7,310)	**Profit/(loss) on ordinary activities before taxation**				**115**			10,021
(1,215)	Tax on profit/(loss) on ordinary activities	7			**(1,145)**			(2,647)
(8,525)	**(Loss)/profit on ordinary activities after taxation**				**(1,030)**			7,374
3,244	Minority interest				**88**			1,296
(5,281)	**(Loss)/profit for the financial period**				**(942)**			8,670
(3,807)	Dividends paid and proposed	9			**(1,646)**			(1,560)
(9,088)	**Retained (loss)/profit for the financial period**				**(2,588)**			7,110
	(Loss)/earnings per share	8						
(3.34)p	– Basic				**(0.64)p**			5.11p
(3.31)p	– Diluted				**(0.64)p**			5.04p
	Earnings/(loss) per share before non-operating exceptional items and goodwill	8						
(0.35)p	– Basic				**2.39p**			4.66p
(0.35)p	– Diluted				**2.38p**			4.60p

Group balance sheet

As at 30 September 2001

As at 31 March 2001 (as restated) £'000		Note	**As at 30 September 2001 (unaudited) £'000**	As at 30 September 2000 (as restated) (unaudited) £'000
	Fixed assets			
	Intangible assets			
1,507	Development costs		**1,378**	1,635
	Goodwill			
88,279	– Goodwill		**82,819**	27,795
(14,916)	– Negative goodwill		**(10,840)**	(16,810)
73,363			**71,979**	10,985
74,870			**73,357**	12,620
37,213	**Tangible assets**		**31,484**	43,996
	Investments			
	Investments in joint ventures			
2,548	– Share of gross assets		**1,903**	2,952
(2,069)	– Share of gross liabilities		**(1,077)**	(2,087)
479			**826**	865
537	Investments in associates		**537**	341
1,624	Other investments		**2,720**	1,119
2,640			**4,083**	2,325
114,723			**108,924**	58,941
	Current assets			
27,975	Stocks		**22,279**	31,925
98,806	Debtors – due within one year		**89,032**	103,559
81,181	Debtors – due after more than one year		**70,330**	80,079
179,987			**159,362**	183,638
25,228	Cash and bank balances	13	**24,542**	109,704
233,190			**206,183**	325,267
	Creditors – amounts due within one year			
(25,892)	– Borrowings	13	**(19,498)**	(17,909)
(173,399)	– Other		**(156,579)**	(170,854)
(199,291)			**(176,077)**	(188,763)
33,899	**Net current assets**		**30,106**	136,504
148,622	**Total assets less current liabilities**		**139,030**	195,445
	Creditors – amounts due after more than one year			
(674)	– Borrowings	13	**(812)**	(935)
(1,868)	– Other		**(513)**	(758)
(2,542)			**(1,325)**	(1,693)
(37,221)	**Provisions for liabilities and charges**		**(38,407)**	(40,157)
108,859	**Net assets**		**99,298**	153,595
	Capital and reserves			
90,588	Called up share capital	10	**88,712**	85,028
37,542	Share premium account		**37,674**	67,248
27,863	Capital redemption reserve		**29,957**	–
(50,357)	Profit and loss account		**(57,092)**	(3,852)
102,868	**Equity interests**		**98,577**	148,424
2,768	**Non-equity interests**		**674**	–
105,636	Shareholders' funds		**99,251**	148,424
3,223	Equity minority interests		**47**	5,171
108,859			**99,298**	153,595

Summarised group cash flow statement
For the six months ended 30 September 2001

Year ended 31 March 2001 £'000		Note	**Six months ended 30 September 2001 (unaudited) £'000**	Six months ended 30 September 2000 (unaudited) £'000
(10,977)	Cash inflow/(outflow) from operating activities	11	**6,739**	(12,707)
2,495	Returns on investments and servicing of finance		**(762)**	2,570
(743)	Taxation		**(531)**	(985)
(7,163)	Capital expenditure and financial investment		**(4,592)**	(2,859)
(59,622)	Acquisitions and disposals		**4,755**	3,230
(4,335)	Equity dividends paid		**(2,237)**	(2,795)
(80,345)	Cash inflow/(outflow) before financing		**3,372**	(13,546)
(18,549)	Financing		**3,390**	206
(98,894)	**Increase/(decrease) in cash in the period**	13	**6,762**	(13,340)

Group statement of total recognised gains and losses
For the six months ended 30 September 2001

Year ended 31 March 2001 (as restated) £'000		Note	**Six months ended 30 September 2001 (unaudited) £'000**	Six months ended 30 September 2000 (as restated) (unaudited) £'000
(5,281)	(Loss)/profit for the financial period		**(942)**	8,670
(649)	Currency translation differences on foreign currency net investments and related loans		**(1,940)**	89
(5,930)	Total recognised gains and losses relating to the period		**(2,882)**	8,759
–	Prior year adjustment	14	**(4,522)**	–
(5,930)	Total gains and losses recognised since last annual report and accounts		**(7,404)**	8,759

Reconciliation of movements in shareholders' funds
For the six months ended 30 September 2001

Year ended 31 March 2001 (as restated) £'000		Note	**Six months ended 30 September 2001 (unaudited) £'000**	Six months ended 30 September 2000 (as restated) (unaudited) £'000
143,932	Shareholders' funds at start of period, as previously reported		**110,158**	143,932
(3,102)	Prior year adjustment	14	**(4,522)**	(3,102)
140,830	Shareholders' funds at start of period, as restated		**105,636**	140,830
(5,930)	Total recognised gains and losses relating to the period		**(2,882)**	8,759
3,356	Shares issued in the period		**237**	395
(28,813)	Redemption of 'B' preference shares		**(2,094)**	–
(3,807)	Dividends		**(1,646)**	(1,560)
(35,194)	Net movement in shareholders' funds		**(6,385)**	7,594
105,636	Shareholders' funds at end of period		**99,251**	148,424

Notes to the financial statements

For the six months ended 30 September 2001

1 Accounting policies

The interim financial statements have been prepared in accordance with the accounting policies adopted in the preparation of the financial statements for the year ended 31 March 2001, as set out in the annual report for that year. FRS19: Deferred Tax has been adopted for the first time in this interim report. The cumulative effect of this change in accounting policy has been recognised as a prior year adjustment and comparative figures have been restated. The effect on the financial statements is set out in note 14.

2 Basis of preparation

The comparative figures for the year ended 31 March 2001 and the other financial information contained in this interim report do not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985.

Statutory accounts for the year ended 31 March 2001 have been delivered to the Registrar of Companies. The auditors have reported on those accounts, their report was not qualified and did not contain a statement under section 273(2) or (3) of the Companies Act 1985.

The interim report for the six months ended 30 September 2001 was approved by the Directors on 21 November 2001.

3 Segmental analysis

	Six months ended 30 September 2001				Six months ended 30 September 2000			
	Group turnover £'000	**Group operating profit before operating exceptional items £'000**	**Operating exceptional items £'000**	**Group operating profit £'000**	Group turnover £'000	Group operating profit before operating exceptional items £'000	Operating exceptional items £'000	Group operating profit £'000
Continuing operations								
BES	103,808	7,940	–	7,940	97,582	6,759	–	6,759
HCS	31,827	3,206	–	3,206	–	–	–	–
BMH	77,295	(3,151)	(1,052)	(4,203)	87,137	4,158	–	4,158
Unallocated costs and other income	–	(1,034)	(625)	(1,659)	–	(1,067)	–	(1,067)
	212,930	6,961	(1,677)	5,284	184,719	9,850	–	9,850
Goodwill amortisation	–	(1,098)	–	(1,098)	–	571	–	571
Total continuing operations	**212,930**	**5,863**	**(1,677)**	**4,186**	184,719	10,421	–	10,421
Discontinued operations	14,060	178	–	178	28,198	(2,022)	(1,190)	(3,212)
Goodwill amortisation	–	–	–	–	–	190	–	190
Total discontinued operations	**14,060**	**178**	–	**178**	**28,198**	**(1,832)**	**(1,190)**	**(3,022)**
Group total	**226,990**	**6,041**	**(1,677)**	**4,364**	212,917	8,589	(1,190)	7,399

4 Discontinued operations

Discontinued operations comprise the Railcare business which was disposed of on 23 May 2001 and the BMH Wood business which was disposed of on 30 August 2001.

5 Operating exceptional items

Exceptional costs of £1.1m have been incurred in restructuring businesses within the BMH division and exceptional costs of £0.6m have been incurred in relation to a proposed acquisition that did not proceed.

6 Loss on sale of operations

The loss on the sale of operations comprises the loss on the disposal of the BMH Wood business and includes the write-off of goodwill amounting to £2.6m.

No taxation is applicable to the loss on disposal. Provision for the loss on disposal of the Railcare business was made in the year ended 31 March 2001.

7 Taxation

Provision has been made for taxation based on the estimated effective tax rate, before non-operating exceptional items and goodwill, for the year ended 31 March 2002.

8 (Loss)/earnings per share

The basic (loss)/earnings per share has been calculated on the loss for the period of £942,000 (2000: restated profit of £8,670,000) and the weighted average number of ordinary shares in issue throughout the period of 146,628,978 (2000: 169,631,217).

The diluted (loss)/earnings per share has been calculated after taking account of 456,187 dilutive share options where the exercise price is less than the average market price of the company's own shares during the period.

The basic and diluted earnings/(loss) per share before non-operating exceptional items and goodwill have been calculated using the same weighted average number of ordinary shares in issue as above and after adjusting for goodwill amortisation of £1,098,000 (2000: credit of £761,000) and the loss on the sale of operations of £3,348,000 (2000: £nil).

9 Dividends

An interim dividend of 1.1p per 60p ordinary share (2000: 1.1p per 'new' 60p ordinary share) will be paid on 25 January 2002 to shareholders registered on 21 December 2001.

10 Share capital

The company redeemed the remainder of the redeemable 'B' preference shares on 23 October 2001.

11 Reconciliation of operating profit/(loss) to cash flow from operating activities

Year ended 31 March 2001 £'000		**Six months ended 30 September 2001 (unaudited) £'000**	Six months ended 30 September 2000 (unaudited) £'000
(4,662)	Group operating profit/(loss)	**4,364**	7,399
12,119	Depreciation	**5,650**	6,024
264	Amortisation of intangibles	**129**	136
(1,473)	Amortisation of goodwill	**1,098**	(761)
(17,415)	Movement on working capital	**(4,516)**	(25,505)
190	Other items	**14**	–
(10,977)	Cash inflow/(outflow) from operating activities	**6,739**	(12,707)

12 Movement in net funds

Year ended 31 March 2001 £'000		**Six months ended 30 September 2001 (unaudited) £'000**	Six months ended 30 September 2000 (unaudited) £'000
(98,894)	Increase/(decrease) in cash in the period	**6,762**	(13,340)
(6,808)	Cash flow from (increase)/decrease in debt and lease financing	**(2,047)**	217
(105,702)	Change in net funds resulting from cash flows	**4,715**	(13,123)
(209)	Loans and finance leases disposed of/(acquired) with subsidiaries	**535**	–
(26)	New finance leases	**(1,027)**	–
–	Loan from minority shareholder in subsidiary capitalised	**1,214**	–
699	Foreign currency translation differences	**133**	83
(105,238)	Movement in net funds/(debt) in the period	**5,570**	(13,040)
103,900	Net (debt)/funds at the start of the period	**(1,338)**	103,900
(1,338)	Net funds/(debt) at the end of the period	**4,232**	90,860

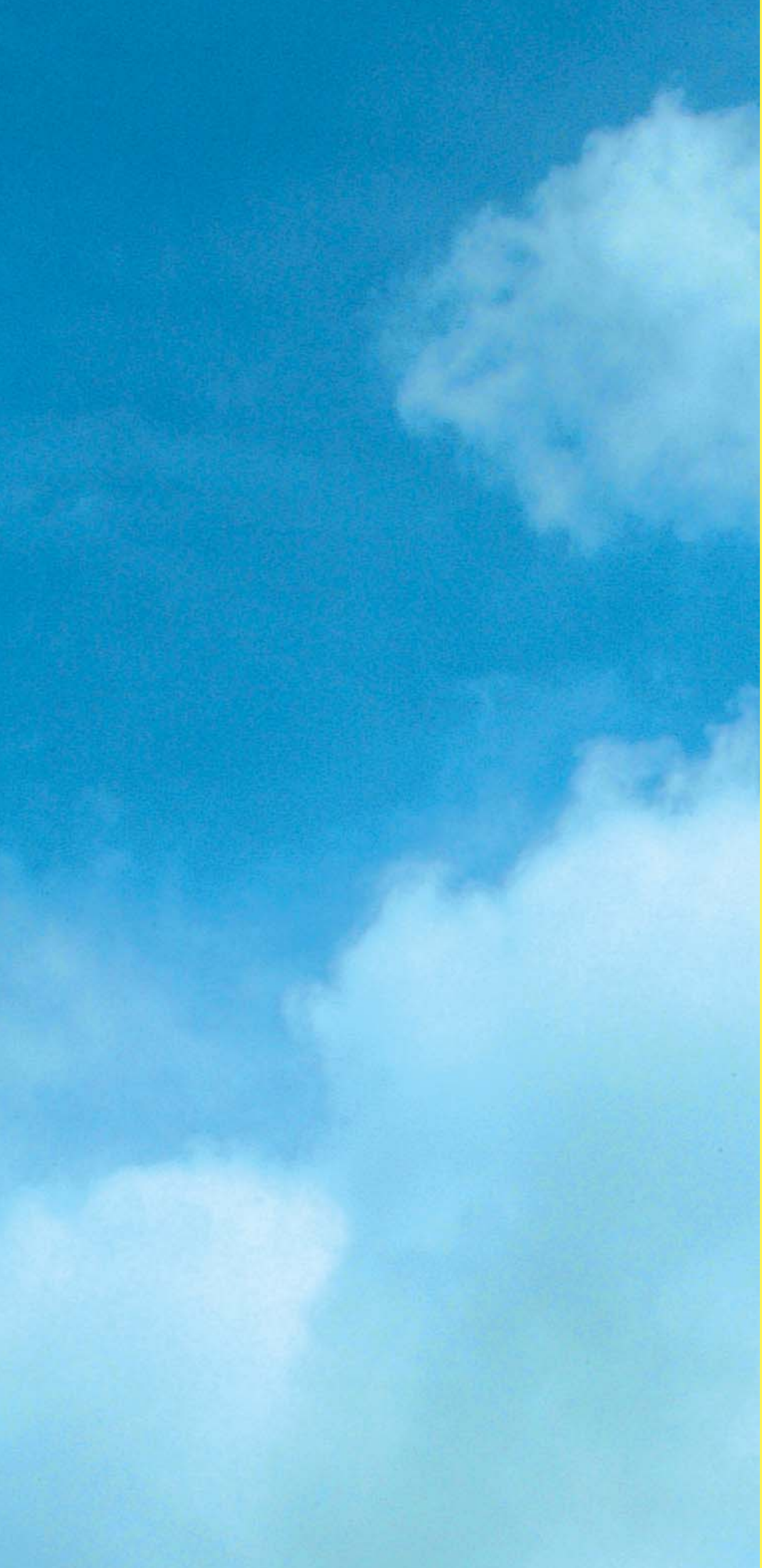
13 Changes in net funds

	At 1 April 2001 £'000	Cash flow £'000	Acquisitions and disposals £'000	Other non-cash changes £'000	Exchange movement £'000	**At 30 September 2001 £'000**
Cash and bank balances	25,228	(1,062)	–	–	376	**24,542**
Bank overdrafts	(16,512)	7,824	–	–	(374)	**(9,062)**
	8,716	6,762	–	–	2	**15,480**
Debt	(8,928)	(2,468)	167	1,214	(1)	**(10,016)**
Finance leases	(1,126)	421	368	(1,027)	132	**(1,232)**
	(10,054)	(2,047)	535	187	131	**(11,248)**
Total	(1,338)	4,715	535	187	133	**4,232**

14 Prior year adjustment
The adoption of FRS 19 : Deferred Tax has resulted in provision for additional deferred tax liabilities, primarily in respect of pension prepayments, and the recognition of additional deferred tax assets, primarily in respect of surplus ACT, accelerated capital allowances and short term timing differences.

The net increase required in the provision for deferred tax at 1 April 2000 was £3,102,000 with an equal reduction in the profit and loss reserve. In the year ended 31March 2001 the tax charge increased by £1,420,000, with £798,000 of that increase relating to the six months ended 30 September 2000. This results in an increase in the provision for deferred tax of £4,522,000 at 31 March 2001 compared to that previously reported. The effect of implementing FRS 19 on the results for the six months ended 30 September 2001 is not material.

15 Distribution
Copies of this interim report will be distributed to all holders of the company's ordinary shares. Copies will also be available at the company's registered office: 2 Cavendish Square, London, W1G 0PX. In addition, this report is available on the company's website: www.babcock.co.uk



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