**Babcock International Group PLC**

Interim report 2002

# Focusing on support services

babcock

# Business highlights

| | H1 2002 £'000 | H1 2001 £'000 | Change % |
|---|---|---|---|
| Sales* | **£181.3m** | £184.1m | **-1.5** |
| Operating Profit** | **£9.2m** | £7.9m | **+15.9** |
| Profit before Tax | **£7.0m** | £0.1m | |
| Basic EPS*** | **3.90p** | 2.39p | **+63.2** |
| Dividend | **1.15p** | 1.10p | **+4.5** |

*excluding discontinued businesses
**excluding discontinued and before exceptional items and goodwill amortisation
***before non-operating exceptionals and goodwill amortisation

Major new contract wins leave order book in excess of £700 million

Preferred bidder status on Single Living Accommodation and Non-Project Procurement will add a further £200 million to the order book

Nomination of Rosyth as preferred site for aircraft carrier assembly by each of the prime contractors

Acquisitions extend support services in the defence industry and provide entry point to the civil market

Disposal programme of Materials Handling business nearing completion

# Introduction

The six months to 30 September 2002 saw Babcock reach and pass some notable milestones in its journey to become a dedicated support services company. The acquisition of both Service Group International ('SGI') and MEF strengthened our defence-related support services and, specific to SGI, also attained an initial presence in the civil support services market. Progress was also made in disposing of non-core businesses in the Materials Handling division and negotiations are at an advanced stage on the sale of a further business.

Preferred bidder status was achieved during the first half year on the Single Living Accommodation Modernisation ('SLAM'), and Non-Project Procurement Organisation ('NPPO'). Contracts for Faslane and Afghanistan were concluded, as well as the renewal of the contract for pilot training.

The total order book now stands at over £700 million, a figure which does not include SLAM and NPPO. The details of these two contracts are still under negotiation but it is anticipated that, in aggregate, they will be valued in excess of £200 million.

The recent nomination of Rosyth as preferred site for the aircraft carrier assembly by each of the prime contractors, BAE SYSTEMS and Thales will, once confirmed, add further security and visibility to the order book.

**Financial overview**

Group operating profit for continuing businesses, before goodwill amortisation and exceptional items, increased 16% to £9.2 million on turnover 1.5% lower. Profit before tax on ordinary activities increased to £7.0 million from £115,000 in the previous corresponding period.

In Technical Services, turnover and operating profit declined 17% and 13% respectively to £92.0 million and £7.2 million, primarily due to the lower workload contracted for HMS Invincible. However, a better performance is expected in the second half from this division due to the arrival of HMS Illustrious at Rosyth and the refit of a number of smaller vessels.

Turnover in Training and Support increased 29% to £64.1 million and operating profit rose 27% to £4.1 million. This was primarily due to a strong showing from Babcock Africa which continued the improvement shown in the second half of last year. Turnover and profit at HDS (the business acquired in March 2001) were similar to the previous corresponding period. Due to the post acquisition restructuring at SGI and MEF, there was only a minor contribution to profit during this period as restructuring costs offset the trading profit.

In Materials Handling a major turn-round in the marine business helped to reduce losses significantly, despite being negatively affected by the issues surrounding the protracted process of selling Chronos Richardson. Equally, the losses on discontinued operations were materially lower, and exceptional items were eliminated.

Group operating profit was, therefore, 84% higher at £8.1 million, and earnings per share before non-operating exceptionals and goodwill increased by 63% to 3.9p per share.

Cash inflow from operating activities was £5.7 million compared to £6.7 million in the six months to September 2001. Largely as a consequence of the two acquisitions, costing £23.6 million, net debt increased to £33.6 million

The Board is recommending an interim dividend of 1.15p per share (1.1p per share in the previous corresponding period), an increase of 4.5%.

# Operational review

## Technical Services

Turnover in Technical Services fell, compared with the similar period last year, in line with our expectations. The programme on HMS Invincible is the smallest of the three aircraft carrier refits and, despite a reduction in overheads, profits fell accordingly. However, with the arrival of HMS Illustrious and the third of the Type-23 frigates, a better performance in the second half is expected.

The MEF acquisition, which materially enhances our overall naval service capability, made a small contribution in the period.

The long term future of the Rosyth dockyard received an additional boost, with the announcement by each of the prime contractors on the new aircraft carrier programme that it would be the prime choice for the assembly of the carriers. There is likely to be further work in terms of building some of the blocks from which the carriers will be constructed. This would enhance the security of the workload at Rosyth for many years.

Meanwhile, the diversification into other areas of activity continues and the Mega-3 railway wagons were completed and an initial delivery made. The final delivery is dependent upon the Strategic Rail Authority's safety approval, but we do not anticipate any problems in achieving this approval. A contract to procure electronic and electrical equipment for the Ministry of Defence was secured, utilising the existing systems at Rosyth. This contract should be worth £100 million over a seven year period, once it commences in 2003.

Rosyth has been recently restructured into four business units and this will enable it to continue to develop its commercial activities.

Compared with the same period last year, the losses in FBM increased, but were significantly down on the second half of 2002. There are a number of potential contracts for FBM, but delays in concluding these contracts left the business in loss. Work continued on the Smit air/sea rescue vessels, and confirmation of the start date for the bridge erection barge contract for the US Coastguard is awaited.

The operation of the dockyard in New Zealand continued at the previous year's good level, and over 50% of the contracted workload is now in the non-defence market.

The pipeline services business in the United States (Eagleton) had a poor first half in the wake of the turmoil in the US energy industry, but entered the second half with a much stronger order book.

## Training and Support

The management contract for HM Naval Base Clyde (Faslane and Coulport) commenced on 1 September 2002. This contract comprises a sharing of cost savings, and we have already identified a number of areas where the savings targets can be achieved. The contract was originally £350 million over a five year period, but this has now been increased to in excess of £400 million and we would expect both the scope and the time period to be extended.

The contract renewal rate at HCS continued at 100%, with renewals for the initial pilot training contract, Cranwell facilities management, and the simulator maintenance for the RAF. However, the size of the contract for the initial pilot training was significantly reduced, with the RAF preferring to use the University Air Squadrons as an alternative, and the Kosovo contract will cease by the end of the year as the British troops are withdrawn. We expect to replace some of the Kosovo contract with a new United Nations contract. A contract was also signed to provide similar facilities for the British troops in Afghanistan, with potential again to increase this, depending on the size of the Allied Forces in that country.

Final bids have been submitted for two large PFI contracts – the Royal School of Military Engineering and the Armoured Vehicle Training System – and the outcome is awaited. We are also progressing the bid for the Airfield Support Services Project.

SGI made a strong debut as part of Babcock by achieving preferred bidder status on the SLAM contract in conjunction with Bovis Lend Lease. SGI will provide the maintenance of the military accommodation once it has been built by Bovis Lend Lease. The initial phase of the contract is for 18,000 units to be built at an estimated cost of £1 billion. SGI's revenue from this contract is expected to be £12 million per annum over seven years, commencing towards the end of 2003. SGI's other business is continuing as predicted and we are seeing significant benefit to the group's overall proposition for the Ministry of Defence. SGI also opens up the possibility of building a civil sector support services business.

Babcock Africa continued its recovery with increased turnover and more robust margins.

### Materials Handling

An improved order book, plus the results of the cost reduction programme implemented last year, lead to Marine, our ship unloading business, contributing a positive performance during this half, which saw the reversal of the heavy losses incurred in the previous corresponding period. We are now progressing with the sale of this business and, once completed, we should have exited all our engineering interests.

We are now at an advanced stage in the disposal of the bagging and batching business, Chronos Richardson. However, losses continued in the first half at this business due to continued market difficulties, which were exacerbated by the longevity of the sale process.

### Summary and prospects

The first half of this year has seen Babcock make significant progress in its objective of becoming a focused support services business and we now have the building blocks in place to realise the potential in this field.

The intended disposals of the Materials Handling businesses have proved to be challenging given the difficult market environment; however, with the expected sale of Chronos Richardson, the remaining business comprises less than 5% of total group turnover.

As a consequence of delivering the strategic plan, we expect to make further progress in the second half, with the benefits of acquisitions and organic growth contributing.

Gordon Campbell

**Gordon Campbell** Chairman

# Group profit and loss account

For the six months ended 30 September 2002

| Year ended 31 March 2002 Total £'000 | | Note | **Six months ended 30 September 2002** Before goodwill and exceptional items (unaudited) £'000 | Goodwill (unaudited) £'000 | Total (unaudited) £'000 | Six months ended 30 September 2001 Before goodwill and exceptional items (unaudited) £'000 | Goodwill and exceptional items (unaudited) £'000 | Total (unaudited) £'000 |
|---|---|---|---|---|---|---|---|---|
| | **Group turnover** | | | | | | | |
| 358,861 | Continuing operations | | **175,392** | **–** | **175,392** | 184,096 | – | 184,096 |
| – | Acquisitions | | **5,904** | **–** | **5,904** | – | – | – |
| 358,861 | | | **181,296** | **–** | **181,296** | 184,096 | – | 184,096 |
| 64,123 | Discontinued operations | 4 | **253** | **–** | **253** | 42,894 | – | 42,894 |
| 422,984 | | 3 | **181,549** | **–** | **181,549** | 226,990 | – | 226,990 |
| | **Group operating profit/(loss)** | | | | | | | |
| 3,545 | Continuing operations | | **8,979** | **(801)** | **8,178** | 7,915 | (2,195) | 5,720 |
| – | Acquisitions | | **197** | **–** | **197** | – | – | – |
| 3,545 | | | **9,176** | **(801)** | **8,375** | 7,915 | (2,195) | 5,720 |
| (2,124) | Discontinued operations | 4 | **(319)** | **–** | **(319)** | (776) | (580) | (1,356) |
| 1,421 | | 3 | **8,857** | **(801)** | **8,056** | 7,139 | (2,775) | 4,364 |
| (529) | Share of operating loss of joint ventures and associates | | **(76)** | **–** | **(76)** | (246) | – | (246) |
| (13,798) | Loss on sale of operations | | **–** | **–** | **–** | – | (3,348) | (3,348) |
| (12,906) | **Profit/(loss) on ordinary activities before interest** | | **8,781** | **(801)** | **7,980** | 6,893 | (6,123) | 770 |
| (1,004) | Net interest and similar charges | | | | **(977)** | | | (655) |
| (13,910) | **Profit/(loss) on ordinary activities before taxation** | | | | **7,003** | | | 115 |
| (3,089) | Tax on profit/(loss) on ordinary activities | 7 | | | **(2,013)** | | | (1,145) |
| (16,999) | **Profit/(loss) on ordinary activities after taxation** | | | | **4,990** | | | (1,030) |
| (143) | Minority interest | | | | **(16)** | | | 88 |
| (17,142) | **Profit/(loss) for the financial period** | | | | **4,974** | | | (942) |
| (4,168) | Dividends paid and proposed | 9 | | | **(1,664)** | | | (1,646) |
| (21,310) | **Retained profit/(loss) for the financial period** | | | | **3,310** | | | (2,588) |
| | Earnings/(loss) per share | 8 | | | | | | |
| (11.68)p | – Basic | | | | **3.36p** | | | (0.64)p |
| (11.66)p | – Diluted | | | | **3.34p** | | | (0.64)p |
| | Earnings per share before non-operating exceptional items and goodwill | 8 | | | | | | |
| 4.51p | – Basic | | | | **3.90p** | | | 2.39p |
| 4.50p | – Diluted | | | | **3.88p** | | | 2.38p |

# Group balance sheet

As at 30 September 2002

| As at 31 March 2002 £'000 | | Note | **As at 30 September 2002 (unaudited) £'000** | As at 30 September 2001 (unaudited) £'000 |
|---|---|---|---|---|
| | Fixed assets | | | |
| | Intangible assets | | | |
| 1,236 | Development costs | | **1,102** | 1,378 |
| | Goodwill | | | |
| 66,670 | – Goodwill | | **87,571** | 82,819 |
| (9,384) | – Negative goodwill | | **(9,141)** | (10,840) |
| 57,286 | | | **78,430** | 71,979 |
| 58,522 | | | **79,532** | 73,357 |
| 22,396 | Tangible assets | | **19,884** | 31,484 |
| | Investments | | | |
| | Investments in joint ventures | | | |
| 1,831 | – Share of gross assets | | **1,616** | 1,903 |
| (1,256) | – Share of gross liabilities | | **(1,191)** | (1,077) |
| 575 | | | **425** | 826 |
| 600 | Investments in associates | | **–** | 537 |
| 3,010 | Other investments | | **3,946** | 2,720 |
| 4,185 | | | **4,371** | 4,083 |
| 85,103 | | | **103,787** | 108,924 |
| | Current assets | | | |
| 15,143 | Stocks | | **21,756** | 22,279 |
| 71,441 | Debtors – due within one year | | **74,993** | 89,032 |
| 68,810 | Debtors – due after more than one year | | **69,096** | 70,330 |
| 140,251 | | | **144,089** | 159,362 |
| 14,142 | Cash and bank balances | 12 | **14,192** | 24,542 |
| 169,536 | | | **180,037** | 206,183 |
| | **Creditors** – amounts due within one year | | | |
| (22,129) | – Borrowings | 12 | **(26,965)** | (19,498) |
| (121,839) | – Other | | **(125,386)** | (156,579) |
| (143,968) | | | **(152,351)** | (176,077) |
| 25,568 | Net current assets | | **27,686** | 30,106 |
| 110,671 | **Total assets less current liabilities** | | **131,473** | 139,030 |
| | **Creditors** – amounts due after more than one year | | | |
| (457) | – Borrowings | 12 | **(20,867)** | (812) |
| (2,440) | – Other | | **–** | (513) |
| (2,897) | | | **(20,867)** | (1,325) |
| (26,799) | Provisions for liabilities and charges | | **(26,217)** | (38,407) |
| 80,975 | Net assets | | **84,389** | 99,298 |
| | Capital and reserves | | | |
| 88,571 | Called up share capital | | **88,876** | 88,712 |
| 37,921 | Share premium account | | **38,068** | 37,674 |
| 30,631 | Capital redemption reserve | | **30,631** | 29,957 |
| (76,195) | Profit and loss account | | **(73,249)** | (57,092) |
| 80,928 | Equity interests | | **84,326** | 98,577 |
| – | Non-equity interests | | **–** | 674 |
| 80,928 | Shareholders' funds | | **84,326** | 99,251 |
| 47 | Equity minority interests | | **63** | 47 |
| 80,975 | | | **84,389** | 99,298 |

# Summarised group cash flow statement

For the six months ended 30 September 2002

| Year ended 31 March 2002 £'000 | | Note | **Six months ended 30 September 2002 (unaudited) £'000** | Six months ended 30 September 2001 (unaudited) £'000 |
|---|---|---|---|---|
| 19,834 | Cash inflow from operating activities | 10 | **5,675** | 6,739 |
| (1,090) | Returns on investments and servicing of finance | | **(839)** | (762) |
| (3,401) | Taxation | | **(1,423)** | (531) |
| (8,489) | Capital expenditure and financial investment | | **(1,846)** | (4,592) |
| (13,907) | Acquisitions and disposals | | **(23,608)** | 4,755 |
| (3,823) | Equity dividends paid | | **(2,536)** | (2,237) |
| (2,917) | Management of liquid resources | | **(460)** | – |
| (13,793) | Cash (outflow)/inflow before financing | | **(25,037)** | 3,372 |
| 14,918 | Financing | | **22,286** | 3,390 |
| 1,125 | **(Decrease)/increase in cash in the period** | 12 | **(2,751)** | 6,762 |

# Group statement of total recognised gains and losses

For the six months ended 30 September 2002

| Year ended 31 March 2002 £'000 | | **Six months ended 30 September 2002 (unaudited) £'000** | Six months ended 30 September 2001 (unaudited) £'000 |
|---|---|---|---|
| (17,142) | Profit/(loss) for the financial period | **4,974** | (942) |
| (1,647) | Currency translation differences on foreign currency net investments and related loans | **(364)** | (1,940) |
| (18,789) | Total recognised gains and losses | **4,610** | (2,882) |

# Reconciliation of movements in shareholders' funds

For the six months ended 30 September 2002

| Year ended 31 March 2002 £'000 | | **Six months ended 30 September 2002 £'000** | Six months ended 30 September 2001 £'000 |
|---|---|---|---|
| 105,636 | Shareholders' funds at start of period | **80,928** | 105,636 |
| (18,789) | Total recognised gains and losses | **4,610** | (2,882) |
| 1,017 | Shares issued in the period | **452** | 237 |
| (2,768) | Redemption of 'B' preference shares | **–** | (2,094) |
| (4,168) | Dividends | **(1,664)** | (1,646) |
| (24,708) | Net movement in shareholders' funds | **3,398** | (6,385) |
| 80,928 | Shareholders' funds at end of period | **84,326** | 99,251 |

# Notes to the financial statements

For the six months ended 30 September 2002

### 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 2002, as set out in the annual report for that year.

### 2 Basis of preparation

The comparative figures for the year ended 31 March 2002 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 2002 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 financial information in the interim report is unaudited.

The interim report for the six months ended 30 September 2002 was approved by the Directors on 20 November 2002.

### 3 Segmental analysis

| | **Six months ended 30 September 2002** | | | | Six months ended 30 September 2001 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Group turnover £'000** | **Group operating profit before goodwill and operating exceptional items £'000** | **Goodwill £'000** | **Group operating profit £'000** | Group turnover £'000 | Group operating profit before goodwill and operating exceptional items £'000 | Goodwill and operating exceptional items £'000 | Group operating profit £'000 |
| Continuing operations | | | | | | | | |
| Technical Services | 91,770 | 7,205 | – | 7,205 | 110,233 | 8,293 | – | 8,293 |
| Training and Support | 64,050 | 4,134 | – | 4,134 | 49,544 | 3,262 | – | 3,262 |
| Materials Handling | 25,476 | (903) | – | (903) | 24,319 | (2,606) | (698) | (3,304) |
| Unallocated costs and other income | – | (1,260) | – | (1,260) | – | (1,034) | (625) | (1,659) |
| | 181,296 | 9,176 | – | 9,176 | 184,096 | 7,915 | (1,323) | 6,592 |
| Goodwill amortisation | – | – | (801) | (801) | – | – | (872) | (872) |
| **Total continuing operations** | **181,296** | **9,176** | **(801)** | **8,375** | **184,096** | **7,915** | **(2,195)** | **5,720** |
| Discontinued operations | 253 | (319) | – | (319) | 42,894 | (776) | (354) | (1,130) |
| Goodwill amortisation | – | – | – | – | – | – | (226) | (226) |
| **Total discontinued operations** | **253** | **(319)** | **–** | **(319)** | **42,894** | **(776)** | **(580)** | **(1,356)** |
| **Group total** | **181,549** | **8,857** | **(801)** | **8,056** | **226,990** | **7,139** | **(2,775)** | **4,364** |

The group made two acquisitions during the six month period ended 30 September 2002. The business and assets of Service Group International Ltd were purchased on 19 June 2002. This business is included in the Training and Support segment and has contributed turnover and operating profit to 30 September 2002 of £5.2 million and £19,000 respectively. The shares of MEF were acquired on 2 August 2002. This business is included in the Technical Services segment and has contributed turnover and operating profit to 30 September 2002 of £0.7 million and £0.2 million respectively.

### 4 Discontinued operations

Discontinued operations comprise the BMH Americas business, the last remaining part of the Materials Handling cement business, which was disposed of on 30 April 2002.

### 5 Operating exceptional items

Exceptional costs of £nil (2001: £1.7 million) have been incurred to 30 September 2002. Prior period operating exceptional costs were in respect of restructuring businesses within the Materials Handling segment (£1.1 million) and a proposed acquisition that did not proceed (£0.6 million).

### 6 Loss on sale of operations

A loss on sale of operations of £nil (2001: £3.3 million) has been incurred to 30 September 2002. The prior period loss on sale was in relation to the BMH Wood business and included the write-off of goodwill amounting to £2.6 million.

### 7 Taxation

The charge for taxation has been based on the estimated effective tax rate for the year ended 31 March 2003.

**8 Earnings/(loss) per share**

The basic earnings/(loss) per share has been calculated on the profit for the period of £4,974,000 (2001: loss of £942,000) and the weighted average number of ordinary shares in issue throughout the period of 148,050,460 (2001: 146,628,978).

The diluted earnings/(loss) per share has been calculated after taking account of 5,942,711 dilutive share options where the exercise price is less that 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 £801,000 (2001: £1,098,000) and the loss on the sale of operation of £nil (2001: £3,348,000).

**9 Dividends**

An interim dividend of 1.15p per 60p ordinary share (2001: 1.1p per 60p ordinary share) will be paid on 24 January 2003 to shareholders registered on 20 December 2002.

**10 Reconciliation of operating profit to cash flow from operating activities**

| Year ended 31 March 2002 £'000 | | **Six months ended 30 September 2002 (unaudited) £'000** | Six months ended 30 September 2001 (unaudited) £'000 |
|---|---|---|---|
| 1,421 | Group operating profit | **8,056** | 4,364 |
| 10,550 | Depreciation | **4,424** | 5,650 |
| 271 | Amortisation of intangibles | **134** | 129 |
| 2,085 | Amortisation of goodwill | **801** | 1,098 |
| (2,455) | Movement on working capital | **(7,739)** | (4,516) |
| 7,873 | Impairment of goodwill | **–** | – |
| 89 | Other items | **(1)** | 14 |
| 19,834 | Cash inflow from operating activities | **5,675** | 6,739 |

**11 Movement in net funds**

| Year ended 31 March 2002 £'000 | | **Six months ended 30 September 2002 (unaudited) £'000** | Six months ended 30 September 2001 (unaudited) £'000 |
|---|---|---|---|
| 1,125 | (Decrease)/increase in cash in the period | **(2,751)** | 6,762 |
| 2,917 | Increase in liquid resources in the year | **460** | – |
| (13,469) | Cash flow from the increase in debt and lease financing | **(21,834)** | (2,047) |
| (9,427) | Change in net funds resulting from cash flows | **(24,125)** | 4,715 |
| 2,152 | Loans and finance leases (acquired)/disposed of with subsidiaries | **(78)** | 535 |
| (790) | New finance leases | **(640)** | (1,027) |
| 1,214 | Loan from minority shareholders in subsidiary capitalised | **–** | 1,214 |
| (255) | Foreign currency translation differences | **(353)** | 133 |
| (7,106) | Movement in net (debt)/funds in the period | **(25,196)** | 5,570 |
| (1,338) | Net debt at the start of the period | **(8,444)** | (1,338) |
| (8,444) | Net (debt)/funds at the end of the period | **(33,640)** | 4,232 |

### 12 Changes in net funds

| | At 1 April 2002 £'000 | Cash flow £'000 | Acquisitions and disposals £'000 | Other non-cash changes £'000 | Exchange movement £'000 | **At 30 September 2002 £'000** |
|---|---|---|---|---|---|---|
| Cash and bank balances | 11,225 | (579) | – | – | 169 | **10,815** |
| Bank overdrafts | (1,832) | (2,172) | – | – | (588) | **(4,592)** |
| | 9,393 | (2,751) | – | – | (419) | **6,223** |
| Debt | (20,020) | (21,991) | – | – | 1 | **(42,010)** |
| Finance leases | (734) | (483) | (78) | – | 65 | **(1,230)** |
| | (20,754) | (22,474) | (78) | – | 66 | **(43,240)** |
| Liquid resources | 2,917 | 460 | – | – | – | **3,377** |
| **Total** | (8,444) | (24,765) | (78) | – | (353) | **(33,640)** |

### 13 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 will be available on the company's website: www.babcock.co.uk

**Babcock International Group PLC**
2 Cavendish Square
London W1G 0PX
United Kingdom

Telephone +44 (0)20 7291 5000
Facsimile +44 (0)20 7291 5055
www.babcock.co.uk