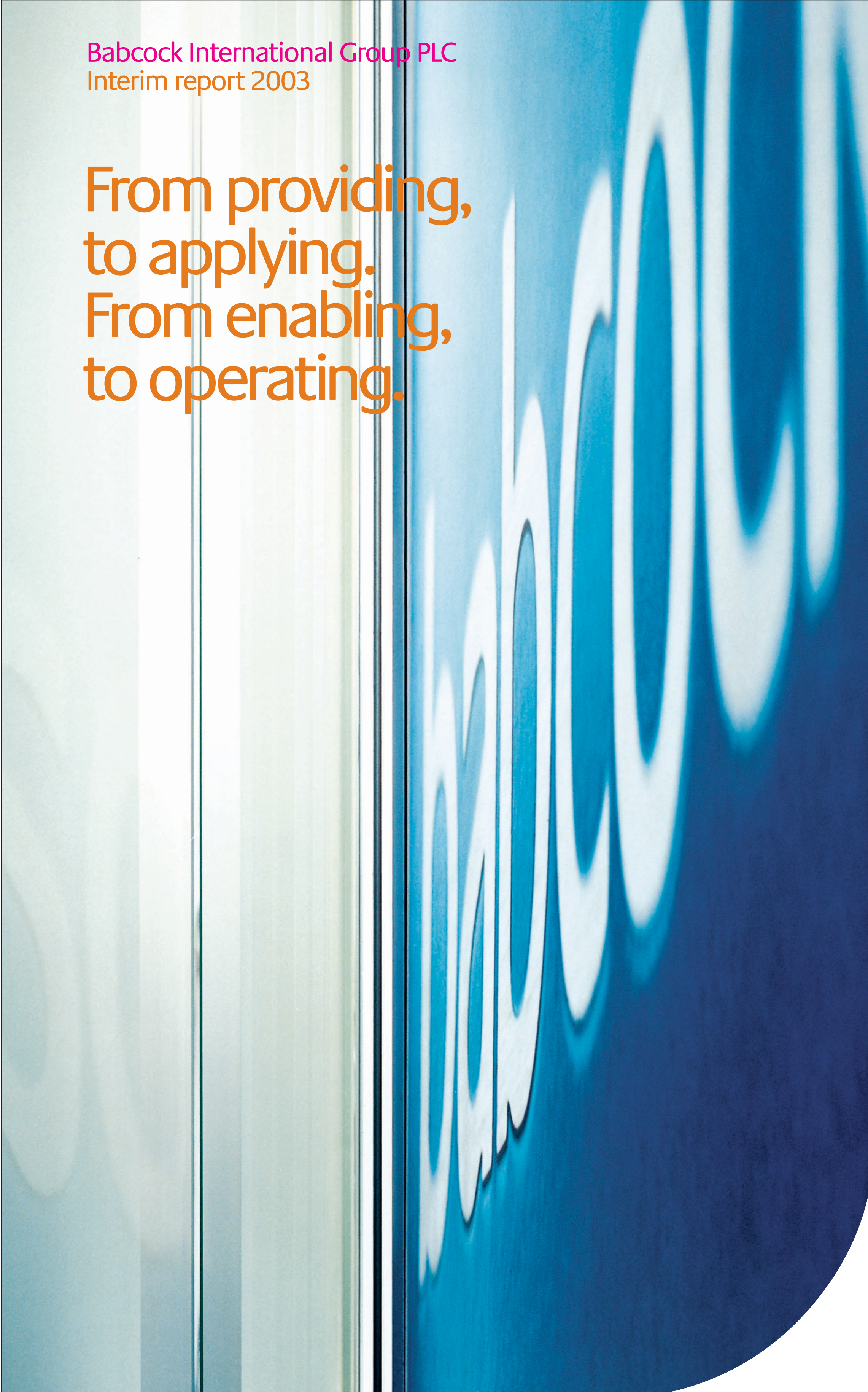
Babcock International Group PLC
Interim report 2003

From providing, to applying. From enabling, to operating.



Business highlights

	First half 2003/04	First half 2002/03	Percentage change
Sales[(1)]	£215m	£156m	+38%
Operating profit[(2)]	£12.3m	£10.1m	+22%
Profit before tax	£9.4m	£7.0m	+34%
Earnings per share[(3)]	6.69p	3.98p	+68%
Dividend	1.25p	1.15p	+8.7%

(1) Before discontinued operations (2004: £10.2 million, 2003: £25.7 million).
(2) Before goodwill amortisation (2004: £1.6 million, 2003: £0.8 million) and discontinued operations losses (2004: £0.2 million, 2003: £1.2 million).
(3) Before exceptional items and goodwill amortisation (2004: £1.7 million, 2003: £0.8 million).

Preferred Bidder on South West Regional Prime (SWRP).

Wins at RAF Valley and Exhibitions.

Contract win for Heathrow Terminal 5 modules.

Further progress on involvement in carrier construction.

Order book stands at £640 million excluding Single Living Accommodation Modernisation (SLAM) and SWRP.

Materials Handling disposal complete.

Introduction

In the period since the end of the last financial year, Babcock has achieved its goal of becoming a dedicated support services company. This was reinforced after the end of the half year with Babcock named as Preferred Bidder on the South West Regional Prime contract and the sale of the last substantial Materials Handling business. Following the award of the RAF Valley contract, Babcock will be responsible for maintaining virtually all Royal Navy and RAF Hawk jet trainers.

The position of Rosyth as the nominated assembly and integration site for the new aircraft carrier programme has been further strengthened as a result of emerging agreement that Rosyth will also have a substantial part to play in the construction programme, which now looks likely to start in 2007. The award to Rosyth of significant work on Heathrow Terminal 5 demonstrates that the structural changes made there are bearing fruit. A number of other substantial opportunities outside the Ministry of Defence are being pursued.

Financial overview

Total group turnover of £225.1 million represents an increase of 24% over the first half of last year (£181.5 million). With the disposal of the remaining BMH business in November 2003, turnover on continuing businesses increased by 38% to £214.9 million, driven by the inclusion of a full six months operations at the Clyde Naval Base and by growth in the Babcock Infrastructure Services (BIS) businesses.

Higher profit contributions from the Clyde Naval Base and BIS increased group operating profit from continuing businesses, pre-goodwill, to £12.3 million, up £2.2 million or 22% compared with the first half of last year (£10.1 million). The operating margin pre-goodwill from continuing businesses was 5.7% compared to 6.1% for the full year last year.

Agreement for the sale of the BMH Marine business was reached in November and as such its operating results have been re-categorised as discontinued at the half year. The loss arising on disposal of £1.8 million is shown as a non-operating exceptional item.

The interest charge before exceptionals for the first six months at £1.0 million was the same as the first half of last year. Net debt at 30 September 2003 stood at £26.7 million compared to £37.2 million at 31 March 2003. The large fluctuations in working capital not withstanding, this position reflects a strong underlying cash performance in the first half.

A one-off cash benefit of £1.7 million arose on the sale of a financial asset in the first half of the year and is reported here as an exceptional gain within the interest and similar income line. This, together with a lower tax charge than originally anticipated, contributed to an increase of 60% in earnings per share from 3.43p in the first half of 2002/03, to 5.50p in the current half year. Excluding the effect of goodwill and exceptional items, earnings per share were 6.69p, up 68% from 3.98p for the first six months of last year.

At the end of the half year the order book stood at £640 million excluding SLAM and SWRP. The addition of these two contracts would take the level to over £1.2 billion.

Improving profitability and cash flow has enabled the Board to declare an interim dividend of 1.25p per ordinary share for the six months ended 30 September 2003, up 8.7% from 1.15p for the first half of last year.

Operational review

Technical Services

Turnover £88.7 million (2002: £91.8 million). Operating profit (before goodwill) £7.3 million (2002: £7.2 million)

Turnover in Technical Services was slightly down, in line with our expectations, reflecting the end of the submarine programme at Rosyth. The restructuring of Rosyth into four separate business units is now complete and is beginning to show dividends, both in aligning the cost base and developing commercial opportunities.

The work programme on HMS Illustrious, the third of the carrier refits, accelerated during the period. The refit continues on schedule and the innovative partnering initiatives introduced at the start of the refit are being viewed as best practice by our customer. This programme will complete in the second half of next year. Work continued on the Type 23 Frigate batch and the fourth started refit in September. Towards the end of the period four small ships contracts, two of which were won in competition, started.

The Engineered Products Business Unit at Rosyth has won a significant contract (£13 million excluding materials) for production design and manufacture of steel modules for the new Terminal 5 construction project at London's Heathrow airport. In addition, its marketing programme to develop other opportunities in the offshore Oil and Gas, Water, Marine and Civil Engineering sectors is beginning to show benefits. The programme for the 'SMIT' training boats has completed and half of the 16 landing craft have been delivered, with the remainder to be delivered in the second half.

Other significant wins for Rosyth include, the 'Design Alliance' contract with the Ministry of Defence. This partnership secures a base load of defence work for Babcock Design & Technology (BD&T), worth in the region of £8 million over the next four years. The success of BD&T's interactive asset information service, V-Bridge®, has continued with the award of contracts to cover a further six RN ships. This ground-breaking solution was awarded the Scottish Enterprise award for Innovation in 2003, and is attracting interest from commercial, asset-intensive markets.

The Non-Project Procurement Organisation (NPPO) contract, which was won last year, is currently ahead of plan and the Supply Chain Services business unit are pursuing a number of opportunities in the same area.

Discussions have continued with the Prime Contract Office for the new aircraft carriers, and a number of packages of information relating to construction options have been submitted. Rosyth remains the nominated site for assembly, integration, final outfit and commissioning of the new aircraft carriers and we are optimistic that significant construction work will also be awarded. Construction is now most likely to start during 2007.

Despite difficult market conditions and severe competition FBM were successful in winning a £9 million contract to construct a 64 metre Ropax ferry for Doeksen with an option for a further vessel. This business remained in loss during the first half, but some improvement should occur in the second half.

Eagleton, the US oil pipeline business, was profitable throughout the period, although there were few significant contracts awarded during the half year.

Training and Support

Turnover £126.2 million (2002: £64.0 million). Operating profit (before goodwill) £7.1 million (2002: £4.1 million)

As expected, turnover in Babcock Defence Services slipped back compared with last year as the effect of British troop withdrawal from Kosovo was seen. Some ground was regained with the award of contracts to support NATO and the UN in the Balkans and for further support in Afghanistan. Towards the end of the half-year there was success in winning a technician-training contract for Hawk maintenance in the UAE – while not large in turnover terms it will be profitable and establishes our credentials in the region which has a large population of Hawk aircraft.

Progress on major bids in BDS continues to be slow with the Ministry of Defence requiring a further bid revision period on The Armoured Vehicle Training System (AVTS), some 14 months after supposed final bids had been submitted for final evaluation. The process on the Royal School of Military Engineering project remains opaque – our elevation from sole bidder to preferred bidder was expected in the half year but has not yet happened. The other long-running process for Airside Support is under evaluation by the Ministry Team, but we have no certainty as to when the award will be made. Babcock has expensed some £6 million on preparing these bids and decisions by the MoD are still awaited.

The disappointment of losing Cranwell was more than compensated by the win of RAF Valley – the RAF station on Anglesey. The win of RAF Valley will result in Babcock, in April 2004, having responsibility for maintenance and operation of virtually all RAF and Royal Navy Hawk trainers. We also retained the RAF Exhibitions contract.

Babcock Infrastructure Services (BIS) turnover grew as a result of the SGI business being included for the full period and as a result of a very strong showing from the South African business. The Single Living Accommodation Modernisation project is on plan, although we do not expect significant income from this project until 2005 when accommodation units have been completed and handed over by our partners, Bovis Lend Lease. It will then provide a steady income for the following seven to ten years. We have also secured a two-year extension on the Ealing education contract and on the Crown Estates contract.

Significant time and money is being invested in bidding for the Regional Prime Contracts for Defence Estates. Nomination as preferred bidder for the South West Regional Prime contract was a significant win for Debut – our joint venture with Bovis Lend Lease. Babcock's element of the contract is currently valued at an average of £65 million a year for seven years and we would expect to achieve substantial growth above this level. The bid was led by the business we acquired last year as SGI and will more than treble the turnover of the acquired business. This is the second of five regional prime contracts to be awarded and the BIS team have already qualified to tender for two further regions. So far, Defence Estates have managed to meet every deadline they set themselves to achieve during the procurement processes.

The scope of these contracts is very broad – covering all maintenance and the majority of capital works projects for the MoD Estates – and will be delivered through management by Babcock of a "best in class" supply chain.

Our South African operations made significant progress, both in revenue and profit terms, over the first half. The support business for energy generation has improved margins substantially (although there is still room for progress) and the Volvo Construction Equipment distributorship has been outstandingly successful with new equipment sales more than doubling compared with the same period last year. Margins should continue to improve as the vehicle park grows, vehicles age, and the parts and service markets develop.

It is still the plan to build on the successful African base to create a company which looks more like the UK operations in addition to the continuation of the existing business.

Babcock Naval Services won the Private Finance Initiative/Public:Private Partnership of the Year Award from Insider Magazine and Bank of Scotland – a recognition of the success of the partnering concept as implemented at the Clyde Naval Base. Savings identified and implemented under the contract are ahead of plan and we remain confident that we will continue to deliver savings and excellent service to the Royal Navy. This will result in further margin improvement. Our relationship with the customer at Faslane remains an excellent example of the partnering ethos and is clearly recognised as such by ourselves.

Materials Handling

Turnover £10.2 million (2002: £25.7 million). Operating loss (before goodwill) £0.2 million (2002: £1.2 million)

The Swedish Material Handling businesses continued to experience difficult market conditions, making a small loss in the first half.

Agreement has been reached for the sale of the business and assets of BMH Marine which effectively completes our strategy of exiting the BMH businesses. Completion of the sale will take place on 30 November.

Summary and prospects

In the period since the end of the last financial year, we attained the goal of becoming a focused support services business. Following the end of the half year the disposal of the Materials Handling business and the nomination as Preferred Bidder for South West Regional Prime underlined the transformation. Current trading is in line with our expectations.

Babcock will now concentrate on continuing to deliver outstanding service to its customers and, at the same time, focus on achieving further contract wins.

Peter Rogers
Chief Executive

Summarised group profit and loss account

For the six months ended 30 September 2003

Year ended 31 March 2003 Total £m		Note	Six months ended 30 September 2003: Before goodwill and non-operating exceptional items (unaudited) £m	Goodwill and non-operating exceptional items (unaudited) £m	Total (unaudited) £m	Six months ended 30 September 2002: Before goodwill (unaudited) £m	Goodwill (unaudited) £m	Total (unaudited) £m
	Group turnover							
377.9	Continuing operations		**214.9**	**–**	**214.9**	155.8	–	155.8
45.6	Discontinued operations	4	**10.2**	**–**	**10.2**	25.7	–	25.7
423.5		3	**225.1**	**–**	**225.1**	181.5	–	181.5
	Group operating profit/(loss)							
21.1	Continuing operations		**12.3**	**(1.6)**	**10.7**	10.1	(0.8)	9.3
(2.2)	Discontinued operations	4	**(0.2)**	**–**	**(0.2)**	(1.2)	–	(1.2)
18.9		3	**12.1**	**(1.6)**	**10.5**	8.9	(0.8)	8.1
(0.2)	Share of operating loss of joint ventures and associates		**–**	**–**	**–**	(0.1)	–	(0.1)
(2.7)	Provision for loss on sale of operations	5	**–**	**(1.8)**	**(1.8)**	–	–	–
16.0	**Profit on ordinary activities before interest**		**12.1**	**(3.4)**	**8.7**	8.8	(0.8)	8.0
(2.6)	Net interest and similar (charges)/income	6	**(1.0)**	**1.7**	**0.7**	(1.0)	–	(1.0)
13.4	**Profit on ordinary activities before taxation**		**11.1**	**(1.7)**	**9.4**	7.8	(0.8)	7.0
(5.1)	Tax on profit on ordinary activities	7			**(1.4)**			(2.0)
8.3	**Profit on ordinary activities after taxation**				**8.0**			5.0
(4.4)	Dividends paid and proposed	9			**(1.8)**			(1.7)
3.9	**Retained profit for the financial period**				**6.2**			3.3
	Earnings per share	8						
5.72p	– Basic				**5.50p**			3.43p
5.69p	– Diluted				**5.47p**			3.41p
	Earnings per share before non-operating exceptional items and goodwill	8						
8.91p	– Basic				**6.69p**			3.98p
8.87p	– Diluted				**6.66p**			3.96p

Group balance sheet

As at 30 September 2003

As at 31 March 2003 £m		Note	As at 30 September 2003 (unaudited) £m	As at 30 September 2002 (unaudited) £m
	Fixed assets			
	Intangible assets			
1.0	Development costs		**0.8**	1.1
	Goodwill			
84.0	– Goodwill		**83.6**	86.3
(6.5)	– Negative goodwill		**(5.6)**	(7.9)
77.5			**78.0**	78.4
78.5			**78.8**	79.5
16.5	**Tangible assets**		**15.0**	19.9
	Investments			
	Investments in joint ventures			
1.4	– Share of gross assets		**2.1**	1.6
(1.8)	– Share of gross liabilities		**(2.6)**	(2.0)
0.8	– Loans to joint ventures		**1.1**	0.8
0.4			**0.6**	0.4
3.9	Other investments		**4.9**	4.0
4.3			**5.5**	4.4
99.3			**99.3**	103.8
	Current assets			
23.4	Stocks		**28.0**	21.7
88.7	Debtors – due within one year		**92.1**	75.0
69.6	Debtors – due after more than one year		**65.4**	69.1
158.3			**157.5**	144.1
12.7	Cash and bank balances	12	**14.0**	14.2
194.4			**199.5**	180.0
	Creditors – amounts due within one year			
(31.1)	– Borrowings	12	**(24.8)**	(27.0)
(128.8)	– Other		**(132.2)**	(125.3)
(159.9)			**(157.0)**	(152.3)
34.5	**Net current assets**		**42.5**	27.7
133.8	**Total assets less current liabilities**		**141.8**	131.5
	Creditors – amounts due after more than one year			
(18.8)	– Borrowings	12	**(15.8)**	(20.9)
(0.2)	– Other		**(0.1)**	–
(19.0)			**(15.9)**	(20.9)
(27.4)	**Provisions for liabilities and charges**		**(31.1)**	(26.2)
87.4	**Net assets**		**94.8**	84.4
	Capital and reserves			
88.9	Called up share capital		**89.2**	88.9
38.1	Share premium account		**38.2**	38.1
30.6	Capital redemption reserve		**30.6**	30.6
(70.3)	Profit and loss account		**(63.3)**	(73.3)
87.3	**Equity interests**		**94.7**	84.3
–	**Non-equity interests**		**–**	–
87.3	Shareholders' funds		**94.7**	84.3
0.1	Equity minority interests		**0.1**	0.1
87.4			**94.8**	84.4

Summarised group cash flow statement

For the six months ended 30 September 2003

Year ended 31 March 2003 £m		Note	Six months ended 30 September 2003 (unaudited) £m	Six months ended 30 September 2002 (unaudited) £m
11.3	Cash inflow from operating activities	10	**13.4**	5.7
(2.5)	Returns on investments and servicing of finance		**0.8**	(0.8)
(3.0)	Taxation		**(0.7)**	(1.4)
(3.0)	Capital expenditure and financial investment		**(1.8)**	(1.9)
(26.8)	Acquisitions and disposals		**1.1**	(23.6)
(4.2)	Equity dividends paid		**(2.7)**	(2.5)
(28.2)	Cash inflow/(outflow) before management of liquid resources and financing		**10.1**	(24.5)
(0.2)	Management of liquid resources		**0.2**	(0.5)
20.7	Financing		**(4.9)**	22.2
(7.7)	**Increase/(decrease) in cash in the period**	11	**5.4**	(2.8)

Group statement of total recognised gains and losses

For the six months ended 30 September 2003

Year ended 31 March 2003 £m		Six months ended 30 September 2003 (unaudited) £m	Six months ended 30 September 2002 (unaudited) £m
8.3	Profit for the financial period	**8.0**	5.0
2.0	Currency translation differences on foreign currency net investments and related loans	**0.7**	(0.4)
10.3	Total recognised gains and losses relating to the period	**8.7**	4.6

Reconciliation of movements in shareholders' funds

For the six months ended 30 September 2003

Year ended 31 March 2003 £m		Six months ended 30 September 2003 £m	Six months ended 30 September 2002 £m
80.9	Shareholders' funds at start of period	**87.3**	80.9
0.5	Shares issued in the period	**0.5**	0.5
10.3	Total recognised gains and losses	**8.7**	4.6
(4.4)	Dividends	**(1.8)**	(1.7)
6.4	Net movement in shareholders' funds	**7.4**	3.4
87.3	Shareholders' funds at end of period	**94.7**	84.3

Notes to the financial statements

For the six months ended 30 September 2003

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 2003, as set out in the annual report for that year.

2 Basis of preparation

The comparative figures for the year ended 31 March 2003 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 2003 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 2003 was approved by the Directors on 19 November 2003.

3 Segmental analysis

	Six months ended 30 September 2003				Six months ended 30 September 2002			
	Group turnover £m	Group operating profit before goodwill £m	Goodwill £m	Group operating profit £m	Group turnover £m	Group operating profit before goodwill £m	Goodwill £m	Group operating profit £m
Continuing operations								
Technical Services	**88.7**	**7.3**	**–**	**7.3**	91.8	7.2	–	7.2
Training and Support	**126.2**	**7.1**	**–**	**7.1**	64.0	4.1	–	4.1
Unallocated costs and other income	**–**	**(2.1)**	**–**	**(2.1)**	–	(1.2)	–	(1.2)
	214.9	**12.3**	**–**	**12.3**	155.8	10.1	–	10.1
Goodwill amortisation	**–**	**–**	**(1.6)**	**(1.6)**	–	–	(0.8)	(0.8)
Total continuing operations	**214.9**	**12.3**	**(1.6)**	**10.7**	155.8	10.1	(0.8)	9.3
Discontinued operations	**10.2**	**(0.2)**	**–**	**(0.2)**	25.7	(1.2)	–	(1.2)
Group total	**225.1**	**12.1**	**(1.6)**	**10.5**	181.5	8.9	(0.8)	8.1

4 Discontinued operations

Discontinued operations comprise BMH Marine AB, which has been sold since the period end and BMH Kellve AB, which is expected to be sold prior to the year end. The prior year results have been adjusted to reflect this. The turnover and operating profit of BMH Kellve were £2.6 million and £0.1 million respectively (2002: £3.1 million and £0.2 million).

5 Provision for loss on sale of operations

A non-operating exceptional loss of £1.8 million was provided for during the period for the disposal of the remaining BMH businesses.

6 Interest exceptional items

A gain arose on the sale of a financial asset in the first half of the year and is reported as an exceptional gain within the interest and similar income line.

7 Taxation

The charge for taxation has been based on the estimated effective tax rate for the year ended 31 March 2004. There is no tax on the exceptional items.

8 Earnings per share

The basic earnings per share has been calculated on the profit for the period of £8.0 million (2002: profit of £5.0 million) and the weighted average number of ordinary shares in issue throughout the period of 144,696,659 (2002: 144,937,815).

The diluted earnings per share has been calculated after taking account of 4,818,062 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 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 £1.6 million (2002: £0.8 million), the provision for loss on sale of operations of £1.8 million (2002: £nil) and the interest exceptional income of £1.7 million (2002: £nil). There is no tax effect on these adjustments.

Last year's average share numbers have been revised to eliminate the shares held by the Babcock Employee Share Trust.

9 Dividends

An interim dividend of 1.25p per 60p ordinary share (2002: 1.15p per 60p ordinary share) will be paid on 23 January 2004 to shareholders registered on 19 December 2003.

10 Reconciliation of operating profit to cash flow from operating activities

Year ended 31 March 2003 £m		Six months ended 30 September 2003 (unaudited) £m	Six months ended 30 September 2002 (unaudited) £m
18.9	Group operating profit	**10.5**	8.1
8.8	Depreciation	**2.4**	4.4
0.3	Amortisation of intangibles	**0.1**	0.1
1.9	Amortisation of goodwill	**1.6**	0.8
(18.6)	Movement on working capital	**(1.2)**	(7.7)
11.3	Cash inflow from operating activities	**13.4**	5.7

11 Movement in net debt

Year ended 31 March 2003 £m		Six months ended 30 September 2003 (unaudited) £m	Six months ended 30 September 2002 (unaudited) £m
(7.7)	Increase/(decrease) in cash in the period	**5.4**	(2.8)
0.2	(Decrease)/increase in liquid resources in the year	**(0.2)**	0.5
(20.2)	Cash flow from the decrease/(increase) in debt and lease financing	**5.4**	(21.8)
(27.7)	Change in net debt resulting from cash flows	**10.6**	(24.1)
(0.1)	Loans and finance leases (acquired)/disposed of with subsidiaries	**–**	(0.1)
(0.7)	New finance leases	**–**	(0.7)
(0.3)	Foreign currency translation differences	**(0.1)**	(0.3)
(28.8)	Movement in net debt in the period	**10.5**	(25.2)
(8.4)	Net debt at the start of the period	**(37.2)**	(8.4)
(37.2)	Net debt at the end of the period	**(26.7)**	(33.6)

12 Changes in net debt

	At 1 April 2003 £m	Cash flow £m	Acquisitions and disposals £m	Other non-cash changes £m	Exchange movement £m	**At 30 September 2003 £m**
Cash and bank balances	9.6	1.4	–	–	–	**11.0**
Bank overdrafts	(7.9)	4.0	–	–	–	**(3.9)**
	1.7	5.4	–	–	–	**7.1**
Debt	(40.7)	5.2	–	–	–	**(35.5)**
Finance leases	(1.3)	0.2	–	–	(0.1)	**(1.2)**
	(42.0)	5.4	–	–	(0.1)	**(36.7)**
Liquid resources	3.1	(0.2)	–	–	–	**2.9**
Total	(37.2)	10.6	–	–	(0.1)	**(26.7)**

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

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