

Our declared strategy, for the last two years, has been to convert Babcock into a support services business. I am delighted to be able to say that this transformation is now almost complete. We have continued to grow our service orientated businesses both organically and through acquisition, whilst disposing of the residual engineering businesses. By the second half of the year ending March 2003, these engineering businesses comprised only 7% of our total turnover, whilst the support services turnover had grown to £222 million from £148 million in the equivalent six months (an increase of 50%). It remains our intent to sell the remaining engineering business and to continue to grow in the support services sector. We have now been reclassified to this sector in the FTSE Index.

Support services offer more growth opportunities, are less exposed to economic downturns, and are largely independent of exchange rate movements. In short, they offer the potential for higher and more secure earnings growth. We are now well positioned to take advantage of this.

Due to the disposals, total turnover was flat year-on-year, but second half turnover grew by 23% as the new businesses more than replaced those that had been sold.

Operating profit, before goodwill and exceptional items, increased by 39% to £20.8 million, and over the two year period of the present strategy, has more than doubled. Operating profit before goodwill and exceptional items for continuing businesses increased by 44%, and with no operating exceptional items, earnings per share were 5.72p compared to a loss in the previous year of 11.86p per share.

The Board is recommending a final dividend of 1.85p per share, giving a total dividend for the year of 3.0p per share, an increase of 5.3% on the previous year.

Part of the turnover growth came from the acquisition of SGI whose purchase was concluded in June 2002, but the bulk of the increase came from new contracts. In particular, the contract to manage Her Majesty's Naval Base Clyde commenced on 1 September 2002. New contracts were also won from the Ministry of Defence to carry out the procurement and distribution of their electrical and electronic components, and our joint venture with Bovis Lend Lease secured the contract to construct and maintain the new Single Living Accommodation Modernisation (SLAM) for the Armed Forces. We were also named as sole bidder for the Royal School of Military Engineering. These latter two contracts should start to contribute in 2004. Of equal importance was the naming of Rosyth as the assembly site for the new aircraft carriers. This should secure a base-load for Rosyth through to 2015.

The sale of the materials handling business progressed and we now have only one business to exit.

As noted in last year's accounts, Mr Alan Wheatley retired at the AGM in 2002 and the Board would like to reiterate its thanks for Mr Wheatley's contribution. We welcome onto the Board Admiral Sir Nigel Essenhigh who, prior to his retirement from the Royal Navy in 2002, was the First Sea Lord. Sir Nigel brings a great understanding of the operations of our Armed Forces and of the Ministry of Defence, and will strengthen our knowledge of our major customer.

2003 saw the first draft of the Higgs' Report on corporate governance. We will watch with care and interest the proposals which stem from this report. Our intention will be to continue to do that which we believe is in the best interests of the company and its shareholders, and to explain if this should be at variance with any revised Code.

We intend, subject to shareholder approval, to introduce a modified long-term incentive scheme for senior managers. The details of this are shown in the Remuneration Committee Report, and the objective is to align managerial reward with the interests of our shareholders, whilst maintaining a competitive remuneration package.

The last two years have been a period of enormous change for Babcock, and this particularly affects our staff. I would like to thank them for their considerable efforts in bringing about these changes, and I am sure that we now have a company which is far more cohesive than that which existed two years ago. We are building a Babcock culture where all our staff are committed to delivering the highest level of service to our customers.

Many companies are reporting large shortfalls in their pension funds, and I am glad to be able to report that our pension funds, in aggregate, remain in surplus, even using the FRS17 approach which introduces such extreme volatility.

Our performance over the last two years is a result of having a clear strategy and a steely determination to implement it. However, the outcome has to be measured by the returns to our shareholders. In that respect, our performance, relative to the FTSE All-Share Index is a key measure. I am pleased to be able to inform you that, over the last 12 months, the Babcock share price has outperformed the All-Share index by 20%. Over the two year period ending March 2003, this outperformance has been 30%. I am confident that, with contracts which have already been won or which we hope to conclude within the next 12 months, turnover and earnings will continue to grow and hence continue to increase shareholder value.


G A Campbell
Chairman

