

Business Review

Financial performance

Net finance cost

Net finance cost was £14.6m (2009: net cost of £3.1m). The year on year increase was attributable to a £9.6m increase in the net finance cost on post-employment benefit liabilities and a significant interest-rate driven reduction in the interest receivable on short-term deposits. The net finance cost is expected to stabilise in 2010/11 and remain similar to that reported in 2009/10.

Taxation

The Group's income tax expense for the year is £19.3m (2009: £18.5m) giving an effective tax rate of 20.0% (2009: 18.0%). The Group's normalised effective tax rate is 19.8% (2009: 18.5%). The rate is lower than the UK rate (28%) due to continued benefits from research and development tax credits and the proportion of overseas profits earned in jurisdictions with a lower tax rate. The Group expects the effective tax rate to continue to benefit from similar tax credits and territorial profile of profits going forward.

Earnings per share (EPS)

Basic EPS for continuing operations was 79.5p (2009: 86.1p). Normalised diluted EPS, which we consider to be a more representative measure of underlying trading and relates to continuing operations, was 77.8p (2009: 82.3p), a decrease of 5.5%.

Pensions Funding

The latest actuarial valuation of the defined benefit Atkins Pension Plan (the Plan) carried out as at 1 April 2007 indicated that the Plan had an actuarial deficit of approximately £215m. Accelerated contributions of £32m were made during the year and the Group has agreed to contribute a further £32m per year for the next four years. The next actuarial valuation will take place as at 1 April 2010 and is likely to be completed in late 2010 or early 2011.

Charges

The Group accounts for pension costs under IAS 19, *Employee benefits*. The total charge to the income statement in respect of defined benefit schemes reduced to £13.9m (2009: £14.8m), comprising total service cost of £5.5m (2009: £8.9m); net finance cost of £15.1m (2009: £5.9m) and curtailment and settlement gains of £2.6m and £2.3m (net) respectively. The charge relating to defined contribution schemes increased to £33.5m (2009: £28.2m).

IAS 19 valuation and accounting treatment

The Group assesses pension scheme funding with reference to actuarial valuations, but for reporting purposes uses IAS 19. Under IAS 19, the Group recognised a much-increased retirement benefit liability of £440.0m at 31 March 2010 (2009: £298.4m) despite a strong performance of the scheme assets. The actuarial loss recognised through the Group's statement of comprehensive income amounted to £119.7m (2009: £88.5m).

The assumptions used in the IAS 19 valuation are detailed in note 29 to the Financial Statements.

Cash

Net funds at 31 March 2010 were £302.5m (2009: £234.2m) made up as follows:

	2010 £m	2009 £m
Cash and cash equivalents	260.3	209.7
Loan notes receivable	21.2	12.9
Financial assets at fair value through profit or loss	32.4	28.7
Borrowings due within one year	(0.7)	(2.8)
Borrowings due after one year	–	(0.6)
Finance leases	(10.7)	(13.7)
Net funds	302.5	234.2

Cash generated from continuing operations was £126.5m (2009: £125.5m), representing 112% of operating profit, and can be summarised as follows:

	2010 £m	2009 £m
EBITDA	134.0	136.5
Outflow relating to pensions	(36.3)	(40.6)
Movement in working capital	29.6	10.9
Movement in long-term payables	1.9	–
Movement in provisions	(5.9)	9.2
Other non-cash items	3.2	9.5
	126.5	125.5

Operating cash flow remained strong as we continued to optimise the cash position on our contracts. Proactive working capital management resulted in a net working capital inflow of £29.6m which was achieved despite a lengthening of debtor days in the Middle East.

The movement in provisions is mainly due to the one-off release of residual provisions within our Asset Management business.

Net tax paid amounted to £18.0m (2009: £12.8m) which includes payments of £3.5m (2009: £0.4m) to Metronet for consortium relief.

Net capital expenditure in the year, including the purchase of computer software licences, amounted to £10.8m (2009: £27.6m). The reduction was due to less spending and better utilisation of assets already in use.

No shares were bought back during the year in respect of the share buyback programme (2009: £12.3m).

Capital structure

As at 31 March 2010, the Group had a shareholders' deficit of £84.9m (2009: £43.5m) and the Company had shareholders' funds of £136.7m (2009: £108.8m).

The Company had 104.5m fully paid ordinary shares in issue at 31 March 2010 (2009: 104.5m). For further details refer to note 31 to the Financial Statements.

Treasury policies and objectives

The Group's treasury function manages and monitors external funding and investment requirements and financial risks in support of the Group's corporate objectives. The Board reviews and agrees policies and authority levels for treasury activities.

The Group's financial instruments, other than derivatives, comprise borrowings, cash and liquid resources and various items, such as trade receivables and trade payables, which arise directly from its operations. The main purpose of these financial instruments is to finance the Group's activities. The Group also enters into derivative transactions, principally forward foreign currency contracts, in order to manage foreign exchange risk on material commercial transactions undertaken in currencies other than the local functional currency. The Group does not trade in financial instruments.

The main risks arising from the Group's financial instruments are market risk (including foreign exchange risk, interest rate risk and price risk), credit risk and liquidity risk, along with the risks

arising from the financing of the Group's activities in the Public Private Partnership (PPP) and Private Finance Initiative (PFI) sectors. The Group's exposures to and management of each of these risks, together with sensitivities and risk concentrations, are described in detail in note 2 to the Financial Statements.

The Group funds its ongoing activities through cash generated from its operations and, where necessary, bank borrowings and finance leases. The Group's banking facilities are described in note 26 to the Financial Statements; utilisation of the facilities mainly relates to letters of credit issued in respect of individual projects undertaken by the Group's operating businesses. As at 31 March 2010 the Group had £87.0m undrawn committed borrowing facility available (2009: £75.0m).

There have been no significant changes to the Group's treasury policies during the year.

Critical accounting policies

The Group's principal accounting policies are described in note 1 to the Financial Statements. The Financial Statements for the year ended 31 March 2010 have been prepared under International Financial Reporting Standards (IFRS) as adopted by the EU.

The preparation of Financial Statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Material estimates applied across the Group's businesses and Joint Ventures are reviewed to a common standard and adjusted where appropriate to ensure that consistent treatment of similar and related

issues that require judgement is achieved upon consolidation. Any revisions to estimates are recognised prospectively.

The accounting policies and areas that require the most significant estimates and judgements to be used in the preparation of the Financial Statements are in relation to contract accounting and defined benefit pension schemes.

Contract accounting

Profit is recognised on contracts on a percentage completion basis, provided the outcome of the project can be reasonably foreseen. Full provision is made for estimated losses. Where contracts span more than two accounting periods profit is not generally recognised until the project is 50% complete.

The projected outcome of any given contract is necessarily based on estimates of revenues and costs to completion. Whilst the assumptions made are based on professional judgements, subsequent events may mean that estimates calculated prove inaccurate, with a consequent effect on the reporting of results.

Defined benefit pension schemes

Accounting for pensions involves judgement about uncertain events in the future such as inflation, salary levels at retirement, longevity rates, rates of return on plan assets and discount rates. Assumptions in respect of pensions and post-retirement benefits are set after consultation with independent qualified actuaries. Management believes the assumptions are appropriate. However, a change in the assumptions used would impact the Group's results and net assets. Any differences between the assumptions and the actual outcome will affect results in future years. An estimate of the sensitivity is disclosed in note 29 to the Financial Statements.