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AEA Technology plc
329 Harwell, Didcot, Oxfordshire OX11 0QJ

Telephone +44 (0)870 190 1900 Facsimile +44 (0)870 190 8261
Email enquiry@aeat.co.uk Website www.aeat.co.uk

AEA Technology plc

Annual Report 2004

*Another year of delivery
Peter Watson*

AEA Technology is one of Britain's leading technology companies.

The Company provides consultancy, technical services and products to three markets;

- Rail
- Environment
- Portable Power

AEA Technology (AEA) is the market leader in each of these sectors because of its strong proprietary technology and strong customer relationships.

AEA operates from 50 locations worldwide, including Harwell, Derby, Thurso and Glasgow in the UK, with offices also in the US, Canada, The Netherlands and Germany. The Company employs 2,880 people and has an annual turnover of £250 million.

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Group Overview

Rail

AEA Technology Rail is Europe's leading advisor and supplier of advanced products. It is the fastest growing advanced railway technology business in the UK and supplies expertise in enhancing railway safety, performance and reliability. We are building on our presence in Europe through our subsidiaries in The Netherlands, Spain and France.

The business is split into 4 divisions:

- 1 Engineering
- 2 Products
- 3 Operations
- 4 Consultancy

Subsidiaries include:

AEA Technology Rail BV Delivers technology services and solutions to the Dutch and other European rail markets.

AEA Technology Global SA Supplies and installs products from the UK on Spanish Railways, delivers technical consultancy and is closely associated with the Spanish High Speed Railway construction programme.

ERSA Sari Develops software for European Rail Traffic Management Systems.

Environment

AEA Technology Environment is the leading UK supplier of environmental consulting services to the UK Government and agencies. It also has a growing private sector business helping industry to meet its environmental obligations.

It comprises a number of focused business units, each responding to specific market demands in the areas of environment, energy and project management.

The business is split into 5 UK divisions:

- 1 Future Energy Solutions (FES)
- 2 Momenta
- 3 Netcen
- 4 Environmental Health & Safety Solutions (EHS Solutions)
- 5 Waste Management Solutions

There is also a Canadian subsidiary, **Kinectrics Inc** which specialises in power generation, transmission and distribution, industrial energy services and environmental technologies in the North American market. It provides essential support to the Ontario power generation and transmission markets.

Battery Systems

Designs, develops and manufactures portable power solutions.

AEA Technology Battery Systems Limited

Provides R&D, technical consultancy, and customised portable battery systems via intelligent charger and battery solutions.

AGM Batteries Limited Produces rugged high performance Lithium-ion cells to meet the demands of specialist industrial and non-consumer applications.

Accentus

Invents, develops and exploits Intellectual Property (IP)

Accentus plc Develops and exploits an IP portfolio including non-thermal plasma technologies and GTL (Gas to Liquid) technologies.

AEA Technology Engineering Services Inc

Based in the US. Exploits process intensified technologies in the environmental restoration market and supplies a range of proprietary technologies to the energy and security markets.

QSA

Supplies high performance radiation sources and services for industrial, medical, security and research markets.

AEA Technology Limited (registered in Hong Kong) Offers customer services for QSA products in Pacific Rim countries and manages CICAM in China.

AEA Technology GmbH Manufactures sources for medical therapies, calibration, measurement and detection in a wide range of industries.

AEA Technology QSA Inc Manufactures Sentinel products, which serve the non-destructive testing market. It also provides sources for oil exploration, security and nuclear medicine markets.

Shenzhen CIC-AEA Technology Manufacturing Co Limited (CICAM) Manufacture units for smoke detection.

Disposal Programme

Nuclear Science – Windscale – divested 2 December 2003 Handling and assessment of nuclear materials

Nuclear Science – Harwell – activities ceased 31 March 2004 Provision of technical services to the nuclear industry

Performance

Group turnover (continuing businesses) has increased by 13% over the last two years with a combined increase of 25% in the Rail and Environment businesses.

Results by Business

	Turnover		Operating profit/(loss) ⁽¹⁾	
	2004 £m	2003 restated £m	2004 £m	2003 restated £m
Rail	88.1	84.4	12.7	11.2
Environment	67.2	64.5	8.1	7.2
Core business	155.3	148.9	20.8	18.4
Battery Systems	15.8	9.6	(1.6)	(3.0)
Accentus	16.5	17.2	0.1	(6.7)
QSA	33.4	35.9	3.0	2.6
Value development	65.7	62.7	1.5	(7.1)
Nuclear Programmes	21.3	30.1	(1.0)	(6.1)
Divested businesses (pre 1 April 2003)	–	22.1	–	(2.9)
Central Programmes	3.6	3.3	(2.3)	(0.2)
Central costs	5.7	5.2	(9.0)	(8.7)
Total	251.6	272.3	10.0	(6.6)

Notes:

(1) Operating profit/(loss) is stated before exceptional operating charges of nil (2003: £6.2 million).

Highlights

Financial Highlights

	2004	2003
	£m	£m
Turnover	251.6	272.3
Operating profit/(loss) ¹	10.0	(6.6)
EBITDA ²	21.0	3.2
Earnings per share (loss)	(3.4)p	(10.5)p
Adjusted earnings per share ³	13.6p	(19.0)p
Dividend per share	5.2p	55.1p ⁴

Notes:

(1) Operating profit/(loss) is stated before exceptional operating charges of nil (2003: £6.2 million).

(2) EBITDA is earnings before interest, tax, depreciation, amortisation, provision for impairment, exceptional operating charges, profit on sale of businesses and loss on termination of operations.

(3) Adjusted earnings per share is stated before amortisation of goodwill of £2.5 million (2003: £1.9 million), impairment of intangibles £0.2 million (2003: nil), exceptional operating charges of nil (2003: £6.2 million), (loss)/profit on sale of businesses of £(8.3) million (2003: £20.0 million), loss on termination of operations of £0.5 million (2003: £8.7 million), and tax credit on exceptional items of nil (2003: £3.4 million). See note 16 for details of the adjusted earnings per share calculation.

(4) Includes a Special Dividend of 50.0p per share.

Group Highlights

- Turnaround of £15 million in pre-exceptional operating profit
- AEA has delivered full year operating profit of £10.0 million
- Profits in Core Businesses increased by 13%
- Strong performance by the Environment business
- Increased R&D investment in Rail to develop new generation of products
- Development Businesses significantly improved performance and moved into profit
- Exit from the UK nuclear industry essentially completed: on time and below budget
- New Group structure will allow Corporate Centre costs to be reduced
- AEA is well positioned to take advantage of increasing opportunities through its offerings of:
 - Consultancy
 - Technical Services
 - Products

Chairman's Statement

This year we have accelerated progress and have delivered an operating profit of £10 million.

AEA delivers an operating profit of £10 million

This year we have accelerated progress and have delivered an operating profit of £10.0 million.

The Company has achieved several significant milestones demonstrating our commitment as leaders in our markets of rail, environment and portable power.

We have experienced continued growth in Rail and Environment. The Development Businesses have moved into profit and we have essentially exited the UK nuclear industry. The Board is committed to building on these achievements and further increasing shareholder value.

AEA returns to profitability

The Company has delivered the first full year operating profit since 2001. The increased focus on our Core Businesses, strong management action in our Development Businesses and tighter cost control of projects has led to a turnaround of £15 million in pre-exceptional operating profit this year.

Improved operational performance

The UK Environment business delivered a strong full year achieving record levels of growth. Momenta, the programme management business, won a number of significant contracts in the transport, health and education markets. Environment continues to help governments understand, define and deliver environmental policies and enable industry to respond to these challenges. This year, Environment's newly established presence in Scotland has already led to a number of contracts in this increasingly important market.

The Development Businesses of Battery Systems, Accentus and QSA together delivered a full year profit for the first time. Battery Systems continues to make good progress with delivery of its main BOWMAN contract on schedule. QSA again performed well and the strong management action taken in Accentus during the last financial year has resulted in this business achieving a small profit.

The past year has seen us maintaining satisfactory margins in the rail sector and we grew our business with our largest customer Network Rail. We won a number of important contracts to help Network Rail identify, prioritise, and drive down the costs of track inspection maintenance.

To further improve our technical position we have increased our R&D investment in Rail by 9%. This will lead to a suite of new and enhanced products.

Improved focus

As promised, in March 2004 AEA exited its last significant UK nuclear facility at Harwell on time and below budget. This follows the divestment of the Nuclear Science business at Windscale in December 2003.

The focus of the Company will be further improved by the proposed divestment of QSA. The business supplies radiation sources for the medical and industrial markets which are non core activities for AEA.

We are committed to keeping the scale and cost of the Corporate Centre in line with the size and needs of the Company. We have now essentially completed the UK nuclear industry divestment programme and simplified the structure of the Group. As a result a restructuring programme within the Corporate Centre is underway to reduce the headcount by over 50%. Net costs for the year ended 31 March 2004 of £9 million were held at the prior year level and are being driven down during 2004/05 to achieve an annual runrate of less than £6 million.

Performance summary

The Company's turnover was £251.6 million, down from £272.3 million last year as a result of the divestment programme. Operating profit was £10.0 million, a turnaround from the £6.6 million pre-exceptional loss for the prior year.

Rail and Environment made progress with a combined turnover up 4% at £155.3 million (2003: £148.9 million). Operating profit was up 13% at £20.8 million (2003: £18.4 million).

The portfolio of Development Businesses returned a profit of £1.5 million compared to a pre-exceptional loss of £7.1 million last year. This was on a turnover of £65.7 million (2003: £62.7 million). Turnover in Battery Systems increased by 65% and losses were reduced by nearly 50%. Accentus delivered a turnaround from a pre-exceptional loss of £6.7 million in 2003 to record a modest profit of £0.1 million this year. QSA's sales fell slightly from £35.9 million to £33.4 million, but operating profit increased from £2.6 million to £3.0 million.

The turnover of Nuclear Programmes was lower at £21.3 million (2003: £30.1 million) as a result of the sale of Nuclear Science. Through strong project control losses were cut dramatically to £1.0 million from a pre-exceptional loss of £6.1 million in 2003.



The Company has appointed four new non-executive directors. Dr Paul Golby, Chief Executive of Powergen UK plc and Rodney Westhead, Group Chief Executive of engineering consultancy Ricardo Group plc, joined the Board in August 2003. April 2004 saw the appointment of Dr Lewis Moonie, MP for Kirkcaldy and Dr Bernard Bulkin, former Chief Scientist for BP.

In December 2003, non-executive director Professor Sir Michael Brady retired from the Board. He had been a director since 1996 and his contribution and commitment have been invaluable.

Thank you

I would like to thank all our employees for their hard work throughout the year. Through their commitment we have accelerated progress and have returned to profitability. However, we will all need to continue to put in maximum effort to build on this and fulfil the potential of this Company for our shareholders.

Outlook

AEA is now in a stronger position to capture opportunities in its markets where it has established lead positions – rail, environment and portable power. The Company will focus on delivering solutions through three business streams:

- Consultancy
- Technical services
- Products

all based on its strong proprietary technology.

The Government continues to increase its investment in the environment with growing focus on policy formulation and implementation. There are further opportunities for Environment's offerings as the devolved administrations in Scotland and Wales take greater responsibility for their own environmental affairs.

In North America, opportunities are arising as a result of the energy crisis that Ontario is facing. The province needs to refurbish, rebuild and replace or conserve 25,000 MW of generating capacity by the year 2020. Environment – through Kinectrics – is uniquely positioned to assist the Ontario government meet these increasing demands.

The disturbance in the UK rail industry may be moving towards resolution and we are well positioned to capitalise on opportunities as they emerge. Increased investment in our Rail Products business, at our newly established technology centre at Glengarnock near Glasgow, will deliver a leading edge development operation designed to strengthen further our position in the UK and international rail transport markets.

Battery Systems is building on its significant success in the military market and is increasing its presence in markets such as space and homeland security where the need for portable power solutions is paramount.

Accentus will benefit from its focus on a manageable portfolio of technologies aimed at the environment and energy markets and will enhance the financial performance with further licensing deals.

The Board is confident that AEA will achieve continued growth based on our:

- Leading position in our chosen markets
- Technical strength
- Strong relationships

Dr Peter Watson
Chairman

Board Q&As

Q Are you satisfied with Rail's performance?

A We expected the year to be difficult for Rail because of the continued disturbance in the industry. In spite of this we managed to maintain satisfactory margins and we grew our business with Network Rail.

Q Can the Environment business sustain its current level of growth?

A Business in the UK in particular has been strong and we have won contracts for Government programmes in new areas. We are confident that we can continue to win further contracts and our increasing presence in Scotland will support the Scottish Executive in its environmental programme.

Q What are the plans for the three Development businesses?

A The three businesses delivered an overall profit for the first time. Our commitment to shareholders remains the same and we will continue to improve the focus of the Group. The timing of any disposals will be influenced by achieving best shareholder value.

Q Are you satisfied with Battery Systems' performance?

A There has been much progress in the business with the successful volume manufacturing of cells and batteries. New chargers have been developed and are now on stream. Sales are growing strongly and we are on track to make a profit in the financial year 2004/2005.

Q What is the Company's strategy for the future?

A The Board will continue to seek ways to grow organically and by acquisition in markets where we have established lead positions: rail, environment and portable power.

Q Where will future growth come from?

A Growth will be generated as a result of improved focus on the markets of rail, environment and portable power where we have a leading position, technological edge and strong relationships.

We will focus on delivering solutions through three business streams: consultancy, technical services and products.

Q The Central Costs still appear to be high. What are you going to do about them?

A We said we would continue to review costs and keep them in line with the needs of the business. The Company has been simplified and is now more focused and we have therefore commenced a restructuring programme which will significantly reduce costs in the Corporate Centre.

Q Are any acquisitions planned?

A We continue to seek bolt-on acquisitions that will strengthen our businesses.

Q How will you fund these?

A The method of funding will be appropriate to the size and timing of any acquisition.

Q Will you be returning more cash to shareholders?

A We will continue to return cash to shareholders through our dividend policy which is moving towards distributions of one third of earnings.

Q Why has net debt increased?

A Net debt is in line with forecast which takes into account deferred consideration on past acquisitions and the cash cost of the withdrawal from the UK nuclear industry.

Financial Review

Our continued focus has enabled the Group to return to operating profitability.

Introduction

During the year the Group continued to focus on its core Rail and Environment businesses, to add value to its Development Businesses namely Battery Systems, Accentus and QSA and to dispose of the remainder. This focus has enabled the Group to return to operating profitability. This review seeks to aid interpretation of the Group's performance.

Operating results

The Group's operating profit of £10.0 million (2003: £6.6 million loss pre-exceptional) is reported on the face of the Consolidated Profit and Loss Account analysed into continuing operations (£7.7 million) and discontinued operations (£2.3 million). The discontinued operations mainly represent the results of the Nuclear Programmes business. *Operations at Windscale were divested on 2 December 2003, and operations in B220 at Harwell ceased on 31 March 2004. There were no exceptional operating costs during the year (2003: £6.2 million).*

A segmental analysis of turnover and operating profit before and after exceptional items is given in note 2. Rail reported an operating profit of £12.7 million (2003: £11.2 million) after pension costs of £2.0 million (2003: £2.6 million) despite the disruption to the UK Rail industry during the year. Environment performed well to report £8.1 million (2003: £7.2 million) after pension costs of £3.4 million (2003: £3.1 million) thanks to organic growth in the UK of 11% and to a steady performance by Kinectrics in Canada. The three Development Businesses improved significantly during the year to report a combined profit of £1.5 million (2003: £7.1 million pre exceptional loss). The loss in Battery Systems almost halved to £1.6 million, Accentus moved into a small profit from a £6.7 million pre-exceptional loss last year and QSA maintained its steady improvement in profitability. The Nuclear Programmes losses have been significantly reduced to £1.0 million (2003: £6.1 million pre-exceptional). Central Costs were contained at close to the prior year level. Finally a loss of £2.3m in Central Programmes (2003: £0.2 million loss) was incurred representing the investment made in fledgling businesses.

Pension costs

The Group operates a number of pension schemes around the world, the major schemes being of the defined benefit type. Full details are disclosed in note 8 which shows that over the year the combined FRS17 deficit of these schemes has reduced to £152.8 million (2003: £178.3 million). Contributions to these schemes are being made at the levels agreed following the latest scheme valuations and costs are being accounted for in line with SSAP 24 based upon the results of the last full actuarial valuations. The Group pension cost charged to profit was £10.0 million (2003: £11.0 million). The cost in the year of higher employer contributions (£1.5 million) was more than offset by the impact of lower staffing levels within Accentus and Nuclear Programmes (£0.7 million), the sale of Engineering Software (£0.4 million) and the benefit of lower charges for the Rail Industry pension schemes (£1.4 million) following an alignment of their SSAP24 calculation with that used for the main plc scheme.

Profit on ordinary activities before taxation

The Group achieved a breakeven position before taxation (2003: £5.4 million) after taking into account losses of £8.8 million (2003: £11.3 million net profit) arising from the sale and closure of businesses during the year. Further details are given below under exceptional items.

Acquisitions

One small acquisition was made in the year as detailed in note 30.

Exceptional items

There were no exceptional items (2003: £6.2 million loss) included within operating profits during the year. *The exceptional loss of £8.3 million (2003: £20.0 million profit) reported below operating profit relates to divestments and a further loss of £0.5 million (2003: £8.7 million) relates to the termination of operations (see note 10). The divestment of the Windscale nuclear facility gave rise to a loss on disposal of £9.9 million whilst other disposal related transactions resulted in a profit of £1.6 million (see note 31).*

Research and development

Total research and development expenditure reduced to £9.6 million (2003: £14.2 million) as the BOWMAN contract within Battery Systems moved into production, activities within Accentus were rationalised, and Engineering Software was divested. Research and development undertaken by the core Rail and Environment businesses totalled £5.9 million (2003: £5.6 million). Details of research and development projects undertaken are given in the Directors' Report on page 19.

Interest

Net interest charges of £2.4 million (2003: £1.6 million before a £2.3 million redemption charge) reflect the higher average net debt.

Taxation

The overall tax charge was £2.3 million (2003: £2.1 million) of which £0.6 million arose in AEA Technology plc and £1.7 million arose overseas. No tax is payable on the disposal of businesses made during the year. At 31 March 2004 the Group deferred asset was £12.5 million (2003: £13.7 million).

Cash flow and borrowings

Year-end net debt increased by £21.8 million to £34.7 million (2003: £12.9 million) after paying £10.8 million in respect of exceptional operating charges and closure costs and £4.3 million on acquisitions net of disposals. Debt is lower than the £36.1 million reported at the half-year as the cash generated by the businesses in the second half exceeded the exceptional cash outflows.

The operating cash inflow, before exceptional items is £8.4 million (2003: £28.2 million). The reduction in operating cash was principally due to an increase in working capital as Battery Systems moved into the production phase of the BOWMAN contract and as Rail experienced disruption in the UK market. Environment again achieved excellent cash generation and continued to require little capital to operate. The cash performance of Accentus and Nuclear Programmes mirrored the improvement in their performance. It is expected that a further £12.4 million will be spent in future years in respect of exceptional restructuring costs. These are already provided in the balance sheet.

Purchases of tangible fixed assets totalled £6.9 million (2003: £10.4 million). The decrease in capital expenditure reflects the completion of a significant property project in Rail and completion of an Yttrium-90 facility in Germany. There were no significant disposals of tangible fixed assets (2003: £0.3 million).

The net tax payment was £1.5 million, an increase of £0.8 million on the prior year and comprised taxes paid overseas, mainly in Germany, Hong Kong and The Netherlands.

Purchases of subsidiaries totalled £6.3 million (2003: £8.0 million) which represented £6.1 million deferred payments on acquisitions made in previous years and £0.2 million relating to one acquisition made during the year (note 30). This was of Summit AEA Corporation, formerly a joint venture, where Central Programmes increased its shareholding to 81%. £0.1 million of the consideration is deferred. Three businesses were divested, the major one of these being the Nuclear Programmes operation at Windscale (note 31). The net cash receipts from these disposals amounted to £2.0 million (2003: £73.3 million). The future cash payments stemming from acquisitions and disposals completed at the balance sheet date are expected to amount to £13.8 million.

The Group finances its operations through a combination of retained profits, bank overdrafts and a revolving credit facility. At the year end £50 million of the available £60 million committed facilities were drawn down. The company has negotiated an extension to these committed facilities until June 2005 with term-out options allowing repayment of the £60 million to be deferred until June 2006.

Dividends and dividend policy

It remains the Board's intention to move towards distributions of around one third of earnings once the disposal programme is completed. In this year of transition the Directors have proposed a final dividend of 3.7p per share which would bring the total dividend for the year to 5.2p per share, equivalent to £3.5 million.

Shareholders' return and value

Earnings per share improved to (3.4)p (2003: (10.5)p). After adjusting for exceptional operating charges, profit on sale of businesses, loss on termination of operations, impairment of goodwill, and amortisation of goodwill earnings per share increased to 13.6p (2003: (19.0)p).

During the year the price of AEA Technology ordinary shares was 128.5p per share at 1 April 2003 and 231.0p per share at 31 March 2004.

Risk management

The Board has an established risk management process that complies with the Turnbull Committee guidance on internal control. This is detailed in Corporate Governance on pages 20 to 26.

Treasury management

The Group uses various financial instruments in order to manage the exposures that arise in its business operations as a result of movements in financial markets. The Group does not undertake speculative foreign exchange or interest rate dealings for which there is no underlying exposure. Treasury dealings such as investments, borrowings and foreign exchange are conducted only to support underlying business transactions. All treasury activities are focused on the management of risk. There have been no significant changes in the Group's policies in the last year. The main risk continues to be movements in foreign currency exchange rates. All such exposures are managed by the Group Finance Director who operates within written policies approved by the Board and within the internal control framework.

Foreign exchange

The Group is exposed to movements in exchange rates for foreign currency transactions and for the translation of net assets and profit and loss accounts of foreign subsidiaries.

The Group is exposed to a number of currencies on transactions. The most significant transactional currency exposures are the US dollar, Canadian dollar and the Euro. The Group seeks to hedge its transactional exposure by the use of forward currency transactions. The objective is to minimise the impact of fluctuations in exchange rates on future transactions and cash flows.

Credit risk management

The Group's policy is to monitor and manage its exposure to counter-parties.

Interest rate risk

The majority of the Group's primary debt is in sterling at a floating rate of interest. The exposure to interest rate increases has been managed by the use of fixed interest rate swaps for a proportion of the expected net debt position.

Information technology

Investment in information technology is continuing with the emphasis on infrastructure and network development. The Group invested in a new Wide Area Network and data storage facilities in the UK in order to improve the performance and resilience of its IT systems. The upgraded infrastructure provides a platform for web based technologies and business specific applications as well as having delivered cost savings.

Accounting policies

A description of the principal accounting policies appears on pages 49 to 52. The policies followed are consistent with those applied last year.

International Accounting Standards Conversion

A working party under the chairmanship of the Group Finance Director has been established to manage the transition to International Accounting Standards due to be implemented for the first time in the September 2005 Interims.



David Lindsay
Group Finance Director
16 June 2004

Operating Review

Rail

AEA Rail is Europe's leading rail technology adviser and supplier.

We provide a complete portfolio of products, consultancy and engineering services.

We are committed to exploiting technology to help optimise the long-term performance of the railways in the UK, and increasingly in selected European markets.

The industry

During the last year there has been continued disturbance in the UK rail industry. This has resulted in a longer than anticipated disruption to the rail market, although there has been continued demand for AEA Rail's technology. Through our increased investment in the development of new technology we are well placed to take advantage of the market's need for improved performance.

In Europe, we are targeting markets like The Netherlands and Spain where the integrated national railways have been separated into infrastructure and service operations.

Performance

Rail had a turnover of £88.1 million, up 4% (2003: £84.4 million). Operating profit increased by 13% to £12.7 million (2003: £11.2 million). These results are against a backdrop of longer than expected market turbulence. While these results benefited from a lower pension charge in 2004, underlying margins were maintained in excess of 13%.

Business highlights

Sales to our main customer, Network Rail, continued to grow. We successfully entered into contracts to support Network Rail in the delivery of a number of key engineering projects such as the Engineering Support Centre, the rollout of Unattended Geometry Measurement Systems and the New Measurement Train. A number of AEA proprietary systems packages are installed on the train. They can measure features such as track geometry which can have an effect on passenger comfort and help to assess derailment risk and improve safety.

We also worked with Network Rail on the development of sophisticated Capacity Management decision support tools that will be worth up to £1.7 million. This will enable them to plan and deliver new timetables more effectively.

AEA Rail has been assisting London Underground Limited (LUL) by carrying out its independent accident investigations. In October 2003, our accident response team was called to a derailment at Camden Town Station. Using our specialised computer package, VAMPIRE®, we were able to identify the cause of the problem, and to design and implement an innovative solution to prevent recurrence.

Following the Ladbroke Grove accident in October 1999, Lord Cullen's Report, issued in 2001, recommended that a solution be found to allow passengers to escape through trapped sliding doors. We produced a safe and cost effective design with our Emergency Egress Saloon doors which are now fitted to First Great Western and Midland Mainline carriages.

Technology developed in the UK to overcome the perennial problem of leaves on the line has been successfully exported and applied to the Dutch railways. LAWS, a Low Adhesion Warning System, which alerts drivers to areas of slippage often likened to black ice, has been successfully rolled out across the network. In parallel, SmartSanders® which apply sand and improve adhesion between wheels and track, have also been installed reducing braking distances to that on a normal dry rail.

AEA Rail has been selected to provide key asset monitoring systems for installation on the new high-speed line between Madrid and Barcelona. This work has included technological integration with third party systems in the new control centre in Zaragoza.

Trackline™, innovative technology for measuring track quality was developed and installed on two Eurostar trains. These were used to carry out final measurements on the first section of the Channel Tunnel Rail Link track thus enabling the route to become operational in September 2003.

Future growth

Investment in the UK railways will grow albeit influenced by political decisions. The key drivers are the market's need for improved safety, performance and reliability at reduced overall costs.

This will further increase the demand for AEA Rail's proven integrated technical solutions which are targeted at improvements in all of these key areas.

Priorities

Our priority is to accelerate growth by delivering new products and services to the UK and European markets.

Investment in research and development has increased by 9% and we have announced plans to create a pioneering Rail Products business in our new Technology Centre at Giengarnock, Glasgow.

We continue to seek further opportunities to take products and services developed in the UK to selected markets in Europe and elsewhere.

Outlook

The industry continues to change. However, AEA Rail's strength lies in its intellectual capital, its deep market knowledge, its strong relationships and its leading edge technical products. With this unique combination, we are well positioned to achieve further growth.

Environment

AEA Technology Environment is the leading UK supplier of environmental, energy and programme management solutions to governments, agencies and industry.

We provide technical and programme management skills to transform data into information and ultimately into solutions.

We have an in-depth understanding of government environmental policy, regulation and practice. We provide advice to government on the creation of policy, its promotion and implementation. We assist the private sector in complying with legislation and meeting its environmental obligations.

The industry

The environmental consultancy market covers a broad spectrum from low volume, high margin contracts to high volume, low margin work.

In the UK, AEA Environment operates in the high added-value, high-margin end of the spectrum often with multi-million pound, multi-year wins. The UK Government is one of our largest customers and continues to invest in improving the environment. As an example, it aims to reduce carbon emissions by an extra 12 million tonnes through energy efficiency and cleaner energy production within the next six years. Priorities include:

- Securing major carbon savings from the UK household sector
- Changing the Building Regulations which will raise standards of new and refurbished buildings from 2005
- A new EU emissions trading scheme and Climate Change Agreements which will ensure that every energy-intensive industry and power generator continues to reduce carbon emissions.

In North America we operate in the energy and environment market via our Canadian subsidiary Kinectrics where opportunities are arising as a result of the energy crisis that Ontario is facing. The province needs to refurbish, rebuild and replace or conserve 25,000 MW of generating capacity by the year 2020 to meet growing demand while replacing polluting coal-fired generators. This represents 80% of Ontario's current generating capacity and would require an investment of \$25 to \$40 billion.

Environment's strong intellectual capital position in Canada and the UK ensures that it is uniquely positioned to assist the Ontario government meet these increasing demands in two complementary ways. Firstly the existing facilities need to operate reliably. Secondly the Ontario government is looking for new capacity, demand side management initiatives and a significant increase in the amount of clean power sources in the province.

Performance

Environment has shown good year on year growth in both turnover and operating profit. Turnover was £67.2 million up 4% (2003: £64.5 million). Operating profit increased by 13% to £8.1 million from £7.2 million giving an improved operating margin of 12.1%.

Business highlights

Environment consists of a portfolio of six distinct but complementary business units. **Netcen** (environmental monitoring) and **FES** (energy and climate change) provide the cornerstone of our business. Both are strong, stable, cash generative businesses where we know our key customers well and invest in those relationships. Netcen has continued to provide UK Government with services and advice on air quality monitoring, modelling and assessment, and is working with Defra on the review of the National Air Quality Strategy. Nearly £5 million of contracts retendered by Defra during the year were secured, including the National Atmospheric Emissions Inventory and the Baseline Measurement and Analysis of UK Ozone and ultraviolet radiation.

In addition, **Netcen** has successfully grown its business with other public sector customers. Notable wins include a contract for the provision of the Air Quality Database for Wales, from the National Assembly of Wales.

FES grew its consultancy work for the private sector by over 30% during the year, including energy surveys for two of GlaxoSmithKline's manufacturing sites and a wind feasibility study for RMC. During the year FES was a major delivery partner for the Carbon Trust, including a project which looked at the technologies used by industry and their potential for carbon saving. This work helped inform the Carbon Trust's strategy and priorities for future work.

Momenta uses a well-defined skill set to access new opportunities in public sector programme management in health, transport and education. Successes during the year included the **SAFED** (Safe And Fuel Efficient Driving) programme which was won in competitive tender earlier for the Department for Transport. It was originally a one year programme aimed at training 4,000 truck drivers to drive more safely and fuel efficiently, and had a value of £1.6 million. The success of the programme led to a £1 million extension to continue during 2004/05.

EHS Solutions is developing growth opportunities in the oil & gas and chemical sectors and in other highly regulated industries. It continues to capitalise on its expertise in planning for, and responding to, chemical emergencies. The year saw over 20% growth in sales into the private sector from a range of niche software products and services that allow clients to handle and transport chemicals safely, and to respond cost effectively to legislative pressures.

Waste Management Solutions is a new business unit, established in December 2003; it brings together in-house expertise to exploit a market that is expected to grow strongly on the back of EU directives and UK Government waste policy.

Our biggest business unit is **Kinectrics** in Canada which offers innovative solutions to the diverse requirements of energy and environmental markets in North America and elsewhere. One programme which made especially notable commercial progress in the year was our patented Dispersed Sodium Technology which will be used for the destruction of PCBs at one of the Japan's central facilities. This will result in substantial royalty income for Kinectrics over the next 3 years.

Future growth

The global market for environmental goods and services is about £300bn, with the UK having a market share of about 5%. The consultancy sector in which AEA operates makes up about 6% (£1bn in the UK) of the overall market and broadly reflects the trends in the larger market. It is estimated that the overall growth rate of this sector is around 10% per year.

In Western Europe, North America and Japan there is a growing demand for resource efficiency, with growth rates of 10% or more. The main drivers are increasing demand for energy and clean water; unsustainable increases in waste generation; climate change policy; energy security and awareness of the cost-saving potential. The public sector in particular is taking the lead in this sector, setting and implementing policy. Both FES and Momenta are well positioned to respond to these new and growing challenges.

Priorities

Our priority is to harness and develop the capabilities of the business units to drive further growth by focusing on:

- Public sector customers who drive and define the market
- High added-value niches in the private sector
- *Building our presence in the North America where we expect energy and environment markets to grow*

Outlook

The outlook for the environment and energy markets in which we operate is positive. We are well placed to capture the opportunities in the UK and North American markets thanks to our market position, experience and skills.

Development Businesses

Battery Systems

Battery Systems provides advanced portable power solutions to customers who demand high performance and reliability for operation in the harshest environments.

The markets

AEA is a leading power solutions provider to the defence sector. Other key markets include aerospace, marine and medical where reliable power is essential for mission success. These markets are demanding even higher standards of performance and increasing intelligence which is the business's competitive strength.

Performance

Turnover increased significantly to £15.8 million from £9.6 million and operating losses were reduced from £3.0 million to £1.6 million.

Business highlights

Volume manufacturing for the BOWMAN battlefield communications programme is well advanced, supplying batteries and chargers to General Dynamics on schedule.

In September 2003, we launched a new high capacity rechargeable Lithium-ion cell designed specifically to meet the needs of the US armed forces. The Chikara cell is capable of delivering 24 hour mission life without recharging.

Battery Systems extended its presence in the space market when its batteries were launched on the Mars Express and the Rosetta spacecraft, powering its 11 year mission towards cometary landing.

Outlook

The outlook for Battery Systems is encouraging. We are unique in our ability to provide a cradle to grave service, comprising our own core technologies and drawing on the expertise of our world-leading scientists and engineers.

Accentus

Accentus is AEA's intellectual property business which owns a number of world-leading patent-protected technologies.

Performance

Turnover was £16.5 million compared with £17.2 million last year, but the strong management action that had been taken resulted in a prior year loss of £6.7 million being transformed into profit of £0.1 million.

Business highlights

The decision to focus on fewer key technologies, coupled with strengthened commercial management, has resulted in a number of licensing contracts being secured.

One key example is the licence deal secured with Aughinish Alumina Ltd (a subsidiary of Glencore) for the application of our unique ultrasound technology to assist in the cost-effective removal of a key impurity from the alumina manufacturing process.

Through GTL Microsystems (joint venture between Accentus and FMC Technologies AG) we have made substantial progress in demonstrating the performance of our unique catalyst technology for conversion of natural gas into liquids.

We have launched a major facility in Scotland to develop world-beating technology for the recycling of Lithium-ion (Li-ion) batteries. This initiative is being assisted by Caithness and Sutherland Enterprise (CASE), part of the Highlands and Islands Enterprise (HIE) network. We expect the plant to capture a significant part of the UK and European markets for Li-ion battery recycling.

QSA

QSA supplies high performance radiation sources and services for industrial, medical, security and research markets.

Performance

Turnover fell slightly from £35.9 million to £33.4 million but operating profit increased to £3.0 million from £2.6 million.

Important medical projects have been secured, including a 3 year manufacturing agreement with pSiMedica Ltd for commercial manufacture of its brachytherapy product at the QSA facility in Braunschweig.

The investment made in QSA has ensured the business continues to make progress.



Andrew McCree
Group Managing Director

Business Development

Central Programmes

During the year a newly identified segment called Central Programmes was set up which includes a number of small businesses and start-ups that are held for realisation of value in the short term. These are:

Lexware A supplier of specialist environmental health and safety software.

EASA A software company providing web-enabled tools that automate and simplify the use of existing software.

Biojoule Working in partnership with Climate Care, Biojoule provides electricity generators and other fuel users with a reliable and well-specified supply of renewable wood fuel.

Risk Solutions A management consulting company with special expertise in dealing with risk and uncertainty.

Summit AEA Corporation (SAC) Represents AEA in Japan. Its role is to take our technology and services to the Japanese market.

Central Costs

We are committed to keeping the size and cost of the Corporate Centre in line with the size and needs of the Group. We have now essentially completed our UK nuclear divestment programme and simplified the structure of the Group.

AEA is smaller and more focused and a restructuring programme within the Corporate Centre is underway to reduce the headcount by over 50%.

Costs for the year ended 31 March 2004 of £9 million have been held at the prior year level and are being driven down during 2004/05 to achieve an annual runrate of less than £6 million.

Disposal Programmes

The strategy to exit the UK nuclear industry is now essentially complete. Turnover decreased from £30.1 million to £21.3 million but the operating loss was reduced to £1.0 million from £6.1 million in 2003.

On 2 December 2003 the Nuclear Science business based at Windscale was sold to BNFL and on 31 March 2004, AEA ceased operations in its last significant nuclear facility, B220 at Harwell.

Business Strategy

The new AEA, created as a result of the strategy announced in late 2000, has returned to profit.

We will continue to focus on markets in which we have a leading position, a technological edge and deep market understanding.

We will offer solutions to these markets through:

- Consultancy
- Technical services
- Products

We will continue to seek acquisition opportunities in the rail and environment markets which will give us additional technologies and extend our market presence.

The Board are confident that this strategy for AEA will deliver continued growth and increase shareholder value.



Dr Charles Hipsley
Director, Business Development

Key Events of the Year

23 April 2003 – Building of Technology Centre at Glengarnock commences	June 2003 – AEA Rail launches e-PLD – an automatic passenger counting device	1 August 2003 – Non-executive Director appointments – Dr Paul Golby and Rodney Westhead	10 September 2003 – Battery Systems launches the new Chikara cell – capable of 24 hour mission life	2 December 2003 – Disposal of Nuclear Science Business based at Windscale to BNFL	31 March 2004 – Operations cease in B220 at Harwell – AEA's last significant UK nuclear facility
May 2003 – Battery Systems forms collaboration with FMC to develop next generation of cell chemistry	July 2003 – Environment win DfES School Sports co-ordinator programme – its first major Education programme	22 August 2003 – AEA Rail's Emergency Egress Saloon doors fitted to First Great Western's High Speed Trains as part of their safety improvement programme	7 October 2003 – AEA launches £2 million facility in Scotland to develop world-beating technology for the recycling of lithium-ion batteries	December 2003 – Kinetics sign license deal for PCB destruction in Japan	26 February 2004 – European Space Agency's Rosetta spacecraft launched, powered by Lithium-ion batteries supplied by Battery Systems

Board of Directors

The directors of the Company at 31 March 2004 were as follows:

Executive Directors

Dr Peter Watson (60)

Executive Chairman

Dr Peter Watson was appointed Executive Chairman in January 2002 having joined AEA Technology as Chief Executive in June 1994. He chairs the Board's Science and Engineering Advisory Committee and is a member of the Nomination Committee. Previously, he was with GKN plc before becoming Board Member for Engineering for British Rail. He is a non-executive director of the Martin Currie Enhanced Income Trust plc.

Andrew McCree (46)

Group Managing Director

Andrew McCree was appointed to the Board in November 2000 originally as Director for Corporate Affairs and Human Resources. He was appointed Group Managing Director in July 2002 taking on additional responsibility for the development businesses of Battery Systems, Accentus plc and QSA plus Nuclear Programmes. He has held a number of senior posts in AEA Technology and, before that, in UKAEA which he joined in 1991. His earlier career was with BP Exploration.

David Lindsay (48)

Group Finance Director

David Lindsay joined the Board in September 2001 upon recruitment as Group Finance Director, with responsibilities also for information technology services. Before joining AEA Technology, he was Group Finance Director, Industrial Controls Services Group, having previously worked in the UK and in France for GEC Alsthom and for BET plc.

Dr Charles Hipsley (47)

Director, Business Development

Dr Charles Hipsley was appointed to the Board in September 2002. He was appointed Head of Strategic Development in 1996 and Director of Business Development in 1999. He is responsible for corporate development, corporate planning, and international business development. He has been with the Company and, before that, UKAEA since 1983 having spent his earlier career in research at Cambridge University.

Non-executive Directors

Dr Leslie Atkinson (60)

Dr Leslie Atkinson was appointed to the Board in August 1996 and has been the Senior Independent Director since January 2004. He became Chairman of the Nomination Committee from 1 April 2004 and is a member of the Audit and Remuneration Committees. He worked for many years with BP plc where he became chairman of BP Asia Pacific. He later was an executive director of Tarmac plc responsible for construction services. He is a non-executive director of Electrocomponents plc, Foreign and Colonial Pacific Investment Trust plc and Samworth Brothers (Holdings) Ltd.

Dr Paul Golby (53)

Dr Paul Golby was appointed to the Board in August 2003. He is a member of the Audit, Nomination and Remuneration Committees. He has been since 2002 Chief Executive of Powergen UK plc, one of the UK's biggest energy suppliers, which he joined in 1998. He is a Top Executive Committee member of E.ON AG, its parent company and the world's largest investor-owned electricity and gas company. After training as a mechanical engineer, he had a series of management appointments with Dunlop and BTR before becoming an executive director of Clayhithe plc. He is a member of the Institution of Electrical Engineers.

Non-executive Directors (continued)

Andrew Shilston (48)

Andrew Shilston was appointed to the Board in August 1996. He chairs the Remuneration Committee and is a member of the Audit and Nomination Committees. He is finance director of Rolls Royce plc and previously was finance director of Enterprise Oil plc before it was acquired by Shell in 2002. He will stand down at the forthcoming AGM and not seek re-election.

Rodney Westhead (60)

Rodney Westhead was appointed to the Board in August 2003. He chairs the Audit Committee and is a member of the Nomination Committee. He has been, since 1996, *Chief Executive of Ricardo plc, a leading automotive engineering consulting company. He was the senior independent non-executive director and audit committee chairman of Parkman plc until its merger with Mouchel to form Mouchelparkman plc, where he continues as the senior independent director. An accountant by profession, he was a partner with Grant Thornton for 14 years holding a number of positions including managing partner of their London office before moving to Ricardo in 1992 as the Group Finance Director.*

Professor Sir Michael Brady resigned from the board in December 2003. He was the Senior Independent Director, Chairman of the Board's Science and Engineering Advisory Committee, and a member of the Audit, Nomination and Remuneration Committees.

Attendance record at Board and Committee meetings

All directors in post for the whole year attended all eleven Board meetings with the exception that Andrew Shilston missed one meeting. Dr Paul Golby and Rodney Westhead respectively attended six and five of the seven Board meetings held after their appointments.

The directors in post at the end of the year attended all Audit and Remuneration Committee meetings held during their appointment. Dr Paul Golby and Rodney Westhead each missed one of the three Nomination Committee meetings held in the year.

Shareholders will appreciate that Board and Committee dates are agreed a long time in advance and that new appointees may have existing commitments that cannot be moved.

The following two non-executive directors were appointed to the Board after the year end.

Dr Lewis Moonie (57)

Appointed on 1 April 2004, Dr Lewis Moonie has been Labour MP for Kirkcaldy since 1987 and was Parliamentary Under Secretary for State at the Ministry of Defence between January 2000 and June 2003, when he had responsibility for MoD's science and technology. He has a long-standing interest in energy generation. Before becoming an MP, he studied medicine and was a consultant in public health medicine for the Fife Health Board and a senior medical adviser and clinical pharmacologist in the pharmaceutical industry. He is a member of the Nomination Committee.

Dr Bernard Bulkin (62)

Appointed on 26 April 2004, Dr Bernard Bulkin was formerly the Chief Scientist for BP. His earlier career included professorships of chemistry at the City University of New York and the Polytechnic Institute of New York. He holds joint UK and US citizenship. A recognised leader in technologies for sustainable development, his positions include Chairman of the SAIC Energy Advisory Panel, a Venture Partner of Vantage Point, a Member of the Boards of Argonne National Laboratory and for the UK Centre for Economic and Environmental Development (CEED) plc, a trustee of the Charles Darwin Trust, and a Fellow of New Hall Cambridge. In the UK public sector, he is a member of the Sustainable Energy Policy Advisory Board and was recently appointed by the Prime Minister to the Sustainable Development Commission, where he will chair the Energy and Transport Steering Group. He is a member of the Nomination Committee and the Science and Engineering Advisory Committee.

Directors' report

Principal activities

AEA Technology plc and its subsidiaries ("the Group") form a consultancy, technical services and products-based business. Its two core businesses are Rail and Environment, which offer customers a range of advanced technology products and services, expert consultancy, and deep industry understanding. AEA Technology also has a value development portfolio of businesses that includes Battery Systems, Accentus and QSA.

Review of the business and future development

The performance of the Group and its business segments is reviewed on pages 7 to 15.

Results and dividends

This year's results are set out in the Consolidated Profit and Loss Account on page 44. The Directors recommend a final dividend of 3.7p per share. Together with the interim dividend of 1.5p a share, paid in February 2004, this would make a total for the year of 5.2p (2003: 5.1p plus a 50p special dividend per share). The final dividend, if approved at the annual general meeting (AGM) on 22 July 2004, will be paid on 6 October 2004 to those shareholders on the register at 9 July 2004.

Changes in fixed assets

Details of changes in fixed assets are given in notes 17 to 19 to the financial statements.

Post-balance sheet events

There are no post balance sheet events.

Directors' interests

The directors' service agreements or appointment letters and their interests in the Company's shares are described in the Report on Directors' Remuneration on pages 31 to 40.

The only contract of significance to which the Company or any of its subsidiary companies is a party and in which a director of the Company is materially interested, is an agreement for the joint purchase of property with Dr Peter Watson (see section C of the Report on Directors' Remuneration).

Share capital

The issued share capital of Ordinary shares of £0.122 pence each increased from 67,482,474 on 1 April 2003 to 67,518,069 on 31 March 2004. This increase of 35,595 represented new issues to meet commitments under the Company's employee share schemes. The total increased up to 31 May 2004 by 22,629 to 67,540,698.

The shareholder authority agreed at the 2003 AGM for the Company to buy shares on the market and to cancel them was not exercised by the directors during the year. The directors will recommend that the authority is renewed at the forthcoming AGM to provide continued flexibility.

Substantial shareholders

As at 31 May 2004, the Company has been notified under section 198 of the Companies Act 1985 (as amended) of the following notifiable interests in its shares:

Schroder Investment Management Limited	23.96%
M&G Investment Management Limited	13.80%

Acquisitions, joint ventures and branches

Acquisitions and new joint ventures entered into during the year are detailed in note 30 to the financial statements. The Company continued to have seven registered overseas branches.

Board Committees

The role and work of the Board's Committees are reported in the report on Corporate Governance or, in the case of the Remuneration Committee, in the Report on Directors' Remuneration.

Research and development

Research and development (R&D) expenditure was £9.6 million (2003: £14.2 million). R&D investment is controlled by the individual businesses as part of their business plans within the overall business strategy for the Group set by the Board. It is directed at the development of new products and ventures in which the Group has a distinctive technological lead as well as longer-term technology developments to underpin future organic growth.

Rail Products development in the year focused on miniaturisation of hardware, including the launch of the ePLD passenger counting system. Extensive software development has also continued to integrate a number of AEA Technology solutions and to allow the systems to integrate with other software utilised by key customers. Initial field trials were carried out for the next generation of our Advanced Asset Maintenance hardware systems. These are being designed to meet the standards required in a number of new markets, as well as enhancing the functionality of the current product range.

The quality of science and engineering remained high in Kinectrics, with over 200 scientist and engineers undertaking \$12m of customer and own funded R&D, some of which was supported by the Canadian Government's scientific research and development program.

In the UK we continued to evolve our Monitor Pro environmental management software, improving its interfacing with web systems and broadening its range of applicants.

Battery Systems invested more than £2.5 million in R&D primarily on the continuing development of cell technology and the electronics associated with batteries and chargers. A key example is the Chikara cell, launched in September 2003, which has a 20% increase in capacity.

Accentus has made good progress in its work on development of gas-to-liquid (GTL) technology for application to stranded gas reserves. It also launched an initiative to develop recycling technology for recovery of value components from Li-ion batteries with financial support from Scottish Executive.

Payment policy

AEA Technology is a registered supporter of the CBI's Prompt Payment Code. Its policy is to agree terms of trading that are appropriate for suppliers' markets and to abide by such terms where suppliers' obligations have been met.

The average creditor payment period at 31 March 2004 was 52 days (2003: 34 days).

Auditors

The Board recommends the reappointment of the external auditors PricewaterhouseCoopers LLP (PwC) at the forthcoming AGM. Shareholders are reminded that PwC were re-selected in a tender process held by the Audit Committee in 2002. The Board has agreed as a policy that work other than statutory reporting work and directly related services will not be placed with the external audit firm unless it gives prior agreement after satisfying itself that to do so is in the best interests of the Company. Such work placed with PwC last year was under £100k. This includes tax advice, which was placed with PwC following a competitive tender process in 2002.

By order of the Board

Keith Russell Keith Russell

Keith Russell, Company Secretary
16 June 2004

Corporate Governance

Statements of appliance of and compliance with the Combined Code

The Board supports the highest standards of corporate governance and bases its arrangements on the corporate guidance recommended by the Financial Services Authority (FSA) in the Listing Rules. For the year ending 31 March 2004, the relevant guidance was the Combined Code issued by the Hampel Committee on Corporate Governance in June 1998 ("the Combined Code"). For future years, the relevant guidance will be the revised Code on Corporate Governance issued by the FSA in July 2003 ("the revised Code") in the light of the Higgs report on non-executives and the Smith report on audit committees, both published in January 2003.

The following report shows how, in the year ended 31 March 2004, the Board applied the 14 principles of good governance set out in section One of the Combined Code. The Group has also been fully compliant throughout the year with the supporting 45 detailed provisions, with the one exception, as explained in the Report on Directors' Remuneration, that Dr Peter Watson's contract provides for a two-year rolling notice period. Since Dr Watson is now less than two years from the end of his current employment contract, this non-compliance effectively lapses in practice.

The Board has discussed the new features in the revised Code and has made changes in order to be compliant as from 1 April 2004. These changes are also explained in the report.

Directors

Board composition

During the year, the Board comprised Dr Peter Watson as Executive Chairman, three other Executive Directors in key management and operational posts, and between three and five non-executive directors. It ended the year with four, with two further appointments made in April 2004. Between them, the directors have a range of international business and financial expertise relevant to the Company and its future. The biographies of the directors as at the date of this report are listed in a separate section, showing the board committees they chair or sit on, and their attendance record during the year. Where they have exceptionally missed a meeting, arrangements exist for them to pass comments to the other directors on the papers. The attendance record does not bring out the time put in by the non-executives outside of formal meetings.

Dr Peter Watson is a non-executive director of the Martin Currie Enhanced Income Trust plc. He was also a non-executive director of Spectris plc but resigned at its 2003 AGM and did not seek re-election.

The Board has publicly justified Dr Peter Watson's position as Executive Chairman and has discussed this with major institutional investors. It has drawn attention to the continuity that his knowledge of the Company brings during the exceptional period of its current restructuring, and the direct and significant value to the Group of his knowledge and reputation within the rail industry. He is also widely known in a number of government departments where the Environment business is targeting future growth.

The Board has satisfied itself that each non-executive director is independent, meaning in character and in judgement, and free of relationship or circumstance which is likely to affect, or could appear to affect, the exercise of independent judgement. Dr Les Atkinson is the Senior Independent Director, taking on this role from January 2004 upon Professor Sir Michael Brady's resignation. At all times during the year, the non-executives have comprised at least one half of the board (excluding the Chairman). The Chairman meets the non-executives without the executives present. The non-executives also meet without the Chairman at least annually to appraise the Chairman's performance and on such other occasions as they decide.

Under the Company's Articles of Association, all Directors must stand for election by shareholders at the first opportunity after their appointment and must stand for re-election every three years. Care is taken to give adequate information to enable shareholders to take an informed decision.

Role of the Board

The role of the Board is to provide entrepreneurial leadership, to set and implement strategy within a framework of effective internal controls, and to ensure the best performance of Group resources for shareholders. The Board meets monthly except in August. It has agreed a schedule of matters reserved for its decision as opposed to what is delegated to executive management, and keeps this under regular review. These reserved powers are enforced by being built into delegations and management procedures. Amongst the reserved decisions are approval of acquisitions and divestments, major capital expenditure proposals, lease commitments and contract bids; agreeing the annual financial budget; deciding interim and recommending final dividend payments; receiving recommendations from the Audit Committee regarding the appointment of external auditors; receiving recommendations from the Nomination Committee regarding new Board appointments; appointing key advisers; and deciding major issues affecting the AEAT Pensions Scheme.

The Board receives a monthly review of operating, financial and cash performance and regular reviews on key aspects of the Group's activities. It has regular presentations from senior managers and holds one meeting a year at a site. Through the Company Secretary, Directors receive papers on all substantive agenda items in sufficient time before meetings to be meaningful and the Chairman ensures that all Directors are properly briefed on issues arising at the Board. All Directors are encouraged to bring an independent judgement to bear on issues of strategy, performance, resources, key appointments, and standards of conduct.

All directors have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures are complied with and that the Board complies with applicable rules and regulations. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

Directors have the right to obtain independent professional advice at the Company's expense in connection with discharging their responsibilities as directors. Directors receive induction and continued training, and regard is paid to best practice advice, for example, from the Institute of Chartered Secretaries and Administrators. Their needs are discussed with the Company Secretary on appointment, and continuing needs are discussed in the evaluation processes described below.

The Company buys Directors' and Officers insurance. This provides, amongst other things, for appropriate cover in respect of legal action against its directors, as recommended in the revised Code.

Directors have been made aware of the Combined Code recommendation that, where they have concerns that cannot be resolved about the running of the Company or a proposed action, they should ensure that their concerns are recorded in the Board minutes. Non-executive directors have also been made aware of the recommendation that, on resignation, they should provide a written statement to the Chairman, for circulation to the Board, if they have any such concerns.

Board evaluation

The revised Code attaches importance to Boards having processes for individual and collective performance evaluation. The Board has accordingly reviewed and updated existing processes for evaluating its operation and performance, including committees. It recognised the potential value that might be gained from use of external consultants, and will keep this approach under consideration, but decided to carry out its first review under the revised Code guidance internally.

For the collective evaluation, the Committee Secretary met each director for a one to one confidential discussion based on a framework of a list of questions (drawn mainly from the Higgs report) covering the role and objectives of the Board and the Committees, their structure and composition, the conduct of meetings, the information put to the Board, and decision making processes. After discussing the findings with the Chairman, he then put a paper to the Board. Whilst the review showed that arrangements were felt to be broadly satisfactory, scope for improvements was identified, which are being implemented, for example, in the format of monthly management information.

For the individual performance evaluation, executive directors are assessed by the Remuneration Committee against annual performance targets. Processes have been introduced for the Chairman to talk to each non-executive at least annually about a review of their performance, and for the Senior Independent Director to lead an evaluation process of the performance of the Chairman in discussion with the other non-executives and taking account of the views of the executives. Regard is being paid to relevant advice in the Higgs report. In future, where a non-executive director stands for re-election, the Chairman will also confirm to shareholders whether he is satisfied from formal performance evaluation that the person's performance continues to be effective and to demonstrate commitment to the role.

Corporate Governance (continued)

Nomination Committee

The Nomination Committee has written terms of reference, which were updated during the year in the light of the revised Code, to lead the process for new Board appointments and succession planning and to make recommendations to the Board. The terms of reference make clear that the aim is to identify potential candidates from a wide range of backgrounds on the basis of personal merit and suitability. They are available on the corporate governance section of the Company's website. The Committee was chaired last year by Dr Peter Watson and, from 1 April 2004, by Dr Les Atkinson as the Senior Independent Director, with Dr Watson continuing as a member. The terms of reference provide that all non-executive directors shall also be members, subject to a restriction that members must not be involved in processes relating to their successor or to posts for which they may be candidates. The Committee met three times during the year. Its work on succession planning includes consideration of individual training and development needs to help secure succession to executive posts. It also satisfies itself that appropriate processes exist in the Group for planning succession to senior management posts.

The Committee has reviewed its processes in the light of the revised Code to ensure that it adopts a demonstrably rigorous, structured and independent recruitment approach to the appointment of new non-executives. The starting point is considering an analysis of the skills, knowledge and experience brought by the existing directors, identifying gaps in terms of future needs that particular new appointments should fill, and going on to agree a description of the role and capabilities required. Two new non-executives were appointed in the year plus two more in April 2004.

Rodney Westhead and Dr Paul Golby, both appointed on 1 August 2003, were identified through a selection process whereby candidates were identified by external recruitment consultants, Egon Zehnder International, against a post and person specification agreed by the Committee. Shortlisted candidates were interviewed by the Nomination Committee, who put recommendations for consideration by the Board. This recruitment action met the needs specified by the Nomination Committee of identifying two senior executives with commercial backgrounds relevant to the Group going forward, one of whom would be a financial professional able to chair the Audit Committee.

Dr Lewis Moonie and Dr Bernard Bulkin, appointed since the year end, were identified from existing contacts as a suitable candidates for further non-executive director vacancies identified later in the year by the Nomination Committee. One was for someone able to contribute to the development of the Group's business strategies in the UK public sector, which is relevant for many parts of the Group's organic growth plans. The second was for someone with a strong scientific background able to contribute at Board and Committee level to help ensure the Group's continuing technology robustness and that research and development remains focused on underpinning business objectives. In both cases, two existing non-executive directors had one to one interviews with them to assess their suitability and then put their recommendations directly to the Board for consideration.

Letters of appointment to non-executives set out the expected time commitment. A check is made in the appointment process that they undertake to have sufficient time to meet what is expected of them. Their other significant commitments are disclosed to the Board and substantial subsequent changes are brought to their attention.

Executive Committees

A committee comprising the Executive Directors and the Company Secretary meets weekly and a Group Executive Meeting, comprising them and the Business MDs, meets monthly. Between them, these committees manage the day to day operations of the Group within the strategy and controls set by the Board. Each Business has its Business Board chaired by a plc Director. Subsidiary companies have statutory boards of directors, operating under a Group framework that respects their legal responsibilities within a framework of shareholder controls for managing the Group.

Remuneration Committee and directors' remuneration

The role and work of the Remuneration Committee is described in the Report on Directors' Remuneration on pages 31 to 40. It has regard to Schedule A of the Combined Code.

Audit Committee

The current members of the Audit Committee are Rodney Westhead (Chairman from August 2003), Dr Leslie Atkinson, Andrew Shilston and Dr Paul Golby. Dr Leslie Atkinson was the chairman until July 2003. Rodney Westhead and Andrew Shilston have professional accounting qualifications and significant recent and relevant financial experience whilst Dr Leslie Atkinson and Dr Paul Golby are experienced businessmen.

The Committee met twice in the reporting year, with external auditors present. It has decided, and has incorporated this decision into its terms of reference, to increase its scheduled meetings to three in future years. This will enable it to extend its review of internal controls and of the external audit process. The Committee talks to the auditors without executive management present. Its Chairman reports the main work and findings of the Committee to the Board. All Directors receive minutes of Audit Committee meetings.

Its written terms of reference were revised last year to reflect the Smith and Higgs reports and the revised Code, and are published on the company's website. In line with these, it reviews financial statements before these are considered by the Board, including the accounting policies adopted and the implementation of changes, and it reviews the significant financial reporting judgements in them. It ensures consistency of reporting from year to year. The review of associated announcements is a matter the Board has reserved for itself.

The Audit Committee reviews the scope, results and cost-effectiveness of internal and external audit, and has delegated power from the Board to exercise the power from shareholders to agree fees for external auditors. The Committee is responsible for satisfying itself on the independence of internal auditors and on the independence and objectivity of external auditors. The Committee reviews the operation of internal controls and, from the coming year, will report to the Board on the annual review of the internal control and risk management. The terms of reference also require the Committee to review the arrangements whereby staff can raise concerns about possible improprieties in financial reporting or other matters, and to satisfy itself that these ensure the proportionate and independent investigation of such matters and appropriate follow-up action. No such concerns were raised in the year.

No directors have a significant connection with the auditors. The Committee has the power to engage outside advisers to provide support, but saw no occasion to use this power last year.

The Committee reviews each year the arrangements for safeguarding auditor objectivity and independence. It satisfied itself that these were maintained in the last year. Its assessment includes a review of the auditors' internal quality control procedures.

The Committee put the audit appointment out to tender in 2002, and the Board accepted its advice to re-appoint PricewaterhouseCoopers ("PwC"), now PwC LLP. The current senior PwC audit partner, Rod McGregor, was appointed in 2002. The Board also accepted the Audit Committee's recommendation that non-audit work should not normally be placed with the audit firm and will in future only be placed with specific prior Board approval. Following a tender exercise in 2002, the Board accepted the advice of the Audit Committee to allow PwC to provide tax advice. Fees for non-audit work given to PwC in the year were under £100k.

Science and Engineering Advisory Committee

The Science and Engineering Advisory Committee was chaired by Professor Sir Michael Brady until December 2003, and by Dr Peter Watson after that date. The Committee includes Dr Bernard Bulkin plus three external university professors in technical fields of relevance to the Group's growth plans. The Board set up this committee to review, advise on and provide insights into the development of the technology base of the Group. The aims are to help to ensure that the technical base of the Group is sufficiently sustained to generate significant new products and services, that technical synergies between businesses are exploited, and that benefits of common software architecture are used, for example, in product design. The Committee met once in the year. A schedule of four meetings is planned for the coming year.

Corporate Governance (continued)

Relations with shareholders

The Group welcomes two-way dialogue with its shareholders and communicates with them through its interim and annual reports, through information placed on its website, and through a planned investor relations programme. A new corporate governance section has recently been added to the web site that includes the terms of reference of board committees. Regular meetings are held between executive directors and institutional investors, for example after the publication of interim and annual results, which involve a wide-ranging discussion about Company performance and plans. During the year, presentations of the Rail and Environment businesses were made to major investors and analysts. The Chairman discusses governance and strategy with major shareholders.

The Board has reviewed its arrangements for ensuring that it knows and understands the concerns and priorities of its shareholders. These include reports of meetings with individual shareholders from directors and from external advisers, circulation of analyst reports, and reports on developments in the corporate governance guidelines of institutional investors. A new step being introduced, as recommended in the revised Code, is to offer one to one meetings between the Senior Independent Director (SID) and the major shareholders, to enhance the understanding that directors have of the views and priorities of the major shareholders. The SID is available as a channel of communication if they have concerns that are not appropriately handled through other channels, and they also have the opportunity to meet new non-executive directors.

All directors attend the AGM so that shareholders have the opportunity to question them, including in their role as chairmen of board committees. Separate resolutions are proposed on each substantially different issue so that each receives proper consideration. Resolutions include the approval of the annual report and accounts and approval of the remuneration report. Proxy votes showing the balance for and against each resolution, including abstentions, are announced at the meeting after each resolution has been dealt with on a show of hands, and are published on the Company's website. The Company discusses with its registrars the process for properly receiving and recording the votes cast. Notice of the AGM and related papers are sent to shareholders at least 20 working days in advance of the meeting.

Shareholders approved a revised Memorandum and Articles of Association in 2002, in which the opportunity was taken to update these for developments such as providing for electronic communications with shareholders. The Company monitors potential interest from shareholders in receiving information electronically through the website run by its registrars. Electronic proxy voting for CREST members is being introduced from the next AGM onwards.

In line with the regulatory requirements applying to listed companies, clear documented procedures exist to control dealing in Company shares by employees, particularly those with regular access to unpublished price sensitive information and particularly in so-called "close periods" such as the two months before the publication of half year and end year results. These controls help to contribute to an orderly market in the Company's shares.

Accountability

The Board is aware of its duty to ensure that it presents a clear and balanced assessment of the Company and Group position and prospects in statutory and in interim and other price-sensitive public reports and in reports to regulators. It takes care to ensure that it meets this duty by reserving for itself the review and approval of such reports, and taking advice from professional advisers.

The Directors' responsibilities for preparing the accounts are set out in the Statement of Directors' Responsibilities on page 41.

Internal Control

Responsibility and process

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. This system is designed to manage rather than to eliminate risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement and loss.

The Board confirms that there is an on-going process for identifying, evaluating and managing the Group's significant risks, that this has been in place for the year ended 31 March 2004 and up to the date of approval of the annual report and accounts, that it covers subsidiaries in which the Group has an interest of 50% or more, that it is regularly reviewed by the Board, and that it accords with the FSA's internal control guidance for directors on the Combined Code ("the Turnbull guidance").

Control environment

The Group's organisational structure has clearly documented and communicated levels of responsibility, delegated authority and reporting procedures. Management systems have been externally accredited. The professionalism and competence of employees is maintained through recruitment, performance appraisal, written job descriptions, and personal training and development plans. The Board supports the highest levels of commitment and integrity from employees and has endorsed a code of business ethics, a copy of which is given to all employees.

Identification of business risk

Each Business and Corporate Service is required to identify and assess risks to meeting objectives, to weight and prioritise these on the basis of their assessed impact and likelihood, and then to take timely actions to manage or eliminate them through compensating internal controls. The relevant management process approved by the Board recognises that risks arise from many internal and external sources and that a wide range should be considered. The effectiveness of these actions is monitored and reviewed regularly. These Business and Service reviews form the basis of an annual review to the Group Executive and Board. They also help to identify areas for improving risk-based internal controls and to target the Group's insurance programme.

The Board, the Group Executive and Business Boards take monthly reports on specific contract risks such as those with reported technical or financial problems, or where items in the accounts assume contract variations as yet unagreed.

Organisational changes can particularly give rise to risks. They are therefore subject to particular review to ensure that there is a documented audit of risks that have been identified and of the arrangements to control and manage these. Such reviews may take the form of papers to management committees and the Audit Committee, and reports to relevant regulators on safety aspects.

Control procedures

Control procedures are documented in the Group's management systems, which are subject to external audit. These include a finance manual, corporate and business quality assurance manuals, safety procedures and environmental management procedures. Procedures are designed to ensure that work is carried out to meet stated objectives, that risk is managed through risk-based internal controls, and delegations are based on risk assessments, and that variances are identified and reported in a timely way to enable corrective actions to be taken. Procedures are also subject to review so that improvements to enhance controls can be made.

Corporate Governance (continued)

Monitoring and corrective actions

The Board approves a three-year business plan and an annual Group budget. It receives monthly reports, supplemented by other reviews, on a range of key performance and risk indicators, and considers possible control issues. The indicators cover financial, operational, safety, environmental and compliance aspects of performance with budget forecasts revised in response to developments. The Group Executive, Business Boards and boards of subsidiary companies similarly receive regular reports. Reviews of strategy implementation roadmaps, with milestones, are now an important feature of all executive meetings.

Throughout the year, the internal audit function reported to the Audit Committee, which approved its programme and considered its recommendations. The Board also received, and decided appropriate action on, reports from the Audit Committee and external auditors.

For its annual review of the internal control system, the Board took account of its own reviews and monitoring during the year plus documentation from the Group Executive, in order to obtain the degree of assurance required under the Combined Code. The Board also has responsibility for satisfying itself with the effectiveness of the Group's risk management processes.

Compliance with control procedures was monitored during the year by internal audit and through reviews of compliance with the Group's Quality Management System. *Businesses are required to confirm their compliance annually with the internal control systems.*

Statement of going concern

After making appropriate enquiries, the directors have a reasonable expectation that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they consider it appropriate to continue to adopt the going concern basis in preparing the financial statements.

Corporate Social Responsibility

Responsibility and approach

The directors take regular account of the significance of social, environmental and ethical (SEE) matters to the business of the Group. They have identified and assessed the significant risks to the Group's short and long term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response. They have received adequate information during the year to make this assessment and account is taken of SEE matters in the training of directors. They have ensured that the Group has in place effective systems for managing significant risks, which, where relevant, incorporate performance management systems and appropriate remuneration incentives including for the Executive Directors. Regular meetings with major shareholders provide them with the opportunity to raise SEE matters affecting the Group.

The Board reviews SEE matters regularly as part of its responsibility for corporate governance, including monitoring Group performance through annual reports on health and safety and on environmental management performance, and through regular performance statistics and indicators. During the year, Peter Watson had board level responsibility for health, safety and environmental management, and Andrew McCree had board level responsibility for Corporate Affairs (including community involvement) and Human Resources. The Group Executive and Business Boards similarly discuss SEE matters on a regular basis.

The Board includes SEE matters within its wider annual review of risks under the Turnbull guidelines. The three that it has identified as most significant in terms of effect on the Group's short and long term value are: high standards of health, safety and environmental management and observance of regulatory requirements; effective employee relations; and systems and culture that maintain the Group's reputation for scientific and technical integrity and independence. Details of the Group's record on key SEE matters and verification for disclosures are described later in this report.

The Board ensures that systematic policies and procedures exist that define clear standards and expectations of corporate performance and employee behaviour, and that document and manage key risks in these areas. These form part of the Group's integrated quality management system. Performance against them is regularly audited and verified externally by Lloyds Register Quality Assurance.

The Board has agreed a code of business ethics which has been distributed to all staff, "Integrity at Work", setting out the standards of behaviour expected of staff in circumstances calling for judgement. The text is on the Company website. It has been translated into Dutch for the Rail subsidiary in Utrecht.

Safety, health and environmental management

AEA Technology's commitments to the health and safety of its staff and to a high standard of environmental performance are set out in the Board's Group-wide safety, health and environmental policy signed by the Chairman.

The policy is put into effect Group-wide by means of a set of formal principles for its implementation, which are mandatory for all business units worldwide. These principles establish a framework of corporate requirements that enable each business unit to demonstrate compliance in a manner that is appropriate to the scale and nature of its activities, having due regard to local regulatory requirements. Training is provided to employees who are required to have, and to demonstrate that they have, a detailed understanding of requirements affecting their work. Compliance is monitored by qualified internal auditors with an appropriate degree of independence of operational management.

Safety and environmental issues, together with the control measures in place, form part of the Group's risk-based internal control system. This includes having appropriate management arrangements implemented by suitably qualified and experienced staff, appropriately monitored and reviewed as part of the annual risk review process laid down and overseen by the Board. The Board also reviews annually a report on health and safety performance and a report on environmental performance. Details of the integrated safety, health and environmental policy, quantified targets, and performance indicators can be found on the Company's website. The environmental data have been independently verified by an external environmental consultancy firm.

Health and safety procedures apply Group-wide. The businesses operate in increasingly regulated environments so compliance with legislative and regulatory requirements is an essential starting point for management processes. Continuous improvement is visibly encouraged through the use of key performance indicators, management of change processes, and mandatory risk assessments. The key performance indicators, reviewed monthly by management, include targeted numbers of safety-related management walkabouts, timeliness of reporting unusual occurrences, and near miss reporting. Specific policies address key health and safety risks including identification and management of safety hazards, physical conditions in the workplace, workplace health, and stress. Health and safety performance is a standard element of the bonus criteria for all line managers. Excellence in safety performance is also publicised by the selection of award winners by the Joint Committee on Health and Safety.

Corporate Social Responsibility (continued)

In 2004, the rolling year reportable lost time accident rate for AEA Technology Group employees was 0.055 per 100,000 hours worked. The Company received 13 British Safety Council awards and seven RoSPA gold awards for its safety during the year.

Our policy statement recognises the contribution that good environmental performance can make to meeting business objectives and to fulfilling our legal duty of care to minimise risks to others from our activities. The policy is built in to our management system at corporate and business levels with commitments to meeting external requirements, to a programme of continuous improvement involving target setting and monitoring, and to providing adequate resources, training and information. Our Environment business is certified to ISO 14001 and other businesses are preparing for certification.

Business Commitment to the Environment (BCE) is one of the world's oldest environmental awards schemes. For nearly 30 years BCE has recognised and promoted environmental best practice across a wide spectrum of British businesses. It is also one of three feeder schemes to the biennial European Environmental Awards. It is currently co-sponsored by AEA Technology Environment and the Brunswick Group.

The most significant environmental effects of the Group's activities during the year continue to be our products and services. Our policy, revised and re-issued during the year, commits us to maximising their environmental benefits. The entire output of the Environment Business, for example, is geared to this objective, whilst the Rail Business delivers products and services that, by helping to make railways safer, more punctual and more reliable, are contributing to the modal shift from road to rail. Accentus is running a pilot battery recycling plant in Scotland to help prove both the technology and the economics of volume recycling.

In operating our business activities, our main environmental impacts are business travel, utilities consumption, office waste production and radioactive discharges. Other than the last, which is specific to a small and reducing part of our activities, our business operations therefore have a narrow and conventional range of environmental impacts. Detailed statistics are on our website.

We have continued to target further reductions in energy consumption across the company. We have set objectives for reducing the amount of non-recycled waste that we generate and for reducing the environmental impact of our business travel. In the latter regard we have seen the benefits of our investment in improved videoconferencing equipment, and we are trialling a partnership with our biggest taxi supplier aimed at increasing taxi sharing. We are also examining proposals to improve the environmental management of our leased vehicle fleet.

We have invested effort in increasing our environmental engagement with our most significant suppliers, including the introduction of an award scheme to reward excellent performance and workshops directed at discussing with suppliers the standards that we expect them to observe.

Discharges of radioactivity are closely monitored in compliance with regulatory requirements, and we sustained our record of continued compliance with all limits and authorisation conditions. Discharges in the year were well within authorised limits. They are regularly reviewed to ensure that they continue to be as low as reasonably practicable.

During the year we again took part in the Business in the Environment Index of Corporate Environmental Engagement. Both our overall score and our position in the ranking table of participating companies increased significantly, reflecting our continued progress in a number of areas including our environmental stewardship and our engagement with external shareholders plus progress with our environmental audit systems.

Occupational Health

Comprehensive occupational health arrangements are in place. Training has been provided to managers and other employees on managing workplace stress. A drugs and alcohol policy was developed during the year and implemented.

Maintaining Scientific and Technical Integrity

The Group is committed to maintaining the reputation, integrity and independence of its science and technology base. A Chief Technologist has overall responsibility for supporting the development of the Group's capacity to meet future market needs. This is achieved both through benchmarking its core competences against external technologies and proposing future technology solutions, and through identifying and helping to develop synergies between the businesses that arise from complementary technology and know-how. The Chief Technologist represents the Group amongst the scientific and engineering community at large, and develops relationships with the UK science base to enhance the Group's scientific and technical reputation and help keep its knowledge base up to date.

The Group places great importance on subjecting its scientific and technical work to external scrutiny. The Board has set up a Science and Engineering Advisory Committee, chaired by a board member. It has three eminent scientists and engineers as external and independent members. The Committee reviews, advises and gives an external perspective on the technology base of the Group, thus providing the Board with an assurance of its robustness and quality.

Technical staff are encouraged to submit their work for external scrutiny by submitting papers to peer-reviewed scientific journals and by presenting papers at scientific conferences. A procedure for ensuring internal quality checks before publication is included in the Group's quality management system.

The Group is committed to active engagement with the external science and engineering community. Through its membership of the Foundation for Science and Technology and of the Parliamentary and Scientific Committee, it is involved in discussion of policy and societal issues with a scientific, engineering and technology element. It engages with the Royal Academy of Engineering in initiatives related to engineering in society, in areas such as ethics and risk perception. Technical staff are encouraged to maintain membership of professional institutions relevant to their competences and to hold appropriate external positions on committees consistent with their professional development.

Societal Aspects of Technology

The Group supports a number of initiatives in the wider scientific and engineering community that are focused on societal aspects of technology:

- as co-sponsor with the Royal Academy of Engineering and the Department for Environment Food and Rural Affairs, it supports Peter Guthrie at Cambridge University as the first professor in Engineering for Sustainable Development in the UK. His Centre for Sustainable Development is a focal point for teaching and research, addressing the increasing need for engineers to formulate systems, technologies and attitudes that deliver a more sustainable approach across all sectors of engineering.
- in partnership with Wolfson College Oxford, the Group sponsors and organises a series of topical meetings on key topics at the interface between business, technology and society; these bring together key players, and provide an opportunity for debating the important questions and for suggesting an agenda for action. Meetings have been held this year on nanoparticles and on technology transfer.
- the Group is providing sponsorship to the Royal Society of Arts to support its Forum for Technology, Citizens & the Market, an initiative that is looking at the role of science and technology in society. The Forum's first project will be to produce practical guidance for UK companies on engaging with public concerns around new technologies.

Marketplace

Group-wide procedures for the development and introduction of new products and services and for capital expenditure include consideration of social aspects such as providing guidance on environmentally responsible use. An example of where such social aspects have been particularly important include our investment in extended battery life and waste minimisation in our Battery Systems business and our related investment in developing a battery recycling capability in Scotland. Another is Safeguard International which provides services to ensure responsible management of end-of-life radioactive industrial and medical products from schools, hospitals and other small users. Our National Chemical Emergency Centre provides safety and environmental support to users and consumers of hazardous materials in case of accidents during transport.

We engage with our main suppliers on environmental matters based on a prioritisation assessment. Details of our environmental expectations of our main suppliers are published on the Company's website.

Corporate Social Responsibility (continued)

Community involvement

Commitment to the community is demonstrated through our membership of Business in the Environment and of the Per Cent Club. The Group's policy is to focus its corporate community involvement on promoting science and technology, for example in local schools. The MDs of several of our business units are members of local or regional business forums whose purpose is to increase local employment opportunities. Dr Stuart Hill, Managing Director of the Environment business, is a Governor at Culham Parochial School. Environmental and social issues are taken into account in site selection decisions for our business units, including the location of our Battery Systems facilities in Scotland, and the use of a brown field site for the headquarters of our Rail business. Our Environment business works with local authorities, helping to develop cycling strategies. We participate in local public liaison meetings at several of our sites.

The Group donated £18,422 (2003: £13,075) for charitable purposes during the year plus contributions in kind. No political contributions were made.

Employees

The Group's employment principles are to pay market rates and to ensure that it has access to the widest possible labour market to secure the best employees for its needs; to achieve a diversified workforce, selected and managed on the basis of individual competence; and to create a culture in which the individual motivation and potential of every employee is developed to the benefit of the employee and the Group overall. Processes for helping to implement these principles include an annual personal development assessment and an individual training and development plan agreed between the employee and line manager. Professional human resources staff are employed corporately and in each Business. Human resource issues are taken every month by the Business Boards and as necessary by the plc Board.

During the year the Group had an average of 3,035 employees.

Employee involvement and participation is actively encouraged. Employees are represented by trade unions and by collective bargaining processes covering, for example, pay and conditions of service. Elected employee representatives sit as full members on the Group Executive meeting and business boards of management and as trustee directors for pension schemes. This contributes to ensuring that employee views and interests are effectively represented and taken into account. A Company-wide joint health and safety committee meets quarterly.

An equal opportunity policy states a clear commitment to the principle of equal opportunities at work, and to the avoidance of direct or indirect discrimination against employees on grounds of gender, marital status, sexual orientation, race, ethnic or national origin, religion, age or disability. The joint venture factory in China, part of the QSA business, is regularly reviewed by suppliers for evidence of adherence to appropriate labour, human rights and ethical standards.

The directors are committed to enhancing opportunities for employees to become shareholders in the Company. Another annual save-as you-earn share option invitation was offered across the Group in January 2004, and the new Government Share Investment Plan was introduced to UK employees in 2003 on the basis that the Company gives one share to every three bought by employees.

Employee satisfaction surveys are carried out from time to time, internally or using external advisers.

Disabled employees

The Group recognises and welcomes its obligations to employ people with disabilities. To the extent that the demands of the business and aptitude and ability of each individual allows, it aims to give people with disabilities equal opportunities for training, promotion, and career development. This policy applies to filling vacancies and in the continuing employment of current employees who may become disabled.

Report on Directors' remuneration

This report complies with the Directors' Remuneration Report Regulations 2002 ('the Regulations'), with the FSA Listing Rules and Schedule B to the Combined Code. A resolution inviting shareholders to approve the Report will be tabled at the AGM on 22 July 2004.

A The Remuneration Committee and its advisers

The Board has delegated the responsibility for the remuneration of executive directors to a Remuneration Committee (the Committee), with written terms of reference. The Committee consists entirely of independent non-executive directors: Andrew Shilston (Chairman), Professor Sir Michael Brady (to 31 December 2003), Dr Leslie Atkinson and Dr Paul Golby (from 1 August 2003). The Company Secretary acts as its secretary. During the year, the Board updated the terms of reference of the Committee in the light of the Higgs Report and subsequent changes in the Combined Code. These can be found on the Company's website. One effect of the changes was to extend the Committee's remit to include the first level of executive managers below Board level.

New Bridge Street Consultants LLP, which provides other advice to the Company from time to time, was commissioned directly by the Committee in the year to review the remuneration of the executive directors and to develop a Performance Share Plan which, subject to shareholder approval, will replace the CSOP as the long term incentive element of the remuneration package. The Committee has a written agreement with it for the provision to it directly of advice and services. It did not provide any other services to the Group. The Committee also consulted the Chairman about the other executive directors' pay and bonuses, but he did not participate in any decision relating to his own remuneration.

B Executive Directors: Remuneration policy and approach

The Remuneration Committee's policy remains that the structure and level of executive remuneration should be in line with that of industrial and support service companies of broadly comparable market capitalisation and turnover; that the total remuneration package should be structured to attract, motivate and retain Executive Directors; and that a significant part of the remuneration package should depend on performance thereby directly aligning directors' interests with those of shareholders. In making market comparisons, the Committee looks at practices in some 25 comparator companies.

This policy is consistent with the broader human resources policy and arrangements applying in the Group. Key features of these are to set basic pay levels in line with median market rates of relevant comparator organisations; to revise basic pay levels each year taking account of movements in market pay rates, company performance, pay inflation elsewhere in the Group and overall affordability; and to reward individual and team performance through the use of bonuses.

The Committee reviews Executive Director remuneration annually to ensure consistency with relevant comparator companies, with Group business objectives, and with any change in legislation and best practice guidelines. Individual remuneration packages comprise fixed and variable performance-related elements, with the latter representing a significant potential part of the total.

Some changes were made during the year to enhance the links between remuneration and shareholder value, and are described below. The Committee will further review executive packages in the light of proposed Government changes to pensions. Changes will be reported in subsequent years, and shareholders will have the opportunity to approve them.

C Executive Directors: Components of individual remuneration packages

a) Fixed elements

The separate components are as follows:

Basic Salary The Committee reviews basic salaries annually, or when changes in responsibilities occur, taking into account relevant external market comparisons, the level of responsibility of each executive and movements in basic pay in the Company.

Post-retirement benefits Executive Directors are eligible to participate in the AEA Technology Pension Scheme, a defined benefit scheme. For those affected by the Inland Revenue pensions earnings cap, the Committee has agreed arrangements in respect of earnings above the cap, as set out in Section J below.

Report on Directors' remuneration (continued)

Other benefits These include the provision of a fully expensed company car and health insurance. The Company also provides permanent health insurance for Dr Peter Watson and death in service benefits in respect of earnings above the pensions earnings cap for Dr Peter Watson, Andrew McCree and David Lindsay.

The Company has invested in a share in a London property occupied by Dr Peter Watson, whose duties require his presence in London for extended periods. The Company's investment in this property is £75,000.

All employee share savings plans Executive Directors are eligible to participate in the Company's all-employee share savings plans, namely Save As You Earn (SAYE) and the Share Incentive Plan (called Buy As You Earn or BAYE). Neither involves performance conditions.

b) Variable elements

The Committee's policy is that executive remuneration packages should include a large variable performance-related component, payable only if, and to the extent that, demanding conditions have been met that have increased shareholder value or contributed significantly to corporate strategy and development.

Annual cash bonus payments In the year ending 31 March 2004, Executive Directors were eligible to earn a cash bonus of up to 60% of basic salary, with payments determined by the Committee in respect of performance against challenging, quantified targets that they set at the start of the year.

Half of this bonus was payable in respect of Group financial performance. The Committee selected five measures relating to the continuing businesses, namely earnings per share (EPS); orders; sales; contribution; and free cash flow. A bonus of up to 6% of basic salary was payable in respect of each measure, with a threshold of bettering the 2003 figure as adjusted for inflation, and payments then being made on a sliding scale.

The other half of the bonus potential was payable at the Committee's discretion having regard to performance by each director against quantified personal targets set by the Committee. These targets were aligned to shareholder interests and reflected the specific challenges set for each individual director as well as the Committee's view that sustainable Group success requires good performance against a broad range of performance and stakeholder indicators. Individual targets included: business-specific targets for sales, orders, contribution and cash flow; objectives in respect of acquisitions and divestments; the successful implementation of a new senior management contract structure; effective company communications; achieving cost savings in overhead areas; and the development of the Board in light of the Higgs recommendations.

Bonuses are taxable but not pensionable. They are paid in cash in the financial year following that in which they are earned. Bonus payments for performance in 2004 are shown in the table in Section J.

For future years, the Committee has increased the maximum bonus payable to 70% of salary, in line with levels in comparator companies. As the Group emerges from its restructuring, the Committee has decided that it is now appropriate to increase the amount payable against a common set of Group financial performance targets to four-fifths, with the remaining one-fifth of the bonus to be determined by the Committee in respect of performance against personal objectives related to the development of the Group. The Committee believes these changes maintain a robust bonus structure that incentivises good performance whilst ensuring that payments are made only where clear benefits have been delivered to shareholders in the year.

Longer term share based incentives A Company Share Option Plan (CSOP), introduced in 1999, was extended with shareholder approval to executive directors in 2000. The CSOP comprises an Inland Revenue approved part, under which participants can hold up to £30,000 worth of options free of income tax on exercise, and an unapproved part for higher amounts. The Committee has made annual CSOP awards since 2000. They awarded options last year to Dr Peter Watson at 200% of salary and to the other Executive Directors at 150% of salary.

CSOP awards are subject to a stringent company performance target set by the Committee based on the achievement over a three-year period of EPS growth as follows:

- Options with a value of up to 100% of a participant's annual salary may be exercised where real growth in the Institute of Investment Management and Research (IIMR) EPS is equal to or greater than 3% per year above the level of the UK Retail Price Index (RPI).
- That part of an option award between 101% of salary and 150% of salary may be exercised where real growth in the IIMR EPS is equal to or greater than 5% per year above the level of the UK RPI. For performance between RPI plus 3% and 5%, this part of an option award may be exercised pro rata.
- That part of an option award above 150% of salary may be exercised where real growth in IIMR EPS is equal to or greater than 8% per year above the level of the UK RPI. For performance between RPI plus 5% and 8%, this part of an option award may be exercised pro rata.

For the 2001 award, vesting is also dependent on the Committee's assessment of the success in implementing the 2000 strategy and the role played by individual Directors. For option awards made in 2002 and 2003 the performance growth condition applies to the continuing businesses.

The EPS performance targets for the CSOP awards in 2001 were met over the three year performance period ending 31 March 2004. The Committee, noting the successful implementation of the 2000 strategy, agreed that the awards to directors would vest in full.

The Committee adopted an earnings per share performance condition because it aligns the incentive with the interests of shareholders in a way that can be objectively measured, since awards only vest if the underlying value of the Company increases in a sustained and absolute way over a long period.

There is no provision for re-testing of performance conditions if these are not met in the three year period. Vesting in the event of termination of the Director's contract or of a change of control is at the discretion of the Committee, with the exception, approved by shareholders in 2000, that automatic vesting in the event of a change of control applies to the first award made to a director. The only outstanding options subject to this exception are 60,256 held by Dr Charles Hipsley at an exercise price of £1.95.

Subject to shareholder approval at the 2004 AGM, the Committee intends to replace the CSOP with a new Performance Share Plan (PSP) offering broadly equivalent potential benefits through the conditional award of shares, the vesting of which will be dependent on company performance against that of a comparator group as measured by Total Shareholder Return, with an over ride that the Committee must be satisfied that the TSR performance is reflective of underlying financial performance. This is the performance measure now preferred by most large investors. The Committee's reasons for wishing to introduce a new scheme are set out in the Notice of AGM.

D Executive Directors: Shareholding guidelines

The Committee has agreed the principle that Executive Directors are expected to build up and maintain significant shareholdings in the Company over time, allowing for differences in individuals' circumstances.

E Executive Directors: Service contracts

Contract dates are as follows:

	Contract Date	Retirement Date	Unexpired term at 31/3/04
Dr Peter Watson	31 March 1996 updated 23 Sept 2002	9 January 2006	1 year, 9 months
Andrew McCree	27 Nov 2000	19 August 2017	13 years, 4 months
Dr Charles Hipsley	26 Sept 2002	12 May 2017	13 years, 1 month
David Lindsay	3 Sept 2001	16 May 2021	17 years, 1 month

Report on Directors' remuneration (continued)

Dr Peter Watson, who had a notice period of two years, is now within two years of retirement and so the provision for a two year notice period will lapse naturally. Andrew McCree, Dr Charles Hipsley and David Lindsay have service contracts that provide for one year's notice of termination of appointment.

The Committee accepts and endorses the principle of mitigation of damages on termination of appointment. In the event of early termination, the Committee negotiates a severance package. Executive Directors' contracts provide for payment of salary and benefits in the notice period, with decisions on other matters (bonus payments, outplacement support and vesting of share options) being at the sole discretion of the Remuneration Committee. In the event of dismissal within 12 months of a change of control, the contracts of the three directors with a one year notice period give a commitment to payment of outplacement support and a bonus, since the Committee believes that, in this circumstance, it is helpful for all parties that arrangements have been pre-determined.

F Executive Directors: External directorships

Executive Directors may hold non-executive director appointments with other companies subject to prior Board agreement. To reflect the personal responsibility entailed in such appointments, they are allowed to retain any fees payable to them with the consent of the Committee, except where the directorship is as a representative of AEA Technology. Currently Dr Peter Watson is the only executive director to hold an external non-executive appointment, with Martin Currie Enhanced Income Trust plc, for which he is paid an annual fee of £10,000.

G Senior Group Executives

During the year, in line with recommended best practice in corporate governance, the Board extended the Committee's remit to include remuneration arrangements for the executive managers immediately below Board level, currently the six Business Managing Directors and the Company Secretary who sit with the Executive Directors to form the Group Executive. Their contract structure is similar to that of the Executive Directors with salaries determined in line with market benchmarking and variable compensation elements being the same as those of the Directors but set at lower levels.

H Non-Executive Directors

No non-executive director has a service contract with the Company. They are appointed for terms of three years at a time, renewable if re-elected by shareholders. Their remuneration is determined by the Board within the limits set out in the Articles of Association. The Board has delegated this responsibility to a sub-committee comprising all Executive Directors.

Of the current non-executives, Andrew Shilston will stand down at the next AGM, Dr Leslie Atkinson will stand down and offer himself for re-election and the other four, having been appointed by the Board since the last AGM, will stand down and offer themselves for election.

Non-executive directors are paid a set fee plus a fee for chairing Board committees, determined by reference to the findings of external remuneration consultants on the fees paid to non-executive directors in other companies of broadly similar size and complexity. The basic fee in 2004 was £28,000, as in 2003 and has been maintained for the coming year. The Committee fee varied. They do not receive share options, performance related bonuses or pension entitlements and they are not eligible to participate in all employee share plans. They are entitled to be reimbursed for reasonable expenses in line with the policies applying to the Group's employees. Dr Leslie Atkinson is also non-executive chairman of the Board of Accentus plc, a subsidiary of AEA Technology plc, for which he receives a separate annual fee of £20,000.

1 Performance graph

In line with the Regulations, the following graph compares the performance of AEA Technology plc, by reference to total shareholder return ('TSR'), with that of the FTSE Support Services sector since the Company was floated on the London Stock Exchange in September 1996. This index has been selected because AEA Technology has been in this sector throughout and because many of the companies used by the Remuneration Committee as market comparators for executive pay are in this sector. TSR is shown as the value of £100 invested in AEA Technology plc and in the FTSE Support Services Sector over the same period, measuring share price growth plus dividends paid.

Report on Directors' remuneration (continued)

J Details of Directors' Remuneration

This and section K have been externally audited.

Directors' emoluments

Details of individual directors' emoluments, excluding contributions into a pension scheme (covered under the next sub-heading), for the year are as follows:

	Basic salary and fees £000	Benefits £000	Annual bonus £000	Termination payment £000	2004 total emoluments £000	2003 total emoluments £000
Executive						
Dr Peter Watson	305	25	106	—	436	405
Andrew McCree	207	47	82	—	336	306
Dr Charles Hipsley ¹	180	21	63	—	264	125
David Lindsay	192	45	67	—	304	268
Stephen Thornton ²	—	—	—	—	—	479
Non Executive						
Dr Leslie Atkinson ³	48	—	—	—	48	44
Professor Sir Michael Brady ⁴	26	—	—	—	26	33
Lord Sharman ⁵	—	—	—	—	—	23
Andrew Shilston	31	—	—	—	31	30
Dr Paul Golby ⁶	19	—	—	—	19	—
Rodney Westhead ⁷	21	—	—	—	21	—
					1,485	1,714

1 Dr Charles Hipsley was appointed a Director on 26 September 2002

2 Stephen Thornton resigned as a Director on 25 July 2002. The total emoluments for 2003 include a termination package as explained in last years report.

3 The figures for Dr Leslie Atkinson include £20,000 as fees for services to Accentus plc from August 2002 onwards

4 Professor Sir Michael Brady resigned as a non-executive director on 31 December 2003

5 Lord Sharman resigned as a non-executive director on 31 December 2002.

6 Dr Paul Golby was appointed a non-executive director on 1 August 2003

7 Rodney Westhead was appointed a non-executive director on 1 August 2003.

The figures above are the emoluments earned during the relevant financial year. Such emoluments are normally paid in the same financial year, with the exception of bonuses, which are paid in the year following that in which they are earned. The benefits column covers the costs of a car, fuel card, health care, and cash payments made in lieu of pension and related benefits in respect of salary above the cap.

Dr Peter Watson has, in previous years, been paid an annual compensation payment in respect of tax incurred on the insurance premia paid by AEA Technology to provide death in service cover and permanent health insurance on his salary above the pensions earnings cap. This applied similarly in 2003/4 to David Lindsay and Andrew McCree in respect of the premia paid for death in service cover. The Inland Revenue have confirmed that these payments should not be classified as benefits in kind and the Directors have repaid compensation payments made in recent years. The 2003 figures in the above table have been restated to exclude the compensation payment made that year to Peter Watson (£20.7k), and the insurance premia paid for Peter Watson, David Lindsay and Andrew McCree. Compensation payments and insurance premia are excluded in the 2004 figures. The Company continues to pay the premia at a total cost of £33k per annum.

Pensions

All the Executive Directors are members of the Senior Executive section of the AEA Technology Pension Scheme. This provides for a two-thirds pension less retained benefits at normal pension age provided that 30 years' service is completed. The Senior Executive Section provides for a 37.5% pension payable to a dependant on the death of the scheme member. Pensions increase each year in line with inflation as measured by the RPI subject to a maximum annual increase of 6% in the Senior Management section. The directors' basic salary is pensionable, but bonuses are not.

Features of the pension and associated arrangements for each director are as follows.

Dr Peter Watson has a retirement age of 62. His pensionable final earnings are enhanced by 3.7% in compensation for a decision in 2000 that the value of his benefits in kind would no longer be pensionable. He has an unfunded top up arrangement designed to bring his total pension benefits up to two-thirds final pay once benefits from former employment have been taken into account. The Company makes a provision in the accounts in order to cover these benefits. The accrual made during the year to 31 March 2004 was £201,000 and the total accrual at 31 March 2004 was £1,386,000. The Company takes out insurance arrangements to provide death in service benefits and permanent health insurance in respect of salary above the earnings cap. The cost of these arrangements was £31,096 in the year.

Andrew McCree has a retirement age of 60. He is paid a salary supplement in lieu of pension benefits above the earnings cap, worth 30% of salary above the earnings cap. This is disclosed in the benefits column of the directors' emoluments table. The Company has also, since August 2002, taken out insurance to provide additional death in service benefits based on salary above the earnings cap (2004 cost: £695).

Dr Charles Hipsley has a retirement age of 60. He is not subject to the earnings cap.

David Lindsay has a retirement age of 65. Like Andrew McCree, he is paid a salary supplement in lieu of pensions earnings above the cap and, since August 2002, has insurance bought by the Company to provide additional death in service benefits based on salary above the earnings cap (2004 cost: £930).

The information in the table below shows the value of directors' pension benefits, including those arising from the unfunded approved top-up arrangement for Dr Peter Watson.

The disclosures in columns (a) and (d) are as required by the Companies Act 1985 Schedule 7A.

Columns (a) and (b) show the deferred pension benefit entitlements at 31 March 2004 and 31 March 2003 respectively.

Column (c) is the transfer value of the deferred pension benefit in (a) calculated at 31 March 2004.

Column (d) is the equivalent transfer value at 31 March 2003 of the deferred pension benefit in (b) on the assumption that the director left service at that date.

Column (e) is the increase in benefit built up during the year, recognising the additional service completed and the effect of pay changes in "real" (inflation adjusted) terms on the benefit already earned at the start of the year.

Column (f) is the capital value of the deferred pension benefit in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listings Authority's rules for plcs. These requirements are different from those of the Companies Act. The Listing Rules require the additional benefit earned over the year to be calculated as the difference between the benefit accrued at the end of the year and the benefit accrued at the start of the year, less the increase in benefit resulting solely due to inflation. The change in the transfer value required by the Companies Act can be significantly influenced by changes in market conditions and actuarial assumptions between the beginning and end of the year.

The transfer values are calculated in accordance with Actuarial Guidance Note GN11.

Report on Directors' remuneration (continued)

The directors, like all members of the AEA Technology Pension Scheme, have the option of paying additional voluntary contributions. Neither the contributions nor the resulting benefits are included in the table below.

Director	(a) Accrued benefit at 31/3/04 £	(b) Accrued benefit at 31/3/03 £	(c) Transfer value at 31/3/04 £	(d) Transfer value at 31/3/03 £	(e) Change in transfer value (c) – (d) £	(f) Additional benefit in year £	(g) Transfer value of the increase £	(h) Directors' contributions in year £
Dr Peter Watson								
Approved pension	32,439	28,619	508,133	422,948	85,185	3,105	48,638	5,363
Unapproved pension	94,462	81,671	1,479,678	1,206,980	272,698	10,749	168,375	–
Andrew McCree¹								
Approved pension	23,684	21,044	239,630	187,601	52,029	2,115	19,833	4,950
Approved lump sum	23,467	23,040	–	–	–	(149)	–	–
Dr Charles Hipsley²								
Approved pension	63,326	52,751	683,547	501,924	181,623	9,256	95,465	9,000
Approved lump sum	100,879	89,878	–	–	–	8,754	–	–
David Lindsay								
Approved pension	5,099	3,062	36,446	19,141	17,305	1,960	14,009	7,095
Stephen Thornton³								
Approved pension	–	3,592	–	21,276	–	–	–	–

1 Separate lump sum benefits accrue under the Closed Section scale of the Company's pension scheme. The transfer values shown include the value of pension and lump sum benefits where applicable.

2 Charles Hipsley was appointed as Executive Director on 26 September 2002. His benefits shown above represent pensionable service from December 1982 plus a period of transferred in service.

3 Stephen Thornton's benefits reflect pensionable service up to 24 October 2002 when his employment with the Company ceased

K Directors' interests in shares and options

Interests in shares

The interests of the directors in the shares of the Company were:

	31 March 2004	1 April 2003
Dr Peter Watson	70,500	48,545
Andrew McCree	941	941
Dr Charles Hipsley	10,001	1,201
David Lindsay	5,193	4,281
Dr Leslie Atkinson	9,301	9,301
Andrew Shilston	558	558
Dr Paul Golby	5,000	—
Rodney Westhead	4,000	—

Neither Dr Lewis Moonie nor Dr Bernard Bulkin, who joined the Board on 1 and 26 April 2004 respectively, had any interests in shares of the Company on appointment.

The holdings of Dr Peter Watson and David Lindsay increased by 145 shares, and the holdings of Dr Charles Hipsley and Andrew McCree by 144 shares in the period 1 April to 31 May 2004, through their participation in the AEA Technology Buy As You Earn plan.

No director had an interest at any time in the year in the share capital or loan stock of other Group companies.

Interests in share options

The interests of executive directors to subscribe for ordinary shares of the Company under the SAYE scheme or the Company Share Option Plan (CSOP) are set out below:

	1 April 2003	Number of options granted in year	Number of options lapsed in year	31 March 2004	Exercise price	Date from which exercisable	Expiry date	Scheme
Dr Peter Watson	1,574		1,574		£3.200	1/3/03	31/8/03	SAYE
	187,042			187,042	£2.965	26/6/04	26/6/11	CSOP
	230,468			230,468	£2.560	1/8/05	1/8/12	CSOP
	7,440			7,440	£1.270	1/4/06	30/9/06	SAYE
Andrew McCree	950		950		£3.630	1/3/03	31/8/03	SAYE
	90,923			90,923	£2.965	26/6/04	26/6/11	CSOP
	110,742			110,742	£2.560	1/8/05	1/8/12	CSOP
	8,461			8,461	£1.950	7/10/05	7/10/12	CSOP
		141,136		141,136	£2.200	15/7/06	15/7/13	CSOP
		2,622		2,622	£1.870	1/4/09	30/9/09	SAYE
		277,272		277,272	£2.200	15/7/06	15/7/13	CSOP
Dr Charles Hipsley	820			820	£2.360	1/3/04	31/8/04	SAYE
	1,938			1,938	£1.960	1/3/05	31/8/05	SAYE
	42,158			42,158	£2.965	26/6/04	26/6/11	CSOP
	56,640			56,640	£2.560	1/8/05	1/8/12	CSOP
	60,256			60,256	£1.950	7/10/05	7/10/12	CSOP
	2,976			2,976	£1.270	1/4/06	30/9/06	SAYE
		122,727		122,727	£2.200	15/7/06	15/7/13	CSOP
		1,008		1,008	£1.870	1/4/07	30/9/07	SAYE
David Lindsay	94,537			94,537	£2.380	26/9/04	26/9/11	CSOP
	92,285			92,285	£2.560	1/8/05	1/8/12	CSOP
	21,153			21,153	£1.950	7/10/05	7/10/12	CSOP
		130,909		130,909	£2.200	15/7/06	15/7/13	CSOP

The market price of the Company's shares at 31 March 2004 was 231p and the range of market prices during the year was 128.5p to 278p.

On behalf of the Board

Andrew Shilston
Remuneration Committee
16 June 2004

Report on Directors' remuneration (continued)

Interests in share options

The interests of executive directors to subscribe for ordinary shares of the Company under the SAYE scheme or the Company Share Option Plan (CSOP) are set out below:

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The market price of the Company's shares at 31 March 2004 was 231p and the range of market prices during the year was 128.5p to 278p.

On behalf of the Board

Andrew Shilston
Remuneration Committee
16 June 2004

Statement of Directors' responsibilities

The Directors are required by UK company law to prepare financial statements that give a true and fair view of the state of affairs of the Company and of the Group as at the end of the financial year and of the profit and loss of the Group for that period.

The Directors confirm that suitable accounting policies have been used and applied consistently, and that reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 March 2004. The Directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on a going concern basis.

The Directors are responsible for keeping proper accounting records, for safeguarding the assets of the Company and of the Group, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the Annual Report and Accounts of the Company is placed on the AEA Technology plc website. The maintenance and integrity of the website is the responsibility of the Directors and the work carried out by the auditors does not involve consideration of these matters. Accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

Keith Russell

Keith Russell
Company Secretary
16 June 2004

Keith Russell

Independent Auditors' report to the members of AEA Technology plc

We have audited the financial statements which comprise the Consolidated Profit and Loss Account, the Balance Sheets, the Consolidated Cash Flow Statement, the Statement of Group Total Recognised Gains and Losses, the Reconciliation of movements in Group Equity Shareholders' Funds and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Report on Directors' Remuneration (the auditable part).

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities. The Directors' are also responsible for preparing the Report on Directors' remuneration.

Our responsibility is to audit the financial statements and the auditable part of the Report on Directors' Remuneration in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the Report on Directors' Remuneration have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only, the Financial Summary, the Chairman's Statement, the Operating Review, the Financial Review, the Corporate Governance Statement, the Report on Directors' Remuneration and the Five Year Summary.

We review whether the Corporate Governance Statement reflects the Company's compliance with the seven provisions of the Combined Code issued in June 1998 specified for our review by the Listing Rules of the Financial Services Authority and we report if it does not.

We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the Report on Directors' Remuneration. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the Report on Directors' Remuneration are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 March 2003 and of the loss and cashflows of the Group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985;
- those parts of the Report on Directors' Remuneration required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

Reading

16 June 2004

Consolidated profit and loss account

FOR THE YEAR ENDED 31 MARCH	Notes	Continuing operations 2004 £m	Discontinued operations 2004 £m	Total 2004 £m	Continuing operations 2003 restated £m	Discontinued operations 2003 restated £m	Total 2003 £m
Turnover							
Group and share of joint ventures	1,2,4	240.6	11.0	251.6	224.0	48.3	272.3
Less: share of joint ventures		(0.1)	–	(0.1)	(1.3)	–	(1.3)
		240.5	11.0	251.5	222.7	48.3	271.0
Operating costs							
Operating costs	4,5	(232.9)	(12.2)	(245.1)	(224.8)	(54.3)	(279.1)
Less 2003 provision on termination of operations		0.8	3.5	4.3	0.5	1.1	1.6
Exceptional operating charges	3	–	–	–	(1.2)	(5.0)	(6.2)
		(232.1)	(8.7)	(240.8)	(225.5)	(58.2)	(283.7)
Group operating profit/(loss)		8.4	2.3	10.7	(2.8)	(9.9)	(12.7)
Share of operating loss in joint ventures & associates		(0.7)	–	(0.7)	(0.1)	–	(0.1)
Total operating profit/(loss): Group and share of joint ventures of associates							
	1-9	7.7	2.3	10.0	(2.9)	(9.9)	(12.8)
(Loss)/profit on sale of businesses	31	–	(8.3)	(8.3)	–	20.0	20.0
Loss on termination of operations	10	–	(0.5)	(0.5)	(0.8)	(7.9)	(8.7)
Income from other fixed asset investments	11	1.2	–	1.2	–	–	–
Profit/(loss) on ordinary activities before interest and taxation		8.9	(6.5)	2.4	(3.7)	2.2	(1.5)
Interest receivable and similar income				0.6			1.1
Redemption on repayment of long-term debt	12			–			(2.3)
Interest payable	12			(3.0)			(2.7)
Result/(loss) on ordinary activities before taxation	2,9			–			(5.4)
Taxation on loss on ordinary activities	13			(2.3)			(2.1)
Loss on ordinary activities after taxation				(2.3)			(7.5)
Minority interests – Equity	27			–			(0.6)
Loss for the financial year				(2.3)			(8.1)
Dividends	15			(3.5)			(48.2)
Loss for the year	26			(5.8)			(56.3)
Earnings per share (pence)	16			(3.4)p			(10.5)p
Adjusted earnings per share (pence)	16			13.6p			(19.0)p
IMR earnings per share (pence)	16			7.5p			(23.8)p
Diluted earnings per share (pence)	16			(3.4)p			(10.5)p

There is no material difference between the result/(loss) on ordinary activities before taxation and the loss for the years stated above, and their historical cost equivalents.

The continuing and discontinued results for the year ended 31 March 2003 have been restated to reflect the continuing position of the Group at 31 March 2004.

Statement of group total recognised gains and losses

FOR THE YEAR ENDED 31 MARCH	2004 £m	2003 £m
Loss for the financial year	(2.3)	(8.1)
Currency translation differences on foreign currency net investments ⁽¹⁾	(3.5)	(0.4)
Total recognised gains and losses for the year	(5.8)	(8.5)

(1) Included within this is nil (2003: £463,000 credit) in respect of exchange differences on foreign currency borrowings that have been used to hedge equity investments. The tax credit on this is nil (2003: nil).

Reconciliation of movements in group equity shareholders' funds

FOR THE YEAR ENDED 31 MARCH	Notes	2004 £m	2003 £m
Equity shareholders' funds at 1 April		21.4	48.7
Loss for the financial year		(2.3)	(8.1)
Dividends	15	(3.5)	(48.2)
Repurchase of shares		—	(9.6)
New share capital issued		0.1	0.6
Goodwill written back to profit on disposals	31	0.1	38.4
Currency translation differences on foreign currency net investments		(3.5)	(0.4)
Equity shareholders' funds at 31 March		12.3	21.4



Balance sheet

AT 31 MARCH	Notes	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Fixed assets					
Intangible assets	7	0.1	—	—	—
Intangible assets – goodwill	17	28.9	31.6	26.3	0.2
Tangible assets	18	33.4	39.7	15.4	20.3
Investments	19	3.3	2.9	91.2	127.3
Investment in associates		—	0.1	—	—
Investments in joint ventures:		—	0.3	—	—
Share of gross assets		—	1.2	—	—
Share of gross liabilities		—	(0.9)	—	—
		65.7	74.6	132.9	147.8
Current assets					
Stock and work in progress	20	23.2	18.7	6.4	5.3
Debtors falling due after more than one year	21	23.7	27.5	23.1	25.7
Debtors falling due within one year	21	81.4	79.1	57.7	57.0
Cash at bank and in hand		22.3	29.2	4.4	11.1
		150.6	154.5	91.6	99.1
Creditors: amounts falling due within one year	22	(153.4)	(150.3)	(126.9)	(129.3)
Net current (liabilities)/assets		(2.8)	4.2	(35.3)	(30.2)
Total assets less current liabilities		62.9	78.8	97.6	117.6
Creditors: amounts falling due after more than one year					
Borrowings	23	(0.2)	(0.3)	(2.1)	(2.1)
Other creditors	23	(11.1)	(4.4)	(0.7)	(0.1)
Provisions for liabilities and charges	24	(38.4)	(51.5)	(24.7)	(35.3)
Net assets		13.2	22.6	70.1	80.1
Capital and reserves					
Called up share capital	25	8.3	8.2	8.3	8.2
Share premium	26	10.6	10.6	10.6	10.6
Capital redemption reserve	26	0.7	0.7	0.7	0.7
Merger reserve	26	—	—	25.0	25.0
Other reserve	26	—	—	49.2	49.1
Profit and loss account (deficit)	26	(7.3)	1.9	(23.7)	(13.5)
Equity shareholders' funds		12.3	21.4	70.1	80.1
Minority interests – Equity	27	0.9	1.2	—	—
		13.2	22.6	70.1	80.1

The financial statements on pages 44 to 93 were approved by the Board on 16 June 2004.

Signed on behalf of the Board of Directors

P. Watson
Dr Peter Watson
Chairman

David Lindsay
David Lindsay
Group Finance Director

David Lindsay



Consolidated cash flow statement

FOR THE YEAR ENDED 31 MARCH	Notes	2004 £m	2003 £m
Net cash (outflow)/inflow from operating activities		(2.4)	15.4
Dividends from joint ventures		—	0.1
Returns on investments and servicing of finance			
Interest received		0.4	1.1
Interest paid		(2.9)	(5.3)
Dividends paid to minority interests		(0.5)	(0.3)
		(3.0)	(4.5)
Taxation			
Corporation tax paid		(1.5)	(0.7)
Capital expenditure and financial investment			
Sale of tangible fixed assets		—	0.3
Purchase of tangible fixed assets		(6.9)	(10.4)
Purchase of fixed asset investments		(0.3)	—
		(7.2)	(10.1)
Free cash flow		(14.1)	0.2
Acquisitions and disposals			
Sale of subsidiaries/businesses	31	2.0	73.3
Net cash disposed with subsidiaries	31	(0.2)	(8.3)
Purchase of subsidiaries	30	(6.3)	(8.0)
Net cash acquired with subsidiaries	30	0.2	0.5
Purchase of associate		—	(0.1)
		(4.3)	57.4
Equity dividends paid		(3.5)	(45.7)
Cash (outflow)/inflow before management of liquid resources and financing		(21.9)	11.9
Management of liquid resources		—	—
Financing			
Issue of shares		0.1	0.5
Repurchase of shares		—	(9.6)
Borrowings drawn down		14.9	35.0
Repayment of loans		(0.1)	(46.7)
Net cash inflow/(outflow) from financing activities		14.9	(20.8)
Decrease in cash in the year	28	(7.0)	(8.9)

Reconciliation of operating profit/(loss) to net cash inflow/(outflow) from operating activities

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
Operating profit/(loss)	10.7	–	10.7	(6.5)	(6.2)	(12.7)
Amortisation of intangible fixed assets	2.5	–	2.5	1.9	–	1.9
Depreciation of tangible fixed assets	6.9	–	6.9	7.8	–	7.8
Impairment of intangible fixed assets	0.2	–	0.2	–	–	–
Impairment of tangible fixed assets	0.2	–	0.2	0.1	0.1	0.2
Loss on sale of tangible fixed assets	–	–	–	–	0.5	0.5
Loss on termination of operations	–	(0.5)	(0.5)	–	(8.7)	(8.7)
(Increase)/decrease in stocks and work in progress	(8.5)	–	(8.5)	(3.3)	3.7	0.4
(Increase)/decrease in debtors	0.2	–	0.2	25.6	–	25.6
(Decrease)/increase in creditors	(2.6)	(0.4)	(3.0)	1.5	(5.2)	(3.7)
(Decrease)/increase in provisions relating to operating activities	(1.2)	(9.9)	(11.1)	1.1	3.0	4.1
Net cash inflow/(outflow) from operating activities	8.4	(10.8)	(2.4)	28.2	(12.8)	15.4

The cash inflow from operating activities includes an outflow of £0.2 million in respect of current costs on termination of operations. Of the total exceptional loss items a profit of £0.8 million has no cash impact. The remaining exceptional loss will generate cash flows of £1.1 million which will be incurred over the next one to four years. In addition a cash outflow of £10.6 million has been incurred in respect of 2001, 2002 and 2003 exceptional items. This comprises £1.3 million of rent, £3.0 million decommissioning and waste costs, £2.7 million of redundancies and £3.6 million of closure costs.

Group share of operating (losses)/profits in joint ventures are accounted for in the profit and loss account for the period. Cash flows arising from these entities are accounted for on receipt of dividends as recorded in the Group Cash Flow Statement. Dividends from joint ventures accounted for in the year ended 31 March 2004 represent Group share of profit after tax in respect of the current and previous years.

Principal accounting policies

The financial statements have been prepared in accordance with the Companies Act 1985 and applicable Accounting Standards in the United Kingdom. A summary of the more important Group accounting policies, which have been applied consistently, is set out below.

Going concern

The financial statements have been prepared on a going concern basis.

Basis of accounting

The financial statements are prepared in accordance with the historical cost convention.

Basis of consolidation

The Consolidated Profit and Loss Account and Balance Sheet include the financial statements of the Company and its subsidiary undertakings made up to 31 March 2004. Subsidiaries, joint ventures and associates with an accounting reference date other than 31 March have been consolidated on the basis of management accounts made up to 31 March 2004. The results of subsidiaries acquired or sold are included in the Consolidated Profit and Loss Account from or to the date on which control passes. Intra-group sales and profits are eliminated fully on consolidation.

Acquisitions are accounted for under the acquisition method. On acquisition of a subsidiary, all of the subsidiary's assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date. All changes to those assets and liabilities, and the resulting gains and losses, that arise after the Group has gained control of the subsidiary are charged to the post acquisition profit and loss account.

Turnover

Group turnover represents the total value of income (excluding sales taxes and intra-group sales) earned in respect of products delivered and services rendered to customers, royalties and contributions receivable in support of programmes, and the value of long-term contract work completed. Turnover relates to ordinary activities and is stated after trade discounts.

Income from licences where the underlying intellectual property is secure and on which AEA Technology will not incur future costs is recognised on signing of the contract with the licensee. Where AEA Technology plc will incur future maintenance and support costs and all components of the contract do not operate independently the full contract value is recognised rateably over the period of the contract. Where the components do operate independently and fair values can be allocated to the individual components each component is treated as if it were a separate contract. Any invoices raised or cash received in advance of recognition of the income is included within payments received on account in creditors. As detailed on page 51 income on long-term contracts is recognised as work is completed under the contract. All other income is recognised on delivery of the product or service or once all risks and rewards have passed to the customer.

Research and development

Research and development expenditure is written off to the profit and loss account as incurred.

Government grants

Capital based government grants are included within accruals and deferred income in the balance sheet and credited to operating profit over the expected useful economic lives of the assets to which they relate. Revenue based government grants are credited to operating profit to match the expenditure to which they relate.

Investment income

Income from fixed asset investments comprises dividends declared for periods up to the balance sheet date.

Pension costs

Costs in relation to defined benefit schemes are charged to the profit and loss account so as to spread the cost over the expected average remaining service lives of employees. Variations from regular cost are spread over the average remaining service lives of the members of the schemes. Actuarial valuations of the schemes are carried out periodically and the rates of contribution payable and the pension costs are determined having regard to the results of these valuations. The funding policy may differ from the accounting policy in the recognition of any surplus/deficit or cost of benefit improvements, which may be over a shorter period than the average remaining service lives of employees.

Principal accounting policies (continued)

Costs of defined contribution schemes are charged to the profit and loss account at the time the related pensionable pay is charged.

The transitional arrangements of Financial Reporting Standard 17: Retirement Benefits have been applied in the preparation of these financial statements with the relevant disclosures being made in note 8.

Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the consideration given over the fair value of the identifiable net assets acquired. From 1 April 1998 goodwill arising on the acquisition of subsidiaries, joint ventures and associates is capitalised and amortised on a straight line basis over its useful life, which is between three and a maximum of 20 years. Provision is made for any impairment. Goodwill arising on acquisitions prior to 1 April 1998 was written off immediately against reserves. This goodwill had been eliminated in line with the accounting policy in place at the time and will be charged or credited in the profit and loss account on the subsequent disposal of the business to which it related.

Goodwill generated within the Company relates to the hive up of subsidiary assets and trade into the Company. This goodwill is capitalised and amortised in line with the related Group goodwill.

Intangible fixed assets

The cost of acquired intangible fixed assets is their purchase cost, together with any incidental costs of acquisition.

Amortisation is calculated so as to write off the cost of intangible fixed assets on a straight line basis over the expected economic lives of the assets concerned. The principal annual rate used for the amortisation of licences, where acquired, is 20% per annum.

Tangible fixed assets

Tangible fixed assets are recorded at cost less accumulated depreciation and any provision for impairment. Where assets were vested in the Group under a transfer scheme, made pursuant to Section one of the Atomic Energy Authority Act 1995, the value at which the assets were vested is deemed to have been the historical cost to the Group. In the case of assets constructed by the Group, directly attributable production overheads are included in the cost capitalised.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis over the expected economic lives of the assets concerned.

The estimated useful lives for the main categories of fixed assets are as follows:

Freehold buildings	up to 30 years
Plant and equipment:	
– computers and vehicles	up to 5 years
– other plant and equipment	5 – 10 years
Assets in course of construction	not depreciated
Freehold land	not depreciated

Leasehold land and buildings are amortised over the period of the lease. For assets held under finance leases the depreciation period is the shorter of the period of the lease or the estimated useful life of the asset.

Investments, joint ventures and associates

Investments are stated at cost less any impairment in value. The Group's share of its joint ventures' turnover and profits less losses is included in the Consolidated Profit and Loss Account. The Group's share of joint ventures' gross assets and liabilities is included in the Consolidated Balance Sheet. The Group's share of its associates' profits less losses is included in the Consolidated Profit and Loss Account. The Group's share of associates' net assets is included in the Consolidated Balance Sheet.

Stock and work in progress (excluding long-term contract work in progress)

Stock is valued at the lower of cost and net realisable value. Where necessary, provision is made for obsolete, slow moving and defective stock. Work in progress is valued at cost, less the cost of work invoiced on incomplete contracts and less foreseeable losses. Cost comprises purchase cost plus production and related overheads.

Long-term contracts

Turnover on long-term contracts is recognised according to the stage reached in the contract by reference to the value of work completed. An appropriate estimate of the profit attributable to work completed is recognised once the outcome of the contract can be assessed with reasonable certainty. The amount by which the turnover exceeds payments on account is shown under debtors as amounts recoverable on contracts. The costs on long-term contracts not yet taken to the profit and loss account less related foreseeable losses and payments on account are shown in stocks as long-term contract work in progress balances.

Decommissioning and waste management

Provision is made for the future costs arising from the closing down and decontamination of certain experimental facilities and the management and final disposal of wastes where these activities are a Group responsibility. These provisions are made for the full liability when operations commence and the facility becomes contaminated. *Many of the liabilities for which provision is being made will not crystallise for many years. The provisions are expressed at current price levels and are discounted at a real rate of interest to take account of the delay in meeting the expenditure.*

Deferred taxation

Deferred taxation is recognised using the incremental liability method whereby deferred taxation is provided on a full provision basis, without discounting, on all timing differences which have arisen but not reversed at the balance sheet date. As required by Financial Reporting Standard 19:

Deferred Taxation no timing differences are recognised in respect of:

- i) fixed assets which are revalued without there being any commitment to sell the asset;
- ii) gains on sale of assets which are rolled over into replacement assets; and
- iii) remittance of subsidiary or joint venture earnings which would cause tax to be payable, but where no commitment has been made to the remittance of the earnings.

The deferred taxation balance has been measured at the tax rate expected to apply when the timing differences reverse.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Derivative financial instruments

The Group uses derivative financial instruments to reduce exposure to foreign exchange risk and interest movements. The Group does not hold or issue derivative financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge, the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are recognised in the profit and loss account when the hedged transaction is recognised.

For an interest rate swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the periods of the contracts.

Leases

Costs in respect of operating leases are charged on a straight line basis over the lease term. Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors.

Principal accounting policies (continued)

Employee share schemes

The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employee's related performance. The Company has applied the exemption in Urgent Issues Task Force Abstract 17: Employee Share Schemes for Inland Revenue approved SAYE schemes and equivalent overseas schemes. As a result no cost is recognised in respect of shares offered under these schemes.

Foreign currencies

All transactions denominated in foreign currencies are translated into sterling at the exchange rate ruling on the date the transaction takes place or at the contracted rate if the transaction is covered by a forward exchange contract. Balances denominated in foreign currencies are translated into sterling at the exchange rate ruling at the balance sheet date or if appropriate at the forward contract rate. All foreign exchange differences are taken to the profit and loss account in the period in which they arise.

Assets and liabilities of subsidiaries in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date and the results of foreign subsidiaries are translated at the average rate of exchange for the year. Differences on exchange arising from the retranslation of the opening net investment in subsidiary companies and from the translation of the results of those companies at average rate are taken to reserves, net of exchange differences on related foreign currency borrowings, and are reported in the Statement of Total Recognised Gains and Losses.

Notes to the financial statements

1. Geographical analysis

Turnover can be analysed by geographical destination as follows:

	Continuing operations 2004 £m	Discontinued operations 2004 £m	Total 2004 £m	Continuing operations 2003 restated £m	Discontinued operations 2003 restated £m	Total 2003 £m
Government and public sector	42.3	8.1	50.4	29.5	21.8	51.3
Private sector	95.4	2.0	97.4	95.1	8.3	103.4
Total UK	137.7	10.1	147.8	124.6	30.1	154.7
Europe	35.3	0.4	35.7	30.8	6.4	37.2
North America	54.2	0.4	54.6	54.2	7.5	61.7
Rest of the World	13.4	0.1	13.5	14.4	4.3	18.7
	240.6	11.0	251.6	224.0	48.3	272.3

Turnover can be analysed by geographical origin as follows:

	Continuing operations 2004 £m	Discontinued operations 2004 £m	Total 2004 £m	Continuing operations 2003 restated £m	Discontinued operations 2003 restated £m	Total 2003 £m
UK	159.2	10.9	170.1	145.4	34.8	180.2
Europe	26.3	–	26.3	23.3	3.6	26.9
North America	49.6	0.1	49.7	49.7	7.9	57.6
Rest of the World	5.5	–	5.5	5.6	2.0	7.6
	240.6	11.0	251.6	224.0	48.3	272.3

The Group's share of joint ventures' turnover increased turnover both to and from the UK by nil (2003: £0.1 million), North America by nil (2003: nil) and to and from the Rest of the World by £0.1 million (2003: £1.2 million).

Operating profit/(loss) can be analysed by geographical origin as follows:

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
UK	3.3	–	3.3	(10.0)	(6.2)	(16.2)
Europe	2.4	–	2.4	1.2	–	1.2
North America	2.4	–	2.4	0.5	–	0.5
Rest of the World	1.9	–	1.9	1.7	–	1.7
	10.0	–	10.0	(6.6)	(6.2)	(12.8)

Included within the UK operating profit before exceptional items shown above is a profit of £2.3 million relating to discontinued operations, Europe loss of nil, North America loss of nil and Rest of the World loss of nil (2003: UK loss of £3.5 million, Europe loss of £1.3 million, North America profit of £0.5 million, Rest of the World loss of £0.6 million).

The Group's operating profit was reduced by its share of joint ventures' operating loss in the UK by nil (2003: £0.1 million) and Rest of the World by £0.1 million (2003: nil) and share of associates' operating loss in North America by £0.6 million (2003: nil).

Notes to the financial statements (continued)

1. Geographical analysis (continued)

Net operating assets/(liabilities) can be analysed by geographical origin as follows:

	2004 £m	2003 £m
UK	37.5	24.5
Europe	2.6	(1.2)
North America	5.6	8.1
Rest of the World	2.2	4.1
	47.9	35.5

The Group's share of joint ventures' net operating assets decreased net operating assets in the UK by £0.1 million (2003: £0.1 million) and increased net operating assets in the Rest of the World by nil (2003: £0.3 million).

2. Segmental analysis by class of business

TURNOVER: CLASS OF BUSINESS	Total turnover 2004 £m	Inter- segmental turnover 2004 £m	External turnover 2004 £m	Total turnover 2003 restated £m	Inter- segmental turnover 2003 restated £m	External turnover 2003 restated £m
Rail	88.5	(0.4)	88.1	85.0	(0.6)	84.4
Environment	69.2	(2.0)	67.2	65.2	(0.7)	64.5
Core business	157.7	(2.4)	155.3	150.2	(1.3)	148.9
Battery Systems	16.1	(0.3)	15.8	9.6	—	9.6
Accentus	17.8	(1.3)	16.5	18.6	(1.4)	17.2
QSA	33.6	(0.2)	33.4	35.9	—	35.9
Value development	67.5	(1.8)	65.7	64.1	(1.4)	62.7
Nuclear Programmes	23.5	(2.2)	21.3	34.9	(4.8)	30.1
Divested businesses (pre 1 April 2003)	—	—	—	22.1	—	22.1
Central Programmes	3.8	(0.2)	3.6	3.3	—	3.3
Central Costs	17.6	(11.9)	5.7	23.6	(18.4)	5.2
Total	270.1	(18.5)	251.6	298.2	(25.9)	272.3

The Group's share of joint ventures' turnover increased turnover in Rail by nil (2003: £0.1 million), Accentus by nil (2003: £1.2 million) and Central Programmes by £0.1 million (2003: nil).

2. Segmental analysis by class of business (continued)

OPERATING PROFIT/(LOSS): CLASS OF BUSINESS	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 restated £m	Exceptional items 2003 restated £m	Total 2003 restated £m
Rail	12.7	–	12.7	11.2	–	11.2
Environment	8.1	–	8.1	7.2	–	7.2
Core business	20.8	–	20.8	18.4	–	18.4
Battery Systems	(1.6)	–	(1.6)	(3.0)	–	(3.0)
Accentus	0.1	–	0.1	(6.7)	(1.2)	(7.9)
QSA	3.0	–	3.0	2.6	–	2.6
Value development	1.5	–	1.5	(7.1)	(1.2)	(8.3)
Nuclear Programmes	(1.0)	–	(1.0)	(6.1)	(5.0)	(11.1)
Divested businesses (pre 1 April 2003)	–	–	–	(2.9)	–	(2.9)
Central Programmes	(2.3)	–	(2.3)	(0.2)	–	(0.2)
Central Costs	(9.0)	–	(9.0)	(8.7)	–	(8.7)
Total operating profit/(loss)	10.0	–	10.0	(6.6)	(6.2)	(12.8)
(Loss)/profit on sale of businesses	–	(8.3)	(8.3)	–	20.0	20.0
Loss on termination of operations	–	(0.5)	(0.5)	–	(8.7)	(8.7)
Profit/(loss) before interest	10.0	(8.8)	1.2	(6.6)	5.1	(1.5)
Income from fixed asset investments	1.2	–	1.2	–	–	–
Net interest payable	(2.4)	–	(2.4)	(3.9)	–	(3.9)
Profit/(loss) before taxation	8.8	(8.8)	–	(10.5)	5.1	(5.4)

The Group's share of joint ventures & associates' operating loss decreased operating profit in Rail by nil (2003: £0.1 million), Accentus by £0.6 million (2003: nil), and Central Programmes by £0.1 million (2003: nil).

The business segment figures have been restated to reflect the new organisational structure splitting out Central Programmes and Central Costs.

Central Programmes is a newly identified segment representing small businesses and start ups managed directly by the central executive, held for realisation of value in the short term.

Corporate overheads of £2.6 million (2003: £2.3 million) have been allocated to segments based upon the involvement of corporate senior management in the operations of the businesses.

Notes to the financial statements (continued)

2. Segmental analysis by class of business (continued)

Turnover relating to discontinued operations may be analysed by segment as follows:

	2004 £m	2003 restated £m
Accentus	–	2.8
QSA	0.2	1.7
Nuclear Programmes	10.8	21.6
Divested businesses (pre 1 April 2003)	–	22.2
Total	11.0	48.3

Operating profit/(loss) relating to discontinued operations may be analysed by segment as follows:

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 restated £m	Exceptional items 2003 restated £m	Total 2003 restated £m
Accentus	–	–	–	(2.7)	–	(2.7)
QSA	–	–	–	0.2	–	0.2
Nuclear Programmes	2.3	–	2.3	0.5	(5.0)	(4.5)
Divested businesses (pre 1 April 2003)	–	–	–	(2.9)	–	(2.9)
Total	2.3	–	2.3	(4.9)	(5.0)	(9.9)

Net operating assets/(liabilities) may be analysed by class of business as follows:

NET OPERATING ASSETS/(LIABILITIES): CLASS OF BUSINESS	Total 2004 £m	Total 2003 restated £m
Rail	46.6	28.3
Environment	(2.2)	2.9
Core business	44.4	31.2
Battery Systems	(3.7)	(2.0)
Accentus	(1.2)	(4.4)
QSA	8.6	2.7
Value development	3.7	(3.7)
Nuclear Programmes	(24.0)	(11.6)
Divested Businesses (pre 1 April 2003)	–	(0.7)
Central Programmes	1.6	(0.5)
Central Costs	22.2	20.8
Net operating assets	47.9	35.5
Net borrowings	(34.7)	(12.9)
Net assets	13.2	22.6

The Group's share of joint ventures' net operating assets decreased operating assets in Rail by £0.1 million (2003: £0.1 million) and increased operating assets in Accentus by nil million (2003: £0.3 million).

3. Exceptional operating charges

For the year ended 31 March 2004, the group had no exceptional operating charges.

The exceptional charges for the year ended 31 March 2003 comprise £1.1 million for redundancies and a £0.1 million asset write-off arising from the rationalisation of the Accentus business within continuing businesses. Within the discontinued operations the exceptional operating charge of £5.0 million represents the write off of work in progress (WIP) and legal costs on two Nuclear Engineering contracts with Hunting BRAE at Aldermaston.

4. Operating results of acquisition

The acquisition during the year had the effect of increasing turnover by £1.3 million and operating profit by nil and net operating assets by £0.2 million. The acquisition had the following impact on operating costs as detailed below:

	Central Programmes £m
Cost of sales	0.8
Administrative expenses	0.5
Research and development	–
Net other operating income	–
	1.3

5. Operating costs

	Before exceptional items 2004 £m	Exceptional Items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional Items 2003 £m	Total 2003 £m
Cost of sales ⁽¹⁾	173.7	–	173.7	179.8	3.6	183.4
Administrative expenses	61.8	–	61.8	88.5	2.6	91.1
Research and development	6.8	–	6.8	11.7	–	11.7
Net other operating income	(1.5)	–	(1.5)	(2.5)	–	(2.5)
	240.8	–	240.8	277.5	6.2	283.7

(1) Includes £2.8 million research and development expenditure (2003: £2.5 million)

Notes to the financial statements (continued)

5. Operating costs (continued)

Operating costs may be analysed between continuing and discontinued activities as follows:

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 restated £m	Exceptional items 2003 restated £m	Total 2003 restated £m
Continuing activities:						
Cost of sales ⁽¹⁾	166.5	–	166.5	148.0	–	148.0
Administrative expenses	60.3	–	60.3	68.9	1.2	70.1
Research and development	6.8	–	6.8	8.9	–	8.9
Net other operating income	(1.5)	–	(1.5)	(1.5)	–	(1.5)
	232.1	–	232.1	224.3	1.2	225.5
Discontinued activities:						
Cost of sales	7.2	–	7.2	31.8	3.6	35.4
Administrative expenses	1.5	–	1.5	19.6	1.4	21.0
Research and development	–	–	–	2.8	–	2.8
Net other operating income	–	–	–	(1.0)	–	(1.0)
	8.7	–	8.7	53.2	5.0	58.2

(1) Includes £2.8 million research and development expenditure (2003: £2.5 million).

Included within net other operating income of continuing activities is £0.8 million (2003: £0.4 million) in respect of grants received by AGM Batteries Limited.

6. Employees

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
STAFF COSTS IN THE YEAR WERE:						
Wages and salaries	107.6	–	107.6	117.0	1.1	118.1
Social security costs	10.5	–	10.5	11.3	–	11.3
Other pension costs (note 8)	10.0	–	10.0	11.0	–	11.0
	128.1	–	128.1	139.3	1.1	140.4

An analysis of the average monthly number of employees based on full-time employment (including Executive Directors) is set out below:

	Group 2004 Number	Group 2003 Number	Company 2004 Number	Company 2003 Number
Managerial and professional	1,647	1,693	1,086	1,045
Support	674	727	359	362
Technical	640	708	412	373
Manufacturing	74	103	26	25
	3,035	3,231	1,883	1,805

7. Directors' emoluments

Detailed disclosures of Directors' individual remuneration and share options are given in the Report on Directors' Remuneration on pages 31 to 40.

REMUNERATION PAYABLE TO DIRECTORS	2004 £000	2003 restated £000
Aggregate emoluments	1,485	1,714

Retirement benefits accrued to the Chairman and three Directors under the Company's defined benefits schemes. Prior to 26 September 1996 retirement benefits accrued to the Chairman and three Directors under UKAEA's defined benefits scheme. The Chairman's retirement benefits accrued under an unfunded pension arrangement prior to 26 September 1996.

EMOLUMENTS PAYABLE TO THE HIGHEST PAID DIRECTOR	2004 £000	2003 restated £000
Aggregate emoluments	436	405
Defined benefit scheme: accrued pension at the year end	127	110

8. Pension costs

The Group operates a number of pension schemes around the world. The major schemes are of the defined benefit type and the assets of the schemes are largely held in separate trustee administered funds. The Group has continued to account for pensions in accordance with Statement of Standard Accounting Practice 24: Accounting for Pensions Costs for the current period. The additional disclosures required under the transitional rules of Financial Reporting Standard 17: Retirement Benefits are also presented below.

Pension arrangements

Following privatisation, the Company set up a new funded defined benefits pension scheme (the AEA Technology Pension Scheme) covering the Company's employees. The Company scheme is an exempt approved occupational pension scheme, is contracted out of the State Earnings Related Pension Scheme and provides final salary benefits. The scheme comprises three sections. Employees at the date of privatisation were eligible to transfer their accrued benefits from the pre-privatisation statutory defined benefit schemes into the closed section of the Pension Scheme on a past service reserve basis and the total amount transferred in to cover this liability was £147.5 million. The open section was the arrangement for new recruits to the Company until 31 March 2003 and some subsidiaries, but pre-privatisation employees were also able to join. The Senior Executive section is available to senior staff by invitation only. Independent actuarial advice in respect of the likely costs of funding and operating the Pension Scheme estimates that the long-term cost will be at 8.8% of pensionable pay. The contributions payable were 17.5% from 1 January 2003. From 1 April 2003, new recruits were no longer eligible to join the scheme. A defined contribution scheme has been established for new recruits joining the Company from this date.

The defined benefit scheme is valued regularly by independent actuaries. The latest valuation of the Company scheme was carried out as at 31 March 2002 using a market valuation basis. The use of a market valuation basis is in line with a general consensus within the pension industry and this approach is easier to understand than the traditional actuarial approach. This approach however does not hide the volatility in the value of pension scheme assets and can result in successive valuations varying substantially. The move to this method of valuation is the first step in the implementation of Financial Reporting Standard 17: Retirement Benefits.

Notes to the financial statements (continued)

8. Pension costs (continued)

The main actuarial assumptions are

Investment return	6.7%pa
Salary growth	4.8%pa
Pension increases:	
closed section	2.9%pa
open section	2.7%pa
-- executive section	2.8%pa

The valuation used for accounting purposes differs from that used for funding purposes. To produce a more realistic actuarial valuation the investment return was increased by 0.5% to 6.7% for accounting purposes. The yield on long-dated gilts at the valuation date was 5.2%. Based on long term historical trends an equity risk premium of 3% could be expected. Therefore, an investment return of 6.7% is considered reasonably prudent.

The market value of the Company scheme's assets as at 31 March 2002 was £187.4 million. The results of the valuation indicated that the actuarial value of the assets represents 90% of the actuarial value of the accrued liabilities.

The Company also provides, on a defined contribution basis, an additional voluntary contribution scheme and a shift pay pension plan. Other defined contribution pension arrangements exist for some employees in subsidiaries and for new recruits joining from 1 April 2003.

Employees who were formerly employees of BR Research Limited prior to their transfer into AEA Technology on 1 April 1997 are members of the AEA Technology Rail Shared Cost Section of the Railways Pension Scheme. Similarly employees who were formerly employees of TCI Limited prior to their transfer to AEA Technology on 1 April 1999 or the Engineering Link prior to their transfer to AEA Technology on 1 April 2003 are members of the AEA Technology Rail (TCI) or the Engineering Link Shared Cost Sections of the Railways Pension Scheme respectively. Both of these sections are contracted out defined benefits pension schemes. As at 31 March 2004 employees are paying on average across the Rail schemes a contribution of 8.4% and the employer is paying 12.6%.

Pension costs

The total pension cost for the Group was £10.0 million (2003: £11.0 million). The charge to the profit and loss account has been reduced by the spread of the provisions built up during contributions holidays and increased by the prepayments arising from earlier surpluses. The charge has been further adjusted by the spread of surpluses or deficits arising from the last valuations. These amounts are spread over the expected remaining service lives of the employees at the date of the relevant scheme valuation.

Included in the Company balance sheet at 31 March 2004 is a provision of £4.2 million (2003: £4.2 million) in respect of pension costs. The provision comprises the excess of accumulated pension charges over the payment of contributions to the Company pension scheme (2004: £1.5 million, 2003: £1.5 million), the unfunded pension arrangements in respect of Directors (2004 £2.2 million, 2003: £2.0 million) and a provision in respect of a contribution holiday in The Engineering Link Limited scheme (2004: £0.5 million, 2003: £0.7 million). Included in debtors is a pension prepayment of £15.5 million (2003: £13.7 million). £3.1 million (2003: £2.1 million) relates to the funding surplus in respect of the AEA Technology Rail Shared Cost Section of the Railways Pension Scheme, £1.8 million (2003: £1.3 million) relates to the surplus on the AEA Technology Rail (TCI) Shared Cost Section of the Railways Pension Scheme and £10.6 million (2003: £10.3 million) relates to a previous surplus on the Company scheme.

Contributions of £0.2 million (2003: £0.2 million) have been made in the year in respect of defined contribution schemes operated by the Company and its UK and overseas subsidiaries.

8. Pension costs (continued)

Financial Reporting Standard 17: Retirement Benefits (FRS 17) Disclosures

The most recent actuarial valuations for the defined benefit schemes operated by the Group have been updated to 31 March 2004 by independent actuaries. The dates of the most recent full actuarial valuations, the main financial assumptions used to calculate the liabilities of the Group's schemes as at 31 March 2004 under FRS 17, and the contribution rates for the current and following year are as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH
Date of most recent full actuarial valuation	31.3.2002	31.12.2001	31.12.2001	31.12.2001	1.1.2001	1.4.2003	31.3.2003
Main financial assumptions:							
Rate of increase in salaries	4.9%	4.9%	4.9%	4.9%	2.5%	5.0%	3.0%
Rate of increase in pensions payment	2.9%	2.9%	2.9%	2.9%	2.0%	—	1.5%
Rate of increase of deferred pensions	—	2.9%	2.9%	2.9%	2.0%	—	—
Discount rate of scheme liabilities	5.5%	5.5%	5.5%	5.5%	6.0%	7.0%	5.5%
Inflation rate	2.9%	2.9%	2.9%	2.9%	2.0%	3.0%	1.5%
Contribution rates:							
1 April 2002–31 March 2003	n/a	n/a	n/a	n/a	—	6.3%	n/a
1 April 2002 – 31 Dec 2002	13.1%	n/a	n/a	n/a	n/a	n/a	n/a
1 Jan 2003 – 31 March 2003	17.5%	n/a	n/a	n/a	n/a	n/a	n/a
1 April 2002–28 Feb 2003	n/a	7.5%	7.5%	7.5%	n/a	n/a	n/a
1 March 2003 – 31 March 2003	n/a	10.5%	10.5%	10.5%	n/a	n/a	n/a
1 April 2003 – 31 Dec 2003	17.5%	10.5%	10.5%	10.5%	—	13.5%	n/a
1 January 2004 – 31 Dec 2004	17.5%	13.5%	13.5%	13.5%	—	13.5%	n/a
1 January 2005 – 31 March 2005	17.5%	16.0%	15.4%	15.4%	—	10.0%	n/a

The main financial assumptions at 31 March 2003, provided for comparative purposes, were as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH
Rate of increase in salaries	4.6%	4.6%	4.6%	4.6%	3.25%	5.0%	3.0%
Rate of increase in pensions payment	2.5%	2.6%	2.6%	2.6%	—	—	1.5%
Rate of increase of deferred pensions	—	2.6%	2.6%	2.6%	—	—	—
Discount rate of scheme liabilities	5.5%	5.5%	5.5%	5.5%	6.75%	7.0%	5.5%
Inflation rate	2.6%	2.6%	2.6%	2.6%	2.25%	3.0%	1.5%

The main financial assumptions at 31 March 2002, provided for comparative purposes, were as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH
Rate of increase in salaries	4.8%	4.0%	4.0%	n/a	3.5%	5.0%	4.0%
Rate of increase in pensions payment	2.8%	2.5%	2.5%	n/a	—	—	2.5%
Rate of increase of deferred pensions	—	2.5%	2.5%	n/a	—	—	—
Discount rate of scheme liabilities	6.1%	5.75%	5.75%	n/a	7.0%	7.5%	7.0%
Inflation rate	2.8%	2.5%	2.5%	n/a	2.5%	3.0%	2.5%

Notes to the financial statements (continued)

8. Pension costs (continued)

Financial Reporting Standard 17: Retirement Benefits (FRS 17) Disclosures (continued)

The expected rates of return of the assets of the defined benefit schemes operated by the Group as at 31 March 2004 were as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH ⁽¹⁾
Equities	7.7%	7.7%	7.7%	7.7%	8.0%	8.8%	n/a
Bonds	4.9%	4.9%	4.9%	4.9%	8.0%	8.8%	n/a
Property	n/a	6.7%	6.7%	6.7%	n/a	n/a	n/a
Other	3.7%	3.7%	3.7%	3.7%	8.0%	8.8%	8.3%

(1) Unfunded scheme

The expected rates of return of the assets of the defined benefit schemes operated by the Group as at 31 March 2003, provided for comparative purposes, were as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH ⁽¹⁾
Equities	7.6%	7.6%	7.6%	7.6%	8.0%	9.0%	n/a
Bonds	5.1%	4.8%	4.8%	4.8%	8.0%	9.0%	n/a
Property	n/a	6.2%	6.2%	6.2%	n/a	9.0%	n/a
Other	3.6%	3.6%	3.6%	3.6%	8.0%	9.0%	11.8%

(1) Unfunded scheme

The market values of the assets of the defined benefit schemes operated by the Group as at 31 March 2004 are set out below together with the present value of scheme liabilities calculated under the projected unit method, the related deferred taxation charge/(credit) and the resulting net pension (liability)/asset.

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH ⁽¹⁾ £m	Total £m
Equities	151.2	33.2	16.0	16.8	23.0	1.1	–	241.3
Bonds	32.6	4.0	2.0	2.1	15.0	0.5	–	56.2
Property	–	2.8	1.6	1.6	–	–	–	6.0
Other	3.9	0.1	–	–	0.5	0.3	2.1	6.9
Market value of scheme assets	187.7	40.1	19.6	20.5	38.5	1.9	2.1	310.4
Present value of scheme liabilities	(322.2)	(45.2)	(21.8)	(24.4)	(48.5)	(3.1)	(2.5)	(467.7)
Scheme (deficit)/surplus	(134.5)	(5.1)	(2.2)	(3.9)	(10.0)	(1.2)	(0.4)	(157.3)
Deferred taxation ⁽²⁾	–	–	–	–	4.0	0.4	0.1	4.5
Net pension (liability)/asset	(134.5)	(5.1)	(2.2)	(3.9)	(6.0)	(0.8)	(0.3)	(152.8)

(1) Unfunded scheme

(2) If FRS 17 had been fully implemented a deferred taxation asset would not have been recognised in respect of deficits on the UK schemes because this asset would not be recoverable in the foreseeable future.

8. Pension costs (continued)

Financial Reporting Standard 17: Retirement Benefits (FRS 17) Disclosures (continued)

The market values of the assets of the defined benefit schemes operated by the Group at 1 April 2003, provided for comparative purposes, were as follows:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH ⁽¹⁾ £m	Total £m
Equities	144.8	25.6	12.8	13.2	19.5	0.9	—	216.8
Bonds	19.0	3.2	1.6	1.6	13.8	0.6	—	39.8
Property	—	2.3	1.3	1.3	—	—	—	4.9
Other	6.7	0.2	(0.1)	—	—	0.2	2.0	9.0
Market value of scheme assets	170.5	31.3	15.6	16.1	33.3	1.7	2.0	270.5
Present value of scheme liabilities	(329.6)	(38.3)	(18.4)	(20.8)	(39.3)	(3.1)	(2.3)	(451.8)
Scheme (deficit)/surplus	(159.1)	(7.0)	(2.8)	(4.7)	(6.0)	(1.4)	(0.3)	(181.3)
Deferred taxation	—	—	—	—	2.5	0.5	—	3.0
Net pension (liability)/asset	(159.1)	(7.0)	(2.8)	(4.7)	(3.5)	(0.9)	(0.3)	(178.3)

(1) Unfunded scheme

The market values of the assets of the defined benefit schemes operated by the Group at 1 April 2002, provided for comparative purposes, were as follows:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH ⁽¹⁾ £m	Total £m
Equities	219.3	34.9	17.9	n/a	27.2	0.8	—	300.1
Bonds	24.8	3.9	2.0	n/a	18.8	0.4	—	49.9
Property	—	2.2	1.2	n/a	—	—	—	3.4
Other	5.6	0.1	—	n/a	2.6	0.5	1.8	10.6
Market value of scheme assets	249.7	41.1	21.1	n/a	48.6	1.7	1.8	364.0
Present value of scheme liabilities	(304.1)	(37.7)	(19.6)	n/a	(44.2)	(2.7)	(1.8)	(410.1)
Scheme (deficit)/surplus	(54.4)	3.4	1.5	n/a	4.4	(1.0)	—	(46.1)
Deferred taxation	16.3	(1.0)	(0.5)	n/a	—	—	—	14.8
Net pension (liability)/asset	(38.1)	2.4	1.0	n/a	4.4	(1.0)	—	(31.3)

(1) Unfunded scheme

The movements in the scheme (deficit)/surplus during the year were as follows:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
(Deficit)/surplus at 31 March 2003	(159.1)	(7.0)	(2.8)	(4.7)	(6.0)	(1.4)	(0.3)	(181.3)
(Deficit)/surplus on non-pension retirement benefits	—	—	—	—	(4.7)	—	—	(4.7)
Currency translation	—	—	—	—	0.5	0.2	—	0.7
Current service cost	(5.8)	(1.2)	(0.3)	(0.6)	(1.6)	(0.3)	(0.1)	(9.9)
Contributions	8.1	0.6	0.2	0.3	0.4	0.3	—	9.9
Past service costs	(0.4)	—	—	—	—	(0.1)	—	(0.5)
Gain on settlement/curtailment	21.3	—	—	—	—	—	—	21.3
Other finance income/(cost)	(5.6)	—	—	—	(0.4)	(0.1)	—	(6.1)
Actuarial (loss)/gain	7.0	2.5	0.7	1.1	1.8	0.2	—	13.3
(Deficit)/surplus 31 March 2004	(134.5)	(5.1)	(2.2)	(3.9)	(10.0)	(1.2)	(0.4)	(157.3)

Notes to the financial statements (continued)

8. Pension costs (continued)

Financial Reporting Standard 17: Retirement Benefits (FRS 17) Disclosures (continued)

The movements in the scheme (deficit)/surplus during the year, ending 31 March 2003, provided for comparative purposes, were as follows:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
(Deficit)/surplus at 31 March 2002	(54.4)	3.4	1.5	—	4.4	(1.0)	—	(46.1)
(Deficit)/surplus on acquisitions	—	—	—	(2.6)	—	—	—	(2.6)
Currency translation	—	—	—	—	(0.5)	0.2	—	(0.3)
Current service cost	(7.5)	(1.0)	(0.3)	(0.3)	(1.3)	(0.2)	(0.1)	(10.7)
Contributions	13.1	0.5	0.1	—	—	0.3	—	14.0
Past service costs	(0.4)	—	—	—	—	—	—	(0.4)
Gain on settlement/curtailment	10.9	—	—	—	—	—	—	10.9
Other finance income/(cost)	1.7	0.4	0.2	—	0.9	(0.1)	0.1	3.2
Actuarial (loss)/gain	(122.5)	(10.3)	(4.3)	(1.8)	(9.5)	(0.6)	(0.3)	(149.3)
(Deficit)/surplus 31 March 2003	(159.1)	(7.0)	(2.8)	(4.7)	(6.0)	(1.4)	(0.3)	(181.3)

The following amounts in respect of the defined benefit schemes would have been included within profit before taxation had FRS 17 been fully implemented.

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
INCLUDED WITHIN OPERATING PROFIT:								
Current service cost	5.8	1.2	0.3	0.6	1.6	0.3	0.1	9.9
Past service cost	0.4	—	—	—	—	0.1	—	0.5
Gains on settlements and on curtailments	(21.3)	—	—	—	—	—	—	(21.3)
Total	(15.1)	1.2	0.3	0.6	1.6	0.4	0.1	(10.9)
INCLUDED WITHIN FINANCING COSTS:								
Interest on pension scheme liabilities	(17.3)	(1.3)	(0.6)	(0.7)	(3.0)	(0.2)	(0.1)	(23.2)
Expected return on pension scheme assets	11.7	1.3	0.6	0.7	2.6	0.1	0.1	17.1
Total financing costs	(5.6)	—	—	—	(0.4)	(0.1)	—	(6.1)

As the Company Scheme, the AEAT Rail and AEAT Rail (TCI) schemes are now closed to new members under the projected unit method the current service cost will increase as the members of the scheme approach retirement.

The impact on profit before taxation if FRS 17 had been fully implemented for the year ending 31 March 2003, for comparative purposes, were as follows

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
INCLUDED WITHIN OPERATING PROFIT:								
Current service cost	7.5	1.0	0.3	0.3	1.3	0.2	0.1	10.7
Past service cost	0.4	—	—	—	—	—	—	0.4
Gains on settlements and on curtailments	(10.9)	—	—	—	—	—	—	(10.9)
Total	(3.0)	1.0	0.3	0.3	1.3	0.2	0.1	0.2
INCLUDED WITHIN FINANCING COSTS:								
Interest on pension scheme liabilities	(18.1)	(2.3)	(1.2)	(0.3)	(2.6)	(0.2)	(0.2)	(24.9)
Expected return on pension scheme assets	19.8	2.7	1.4	0.3	3.5	0.1	0.3	28.1
Total financing costs	1.7	0.4	0.2	—	0.9	(0.1)	0.1	3.2

If the above amounts had been recognised in the financial statements, the following amounts would have been included in the Group's Statement of Total Recognised Gains and Losses:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
Actual returns less expected returns on pension								
scheme assets	32.4	4.0	1.8	2.2	5.0	0.1	—	45.5
Experience (losses)/gains arising on scheme liabilities	(1.6)	0.1	(0.4)	(0.2)	(0.7)	0.1	—	(2.7)
Changes in assumptions underlying the present value of the scheme liabilities	(23.8)	(1.6)	(0.7)	(0.9)	(2.5)	—	—	(29.5)
Actuarial gain/(loss) recognised in the Statement of								
Total Recognised Gains and Losses	7.0	2.5	0.7	1.1	1.8	0.2	—	13.3

For comparative purposes, the impact on the Group's Statement of Total Recognised Gains and Losses for the year ending 31 March 2003, were as follows:

	Company scheme £m	AEAT Rail £m	AEAT Rail (TCI) £m	The Engineering Link £m	Kinectrics Inc £m	QSA Inc £m	QSA GmbH £m	Total £m
Actual returns less expected returns on pension								
scheme assets	(78.4)	(7.7)	(3.8)	(1.0)	(8.8)	(0.3)	—	(100.0)
Experience (losses)/gains arising on scheme liabilities	(10.7)	—	0.6	0.2	(0.7)	—	(0.3)	(10.9)
Changes in assumptions underlying the present value of the scheme liabilities	(33.4)	(2.6)	(1.1)	(1.0)	—	(0.3)	—	(38.4)
Actuarial gain/(loss) recognised in the Statement of								
Total Recognised Gains and Losses	(122.5)	(10.3)	(4.3)	(1.8)	(9.5)	(0.6)	(0.3)	(149.3)

Notes to the financial statements (continued)

8. Pension costs (continued)

Financial Reporting Standard 17: Retirement Benefits (FRS 17) Disclosures (continued)

The history of experience gains and losses is as follows:

	Company scheme	AEAT Rail	AEAT Rail (TCI)	The Engineering Link	Kinectrics Inc	QSA Inc	QSA GmbH	Total
Difference between expected and actual return on scheme assets:								
£m	32.4	4.0	1.8	2.2	5.0	0.1	–	45.5
% of scheme assets	17%	10%	9%	11%	13%	5%	–	15%
Experience (losses)/gains on scheme liabilities:								
£m	(1.6)	0.1	(0.4)	(0.2)	(0.7)	0.1	–	(2.7)
% of present value of scheme liabilities	1%	0%	2%	1%	2%	3%	–	2%
Total amount recognised in Statement of Total Recognised Gains and Losses:								
£m	7.0	2.5	0.7	1.1	1.8	0.2	–	13.3
£m% of present value of scheme liabilities	2%	6%	3%	5%	1%	6%	–	8%

	2004 £m	2003 £m
Difference between expected and actual return on scheme assets:		
£m	45.5	(100.0)
% of scheme assets	15%	37%
Experience (losses)/gains on scheme liabilities:		
£m	(2.7)	(10.9)
% of present value of scheme liabilities	2%	2%
Total amount recognised in Statement of Total Recognised Gains and Losses:		
£m	13.3	(149.3)
% of present value of scheme liabilities	8%	33%

If the above amounts had been recognised in the financial statements, the Group's net liabilities and profit and loss reserve at 31 March 2004 would have been reported as follows:

	31 March 2004 £m	31 March 2003 £m
Net assets excluding pension liability and SSAP 24 balances	10.5	12.1
Net pension liability	(152.8)	(178.3)
Net assets including pension liability	(142.3)	(166.2)
Profit and loss reserve excluding pension reserve and SSAP 24 balances	(10.0)	(8.6)
Pension reserve	(152.8)	(178.3)
Profit and loss reserve	(162.8)	(186.9)

9. Result/(loss) on ordinary activities before taxation

Result/(loss) on ordinary activities before taxation is stated after charging/(crediting):

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
Loss on disposal of plant and equipment	–	–	–	–	0.5	0.5
Loss/(profit) on disposal of subsidiaries/businesses	–	8.3	8.3	–	(20.0)	(20.0)
Auditors' remuneration ⁽¹⁾	0.3	–	0.3	0.4	–	0.4
Audit (Company £0.1 million 2003: £0.2 million)	0.1	–	0.1	0.6	–	0.6
Non audit fees ⁽²⁾	2.4	–	2.4	3.4	–	3.4
Hire of plant and equipment – operating leases	8.3	–	8.3	11.7	–	11.7
Hire of other assets – operating leases	–	–	–	–	–	–
Depreciation/amortisation charge for the year:						
Goodwill	2.5	–	2.5	1.9	–	1.9
Tangible fixed assets	6.9	–	6.9	7.8	–	7.8
Impairment of intangible fixed assets	0.2	–	0.2	–	–	–
Impairment of tangible fixed assets	0.2	–	0.2	0.1	0.1	0.2
Research and development	9.6	–	9.6	14.2	–	14.2

(1) Payable to PwC LLP and network firms.

(2) Relates to nil (2003: £0.1 million) paid for taxation services, nil (2003: £0.4 million) for financial advice and assistance in respect of disposals and £0.1 million (2003: £0.1 million) for consultancy services.

10. Loss on termination of operations

In focusing and rationalising the Group various business streams have been discontinued in the year or the decision to exit has been announced and activities will terminate over the next twelve months. The costs relating to these closures and provisions for future costs comprise redundancy payments, asset impairments, contract balance write-offs and provisions for future operating losses. The split by segment is as follows:

	2004 £m
Accentus	0.1
Nuclear Programmes	0.4
Total	0.5

The results of business streams that have been discontinued by 16 June 2004 are included in discontinued operations. Turnover for these operations was £4.7 million (2003: £9.4 million) and operating profit/(loss) pre exceptional operating charges was £1.0 million (2003: £(4.6) million).

11. Income from other fixed asset investments

	2004 £m	2003 £m
Dividend receivable	1.2	–

Notes to the financial statements (continued)

12. Interest payable and similar charges

	2004 £m	2003 restated £m
Interest payable on bank loans and overdrafts	2.8	2.5
Notional finance cost related to deferred consideration on acquisitions	0.1	0.1
Unwinding of discount on provisions	0.1	0.1
Redemption on repayment of long-term debt	–	2.3
	3.0	5.0

13. Taxation

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
TAXATION ON (LOSS)/PROFIT ON ORDINARY ACTIVITIES						
United Kingdom corporation tax at 30% (2003: 30%)						
Current	–	–	–	4.3	(4.3)	–
Deferred taxation	1.2	–	1.2	(0.2)	–	(0.2)
Overseas deferred taxation	–	–	–	0.2	–	0.2
Overseas taxation	1.7	–	1.7	2.4	0.9	3.3
Under/(over) provision in respect of prior years:						
Current	(0.6)	–	(0.6)	0.1	–	0.1
Deferred taxation	–	–	–	(1.3)	–	(1.3)
	2.3	–	2.3	5.5	(3.4)	2.1
Share of joint ventures taxation	–	–	–	–	–	–
	2.3	–	2.3	5.5	(3.4)	2.1

The table below reconciles the UK standard rate of Corporation tax of 30% on profit/(loss) on ordinary activities before taxation to the Group's taxation charge:

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
Profit/(loss) on ordinary activities before taxation	8.8	(8.8)	–	(10.5)	5.1	(5.4)
Expected taxation charge at UK Corporation tax rate of 30% (2003: 30%)	2.6	(2.6)	–	(3.1)	1.5	(1.6)
Income not taxable	–	–	–	2.9	(5.1)	(2.2)
Expenses not deductible for tax purposes	0.5	2.6	3.1	2.5	0.2	2.7
Tax credits not recognised	1.7	–	1.7	6.9	–	6.9
Utilisation of tax losses	(2.8)	–	(2.8)	(1.6)	–	(1.6)
Net effect of higher and lower tax rates on overseas earnings	(0.3)	–	(0.3)	(0.6)	–	(0.6)
(Over)/under provision in respect of prior years	(0.6)	–	(0.6)	0.1	–	0.1
Reversal of timing differences	–	–	–	(0.3)	–	(0.3)
Tax on (loss)/profit on ordinary activities	1.1	–	1.1	6.8	(3.4)	3.4

14. Profit for the financial year

As permitted by section 230 of the Companies Act 1985, the parent Company's profit and loss account has not been included in the financial statements. The result for the financial year of the parent Company after exceptional operating profit/(loss) of £4.0 million (2003: £(5.0) million), net exceptional (loss)/profit on disposals and termination of operations of £(9.2) million (2003: £4.0 million), impairment of investments of £2.9 million (2003: nil) and amortisation of goodwill generated on hive up of subsidiary assets and trade £7.0 million (2003: nil) was a loss of £6.7 million (2003: profit of £8.0 million).

15. Dividends

DIVIDENDS ON EQUITY SHARES	2004 £m	2003 £m
Ordinary – Interim paid of 1.5p per share (2003: 1.4p per share)	1.0	1.0
Ordinary – Final proposed of 3.7p per share (2003: 3.7p per share)	2.5	2.5
Special Dividend paid (2003: 50.0p per share)	–	44.7
	3.5	48.2

16. Earnings per share

Earnings per share is calculated for both the current and previous years using the (loss)/profit for the year. The earnings per share and Institute of Investment Management and Research (IIMR) calculation is based on 67.5 million shares (2003: 77.2 million shares), being the weighted average number of ordinary shares in issue for the year.

The adjusted earnings per share is based on the loss for the year before the amortisation of goodwill, exceptional items and impairment of intangible assets.

	2004 £m	2003 £m
Loss for the financial year	(2.3)	(8.1)
Amortisation of goodwill	2.5	1.9
Impairment of intangibles	0.2	–
Exceptional operating charges (note 3)	–	6.2
Loss/(profit) on sale of businesses (note 31)	8.3	(20.0)
Loss on termination of operations (note 10)	0.5	8.7
Tax on exceptional items (note 13)	–	(3.4)
Adjusted profit/(loss)	9.2	(14.7)

Notes to the financial statements (continued)

16. Earnings per share (continued)

A reconciliation of earnings per share with the Institute of Investment Management and Research (IIMR) earnings per share is as follows:

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
Loss for the financial year	(2.3)	–	(2.3)	(14.3)	6.2	(8.1)
Release of provisions for operating losses on termination	(4.3)	–	(4.3)	(1.6)	–	(1.6)
Impairment of tangible fixed assets	0.2	–	0.2	0.1	0.1	0.2
Impairment of intangible fixed assets	0.2	–	0.2	–	–	–
Loss on sale of tangible fixed assets	–	–	–	–	0.5	0.5
Loss/(profit) on sale of subsidiaries/businesses	–	8.3	8.3	–	(20.0)	(20.0)
Loss on termination of operations	–	0.5	0.5	–	8.7	8.7
Amortisation of goodwill	2.5	–	2.5	1.9	–	1.9
Redemption penalty on long-term debt	–	–	–	–	2.3	2.3
Taxation on above items	–	–	–	–	(2.3)	(2.3)
IIMR adjusted (loss)/profit	(3.7)	8.8	5.1	(13.9)	(4.5)	(18.4)

Diluted earnings per share is based on the (loss)/profit for the year and 68.9 million shares (2003: 77.4 million shares). The number of shares is equal to the weighted average number of ordinary shares in issue adjusted to assume conversion of all dilutive potential ordinary shares. The Company has only one category of dilutive potential ordinary shares: those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year.

	Before exceptional items 2004	Exceptional items 2004	Total 2004	Before exceptional items 2003	Exceptional items 2003	Total 2003
Earnings per share based on loss for the financial year	9.6p	(13.0)p	(3.4)p	(21.5)p	11.0p	(10.5)p
Adjusted earnings per share based on adjusted profit/(loss)	13.6p	–	13.6p	(19.0)p	–	(19.0)p
IIMR earnings per share based on IIMR adjusted profit/(loss)	(5.5)p	13.0p	7.5p	(18.0)p	(5.8)p	(23.8)p
Diluted earnings per share	9.6p	(13.0)p	(3.4)p	(21.5)p	11.0p	(10.5)p

17. Intangible fixed assets

GROUP	Goodwill £m	Other £m	Total £m
Cost			
At 1 April 2003	36.9	0.1	37.0
Additions in relation to acquisitions (note 30)	0.1	0.1	0.2
Disposals (note 31)	(0.1)	—	(0.1)
At 31 March 2004	36.9	0.2	37.1
Accumulated amortisation			
At 1 April 2003	5.3	0.1	5.4
Charge for year	2.5	—	2.5
At 31 March 2004	7.8	0.1	7.9
Provision for impairment			
At 1 April 2003	—	—	—
Impairment losses	0.2	—	0.2
At 31 March 2004	0.2	—	0.2
Net book value at 31 March 2004	28.9	0.1	29.0
Net book value at 31 March 2003	31.6	—	31.6

In accordance with the Group's accounting policy, costs in respect of internally developed intellectual property rights and patents are written off to the profit and loss account as incurred.

The goodwill arising on acquisitions post the implementation of Financial Reporting Standard 10: Goodwill and Intangible Fixed Assets is being amortised on a straight line basis over three to twenty years. This is the period over which the Directors estimate that value of the underlying businesses is expected to exceed the value of the underlying assets.

COMPANY	Goodwill £m	Other intangibles £m	Total £m
Cost			
At 1 April 2003	0.2	0.1	0.3
Additions	33.2	—	33.2
Disposals	(0.1)	—	(0.1)
At 31 March 2004	33.3	0.1	33.4
Accumulated amortisation			
At 1 April 2003	—	0.1	0.1
Charge for year	7.1	—	7.1
Disposals	(0.1)	—	(0.1)
At 31 March 2004	7.0	0.1	7.1
Net book value at 31 March 2004	26.3	—	26.3
Net book value at 31 March 2003	0.2	—	0.2

Notes to the financial statements (continued)

18. Tangible fixed assets

GROUP	Freehold land and buildings £m	Leasehold improvements £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Cost					
At 1 April 2003	0.6	13.5	62.0	6.3	82.4
Currency translation differences	–	(0.1)	(1.3)	–	(1.4)
Additions	–	0.1	3.5	3.5	7.1
Disposals	–	(2.1)	(20.3)	(0.2)	(22.6)
Transfers	–	1.1	3.5	(4.6)	–
At 31 March 2004	0.6	12.5	47.4	5.0	65.5
Accumulated depreciation					
At 1 April 2003	0.1	4.8	30.2	–	35.1
Currency translation differences	–	(0.1)	(1.0)	–	(1.1)
Charge for year	–	1.0	5.9	–	6.9
Disposals	–	(0.8)	(10.0)	–	(10.8)
At 31 March 2004	0.1	4.9	25.1	–	30.1
Provision for impairment					
At 1 April 2003	–	0.6	5.8	1.2	7.6
Impairment losses	–	–	0.2	–	0.2
Disposals	–	(0.3)	(5.2)	(0.3)	(5.8)
At 31 March 2004	–	0.3	0.8	0.9	2.0
Net book value at 31 March 2004	0.5	7.3	21.5	4.1	33.4
Net book value at 31 March 2003	0.5	8.1	26.0	5.1	39.7

Depreciation has not been charged on freehold land, which is stated at its cost of £0.1 million (2003: £0.1 million).

Included within plant and equipment are assets held under finance leases with a net book value of £0.1 million (2003: £0.1 million) and a depreciation charge for the year of £0.1 million (2003: £0.1 million).

18. Tangible fixed assets (continued)

COMPANY	Freehold land and buildings £m	Leasehold improvements £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Cost					
At 1 April 2003	0.3	12.1	28.5	5.1	46.0
Additions	–	–	1.3	2.5	3.8
Disposals	–	(2.1)	(19.5)	(0.2)	(21.8)
Transfers	–	1.2	2.0	(3.2)	–
At 31 March 2004	0.3	11.2	12.3	4.2	28.0
Accumulated depreciation					
At 1 April 2003	–	3.9	14.5	–	18.4
Charge for year	–	0.8	2.0	–	2.8
Disposals	–	(0.7)	(9.4)	–	(10.1)
At 31 March 2004	–	4.0	7.1	–	11.1
Provision for impairment					
At 1 April 2003	–	0.6	5.5	1.2	7.3
Impairment losses	–	–	0.1	–	0.1
Disposals	–	(0.3)	(5.3)	(0.3)	(5.9)
At 31 March 2004	–	0.3	0.3	0.9	1.5
Net book value at 31 March 2004	0.3	6.9	4.9	3.3	15.4
Net book value at 31 March 2003	0.3	7.6	8.5	3.9	20.3

Included within plant and equipment are assets held under finance leases with a net book value of nil (2003: nil) and a depreciation charge for the year of nil (2003: £0.1 million).

Property clawback

Arrangements have been put in place to entitle the Secretary of State for Trade and Industry to a proportion of any property gains accruing to the Company as a result of disposals or events treated as disposals for clawback purposes after 1 September 1996 but on or before 31 August 2008. The Clawback Debenture applies these clawback arrangements to the Company's freehold land and buildings at Risley and to leases vested in the Company by the Transfer Scheme where the landlord is not UKAEA. These remaining Risley properties were disposed of during the year ended 31 March 2000. Clawback payments are to be made annually by reference to gains arising in each year commencing 1 September in the clawback period.

19. Fixed asset investments

GROUP	Other investments £m
Cost and net book value	
At 1 April 2003	2.9
Additions	0.4
At 31 March 2004	3.3

Notes to the financial statements (continued)

19. Fixed asset investments (continued)

Included within fixed asset investments is an investment of £8k in Sprue Aegis plc which was admitted to OFEX in June 2001. The aggregate market value of this investment at the mid-price quoted on 31 March 2004 was £85k.

COMPANY	Subsidiary undertakings Shares £m	Loans £m	Joint ventures shares £m	Other investments £m	Total £m
Cost					
At 1 April 2003	93.6	38.6	0.3	2.5	135.0
Additions	0.9	4.0	–	0.3	5.2
Disposals	(0.9)	–	(0.3)	–	(1.2)
Disposals in relation to hive up of subsidiary assets and trade	(33.7)	(0.1)	–	–	(33.8)
Repayments of loans	–	(3.9)	–	–	(3.9)
At 31 March 2004	59.9	38.6	–	2.8	101.3
Provision					
At 1 April 2003	7.7	–	–	–	7.7
Provision in year	1.7	1.2	–	–	2.9
Disposals in relation to hive up of subsidiary assets and trade	(0.5)	–	–	–	(0.5)
At 31 March 2004	8.9	1.2	–	–	10.1
Net book value at 31 March 2004	51.0	37.4	–	2.8	91.2
Net book value at 31 March 2003	85.9	38.6	0.3	2.5	127.3

19. Fixed asset investments (continued)

Principal subsidiary undertakings as at 31 March 2004:

<i>Name</i>	<i>Country of incorporation</i>	<i>Description of shares held</i>	<i>Proportion of nominal value of issued shares held by the Group</i>	<i>Nature of business</i>
AEA Technology Rail BV	The Netherlands	DFL 1,000 shares	100% ⁽¹⁾	Consultancy to rail market
nCode International Limited	England and Wales	Ordinary £1 shares	100%	Engineering software
SoMat Corporation Inc	USA	Common Stock	100% ⁽¹⁾	Data acquisition systems
ERSA Sarl	France	Ordinary shares	100%	Rail engineering software
AEA Technology Global SA	Spain	Ordinary shares	100%	Consultancy to rail market
AEA Technology GmbH	Germany	50,000 DM	100%	Engineering software and consultancy
Kinectrics Inc	Canada	Common Stock	100% ⁽¹⁾	Energy and environment technologies and consulting
Lexware International Limited	Scotland	Ordinary £1 shares	100%	Environmental software
AEA Technology Battery Systems Limited	England and Wales	Ordinary £1 shares 'A' Ordinary £1 shares	100% 100%	Specialist battery pack manufacturer
AGM Batteries Limited	England and Wales	'A' Ordinary £1 shares	60.5%	Specialist battery cell manufacturer
Accentus plc	England and Wales	Ordinary £1 shares	100%	Intellectual property
AEA Technology Engineering Services Inc	USA	Common stock with no par value	100% ⁽¹⁾	Nuclear engineering services & US Government utilities contractor
AEA Technology Limited	Hong Kong, China	Ordinary HK\$ 1 shares	100%	Quality and Safety Assurance
AEA Technology QSA GmbH	Germany	50,000 DM	100%	Quality and Safety Assurance
AEA Technology QSA Inc	USA	Common stock	100% ⁽¹⁾	Quality and Safety Assurance
Shenzhen CIC-AEA Technology Manufacturing Co Limited	China	Ordinary	51% ⁽¹⁾	Quality and Safety Assurance
RiskSol Consulting Limited	England and Wales	Ordinary £1 shares	100%	Consultancy
AEA Technology Sarl	France	Ordinary	100%	Engineering software
AEA Technology Inc	USA	\$1 common stock	100%	Holding company
Summit AEA Corporation	Japan	Common stock	81%	Agents
Biojoule Limited	England and Wales	Ordinary £1 shares	80%	Renewable energy

(1) Held by a subsidiary of AEA Technology plc

The information above relates to those subsidiary undertakings which principally affected the results or financial position of the Group.

In addition to those listed above, the Group has other subsidiary undertakings which operate in the UK, the US, Canada and Spain. All subsidiaries are included in the consolidated accounts. All subsidiaries and joint ventures have an accounting year end of 31 March. The associate undertaking has an accounting year end of 31 December.

Notes to the financial statements (continued)

19. Fixed asset investments (continued)

Joint venture as at 31 March 2004:

Name	Country of incorporation	Description of shares held	Proportion of nominal value of issued shares held by the Group	Nature of business
Spectrum	n/a	n/a	n/a	Rail maintenance software

Associate as at 31 March 2004:

Name	Country of incorporation	Description of shares held	Proportion of nominal value of issued shares held by the Group	Nature of business
GTL Microsystems Ag	Switzerland	Ordinary Shares	40%	Contractor

20. Stock and work in progress

	Group 2004 £m	2003 £m	Company 2004 £m	2003 £m
Raw materials and consumables	14.6	12.2	–	0.3
Work in progress	8.6	6.5	6.4	5.0
	23.2	18.7	6.4	5.3

21. Debtors

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Amounts falling due after more than one year:				
Other debtors	0.2	0.2	–	0.1
Amounts due in respect of decommissioning and waste management (note 24)	–	0.9	–	0.9
Accrued income	0.3	0.1	–	0.1
Pension prepayment ⁽¹⁾	14.2	13.3	13.9	10.9
Deferred taxation (note 24)	9.0	13.0	9.2	13.7
	23.7	27.5	23.1	25.7
Amounts falling due within one year:				
Trade debtors	52.8	59.9	35.0	35.2
Amounts recoverable on long-term contracts	5.0	7.4	3.3	5.6
Amounts owed by group undertakings	–	–	3.1	8.6
Amounts owed by joint ventures	0.4	0.4	–	0.4
Corporation tax recoverable	–	–	0.8	0.5
Other debtors ⁽²⁾	7.7	2.5	4.9	1.3
Prepayments and accrued income	12.0	8.2	7.2	4.8
Deferred taxation (note 24)	3.5	0.7	3.4	0.6
	81.4	79.1	57.7	57.0
Total debtors	105.1	106.6	80.8	82.7

(1) As part of the adjustments to arrive at fair value in relation to the acquisition of BR Research Limited in 1997, a sum of £3.1 million (2003: £2.1 million) has been included on the balance sheet (£3.0 million debtors due after more than one year and £0.1 million debtors due within one year), representing the funding surplus in respect of the AEA Technology Rail Shared Cost Section of the Railways Pension Scheme at the date of acquisition. This surplus continues to be amortised. The remaining £12.4 million relates to a surplus on the AEA Technology plc scheme of £10.6 million (2003: £10.3 million) of which £1.2 million is due within one year, and a surplus on the AEA Technology Rail (TCL) Shared Cost Section of the Railways Pension Scheme of £1.8 million (2003: £1.3 million).

(2) Included in other debtors is a dividend receivable of £1.2 million (2003: nil) relating to income from other fixed asset investments.

22. Creditors: amounts falling due within one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Loans and overdrafts	56.7	41.6	55.6	40.6
Payments received on account	25.5	29.3	14.0	14.1
Trade creditors	23.4	20.4	16.2	14.3
Amounts owed to group undertakings	–	–	7.1	19.6
Taxation and social security	7.8	9.8	6.1	7.2
Corporation tax	0.6	1.4	–	–
Other creditors	5.5	11.2	2.7	7.7
Accruals	31.3	33.9	22.6	23.2
Finance lease creditors	0.1	0.2	0.1	0.1
Dividend payable	2.5	2.5	2.5	2.5
	153.4	150.3	126.9	129.3

Notes to the financial statements (continued)

22. Creditors: amounts falling due within one year (continued)

Of the Group and Company bank loans and overdrafts £5.6 million is a cash advance, repayable on demand, from our investment in Hunting BRAE. Of the £5.6 million, £4.5 million bears no interest and £1.1 million bears interest at 6.0%. (Of the Group and Company bank loans and overdrafts £50.0 million bears interest at LIBOR plus 1%. It was repayable in sections as follows: £5.0 million at 13 April 2004, £10.0 million at 26 May 2004 and £35.0 million at 18 June 2004. Subsequent to the year end the borrowings have been renegotiated. The remaining Group balance of £1.1 million relates to subsidiaries' overdrafts).

23. Creditors: amounts falling due after more than one year

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
BORROWINGS				
Bank loans	0.1	0.1	—	—
Debenture loan	—	—	2.0	2.0
Finance lease creditors	0.1	0.2	0.1	0.1
	0.2	0.3	2.1	2.1

The debenture loan is repayable to a subsidiary and does not bear interest. The Group bank loans of £0.1 million bear interest at 5.0% to 6.0% and mature within one to three years.

The maturity of obligations under finance leases is as follows:

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Within one year	0.1	0.2	0.1	0.1
In the first to second years	0.1	0.1	0.1	—
In the second to fifth years	—	0.1	—	0.1
	0.2	0.4	0.2	0.2

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
OTHER CREDITORS REPAYABLE AS FOLLOWS:				
Payments received on account:				
— between one and two years	9.4	2.7	0.4	0.1
Other creditors:				
— between one and two years	0.2	0.3	—	—
— two to five years	0.6	0.5	0.1	—
— after five years	0.9	0.9	0.2	—
	11.1	4.4	0.7	0.1

24. Provisions for liabilities and charges

GROUP	Acquisitions £m	De- commissioning and waste management £m	Pensions and similar obligations £m	Other £m	Total £m
At 1 April 2003	0.3	14.3	12.8	24.1	51.5
Currency translation differences	—	(0.3)	(0.4)	—	(0.7)
Charge for the year	—	1.3	—	1.7	3.0
Contributions paid to the Group pension schemes	—	—	1.1	—	1.1
Utilised in the year	(0.1)	(3.0)	(0.4)	(9.3)	(12.8)
Reclassification	—	2.4	—	(2.4)	—
Released in the year	—	(2.5)	—	(1.2)	(3.7)
At 31 March 2004	0.2	12.2	13.1	12.9	38.4

Included within other provisions is our share of net liabilities of £0.1 million (2003: £0.1 million) in a joint venture. This comprises gross assets of £0.2 million (2003: £0.2 million) and gross liabilities of £0.3 million (2003: £0.3 million).

COMPANY	De- commissioning and waste management £m	Pensions and similar obligations £m	Other £m	Total £m
At 1 April 2003	9.9	4.2	21.2	35.3
Charge for the year	1.1	—	1.6	2.7
Contributions paid to the Company pension schemes	—	0.2	—	0.2
Utilised in the year	(2.7)	(0.2)	(6.9)	(9.8)
Reclassification	2.4	—	(2.4)	—
Released in the year	(2.5)	—	(1.2)	(3.7)
At 31 March 2004	8.2	4.2	12.3	24.7

Acquisitions

These provisions relate to QSA and will be utilised to offset depreciation charged over the life of revalued acquired assets, which were acquired at nil value.

Decommissioning and waste management

On 31 March 1996, certain properties, rights and liabilities of UKAEA were vested in the Company in accordance with a transfer scheme made pursuant to section 1 of the Atomic Energy Authority Act 1995.

A supplemental agreement entered into pursuant to the Transfer Scheme provides that liabilities for decommissioning any nuclear facility in existence as at 31 March 1996 and for any waste transferred to UKAEA ("the Authority") for disposal prior to 31 March 1996 are to remain with the Authority. All new or incremental decommissioning, waste management and clean up liabilities arising after 1 April 1996 will be assumed by the Group except for certain liabilities which have been transferred to or assumed by third parties.

Provisions for these costs are made in full once the facility becomes contaminated and are calculated on the latest technical assessments of the processes and methods likely to be used in the future and represent estimates derived from a combination of the technical knowledge available, existing legislation and regulations and commercial agreements. The estimates are reviewed annually and changes to the provisions that are required, including price level changes, are accounted for in the year in which they arise, together with the notional interest on provisions which have been discounted.

Notes to the financial statements (continued)

24. Provisions for liabilities and charges (continued)

The utilisation of these provisions is uncertain and costs will be incurred when the facilities are decommissioned and the waste disposed of. It is currently anticipated that utilisation will occur between 2004 and 2015. Of this provision £7.4 million relates to the B220 facilities, these costs will be incurred over the next 4-5 years.

Pensions and similar obligations

The breakdown of the Company pension provision is given in note 8. Part of this provision will be utilised over the average service lives of employees and the remainder once the Executive Directors retire.

The Group provision also includes pension provisions relating to the QSA and Kinectrics acquisitions. The QSA provision will be utilised over the average service lives of the employees in the QSA group undertakings. The Kinectrics provision is for the unfunded supplementary pension and other post retirement benefits.

Other

Included in the other provisions are exceptional redundancy provisions (Company £3.8 million, Group £4.1 million) and provisions for closure costs (Company £0.9 million and Group £1.1 million). These provisions will be utilised during the next one to two years.

The remainder of other provisions principally comprise projected losses or commitments on long-term contracts (Company £4.5 million, Group £4.7 million) and building lease related provisions such as dilapidations and wear and tear provisions (Company and Group £1.3 million) and provisions for leases on vacant properties (Company £0.8 million and Group £0.9 million). These will be utilised when the costs are incurred on the long-term contracts, as lease payments are made on the vacant properties and as dilapidation repairs are carried out. As the provisions for losses on long-term contracts and for wear and tear are utilised these are likely to be replaced with provisions on other long-term contracts and new wear and tear provisions.

Deferred taxation

The amounts of deferred taxation accounted for in the financial statements are as follows:

GROUP	Accelerated capital allowances £m	Tax losses carried forward £m	Provisions £m	Other £m	Total £m
At 1 April 2003	(1.3)	9.5	6.1	(0.6)	13.7
(Charged)/credited to profit and loss account	(0.2)	(1.1)	–	0.1	(1.2)
At 31 March 2004	(1.5)	8.4	6.1	(0.5)	12.5

THE GROUP NET DEFERRED TAX ASSET IS DISCLOSED AS FOLLOWS:	2004 £m
Debtors – amounts falling due within one year (note 21)	3.5
Debtors – amounts falling due after more than one year (note 21)	9.0

24. Provisions for liabilities and charges (continued)

COMPANY	Accelerated capital allowances £m	Tax losses carried forward £m	Provisions £m	Other £m	Total £m
At 1 April 2003	(1.3)	9.5	6.1	—	14.3
Charged to profit and loss account	(0.2)	(1.0)	—	—	(1.2)
Transfer from subsidiary	—	—	—	(0.5)	(0.5)
At 31 March 2004	(1.5)	8.5	6.1	(0.5)	12.6

THE COMPANY NET DEFERRED TAX ASSET IS DISCLOSED AS FOLLOWS:	2004 £m
Debtors – amounts falling due within one year (note 21)	3.4
Debtors – amounts falling due after more than one year (note 21)	9.2

The Company made a profit before exceptional items in the current year and has continued to recognise a deferred taxation asset of £12.6 million (2003: £14.3 million). Based on current budgets and a three year strategic plan adequate profits will be made in the future to recover this asset.

Deferred taxation has not been provided on retained overseas earnings because dividends will only be remitted to the UK if there is no further taxation liability. In addition a deferred taxation asset of £8.2 million (2003: £7.7 million) has not been recognised in respect of tax losses in UK subsidiaries as it is anticipated that this asset will not be recovered in the foreseeable future.

25. Called up share capital

	2004 £m	2003 £m
Authorised		
98,181,810 ordinary shares of 12.2p each (2003: 98,181,810 million ordinary shares of 12.2p each)	12.0	12.0
	12.0	12.0
Allotted, called up and fully paid		
67,518,069 ordinary shares of 12.2p each (2003: 67,482,474 ordinary shares of 12.2p each)	8.3	8.2
	8.3	8.2

35,595 shares of 12.2p each were issued in the year for total consideration of £0.1m to meet commitments under the Company's employee share schemes.

Notes to the financial statements (continued)

26. Reserves

GROUP	Share premium £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2003	10.6	0.7	1.9
Issue of share capital (note 25)	—	—	—
Goodwill written back to profit on disposal (note 30)	—	—	0.1
Currency translation difference on foreign currency net investments	—	—	(3.5)
Loss for the year	—	—	(5.8)
At 31 March 2004	10.6	0.7	(7.3)

Net cumulative goodwill of £32.8 million (2003: £32.9 million) has been eliminated against reserves on acquisitions made prior to 1 April 1998.

COMPANY	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Other reserve £m	Profit and loss account £m
At 1 April 2003	10.6	0.7	25.0	49.1	(13.5)
Issue of share capital (note 25)	—	—	—	—	—
Goodwill written back to profit on disposal (note 30)	—	—	—	0.1	—
Loss for the year	—	—	—	—	(10.2)
At 31 March 2004	10.6	0.7	25.0	49.2	(23.7)

Under the terms of the Atomic Energy Authority Act 1995, the Other Reserve is deemed to be distributable to the extent that it was not capitalised after 31 March 1996.

27. Equity minority interests

GROUP	2004 £m
At 1 April 2003	1.2
Additions (note 30)	0.2
Dividends paid	(0.5)
Profit and loss account	—
At 31 March 2004	0.9

28. Reconciliation of net cash flow to movement in net debt

MOVEMENT IN NET DEBT IN THE YEAR	2004 £m	2003 £m
(Decrease) in cash in the year	(7.0)	(8.9)
Cash flow from (increase)/decrease in debt	(14.8)	11.7
Change in net funds resulting from cash flow	(21.8)	2.8
Loans acquired on acquisitions	–	(0.3)
Net debt at 1 April	(12.9)	(15.4)
Net debt at 31 March	(34.7)	(12.9)

ANALYSIS OF NET DEBT	At 1 April 2003 £m	Cash flow £m	Acquisitions and disposals £m	At 31 March 2004 £m
Cash in hand and at bank	29.2	(6.9)	–	22.3
Bank overdrafts	(1.0)	(0.1)	–	(1.1)
	28.2	(7.0)	–	21.2
Debt due after one year	(0.3)	0.1	–	(0.2)
Debt due within one year	(40.8)	(14.9)	–	(55.7)
	(12.9)	(21.8)	–	(34.7)

29. Employee share schemes

Savings-related share option schemes

The Company operates an Inland Revenue approved savings-related share option scheme (the Save As You Earn or SAYE scheme) through which eligible employees (including executive directors) choosing to participate save monthly from salary (after tax) and are granted an option to buy AEA Technology shares at a pre-determined option price. Equivalent schemes are offered to Group employees not subject to UK income tax under which the option to buy shares is replaced by eligibility for a cash payment based on growth in the share price over the period of savings.

Savings contracts are for three years with five-year savings contracts also possible in the UK. Options can be exercised anytime in the six months following the savings contract maturity date.

Notes to the financial statements (continued)

29. Employee share schemes (continued)

Outstanding options under SAYE schemes at 31 March 2004 are as follows:

PERIOD OF OPTION	Number of shares 2004	Number of shares 2003	Subscription price per share
1 March 2004 to 31 August 2004	15,237	15,804	595p
1 March 2003 to 31 August 2003	–	214,727	363p
1 March 2003 to 31 August 2003	–	299,224	320p
1 March 2005 to 31 August 2005	82,187	92,643	320p
1 March 2004 to 31 August 2004	240,934	301,833	236p
1 March 2006 to 31 August 2006	90,859	113,224	236p
1 March 2005 to 31 August 2005	571,806	697,746	196p
1 March 2007 to 31 August 2007	216,717	260,819	196p
1 April 2006 to 30 September 2006	1,487,421	1,556,670	127p
1 April 2008 to 30 September 2008	546,543	609,393	127p
1 April 2007 to 30 September 2007	418,611	–	187p
1 April 2009 to 30 September 2009	162,030	–	187p
	3,832,345	4,162,083	

Share incentive plan

The Company introduced an Inland Revenue-approved share incentive plan in the UK in 2003. Known as the Buy As You Earn (BAYE), the plan allows all eligible UK employees in the Group (including executive directors) to invest monthly in AEA Technology shares from pre-tax salary. For every three shares bought under the plan, AEA Technology allots one additional share to the employee. Dividends earned by shares held in the plan are automatically invested in further shares. Shares are bought on the market each month and held in trust. There are tax advantages for holding the shares in trust for at least three years and forfeiture provisions if shares are withdrawn from the plan within three years of their allocation. The first investments in the BAYE scheme were made from March 2003 salaries. At 31 March 2004, 220 staff (10% of eligible employees) were participants in the BAYE scheme, investing an average of £75 a month.

Company share option plan (CSOP)

In 1999 the Company established an Inland Revenue-approved CSOP and an unapproved CSOP for which all employees (excluding executive directors) were eligible, with awards made by the board. In 2000 the Company, with shareholder approval, amended the schemes and opened them up to executive directors. CSOP awards have since been made annually. Re-testing of performance conditions is not allowed under the Plan rules.

Outstanding CSOP options (including those granted to directors) are as follows:

SCHEME	Option price	Outstanding options at 31 March 2004	Performance period
2000	205.0p	14,634	1 April 2000 to 31 March 2003
2001	296.5p	1,309,963	1 April 2001 to 31 March 2004
2001	238.0p	94,537	1 April 2001 to 31 March 2004
2002	256.0p	2,028,101	1 April 2002 to 31 March 2005
2002	195.0p	89,870	1 April 2002 to 31 March 2005
2003	220.0p	3,153,705	1 April 2003 to 31 March 2006
2003	232.5p	25,806	1 April 2003 to 31 March 2006

29. Employee share schemes (continued)

The performance conditions of CSOP awards made in 1999 and 2000 were not met and most awards accordingly lapsed. Those that remain from 2000 are held by one former employee where the performance condition had been met up to the time he left the Group, and who has a limited period after leaving in which to exercise the award.

The performance condition for the 2001 CSOP award has been met and award holders will be able to exercise their options between 26 June 2004 (the third anniversary of the option grant date) and 26 June 2011.

The performance condition for the 2002 and 2003 awards is that growth in adjusted earnings per share, for the continuing AEA Technology businesses, must equal or exceed 3% above RPI over the performance period of the plan (with more demanding performance targets for higher levels of directors' awards, as explained in the report on directors' remuneration).

Performance Share Plan

Shareholders are being invited to approve at the 2004 AGM, the introduction of a performance share plan (PSP). The PSP will award employees, at the discretion of the company, with a conditional right to receive shares, exercisable after three years subject to continued employment and the achievement of stretching financial performance conditions for the group. If approved, it is anticipated that the first PSP awards will be made in August 2004. As explained in the shareholder circular for the AGM, the intention is that PSP awards will replace CSOP awards for executive directors and senior executives. However, there may be continued use of the CSOP awards for other employees because option awards can be tax-beneficial.

30. Acquisitions and goodwill

Acquisitions completed during the year were as follows:

NAME	Date	Percentage of share capital acquired
Summit AEA Corporation	7 July 2003	31%

This acquisition was accounted for using acquisition accounting. The goodwill on this acquisition has been capitalised as an intangible asset and is finalised.

Notes to the financial statements (continued)

30. Acquisitions and goodwill (continued)

The assets and liabilities of Summit AEA Corporation are set out below:

	Book value £m	Accounting policy alignment £m	Fair value adjustments £m	Fair value £m
Fixed assets				
Intangible fixed assets	0.1	(0.1)	–	–
Current assets				
Stocks and work in progress	0.3	–	–	0.3
Debtors	0.7	0.1	–	0.8
Cash	0.1	–	–	0.1
Total assets	1.2	–	–	1.2
Liabilities				
Creditors	(0.7)	–	–	(0.7)
Net assets	0.5	–	–	0.5
Goodwill				0.1
Purchase consideration				0.6
Satisfied by				
Deferred consideration				0.1
Cash				0.5
				0.6

Deferred consideration is payable in two instalments: £52k in April 2004 and £52k in April 2005.

Impact on cash flows

Summit AEA Technology contributed a £0.1 million inflow to the Group's operating cash flows.

Goodwill movement

GOODWILL WRITTEN OFF AGAINST RESERVES	Group £m	Company £m
At 1 April 2003	32.9	7.1
Goodwill written back on disposals	(0.1)	(0.1)
At 31 March 2004	32.8	7.0

31. Sale of subsidiaries/businesses

Disposals completed during the year were as follows:

NAME	Date	Percentage of share capital disposed of
Gemini (assets and trade)	2 December 2003	n/a
Monserco Ltd	16 May 2003	100%
Stat Attack – industrial division (assets and trade)	27 June 2003	n/a

31. Sale of subsidiaries/businesses (continued)

The net assets disposed of and the related sale proceeds were as follows:

	Gemini £m	Monserco £m	Other £m	Total £m
Tangible fixed assets	5.7	–	–	5.7
Stocks and work in progress	4.2	–	–	4.2
Debtors	0.5	0.3	–	0.8
Cash	–	0.2	–	0.2
Creditors	(1.0)	(0.3)	(1.4)	(2.7)
Goodwill	–	–	0.1	0.1
(Loss)/profit on disposal	(9.9)	0.3	1.3	(8.3)
Net consideration on disposal	(0.5)	0.5	–	–
Satisfied by:				
Net cash proceeds	(0.5)	0.5	–	–

The other column relates to the disposal of Stat Attack and further resolution of prior year disposal liabilities.

The net assets disposed and the related loss on the disposal of Gemini are provisional as the loss calculation has not yet been finalised.

The sale proceeds for Gemini of £7.4 million less disposal costs of £7.9 million give the net consideration on disposal of £(0.5) million. As of the 31 March 2004, proceeds of £6.1 million have been received and £2.3 million of disposal costs paid giving a net cash inflow of £3.8 million. The remaining proceeds of £1.3 million will be settled on agreement of completion accounts.

The results of all disposals are included in discontinued activities. Turnover in respect of disposals was £6.3 million (2003: £38.9 million) and operating profit/(loss) pre exceptional operating charges was £1.3 million (2003: £(0.3) million).

Impact on cash flows

Businesses sold during the year contributed £0.1 million outflow to the Group's operating cash flows and paid £0.1 million of interest.

Notes to the financial statements (continued)

32. Derivatives and other financial instruments

Page 9 of the Financial Review provides an explanation of the role that financial instruments have had during the year in creating or changing the risks the Group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13: Derivatives and Other Financial Instruments: Disclosures (FRS13). Certain financial assets and liabilities such as investments in subsidiary and associated companies, obligations under employee share option plans and employee share schemes, pension assets and rights and obligations arising under operating leases are excluded from the scope of these disclosures. As permitted by FRS13, short-term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Interest rate profile

After taking into account interest rate swaps and forward foreign currency contracts entered into by the Group, the interest rate profile of the Group's financial liabilities at 31 March 2004 was as follows:

CURRENCY	Borrowings on which no interest is paid £m	Fixed rate £m	Floating rate £m	Total £m
Sterling	4.5	1.2	51.2	56.9
Other	0.1	—	—	0.1
Total	4.6	1.2	51.2	57.0

The profile at 31 March 2003 for comparison purposes was as follows:

CURRENCY	Borrowings on which no interest is paid £m	Fixed rate £m	Floating rate £m	Total £m
Sterling	4.5	1.4	36.1	42.0
Other	0.1	—	—	0.1
Total	4.6	1.4	36.1	42.1

The Group also has additional pension obligations for Directors due after one year of £2.6 million (2003: £2.4 million), provisions for onerous property contracts due after one year of £0.4 million (2003: £0.5 million), redundancy costs due after one year of nil (2003: £4.2 million), decommissioning and waste due after one year of £7.0 million (2003: £2.3 million) and provisions for dilapidations due after one year of £1.2 million (2003: nil). These do not bear any interest. These amounts are all payable in sterling.

The interest rate profile of the financial assets of the Group as at 31 March was as follows:

ASSETS HELD AS PART OF THE FINANCING ARRANGEMENTS FOR THE GROUP:	2004 £m	2003 £m
Sterling cash deposits	7.4	18.0
US dollar cash deposits	4.2	5.6
Canadian dollar cash deposits	6.2	1.8
Euro cash deposits	4.1	3.4
Other cash deposits	0.4	0.4
Total	22.3	29.2

32. Derivatives and other financial instruments (continued)

Interest rate profile (continued)

The cash deposits comprise cash at bank and on overnight deposits at the relevant LIBID rate (in the case of sterling deposits) or equivalent relevant rate for overseas deposits.

The Group also has other debtors falling due after one year of £0.2 million (2003: £0.2 million) and accrued income falling due after one year of £0.2 million (2003: £0.1 million). These do not attract interest but are discounted and the unwinding of the discount is credited to interest receivable in the profit and loss account.

Further analysis of the interest rate profile as 31 March is as follows:

	2004 Fixed rate Weighted average interest rate %	2004 Fixed rate Weighted average period for which rate is fixed Years	2003 Fixed rate Weighted average interest rate %	2003 Fixed rate Weighted average period for which rate is fixed Years
Sterling	7.0	0.3	7.3	0.6

The floating rate financial liabilities comprise bank borrowings bearing interest rates fixed in advance, for periods ranging from one to six months, by reference to the relevant LIBOR rate or equivalent relevant rate for overseas borrowings.

Currency exposures

As explained on page 9 of the Financial Review, the Group's objectives in managing the currency exposures arising from its net investment overseas (in other words, its structural currency exposures) are to maintain a low cost of borrowings and to retain some potential for currency-related appreciation while partially hedging against currency depreciation. Gains and losses arising from these structural currency exposures are recognised in the Statement of Group Total Recognised Gains and Losses.

The table below shows the Group's currency exposures; in other words, those transactional (or non-structural) exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that were not denominated in the operating (or "functional") currency of the operating unit involved.

As at 31 March 2004 these exposures were as follows:

FUNCTIONAL CURRENCY OF GROUP OPERATION	Net foreign currency monetary assets/(liabilities)				Total £m
	Sterling £m	US dollar £m	Euro £m	Other £m	
Sterling	–	0.5	0.1	–	0.6
Canadian dollar	–	0.4	–	–	0.4
US dollar	0.1	–	–	–	0.1
Euro	–	(0.1)	–	–	(0.1)
Total	0.1	0.8	0.1	–	1.0

Notes to the financial statements (continued)

32. Derivatives and other financial instruments (continued)

Currency exposures (continued)

The exposures at 31 March 2003 for comparison purposes were as follows:

FUNCTIONAL CURRENCY OF GROUP OPERATION	Net foreign currency monetary assets/(liabilities)				Total £m
	Sterling £m	US dollar £m	Euro £m	Other £m	
Sterling	–	2.8	(0.1)	0.6	3.3
Canadian dollar	–	0.5	–	–	0.5
US dollar	(0.4)	–	–	0.3	(0.1)
Total	(0.4)	3.3	(0.1)	0.9	3.7

The amounts shown in the tables above take into account the effect of any currency swaps, forward contracts and other derivatives entered into to manage these currency exposures.

Maturity of financial liabilities

The maturity profile of the Group's financial borrowings at 31 March was as follows:

	2004 £m	2003 £m
In one year or less	56.8	41.8
In more than one year but not more than two years	0.2	0.2
In more than two years but not more than five years	–	0.1
Total	57.0	42.1

The maturity profile of the Group's financial liabilities at 31 March was as follows:

	2004 £m	2003 £m
In one year or less	56.8	41.8
In more than one year but not more than two years	3.0	6.8
In more than two years but not more than five years	5.4	0.6
In more than five years	3.0	2.3
Total	68.2	51.5

Borrowing facilities

The Group had undrawn committed borrowing facilities at 31 March, in respect of which all conditions precedent had been met, as follows:

	2004 £m	2003 £m
Expiring in less than one year	10.0	–

32. Derivatives and other financial instruments (continued)

Fair values

Set out below is a comparison by category of book values and fair values of the Group's financial assets and liabilities at 31 March:

	2004		2003	
	Book value	Fair value	Book value	Fair value
	£m	£m	£m	£m
Primary financial instruments held or issued to finance the Group's operations				
Short-term financial liabilities and current proportion of long-term borrowings	(56.8)	(56.8)	(41.8)	(41.8)
Long-term borrowings	(0.2)	(0.2)	(0.3)	(0.3)
Other financial liabilities	(11.2)	(11.2)	(9.4)	(9.4)
Cash deposits	22.3	22.3	29.2	29.2
Other financial assets	—	—	0.3	0.3
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	—	—	—	—
Forward foreign currency contracts	—	—	—	—

As at 31 March 2004 the Group also held open various currency swaps and forward contracts that the Group had taken out to hedge expected future foreign currency sales.

The fair values of the interest rate swaps and forward foreign currency contracts with a carrying amount of nil have been determined by reference to prices available from the markets on which the instruments involved are traded. The fair value of short-term deposits, loans and overdrafts approximates to the carrying amount because of the short maturity of these instruments. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

Gains and losses on hedges

The Group enters into forward foreign currency contracts to eliminate the currency exposures that arise on sales denominated in foreign currencies immediately those sales are transacted. It also uses interest rate swaps to manage its interest rate profile. Using Statement of Standard Accounting Practice 20: Foreign Currency Translation, all hedged transactions are recorded at the hedged rate so there are no unrecognised foreign currency contracts and interest rate swaps.

Notes to the financial statements (continued)

33. Commitments

Annual commitments under non-cancellable operating leases which expire as follows:

	Plant and equipment at 31 March		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Within one year	0.9	0.4	0.8	0.2
In two to five years	2.5	2.9	2.0	2.5
After more than five years	—	0.1	—	—
	3.4	3.4	2.8	2.7

	Land and buildings at 31 March		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Within one year	0.6	0.5	0.1	0.1
In two to five years	4.4	5.7	3.1	3.5
After more than five years	3.5	2.9	2.6	2.6
	8.5	9.1	5.8	6.2

CAPITAL COMMITMENTS	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Future capital expenditure contracted but not provided for in the financial statements:	0.5	1.1	0.1	0.9

34. Contingent liabilities

AEA Technology plc also guarantees the credit facilities, overdraft facilities, BACS facilities and leasing obligations for certain subsidiary companies. At 31 March 2004 these guarantees totalled £5.1 million (2003: £5.1 million).

The Group has contingent liabilities in respect of contracts entered into in the normal course of business and in respect of disposal of businesses and subsidiaries. It is not expected that these will have a material effect on the financial position of the Group.

35. Transactions with the Department of Trade and Industry and other government departments

Turnover and cost of sales exclude reimbursements and the relating payments made in respect of certain contracts with the Department of Trade and Industry and other government departments. Under the terms of these agreements, the Group receives funding from the Department of Trade and Industry and other government departments in respect of certain programmes and pays such moneys directly to third parties in connection with work carried out under these programmes. The Group does not make any profit or loss directly from these contract payments.

The gross value of the payments made and received under these programmes was £70.1 million (2003: £28.0 million). The cost of administering the overall programmes and the relating income received has been included in the profit and loss account.

36. Related party transactions

The Group's related parties, the nature of the relationship and the extent of transactions with them, as defined by Financial Reporting Standard 8:

Related Party Transactions are summarised below:

JOINT VENTURES AND ASSOCIATED UNDERTAKINGS	2004 £m	2003 £m
Sales to joint ventures and associated undertakings on normal trading terms	1.3	0.9
Purchases from joint ventures and associated undertakings on normal trading terms	–	0.2
Amounts due from joint ventures and associated undertakings	0.4	0.6
Amounts owed to joint ventures and associated undertakings	–	0.1

Details of the Group's principal joint ventures and associates at 31 March 2004 are set out in Note 19.

Except for an agreement to purchase property jointly with Dr Peter Watson, there are no contracts of significance that existed during or at the end of the year to which the Company and its subsidiary undertakings were a party and in which an Executive Director of the Company was materially interested.

This agreement involved investment totalling £75,000 in part-share of the property in which Dr Peter Watson resides when required to be in London.

See section C of the Report on Directors' Remuneration on pages 31 to 33.

37. Post balance sheet events

There are no post balance sheet events.

Five year summary

FOR THE FIVE YEARS ENDED 31 MARCH	2004 £m	2003 restated ⁽⁴⁾ £m	2002 restated £m	2001 restated £m	2000 ⁽⁵⁾ £m
Sales and results					
<i>Group and share of joint ventures' turnover:</i>					
Continuing operations	240.5	222.7	222.0	218.0	362.5
Discontinued operations	11.0	48.3	109.4	146.2	–
Share of joint ventures	0.1	1.3	3.0	4.6	3.5
	251.6	272.3	334.4	368.8	366.0
Operating profit/(loss)					
Continuing operations	8.4	(1.6)	(7.2)	(1.9)	34.0
Discontinued operations	2.3	(4.9)	(2.6)	13.8	–
Group operating profit/(loss) before exceptional items	10.7	(6.5)	(9.8)	11.9	34.0
Joint ventures and associates	(0.7)	(0.1)	0.2	0.1	–
Exceptional operating charges	–	(6.2)	(21.1)	(24.0)	–
(Loss)/profit on sale of businesses	(8.3)	20.0	53.7	–	–
Loss on termination of operations	(0.5)	(8.7)	(5.9)	–	–
Other income and expenses ⁽¹⁾	1.2	–	–	0.3	1.8
Profit/(loss) on ordinary activities before interest	2.4	(1.5)	17.1	(11.7)	35.8
Net interest payable and similar charges	(2.4)	(3.9)	(3.6)	(5.5)	(6.1)
(Loss)/profit before taxation	–	(5.4)	13.5	(17.2)	29.7
Taxation ⁽¹⁾	(2.3)	(2.1)	8.8	5.4	(8.9)
(Loss)/profit after taxation	(2.3)	(7.5)	22.3	(11.8)	20.8
Minority interests	–	(0.6)	0.1	0.4	0.2
Dividends and appropriations	(3.5)	(48.2)	(3.4)	(9.9)	(9.8)
(Loss)/retained profit	(5.8)	(56.3)	19.0	(21.3)	11.2
Net assets employed					
Fixed assets	65.7	74.6	72.7	68.4	76.4
Net current assets	54.0	46.0	71.2	31.6	91.3
	119.7	120.6	143.9	100.0	167.7
Borrowings	(57.0)	(42.1)	(46.8)	(46.7)	(82.5)
Provisions and creditors due after more than one year	(49.5)	(55.9)	(48.4)	(29.1)	(19.9)
Net assets	13.2	22.6	48.7	24.2	65.3
Ratios					
Operating profit/(loss) as a % of turnover ⁽²⁾	4.3%	(2.4)%	(2.9)%	3.3%	9.3%
Adjusted earnings per share ⁽³⁾	13.6p	(19.0)p	(11.4)p	10.6p	25.6p
IMR earnings per share	7.5p	(23.8)p	(25.6)p	(5.2)p	24.7p

(1) Dividends receivable and taxation have been restated to reflect the removal of the associated tax credit as required by Financial Reporting Standard 16: Current Taxation.

(2) Operating profit/(loss) before exceptional items as a percentage of turnover.

(3) Adjusted earnings per share is after the write back of goodwill and exceptional items.

(4) The results of continuing and discontinued activities for 2003 have been restated to reflect the discontinued activities at 31 March 2004. The figures for 2000, 2001 and 2002 have not been restated as it has not been practical to do so.

(5) The figures for 2000 have not been restated for the changes in accounting policy in the year ended 31 March 2002 because it has not been practical to do so.

Shareholders' information

SHARES AS AT 31 MARCH 2004	Number of shareholders	Percentage of total shareholders	Percentage of ordinary shares
1 – 100	2,356	27.5	0.2
101 – 1,000	4,679	54.7	2.9
1,001 – 5,000	1,219	14.2	3.7
5,001 – 50,000	212	2.5	4.6
50,001 – 100,000	23	0.3	2.5
Over 100,000	66	0.8	86.1
	8,555	100.0	100.0

FINANCIAL CALENDAR

Financial year end	31 March
Ex-dividend date	7 July 2004
Record date	9 July 2004
Annual general meeting	22 July 2004
2004 final dividend payable	6 October 2004
2005 interim results announcement	December 2004
2005 interim dividend payment	1 February 2005
2005 preliminary results announcement	June 2005

Shareholder contact

If you have any general comments or queries, you are welcome to write to Keith Russell, the Company Secretary, at 329, Harwell, Oxfordshire OX11 0QJ. If you have a query for a specific director, please write to them at the same address.

Registrar services

If you have an administrative query about your shareholding (such as details of previous dividend payments, recording a change of address, or reporting the loss of a share certificate), please direct these to Lloyds TSB Registrars, either in writing to them at The Causeway, Worthing, West Sussex BN99 6DA, or by telephoning 0870 600 3970. Textphone number, UK only, is 0870 600 3950.

If you are dialling from outside the UK, please telephone on 44 121 715 7047 or fax on 44 1903 854031.

You can now find a number of shareholder services on-line. The portfolio service from Lloyds TSB Registrars gives you access to more information on your investments including balance movements, indicative share prices, and information on recent dividends. For more details on this and practical help on transferring shares or updating your details, please visit www.shareview.co.uk. This also gives you the opportunity to register an interest in receiving information from the Company electronically, should this option be offered at some stage.

Amalgamation of shareholdings

If you have received more than one copy of this report, your shareholding may be registered under two or more shareholder reference numbers. Please contact Lloyds TSB Registrars to amalgamate these accounts.

CREST

The Company's shares are available for electronic settlement by CREST. If you would like to find out more about the CREST settlement system, please contact Lloyds TSB Registrars for an information leaflet.

Low cost share dealing service

Our brokers, Cazenove, offer a special postal dealing service for buying and selling AEA Technology plc shares, where the commission is 1% on the first £5,000, 0.55% on the next £145,000 and 0.3% thereafter, with a £10 minimum. You can get full details by contacting: Cazenove, AEA Technology plc Share Dealing Service, 20 Moorgate, London EC2R 6DA, telephone 020 7155 5155.

Payment of dividends

You can have future dividends paid directly into a UK bank or building society account. Please contact Lloyds TSB Registrars for a dividend mandate form. A tax voucher will be posted to your home address.

Dividend Reinvestment Plan (DRIP)

Our Dividend Reinvestment Plan (DRIP) gives shareholders the opportunity to use the whole of their cash dividends to buy additional ordinary shares in the Company in the market at competitive dealing rates. Full details can be obtained by ringing Lloyds TSB Registrars on 0870 241 3018.

The latest date for a shareholder to elect to join the DRIP in respect of the next dividend payment (the 2004 final dividend payment due on 6 October 2004) is Wednesday 15 September. The election form must be with Lloyds TSB Registrars by no later than this date.

Individual savings account (ISA)

We have a Company Sponsored ISA enabling shareholders to hold AEA Technology plc shares in a tax advantageous manner. Your dividends will attract the basic rate of income tax only, any profits should you later sell some or all of your investment are exempt from capital gains tax, and you do not need to show details of your ISA on your tax return.

For details, please contact Lloyds TSB Registrars ISA Team at the address given earlier or telephone 0870 242 4244.

ShareGift

Shareholders who only have a small number of shares whose market value makes selling uneconomic may wish to consider donating them to charity through ShareGift, an independent charity share donation scheme. ShareGift is administered by the Orr Mackintosh Foundation registered charity number 1052686. Further information may be obtained on 020 7337 0501 or from www.sharegift.org.

Registered office

329 Harwell
Didcot
Oxfordshire
OX11 0QJ

Company registration

Registered in England and Wales No.3095862

AEA Technology's internet address is: www.aeat.co.uk

Secretary and Advisers

Secretary

Keith Russell FCIS
AEA Technology plc
329 Harwell
Didcot
Oxfordshire OX11 0QJ

Financial Advisers

Greenhill & Co International LLP
Regent Gate
56-58 Conduit Street
London W1S 2YZ

Registrars

Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA

Principal bankers

Lloyds TSB
6-8 Eastcheap
London EC3M 1LL

Solicitors

Eversheds LLP
Senator House
85 Queen Victoria Street
London EC4V 4JL

Linklaters

One Silk Street
London EC2Y 8HQ

Brokers

Cazenove & Co. Limited
20 Moorgate
London EC2R 6DA

Auditors

PricewaterhouseCoopers LLP
9, Greyfriars Road
Reading
Berkshire RG1 1JG