PAM TRANSPORTATION SERVICES INC
Form 8-K
April 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934

Date of report (Date of earliest event reported): April 24, 2013

P.A.M. TRANSPORTATION SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware	0-15057	71-0633135
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

297 West Henri De Tonti, Tontitown, Arkansas 72770
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (479) 361-9111

N/A
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02 Results of Operations and Financial Condition.

On April 24, 2013, P.A.M. Transportation Services, Inc. issued a news release announcing its financial results for the first quarter ending March 31, 2013. A copy of the news release is attached hereto as Exhibit 99.1.

The information contained in this report and the exhibit hereto shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

The information herein (including the exhibit hereto) may contain "forward-looking statements" that are made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995 and otherwise may be protected. Such statements are made based on the current beliefs and expectations of the Company's management and are subject to significant risks and uncertainties. Actual results may differ from those anticipated by forward-looking statements.

Please refer to the Company's Annual Report on Form 10-K and other filings with the Securities and Exchange Commission for information concerning risks, uncertainties and other factors that may affect future results.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits. The following exhibits are furnished with this Report:

99.1 News release issued by the Registrant on April 24, 2013

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

P.A.M. TRANSPORTATION SERVICES, INC.
(Registrant)

Date: April 24, 2013

By:/s/ Lance K. Stewart
Lance K. Stewart
Vice President of Finance, Chief Financial Officer,
Secretary and Treasurer

EXHIBIT INDEX

Exhibit Number	Exhibit Description
99.1	News release issued by the Registrant on April 24, 2013

New Roman" SIZE="2"> $(1.62) $1.48 $1.25

Diluted:

Before cumulative effect of a change in accounting principle

$(1.44) $1.42 $1.21

Cumulative effect of a change in accounting principle

(0.18) $(1.62) $1.42 $1.21

See accompanying notes to consolidated financial statements.

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DURATEK, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders Equity

Years Ended December 31, 2003, 2004 and 2005

(in thousands of dollars, except share amounts)

	Common stock							
	Shares	Amount	Capital in Excess of Par Value	Deferred Compensation Employee Stock Trust	Retained Earnings (Accumulated Deficit)	Treasury Stock	Deferred Stock Compen-sation	Total Stock-holders Equity
Balance, December 31, 2002	15,142,419	$ 151	$ 77,715	$	$ (8,108)	$ (9,577)	$ (319)	$ 59,862
Net income					14,236			14,236
Amortization of deferred stock compensation							319	319
Exercise of stock options	78,662	1	419					420
Other issuances of common stock	8,019		45					45
Income tax benefit from exercise of non-qualified stock options			196					196
Treasury stock transactions						(1,058)		(1,058)
Preferred stock repurchase premium, dividends and charges for accretion					(36,154)			(36,154)
Balance, December 31, 2003	15,229,100	152	78,375		(30,026)	(10,635)		37,866
Net income					21,046			21,046
Exercise of stock options	743,050	7	5,352					5,359
Other issuances of common stock	6,634		117					117
Conversion of restricted stock units	157,930	2		1,323				1,325
Income tax benefit from exercise of non-qualified stock options			2,641					2,641
Treasury stock transactions						(265)		(265)
Preferred stock conversion	100,067	1	299					300
Preferred stock dividend					(63)			(63)
Balance, December 31, 2004	16,236,781	162	86,784	1,323	(9,043)	(10,900)		68,326
Net income					18,423			18,423
Exercise of stock options	233,036	2	1,557					1,559
Other issuances of common stock	807	1	97					98
Income tax benefit from exercise of non-qualified stock options			1,453					1,453
Balance, December 31, 2005	16,470,624	$ 165	$ 89,891	$ 1,323	$ 9,380	$ (10,900)	$	$ 89,859

See accompanying notes to consolidated financial statements.

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DURATEK, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years Ended December 31, 2003, 2004 and 2005

(in thousands of dollars)

	2003	2004	2005
Cash flows from operating activities:			
Net income	$ 14,236	$ 21,046	$ 18,423
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	15,279	10,639	9,847
Deferred income taxes	4,445	(83)	(239)
Cumulative effect of a change in accounting principle, net of taxes	2,414		
Stock compensation expense	517	246	98
Income tax benefit from exercise of non-qualified stock options	196	2,641	1,453
Provision (recoveries) for doubtful accounts	46	(558)	(106)
Equity in (income) loss of joint ventures, net of distributions	(46)	109	(418)
Loss on disposal of assets	701	213	301
Other non-cash changes	(482)	597	(52)
Changes in operating assets and liabilities:			
Accounts receivable	10,151	7,939	(5,144)
Costs and estimated earnings in excess of billings on uncompleted contracts	(6,830)	(8,191)	(6,532)
Prepaid expenses and other current assets	871	1,486	2,717
Accounts payable and accrued expenses and other current liabilities	(2,386)	(8,856)	(6,058)
Unearned revenues	4,934	(6,716)	(1,335)
Waste processing and disposal liabilities	(1,935)	(1,021)	(2,680)
Facility and equipment decontamination and decommissioning liabilities	959	956	327
Retainage	(1,582)	1,781	5,030
Other	(817)	(1,701)	(980)
Net cash provided by operating activities	40,671	20,527	14,652
Cash flows from investing activities:			
Additions to property, plant and equipment	(4,839)	(6,242)	(4,720)
Other	(378)	(115)	(29)
Net cash used in investing activities	(5,217)	(6,357)	(4,749)
Cash flows from financing activities:			
Repayments of long-term debt	(61,149)	(30,975)	(15,644)
Proceeds from long-term debt	115,000		
Proceeds from issuance of common stock	420	5,359	1,559
Repayments of capital lease obligations	(388)	(282)	(546)
Deferred financing costs paid	(4,209)	(27)	(128)
Preferred stock dividends paid	(3,101)	(123)	
Preferred stock repurchase	(49,176)		
Net cash used in financing activities	(2,603)	(26,048)	(14,759)
Net increase (decrease) in cash and cash equivalents	32,851	(11,878)	(4,856)
Cash and cash equivalents, beginning of year	2,323	35,174	23,296

Cash and cash equivalents, end of year	$ 35,174	$ 23,296	$ 18,440

See accompanying notes to consolidated financial statements.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2003, 2004 and 2005

(1) Description of Business

Duratek, Inc., together with our wholly owned subsidiaries (we , our , Duratek , or the Company), provide services to commercial and governmen customers primarily in the United States that ensure safe and secure radioactive materials disposition and nuclear facility operations. We possess a breadth of capabilities, technologies, assets, facilities, and qualified technical personnel. Our services include decommissioning services, nuclear facility operations, radioactive material characterization, processing, transportation, accident containment and restoration services, and final disposal. Our strength lies in our vertical integration of the following:

on-site waste management and processing work at customer sites;

transportation logistics and engineering services;

processing of customer waste at our facilities; and

operation of waste disposal facilities.

We own a number of patents and related trademarks pertaining to the detection, storage, decontamination, processing and handling of radioactive and hazardous waste materials. Our revenues are derived almost equally from government and commercial customers. Our government work comes largely from the United States Department of Energy (DOE). The majority of our commercial clients are commercial nuclear utilities. We also provide services to non-utilities, including pharmaceutical companies, research laboratories, universities, and industrial facilities. We have three business segments: (i) Federal Services, (ii) Commercial Services, and (iii) Commercial Processing and Disposal.

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries. Investments in joint ventures in which we do not have control or majority ownership are accounted for under the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and generally do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses from the existing accounts receivable. We determine the allowance based on historical experience, review of specific accounts, and past due balances over 90 days and over a specific amount. Account balances are written off against the allowance after all reasonable means of collection have been exhausted and recovery is considered remote.

(c) Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts, Unearned Revenues, and Retainage

Costs and estimated earnings in excess of billings on uncompleted contracts represent amounts recognized as revenues that have not been billed. Unearned revenues represent amounts billed and collected for which revenues have not been recognized. Contracts typically provide for the billing of costs incurred and estimated earnings on a monthly basis or based on contract milestones. As of December 31, 2004, costs and estimated earnings in excess of billings on uncompleted contracts was $27.8 million, of which $16.7 million was classified as a current asset and $11.1 million is included in other assets in our consolidated balance sheets. We have costs and estimated earnings in excess of billings on

uncompleted contracts of $34.4 million as of December 31, 2005,

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

of which $14.4 million is expected to be collected in the next 12 months. As of December 31, 2005, costs and estimated earnings in excess of billings on uncompleted contracts that will not be collected within the next twelve months of $20.0 million is included in other assets in our consolidated balance sheets. We have unearned revenues of $14.7 million as of December 31, 2004 and $13.4 million as of December 31, 2005.

Retainage represents amounts billable but withheld, due to contract provisions, until the contract provisions are satisfied. As of December 31, 2004, we had retainage balances of $7.0 million, of which $5.7 million was included in prepaid expenses and other current assets in the consolidated balance sheets. As of December 31, 2005, we have retainage balances of $1.9 million, of which $900,000 is expected to be collected within the next 12 months and is included in prepaid expenses and other current assets in the consolidated balance sheets.

(d) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Equipment under capital leases is stated at the present value of minimum lease payments.

Depreciation on property, plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Estimated useful lives of the assets are as follows:

Land improvements	5 to 10 years
Buildings	20 to 35 years
Computer hardware and software	3 years
Furniture and fixtures	5 to 7 years
Machinery and equipment	5 to 12 years
Trucks and vehicles	5 to 15 years

Equipment held under capital leases and leasehold improvements are amortized on the straight-line method over the shorter of the lease term or estimated useful life of the asset. Total depreciation and amortization of property, plant and equipment is $10.5 million for 2003, $8.9 million for 2004, and $8.1 million for 2005. Maintenance and repairs that do not extend the lives of the assets are expensed as incurred.

(e) Impairment of Long-lived Assets

Long-lived assets such as property, plant, and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the excess of carrying amount over the fair value of the asset. Assets to be disposed of would be separately presented in our consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill is tested annually for impairment, and is reviewed for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value.

We reviewed our goodwill as of January 1 of 2003, 2004, and 2005 in accordance with the Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and concluded that no impairment charge was required.

DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(f) Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives, and reviewed for impairment whenever events or circumstances indicate that the carrying value of such assets may not be recoverable (see note 5).

(g) Facility and Equipment Decontamination and Decommissioning (D&D) Liabilities

Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations,* (SFAS 143), requires us to record the fair value of an asset retirement obligation (ARO) as a liability in the period in which we incur a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. We are also required to record a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the ARO, the ARO is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligations.

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligations An Interpretation of FASB Statement No. 143*. FIN 47 clarifies that the term conditional asset retirement obligation, as used in SFAS No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 has no material effect on our consolidated financial position or results of operations for the year ended December 31, 2005.

We are obligated, under our license granted by the State of South Carolina and the Atlantic Interstate Low-Level Radioactive Waste Compact Implementation Act (Atlantic Waste Compact Act), for costs associated with the ultimate closure of the Barnwell Low-Level Radioactive Waste Disposal Facility in South Carolina and our buildings and equipment located at the Barnwell site (Barnwell Closure). Under the terms of the Atlantic Waste Compact Act and our license with the State of South Carolina, we are required to maintain a trust fund to cover the Barnwell Closure obligation. We recognized our Barnwell Closure obligation, which is effectively limited to the amount in the trust fund, for an amount equal to the balance in the trust fund.

(h) Derivative Financial Instruments

All derivative instruments are recognized as assets or liabilities in the balance sheet at fair value. Fair value adjustments are included in the determination of net income.

We use derivative financial instruments to help us to manage our exposure to movements in interest rates by converting our variable rate debt to fixed rate debt. At December 31, 2005, we had one contract that locks in a fixed rate of interest with a pay-fixed, receive-variable interest rate swap, thereby hedging exposure to the variability in market interest rate fluctuations. We have implemented policies which restrict the usage of derivatives to non-trading purposes.

(i) Deferred Compensation

We have contributed shares of our common stock to the Duratek Inc. Deferred Compensation Plan. In accordance with Emerging Issues Task Force (EITF) Issue No. 97-14, *Accounting for Deferred Compensation*

DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Arrangements Where Amounts are Held in a Rabbi Trust and Invested, assets of rabbi trusts are to be consolidated with those of the employer, and the value of the employer s stock held in rabbi trust is classified in stockholder s equity and generally accounted for in the manner of treasury stock.

(j) Revenue Recognition

Contract Revenues and Cost Recognition

Federal and Commercial Contracts for Services

We have contracts to provide engineering and technical support services to the Federal government and its agencies and to commercial companies. Our Federal government contracts are subject to periodic funding by the respective contracting agency. Funding for a contract may be provided in full at inception of the contract or periodically throughout the term of the contract as the services are provided. From time to time, we may proceed with work based on customer direction pending a Request for Equitable Adjustment (REA) or finalization and signing of formal funding documents. We have an internal process for approving such work. Contract acquisition costs are expensed as incurred.

Our services are provided under time-and-materials, cost-plus award or incentive-fee, firm-fixed-price, and fixed-unit-rate contracts. The following describes our policies for these contract types:

Time-and-materials contracts We are paid for labor and costs incurred at negotiated contractual rates. Profitability on these contracts is driven by the extent of utilization of our billable personnel and the rates that are applied based on contractual terms.

Cost-plus award or incentive fee contracts We are reimbursed for allowable costs in accordance with Federal Acquisitions Regulations (FAR) or contractual provisions. If our costs exceed the contract ceiling or are not allowable under the provisions of the contract or FAR, we may not be able to obtain reimbursement for all such costs. We earn award and incentive fees in addition to cost reimbursements if we meet certain contract provisions, including schedule, budget, and safety. If any of these provisions are not satisfied in accordance with management s estimates, we could have a reduction in expected revenues. Monthly assessments are made to measure our compliance with established contract provisions. We receive award and incentive fees on certain Federal government contracts, which are accrued when estimable, and collection is reasonably assured. Included in the incentive fees recognized is an incentive fee on a Federal government subcontract for the Fernald Closure Project that is not billable until the project is complete, which is currently estimated to be in the second half of 2006.

Firm-fixed-price and fixed-unit-rate contracts We receive a fixed price irrespective of the actual costs we incur and, consequently, we are exposed to a number of risks. These risks include underestimation of costs, problems with new technologies, unforeseen costs or difficulties, delays beyond our control, and economic and other changes that may occur during the contract period. For firm-fixed-price contracts, our revenues are recognized on a proportional performance method using proportional output measures, where estimable, or based on other measures, such as the proportion of costs incurred to total estimated contract costs or units of production. For fixed-unit-rate contracts, our revenues are recognized as units are completed based on the contractual unit rates.

Revisions in revenues, costs, and profit estimates, or measurements in the extent of progress toward completion are changes in accounting estimates accounted for in the period of change (cumulative catch-up method). Such revisions could occur at any time and the effects could be material. Although we have a history of

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

making reasonably dependable estimates of the extent of progress towards completion of contract revenue and of contract completion costs on our long-term engineering and construction contracts, due to uncertainties inherent in the estimation process, it is possible that actual completion costs may vary from estimates, and it is possible that such variances could be material to our operating results.

Contracts typically provide for periodic billings on a monthly basis or based on contract milestones. Cost and estimated earnings in excess of billings on uncompleted contracts represents amounts recognized as revenue that have not been billed. Unearned revenue represents amounts billed and collected for which revenue has not been recognized. Retainage represents amounts recognized as revenue that have been retained by the customer until certain conditions are met in accordance with contract provisions.

Change Orders and Requests for Equitable Adjustment (REAs)

We record contract claims and pending change orders, including REAs, when revenue is probable, which generally is when accepted in writing by the customer. The cost to perform the work related to these claims and pending change orders, including REAs, is included in the financial statements in the period that they are incurred and are included in our estimates of contract profitability. As of December 31, 2005, there are approximately $5.7 million outstanding REAs in Federal Services, and no amount of these claims have been included in the contract value. As of December 31, 2005, there are no outstanding REAs in Commercial Services.

Subcontractors have requested contract change orders related to scope changes requested by our customers. Based on agreement with our customers and the provisions of the contracts, recovery by these subcontractors is contingent upon our recovery from our customers. As of December 31, 2005, subcontractors have requested contract change orders totaling approximately $2.9 million related to scope changes requested by our customers. These amounts, including subcontractor costs and our corresponding revenue, have not been included in the results of our operations and are generally recognized when accepted in writing by the customer.

Provision for Estimated Losses

Provision for estimated losses on individual contracts are recognized in the period in which the losses are identified and include all estimated direct costs to complete the contract (excludes future selling, general, and administrative costs expected to be allocated to the contract). Monthly assessments are made to measure our estimates and changes are made based on the latest information available. As of December 31, 2005, there were loss provisions of $486,000 on two Federal Services contracts.

Commercial Waste Processing

The commercial waste processing operations have contracts with commercial companies and governmental agencies to provide fixed-based waste processing services. Our services are provided primarily under fixed-unit-price contracts and usually require us to ship the processed waste for burial on behalf of the customer. Revenue is recognized as units of waste are processed based on the unit prices provided in the contracts. Our fixed unit price contracts provide for additional customer billings if the characterization or volume of waste received is different from contract specifications or for certain increases in burial and transportation costs. These variances are identified when the waste is sorted and during the processing cycle and can have either a positive or negative impact on revenue, depending on the provisions of the contract. When these variances are identified, rates are adjusted to the correct weight or classification and revenue is adjusted in the period that the variance is identified.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Disposal

Revenues from the operation of a low-level radioactive waste disposal facility in Barnwell, South Carolina (Barnwell Disposal Facility) are recognized in accordance with the Atlantic Waste Compact Act. Under the Atlantic Waste Compact Act, we are reimbursed for allowable costs incurred in operating the Barnwell Disposal Facility that are identified by the South Carolina Public Service Commission and incurred by us plus an operating margin of 29% on certain of those allowable costs. In addition, costs incurred for decommissioning activities at the Barnwell Disposal Facility are reimbursed by the State of South Carolina from a trust fund established to cover the Barnwell closure obligation plus an operating margin of 14% on those costs. Our results from July 1, 2000 forward are based on the economic regulations imposed by the Atlantic Waste Compact Act. Allowable costs are subject to audit annually by the Office of Regulatory Staff (ORS) of the State of South Carolina to ensure compliance with the Atlantic Waste Compact Act. Recommended audit adjustments to allowable costs are thoroughly reviewed by management and resolved with ORS. As of December 31, 2005, favorable adjustments to revenues totaling $0.2 million are included in the results of our operations for the audit of costs related to the State fiscal year ended June 30, 2005.

(k) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We establish a valuation allowance if we determine that it is more likely than not that a deferred tax asset will not be realized.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(l) Stock Option Plan

We apply the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation,* to account for our fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. SFAS No. 123, *Accounting for Stock-Based Compensation* (as amended by SFAS No. 148, *Accounting for Stock Based Compensation Transition and Disclosure)*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, we have elected to continue to apply the intrinsic-value-based method of accounting described above, and have adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income (loss) attributable to common shareholders if the fair-value-based method had been applied to all outstanding and unvested awards in each year:

	2003	2004	2005
	(in thousands of dollars)		
Net income	$ 14,236	$ 21,046	$ 18,423
Add stock-based employee compensation expense included in reported net income, net of taxes	147	151	
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of taxes	1,002	1,002	1,399
Pro forma net income	13,381	20,195	17,024
Deduct preferred stock repurchase premium, dividends, and charges for accretion	36,154	63	
Pro forma net income (loss) attributable to common stockholders	$ (22,773)	$ 20,132	$ 17,024
Income (loss) per share:			
Basic as reported	$ (1.62)	$ 1.48	$ 1.25
Basic pro forma	$ (1.68)	$ 1.42	$ 1.15
Diluted as reported	$ (1.62)	$ 1.42	$ 1.21
Diluted pro forma	$ (1.68)	$ 1.36	$ 1.11

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2003, 2004, and 2005:

	2003	2004	2005
Risk free interest rate	4.3%	4.2%	4.4%
Expected volatility	64%	61%	59%
Expected life	4 years	4 years	8 years
Contractual life	10 years	10 years	10 years
Expected dividend yield	0%	0%	0%
Fair value of options granted	$ 6.06	$ 9.71	$ 16.06

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 revised 2004 (SFAS No. 123R), *Share-Based Payment*, which replaces SFAS No. 123, supersedes APB Opinion No. 25, and amends SFAS No. 95, *Statement of Cash Flows*. SFAS No. 123R requires the measurement of all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of expense in our consolidated statements of income.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

We are required to adopt SFAS No. 123R beginning in our first quarter of fiscal year 2006. SFAS No. 123R permits the adoption using one of two methods:

A modified prospective method in which compensation cost is recognized based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date.

A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits the restatement, based on amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures, either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We plan to adopt SFAS No. 123R using the modified prospective method.

The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition, and thus our financial results will be negatively affected by the adoption of this standard beginning next year, although it will have no impact on our overall financial position. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had we adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the pro forma net income and earnings per share per above. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required under accounting principles generally accepted in the United States of America. This requirement will reduce net operating cash flows and increase net financing cash flows upon adoptions of SFAS No. 123R. While we cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of cash flows recognized in prior periods for such excess tax deductions were $196,000 in 2003, $2.6 million in 2004, and $1.5 million in 2005.

(m) Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and revenues and expenses recognized during the reporting period. Significant estimates and judgments made by our management include: (i) proportion of completion on long-term contracts, (ii) the cost to D&D facilities and equipment, (iii) recovery of long-lived assets, including goodwill, and (iv) contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ significantly from those estimates.

(n) Commitments and Contingencies

Liabilities for loss contingencies, including environmental remediation costs not within the scope of SFAS No. 143 arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Recoveries for environmental remediation costs from third parties would be recorded when agreed upon with a third party.

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Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(o) Reclassifications

Certain amounts for 2003 and 2004 have been reclassified to conform to the presentation for 2005.

(3) Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the diluted weighted average common shares, which reflect the potential dilution of stock options, restricted stock, and convertible redeemable preferred stock that could share in our income. The reconciliation of amounts used in the computation of basic and diluted net income (loss) per share for the years ended December 31, 2003, 2004, and 2005 consist of the following:

	2003	2004	2005
	(in thousands of dollars, except per share amounts)		
Numerator:			
Net income (loss) attributable to common stockholders	$ (21,918)	$ 20,983	$ 18,423
Add income impact of assumed conversions preferred stock dividends and charges for accretion(1)		63	
Net income (loss)	(21,918)	21,046	18,423
Add cumulative effect of a change in accounting principle, net of taxes	2,414		
Net income (loss) before cumulative effect of a change in accounting principle	$ (19,504)	$ 21,046	$ 18,423
Denominator:			
Weighted-average shares outstanding	13,561	14,191	14,776
Effect of dilutive securities:			
Incremental shares from assumed conversion of:			
Employee stock options		569	510
Diluted weighted average common shares outstanding	13,561	14,760	15,286
Income (loss) per common share:			
Basic:			
Before cumulative effect of a change in accounting principle	$ (1.44)	$ 1.48	$ 1.25
Cumulative effect of a change in accounting principle	(0.18)		
	$ (1.62)	$ 1.48	$ 1.25
Diluted:			
Before cumulative effect of a change in accounting principle	$ (1.44)	$ 1.42	$ 1.21
Cumulative effect of a change in accounting principle	(0.18)		

	$ (1.62)	$ 1.42	$ 1.21

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(1) In 2003, we had a net loss attributable to common stockholders. Accordingly, there is no dilutive impact on earnings per share.

The effects on weighted average shares outstanding of options to purchase common stock and other potentially dilutive securities of ours that were not included in the computation of diluted net income (loss) per

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

share because the effect would have been anti-dilutive were 2.4 million shares in 2003, and 143,000 shares as of December 31, 2005. There were no anti-dilutive shares as of December 31, 2004.

(4) Property, Plant and Equipment

Property, plant and equipment as of December 31, 2004 and 2005 consist of the following:

	2004	2005
	(in thousands of dollars)	
Land and land improvements	$ 3,871	$ 4,499
Buildings	43,297	42,357
Computer hardware and software	5,388	6,014
Furniture and fixtures	2,584	2,659
Machinery and equipment	62,797	63,701
Trucks and vehicles	1,818	3,563
Leasehold improvements	182	235
Capital leases	2,556	3,012
Construction in progress	1,964	1,747
	124,457	127,787
Less accumulated depreciation and amortization	58,306	65,985
	$ 66,151	$ 61,802

(5) Goodwill and Other Intangible Assets

Other intangible assets subject to amortization consist principally of amounts assigned to operating rights related to the Barnwell, South Carolina low-level radioactive waste disposal facility, covenants not-to-compete, and costs incurred to obtain patents. We do not have any other intangible assets that are not subject to amortization. Other intangible assets as of December 31, 2004 and 2005 consist of the following:

		As of December 31, 2004		As of December 31, 2005	
	Amortization Period	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
			(in thousands of dollars)		
Barnwell operating rights	8 yrs	$ 7,340	$ (4,129)	$ 7,340	$ (5,046)
Patents	20 yrs	1,553	(1,045)	1,469	(1,077)
Covenants-not-to-compete	17 yrs	102	(74)	102	(80)
Total		$ 8,995	$ (5,248)	$ 8,911	$ (6,203)

Aggregate amortization expense for amortizing intangible assets was $978,000 for the year ended December 31, 2003, $979,000 for the year ended December 31, 2004, and $980,000 for the year ended December 31, 2005. Estimated annual amortization expense for the next five years

beginning January 1, 2006 is $976,000 for fiscal year ended December 31, 2006, $963,000 for fiscal year ended December 31, 2007, $500,000 for fiscal year ended December 31, 2008, $38,000 for fiscal year ended December 31, 2009, and $33,000 for fiscal year ended December 31, 2010.

In 2004, the goodwill and deferred tax liability balances were increased by $1.3 million for certain deferred tax liabilities related to prior year acquisitions.

DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(6) Long-Term Debt

Long-term debt as of December 31, 2004 and 2005 consisted of the following:

	2004	2005
	(in thousands of dollars)	
Bank Credit Facility:		
Term loan, interest payable quarterly, due December 16, 2009	$ 85,000	$ 69,356
Less current portion of long-term debt	858	708
	$ 84,142	$ 68,648

In December 2003, in connection with the 8% Cumulative Convertible Redeemable Preferred Stock $.01 par value (the Cumulative Convertible Redeemable Preferred Stock) repurchase transaction (see note 11), we entered into a new bank credit facility. This bank credit facility consists of a $30.0 million revolving line of credit, which includes a $15.0 million sub-limit for the issuance of standby letters of credit, and a six-year $115.0 million term loan. Proceeds of the term loan were used to repay $53.9 million of existing term debt and accrued interest under our prior credit facility and to repurchase 151 shares of the Cumulative Convertible Redeemable Preferred Stock for $49.2 million in cash plus accrued and unpaid dividends of $2.5 million, net of transaction costs and related expenses. Borrowings under the credit facility bear interest at the prime rate plus an applicable margin or, at our option, London Interbank Offered Rates (LIBOR) plus an applicable margin.

Effective February 23, 2005, the bank credit facility was amended to lower the applicable margin on borrowings under the bank credit facility. For term loans, the applicable margin is 2.00% for prime rate loans and 3.25% for LIBOR loans. For revolving loans, the applicable margin is determined based on our leverage ratio and can range from 2.00% to 2.50% for prime rate loans and from 3.25% to 3.75% for LIBOR loans. The term loan must be prepaid to the extent of any excess cash flows, as defined. The bank credit facility requires us to maintain certain financial ratios and contains restrictions on our ability to pay cash dividends and limitations on our ability to make acquisitions. As of December 31, 2005, we were in compliance with the provisions of the bank credit facility, including all financial covenant requirements. The bank credit facility is secured by substantially all of the assets of the company and its direct and indirect subsidiaries. As of December 31, 2005, the $30.0 million in total available borrowings under the revolving line of credit was reduced by $8.2 million in outstanding letters of credit, for a net borrowing availability of $21.8 million under the revolving line of credit. As of December 31, 2005, $69.4 million of the six-year term loan remains outstanding from the $115.0 million term loan issued in December 2003. During 2005, we made $15.6 million in payments on the term loan of which $859,000 were scheduled repayments and $14.8 million were voluntary prepayments.

Aggregate maturities of long-term debt as of December 31, 2005 are as follows:

Year Ending December 31,	(in thousands of dollars)
2006	$ 708
2007	708
2008	708
2009	67,232
	$ 69,356

We paid interest of $2.7 million in 2003, $6.1 million in 2004 and $5.7 million in 2005.

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Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(7) Due to the State of South Carolina

On an annual basis, following the State of South Carolina s fiscal year end on June 30, we remit the net of the amounts billed and paid by customers of the State of South Carolina less our fee for operating the site during such fiscal year, pursuant to the provisions of the Atlantic Waste Compact Act (see note 2(j)). For the fiscal year ended June 30, 2005, we remitted $13.8 million and for the fiscal year ended June 30, 2004, we remitted $25.6 million. As of December 31, 2004, we had a balance Due to the State of South Carolina of $6.1 million, of which $2.4 million was billed to customers of the State of South Carolina but uncollected. As of December 31, 2005, we had a balance due to the State of South Carolina of $6.9 million, of which $2.6 million is billed to customer of the State of South Carolina but uncollected.

(8) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities as of December 31, 2004 and 2005 consist of the following:

	2004	2005
	(in thousands of dollars)	
Salaries and related expenses	$ 13,625	$ 10,548
Contract costs subcontractors	4,512	3,766
Other accrued expenses	6,509	7,469
	$ 24,646	$ 21,783

(9) Waste Processing and Disposal Liabilities

Our waste processing technologies create waste by-products (secondary waste), which generally requires transportation and disposal costs to be incurred. We accrue the estimated costs of transportation and disposal based on the characterization of the waste and contractual disposal rates currently in effect at the disposal sites. The ultimate cost of disposal will depend on the actual contamination of the waste, volume reduction, activity, and disposal density. We had an accrual for the expected cost of secondary waste of $3.6 million as of December 31, 2004 and $2.1 million as of December 31, 2005.

In addition, we had accrued for customer waste that has been completely processed and is awaiting shipment for burial of $3.4 million as of December 31, 2004 and $2.2 million as of December 31, 2005, respectively, based on contractual rates, which are negotiated annually.

(10) Facility and Equipment Decontamination and Decommissioning (D&D)

We are responsible for the costs for D&D of our facilities and equipment in Tennessee and South Carolina and certain equipment used at customer sites. These costs will generally be paid upon the closure of these facilities or the disposal of this equipment. We are also obligated, under our license granted by the State of South Carolina and the Atlantic Waste Compact Act, for the Barnwell Closure and we are required to maintain a trust fund to cover the Barnwell Closure obligation, which limits our obligation to the amount of the trust fund. During 2005, $760,000 was used to fund decommissioning activity at the Barnwell Low-Level Radioactive Waste Disposal Facility, therefore decreasing the trust fund balance.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Our D&D liabilities consist of the following as of December 31, 2004 and 2005:

	2004	2005
	(in thousands of dollars)	
Facilities & equipment ARO	$ 21,369	$ 19,632
Barnwell Closure	19,050	19,295
	$ 40,419	$ 38,927

The following is a reconciliation of our facility & equipment ARO for 2004 and 2005:

	2004	2005
	(in thousands of dollars)	
Balance at January 1	$ 20,413	$ 21,369
Accretion expense	978	664
Liabilities incurred during the year	60	36
ARO estimate adjustments	(82)	(2,437)
Balance at December 31	$ 21,369	$ 19,632

Upon the adoption of SFAS No. 143 on January 1, 2003, we recognized the following changes to our consolidated financial statements: increased property, plant and equipment by $5.9 million; increased D&D liabilities by $9.9 million; and recorded a cumulative effect of a change in accounting principle, net of tax of $2.4 million ($4.0 million pre-tax).

We have purchased insurance to fund our obligation to clean and remediate our Tennessee facilities and equipment upon closure. We are accounting for these insurance policies using deposit accounting, whereby a portion of the premiums paid are viewed as funding to cover our obligation and is capitalized as a deposit asset. This asset has no impact on the asset retirement obligation. The remainder of the premium is being charged to earnings in the period in which the premiums are paid. The deposit asset is included in other assets in our consolidated balance sheets and is $2.0 million as of December 31, 2004 and $2.3 million as of December 31, 2005. Related insurance expense was $629,000 in 2004 and $597,000 in 2005. In addition, we were required to place cash deposits in escrow relating to the insurance policy for the Bear Creek Operations Facility. The cash deposits in escrow are included in other assets in our consolidated balance sheets and were $3.6 million as of December 31, 2004 and $5.2 million as of December 31, 2005.

(11) 8% Cumulative Convertible Redeemable Preferred Stock

In January 1995, we issued 160 shares of Cumulative Convertible Redeemable Preferred Stock and an option (the Carlyle Option) to purchase up to an additional 1.3 million shares of our Common Stock. The Cumulative Convertible Redeemable Preferred Stock was initially convertible into our Common Stock at a conversion price of $3.00 per share and, if not previously converted, we were required to redeem the outstanding Cumulative Convertible Redeemable Preferred Stock on September 30, 2005 for $100 per share plus accrued and unpaid dividends, unless such date was extended with the approval of the holders of the Cumulative Convertible Redeemable Preferred Stock.

On December 16, 2003, we repurchased approximately 151,000 shares of our Cumulative Convertible Redeemable Preferred Stock from investment partnerships controlled by The Carlyle Group for $49.2 million in cash plus accrued and unpaid dividends of $2.5 million. The

purchase was based on a price of $9.74 per share of

DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

our Common Stock. Each share of Cumulative Convertible Redeemable Preferred Stock was convertible into 33.333 shares of our Common Stock. As of December 31, 2003, there were approximately 3,000 shares of Cumulative Convertible Redeemable Preferred Stock outstanding that were held by The Carlyle Group. Prior to this repurchase transaction, there were approximately 157,000 shares of Cumulative Convertible Redeemable Preferred Stock outstanding.

In connection with the repurchase transaction, we entered into a stockholder agreement with The Carlyle Group. The stockholders agreement provided that we were obligated to purchase the outstanding approximately 3,000 shares of Cumulative Convertible Redeemable Preferred Stock from The Carlyle Group on or before September 29, 2005 at a minimum purchase price of $324.67 per share. Pursuant to these terms, we purchased the remaining 3,000 shares from The Carlyle Group during the fourth quarter of 2004 for $975,000.

Following the Cumulative Convertible Redeemable Preferred Stock repurchase transaction in December 2003, we had approximately 3,000 shares of Cumulative Convertible Redeemable Preferred Stock that remained outstanding with parties other than The Carlyle Group. During 2004, all these shares were converted into Common Stock at the option of the holder.

(12) Derivative Financial Instrument

We entered into an interest rate swap agreement effective on July 22, 2003 to partially mitigate our exposure to fluctuations in interest rates relating to our outstanding variable rate debt. The contract s notional amount was $55.9 million at inception and declines each quarter over the life of the contract in proportion to our reduction in the outstanding balance of the related long-term debt under the prior credit facility. At the inception of the current credit facility, we were required to have in place an interest rate protection agreement for the aggregate notional amount of at least 40% of the aggregate outstanding principal amount of the term loans, at which date the contract s notional amount was $50.7 million. The current credit facility requires us to maintain the interest rate swap agreement until June 30, 2006. This interest rate swap agreement is not designated as an accounting hedge. The contract s notional amount is $8.7 million at December 31, 2005. Under the terms of the contract, we pay a fixed rate of 1.895% and receive the LIBOR rate, which resets every 90 days. The contract matures on June 30, 2006. The fair value of the contract, which was based upon the fair value estimate by a financial institution, is $272,000 as of December 31, 2004 and $85,000 as of December 31, 2005, which is included in prepaid expenses and other current assets in the consolidated balance sheets.

Adjustments to the fair value of the contract are included in other income, net and was a gain of $265,000 in 2004 and a gain of $163,000 in 2005.

(13) Fair Value of Financial Instruments

The fair value of cash, accounts receivable, other receivables, accounts payable and accrued expenses approximates the carrying amount due to the short maturities of these instruments. Under our bank credit facility, we have $69.4 million in long-term debt outstanding, which approximates the fair value as of December 31, 2005.

(14) Stock Compensation and Stockholders Rights

(a) Stock Option Plan

In May 2000, our stockholders approved the 1999 Stock Option and Incentive Plan which authorizes a committee of the Board of Directors to grant various types of incentive awards (including incentive stock

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options, non-qualified options, stock appreciation rights, restricted shares, and performance units on shares) to our directors, officers, and employees for issuance of up to 5.0 million shares of Common Stock in the aggregate. As of December 31, 2005, we had 1.4 million outstanding options.

Changes in options outstanding are as follows:

	Weighted Average Exercise Price	Number of Shares (in thousands of shares)
December 31, 2002	$ 6.19	1,983
Granted	8.11	309
Exercised	5.39	(82)
Terminated and expired	7.60	(207)
December 31, 2003	6.38	2,004
Granted	13.30	338
Exercised	6.62	(743)
Terminated and expired	7.72	(62)
December 31, 2004	7.75	1,537
Granted	22.33	143
Exercised	6.69	(233)
Terminated and expired	8.11	(20)
December 31, 2005	$ 7.15	1,427

The following table summarizes information about outstanding and exercisable options at December 31, 2005:

	Outstanding			Exercisable	
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price

		(in thousands of shares)			(in thousands of shares)	
$ 3.92	$ 5.75	569	5.45 years	$ 4.61	422	$ 4.71
$ 8.11	$ 8.75	346	6.33 years	$ 8.14	203	$ 8.16
$10.50	$13.54	369	7.12 years	$12.84	118	$12.01
$22.33		143	9.14 years	$22.33		$22.33
		1,427			743	

Certain stock options issued in 2000 and granted to our executive officers have exercise prices that were less than the fair value of our common stock on the date of grant. The difference of $269,000 was recorded as deferred compensation and was being recognized over the vesting period. These options fully vested by December 31, 2003. We recognized compensation expense of $54,000 during year ended December 31, 2003. In addition, during 2003, the vesting term of certain stock options were accelerated. As a result, we recognized compensation expense of $198,000 in 2003 and $246,000 in 2004.

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(b) Restricted Stock Units

Upon approval of the Plan by the stockholders in May 2000, two of our senior executives were granted approximately 158,000 restricted stock units. The units vested over a four-year period. Upon vesting, the executives had the right to receive Common Stock in exchange for such units. We accounted for this plan as a compensatory fixed plan under APB Opinion No. 25, which resulted in a compensation charge of approximately $1.3 million of which $264,000 was recognized during 2003. In January 2004, all restricted stock units were vested and these restricted stock units were exchanged for our Common Stock and transferred to the Duratek Deferred Compensation Plan (see note 17).

(c) Stockholder Rights

On December 16, 2003, our Board of Directors approved a stockholder rights plan. Under this plan, each share of our Common Stock and each share of our Cumulative Convertible Redeemable Preferred Stock is accompanied by a right that entitles the holder of that share, upon the occurrence of specified events that may be intended to affect a change in control, to purchase one one-thousandth of a share of Series B Junior Participating Preferred Stock at an exercise price of $58.00. In the event the rights become exercisable, the rights plan allows for our stockholders to acquire our stock or the stock of the surviving corporation, whether or not we are the surviving corporation, at a value that is twice that of the exercise price of the rights. On February 6, 2006, our Board of Directors approved an amendment to the Stockholder Rights Plan that exempted the proposed Energy*Solutions* merger as a transaction that would trigger the exercise of the rights accompanying the common stock.

(15) Income Taxes

Income taxes for the years ended December 31 2003, 2004, and 2005 consist of the following:

	2003	2004	2005
	(in thousands of dollars)		
Current:			
State	$ 933	$ 984	$ 953
Federal	6,293	12,197	9,937
	7,226	13,181	10,890
Deferred:			
State	1,019	69	269
Federal	3,426	(152)	(508)
	4,445	(83)	(239)
	$ 11,671	$ 13,098	$ 10,651

Income taxes are reconciled to the amount computed by applying the statutory Federal income tax rate of 35% to income before income taxes, equity in income of joint ventures, and cumulative effect of a change in accounting principle as follows:

	2003	2004	2005
	(in thousands of dollars)		
Federal income taxes at statutory rate	$ 9,842	$ 11,907	$ 10,111
State income taxes, net of federal tax benefit	1,269	685	794
Other	560	506	(254)
	$ 11,671	$ 13,098	$ 10,651

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2004 and 2005 are presented below:

	2004	2005
	(in thousands of dollars)	
Deferred tax assets:		
Accounts receivable principally due to allowance for doubtful accounts	$ 61	$ 7
Decontamination and decommissioning liabilities	6,611	6,513
Net operating loss carryforwards	944	538
Accrued compensation	1,469	1,844
Other	943	427
	10,028	9,329
Less valuation allowance	503	578
Net deferred tax assets	9,525	8,751
Deferred tax liabilities:		
Prepaid expenses	(1,363)	(1,376)
Plant, equipment and intangibles principally due to differences in depreciation and amortization	(12,733)	(11,871)
Net deferred tax liabilities	$ (4,571)	$ (4,496)

In 2004, deferred tax liabilities were increased by $1.3 million to correct the recording of certain deferred tax liabilities related to prior year acquisitions.

At December 31, 2005, we had state net operating loss carry forwards, net of valuation allowances, of $33,000 that expire at various dates up to 2022.

In assessing the realizability of deferred tax assets, we considered whether it was more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during periods in which temporary differences become deductible. We considered income taxes paid during the previous two years, projected future taxable income, the types of temporary differences, and the timing of the reversal of such differences in making this assessment. During 2003, we increased our valuation allowance by $178,000, primarily for certain capital loss carry forwards that may not be realized. During 2004, we decreased our valuation allowance by $147,000. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the temporary differences are deductible, we have deemed a valuation allowance of $503,000 at December 31, 2004 and $578,000 as necessary at December 31, 2005. The net change in the valuation allowance for the year ended December 31, 2005 was an increase of $75,000.

We paid income taxes of $3.5 million in 2003, $16.2 million in 2004, and $5.9 million in 2005. The amount paid in for 2004 includes $4.6 million relating to 2003.

(16) Profit Investment Plan

We maintain a Profit Investment Plan for employees. The Profit Investment Plan permits pre-tax contributions to the Profit Investment Plan by participants pursuant to Section 401(k) of the Internal Revenue Code of 1% to 60% of base compensation. We match 25% of a participant s eligible contributions based on a

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formula set forth in the Profit Investment Plan and may make additional matching contributions up to 25% of a participant s eligible contributions. Our contributions vest at a rate of 20% per year of service. Our matching contributions, which include the 25% of a participant s eligible contributions for the current fiscal year plus the approved additional matching contribution from the prior fiscal year, were $1.4 million for the year ended December 31, 2003, $1.4 million for the year ended December 31, 2004, and $1.5 million for the year ended December 31, 2005.

(17) Deferred Compensation Plan

In 2003, we established the Duratek, Inc. Deferred Compensation Plan (the Plan) to allow certain eligible key employees to defer a portion of their compensation. The participant s contributions earn income based on the performance of the investment funds they select. As of December 31, 2004, we had deferred compensation of $861,000. As of December 31, 2005, we had deferred compensation of $1.2 million. We were invested in three life insurance products in 2004 and four insurance products in 2005 that are designed to approximate the performance of the investment funds that the participants select. These investments, which are recorded at their fair market value, are included in other assets in our consolidated balance sheets. As of December 31, 2004, the insurance products had a cash surrender value of $793,000. As of December 31, 2005, the insurance products had a cash surrender value of $1.2 million.

In December 2003, the vested portion of the restricted stock units issued to two of our senior executives were contributed to the Plan and in January 2004, the remaining portion of restricted stock units vested and were contributed to the Plan (see note 14). These restricted stock units are being held in trust, and in January 2004, all of the restricted stock units were exchanged for our common stock. Our shares have been contributed to the rabbi trust and the corresponding liability related to the deferred compensation plan is presented as a component of stockholders equity as deferred compensation employee stock trust in the amount of $1.3 million.

(18) Related Party Transactions

Two of our executive officers held loans in the amount of $431,000 at December 31, 2003. During 2004, the outstanding balance was repaid.

Joint Venture Financing

On June 29, 2005, we entered into an agreement with UDS, LLC, one of our joint ventures, to loan up to $1.6 million to UDS, LLC for working capital requirements. The loan is subject to interest at the higher of 5% or the prime rate plus 1.0%. Interest is payable monthly, and the entire loan balance must be repaid within one year from the date of the loan. As of December 31, 2005, there were outstanding borrowings to UDS, LLC of $0.6 million. We own 26% of UDS, LLC and share proportionally in its profits and losses. The other partners and their proportionate share include Framatome AMP (48%) and Burns & Roe Enterprises (26%).

(19) Segment Reporting and Business Concentrations

We have three primary segments: (i) Federal Services (FS), (ii) Commercial Services (CS), and (iii) Commercial Processing and Disposal (CPD). We realigned our reporting segments for the following:

In 2003, we realigned our reporting segments to include the results of our Memphis operations in the CS segment from the CPD segment. The related revenues were $3.6 million in 2003.

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In 2004, we realigned the following:

- certain projects from our CS segment to our CPD segment. The related revenues were $1.6 million in 2003 and $1.6 million in 2004.

- the transportation services provided for customers of the CPD segment in the CS segment from the CPD segment. The related revenues were $4.4 million in 2003 and $2.5 million in 2004.

- the subcontract services provided by our CS segment to our FS segments in the CS segment from the FS segment. The related revenues were $615,000 in 2003 and $614,000 in 2004.

In 2005, we realigned certain projects from our CPD segment to our CS segment. The related revenues were $1.2 million in 2004 and $486,000 in 2005.

The consolidated statement of operations for the years 2003, 2004 and 2005 do not change.

We evaluate the segments operating results to measure performance. The following is a brief description of each of the segments:

(a) FS Segment

Our FS segment is focused on providing the following services to support major programs in the DOE:

- on-site waste disposition services;

- site closure services;

- nuclear facility operations and commissioning services;

- engineering design and technology research; and

- safety, health, and quality assurance services.

(b) CS Segment

Our CS segment provides a broad range of technologies and services to nuclear power plants, government and industrial facilities, universities, and research/pharmaceutical laboratories in the following areas:

- on-site liquid and solid waste processing;
- transportation logistics;
- transportation services;
- license stewardship;
- decontamination and decommissioning;
- project services; and
- radiological engineering services.

We also provide technical support services to our commercial clients including project management, engineering, radiation protection support, and environmental consulting.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

(c) CPD Segment

Our CPD segment operates two facilities in Tennessee and two facilities in South Carolina. At the Tennessee facilities, we use multiple technologies to volume reduce and package customer waste for final disposition such as:

incineration;

compaction;

metal melting and decontamination; and

treatment under our bulk waste assay program (GARDIAN).

At the South Carolina facilities, we perform the following services:

operate a low-level radioactive waste disposal facility in Barnwell, South Carolina on behalf of the State of South Carolina;

process and package materials for disposal; and

specialty waste processing for nuclear power plants.

	As of and for the Year Ended December 31, 2003				
				Unallocated	
	FS	CS	CPD	Items	Consolidated
	(in thousands of dollars)				
Revenues from external customers(1)	$ 125,224	$ 78,349	$ 82,328	$	$ 285,901
Income from operations	11,847	14,752	8,347		34,946
Interest expense				(6,903)	(6,903)
Other income, net				76	76
Income taxes				11,671	11,671
Equity in income of joint ventures	250			(48)	202
Cumulative effect of a change in accounting principle, net of tax				(2,414)	(2,414)
Net income	12,097	14,752	8,347	(20,960)	14,236
Depreciation and amortization expense	1,093	2,400	6,754	5,032	15,279
Goodwill	32,244	30,411	8,142		70,797

Other long-lived assets(2)	1,352	24,249	47,300	1,233	74,134
Capital expenditures for additions to property, plant and equipment	180	2,565	1,823	271	4,839
Total assets	70,678	68,446	99,883	44,137	283,144

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

	As of and for the Year Ended December 31, 2004				
				Unallocated	
	FS	CS	CPD	Items	Consolidated
	(in thousands of dollars)				
Revenues from external customers(1)	$ 115,565	$ 84,942	$ 85,706	$	$ 286,213
Income from operations	16,411	14,351	9,830		40,592
Interest expense				(6,970)	(6,970)
Other income, net				398	398
Income taxes				13,098	13,098
Equity in income of joint ventures	204			(80)	124
Net income	16,615	14,351	9,830	(19,750)	21,046
Depreciation and amortization expense	443	2,440	6,540	1,216	10,639
Goodwill	32,671	31,316	8,142		72,129
Other long-lived assets(2)	1,240	23,372	43,673	1,613	69,898
Capital expenditures for additions to property, plant and equipment	186	2,669	2,129	1,258	6,242
Total assets	70,736	69,740	92,735	35,326	268,537

	As of and for the Year Ended December 31, 2005				
				Unallocated	
	FS	CS	CPD	Items	Consolidated
	(in thousands of dollars)				
Revenues from external customers(1)	$ 115,607	$ 79,557	$ 86,048	$	$ 281,212
Income from operations	14,583	9,992	10,822		35,397
Interest expense				(6,539)	(6,539)
Other income, net				31	31
Income taxes				10,651	10,651
Equity in income of joint ventures	245			(60)	185
Net income	14,828	9,992	10,822	(17,219)	18,423
Depreciation and amortization expense	619	2,272	5,793	1,163	9,847
Goodwill	32,671	31,316	8,142		72,129
Other long-lived assets(2)	1,053	22,730	38,203	2,524	64,510
Capital expenditures for additions to property, plant and equipment	589	1,596	2,015	520	4,720
Total assets	73,257	70,614	92,085	27,958	263,914

(1) Intercompany revenues have been eliminated and are not material for the years ended December 31, 2003, 2004 and 2005. Revenues by segment represent revenues earned based on third party billing to customers.

(2) Other long-lived assets include property, plant and equipment and other intangible assets.

(d) Business Concentrations

Our revenues are derived primarily from contracts with utility companies and from subcontracts with a number of DOE prime contractors. Our revenues are derived almost equally from government and commercial customers. Revenues from DOE contractors and subcontractors represented approximately 45% of consolidated revenues in 2003, 43% in 2004, and 47% in 2005. The Federal Services work that we performed for customers that represent greater than 10% of our consolidated revenues were with prime contractors Bechtel Corporation and Fluor Corporation. No commercial customer represented more than 10% of consolidated revenues for the years ended December 31, 2003, 2004, and 2005.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts relating to DOE contractors and subcontractors amounted to and $12.7 million and $18.8 million, respectively, at December 31, 2004, and $12.8 million and $28.4 million respectively, at December 31, 2005.

The CPD segment is primarily reliant upon a single provider for its burial services for both customer and secondary waste disposal. We have an agreement in place at set rates through December 31, 2007.

(20) Commitments and Contingencies

(a) Leases

We have several noncancellable leases that cover real property and machinery and equipment. Such leases expire at various dates with, in some cases, options to extend their terms. Several of the leases contain provisions for rent escalation based primarily on increases in real estate taxes and operating costs incurred by the lessor. Rent expense on noncancellable leases was $3.5 million for the year ended December 31, 2003, $3.9 million for the year ended December 31, 2004, and $3.4 million for the year ended December 31, 2005.

We are obligated under capital leases covering computer equipment and certain machinery and equipment that expire at various dates during the next four years. At December 31, 2004 and 2005, the gross amount of plant and equipment and related accumulated amortization recorded under capital leases were as follows:

	2004	2005
	(in thousands of dollars)	
Computer equipment	$ 530	$ 1,742
Machinery and equipment	1,197	1,270
Trucks and vehicles	829	829
	2,556	3,841
Less accumulated amortization	1,971	2,570
	$ 585	$ 1,271

Amortization of assets held under capital leases is included with depreciation and amortization expense.

The following is a schedule of future minimum annual lease payments for all operating and capital leases with initial or remaining lease terms greater than one year at December 31, 2005:

Years ending December 31,	Operating	Capital
	(in thousands of dollars)	
2006	$ 2,960	$ 621
2007	2,242	520
2008	1,859	194
2009	1,541	

2010 and beyond	8,637	
Future minimum lease payments	$ 17,239	1,335
Less portion representing interest		106
Less current portion of capital lease obligations		554
Long-term portion of capital lease obligations		$ 675

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

The short-term portion of the capital lease obligations is included in accrued expenses and other current liabilities. The long-term portion of the capital lease obligations is included in other noncurrent liabilities in our consolidated balance sheets.

(b) Financial Assurance Instruments

We are required to post, from time to time, standby letters of credit and surety bonds to meet certain customer contract requirements. We do not directly post financial assurance instruments or other guarantees for our subcontractors. As of December 31, 2005, we had outstanding assurance instruments of $16.8 million, including $8.2 million in letters of credit and $8.7 million in surety bonds, which expire at various contract completion dates. We have entered into certain indemnification agreements with the providers of the surety bonds, which would require funding only if we failed to perform under the contracts being insured and the surety bond issuer was obligated to make payment to the insured parties. The letters of credit are issued under our bank credit facility up to $15.0 million as a sub-limit to the $30.0 million revolving line of credit. In addition, the credit facility provides for the ability to obtain supplemental letters of credit, as defined in the credit facility. As of December 31, 2005, we had no outstanding supplemental letters of credit. Effective July 22, 2005, the credit facility was amended to increase the supplemental letters of credit from $10.0 million to $20.0 million. The credit facility limits the total amount of outstanding supplemental letters of credits and surety bonds to $35.0 million. Therefore, we are able to issue up to $50.0 million in financial assurance instruments under our credit facility.

(c) Legal Proceedings

In February of 2003, we filed multiple claims, including misappropriation of trade secrets, unfair trade practices, and patent infringement against AVANTech, Inc. in the Federal Court of South Carolina. AVANTech, Inc. then filed numerous counterclaims against us. All counterclaims brought against us by AVANTech, Inc. were dismissed by summary judgment. In October 2005, a South Carolina jury found against us on all of our claims. AVANTech, Inc has stated that they would petition the court for an award of attorneys fees in an amount that has not been determined. To date, no petition for attorneys fees has been made; however, we cannot provide any assurance that a claim for a material amount of attorneys fees will not be asserted. We intend to appeal this decision.

In December 2003, we received a Request for Equitable Adjustment (REA) from a subcontractor, Performance Abatement Services, Inc. (PAS), that seeks a price adjustment of approximately $6.7 million to an ongoing, fixed-price subcontract between PAS and Duratek Federal Services, Inc. for asbestos-abatement services. The subcontract at issue arises under a fixed-price contract that we are performing for Bechtel Jacobs Company, LLC (Bechtel Jacobs). PAS has claimed amounts based on an extrapolation of their total anticipated cost through completion of this project over a substantially extended performance period, not just based on costs incurred to date. It assumes ongoing project inefficiencies resulting from nine alleged causes.

We received REAs totaling $300,000 for two of the nine sub-claims during 2004 and some of the other claims have been settled or dropped. In 2005, there were no REAs received relating to the sub-claims. We are still evaluating the remaining REAs. PAS continues to pursue REAs totaling $2.9 million, most of which we believe are unsupported. We are negotiating with both Bechtel Jacobs and PAS to resolve the outstanding REAs. We believe that we have valid defenses to most if not all of the claims, however, it is possible that some payment to PAS that is not passed on to Bechtel Jacobs may be required to resolve these claims.

On September 21, 2004, Washington State Department of Ecology (Ecology) issued a Notice of Penalty Incurred and Due No. 1672 with a fine of $270,000 jointly and severally assessed against the U.S. Department of

DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Energy Richland Operations, the U.S. Department of Energy Office of River Protection, Fluor Hanford Incorporated, and Duratek Federal Services of Hanford, Inc. Ecology issued the Notice of Penalty listing four types of violations: Facility Reporting, Personnel Training, Facility Record Keeping, and General Waste Analysis. The four issues are positions that Ecology has taken relating to how certain drums of material sent off site for treatability studies were handled. All the named parties disagree with the finding and are working as a joint defense team. The DOE is leading the appeal effort, and the named parties filed an appeal with Ecology in Hanford, Washington on October 20, 2004. The Department of Justice has joined the appeal in support of the DOE, Fluor Hanford, and Duratek. Discovery has been completed and summary judgment motions were filed during the first week of February 2006.

In addition, from time to time, we are a party to litigation or administrative proceedings relating to claims arising from our operations in the normal course of our business. Our management believes that the ultimate resolution of matters in litigation, administrative proceedings, or other matters, including those described above, currently pending against us is unlikely, either individually or in the aggregate, to have a material adverse effect on our results of operations or financial condition.

(21) Subsequent Events

On February 6, 2006, we entered into an Agreement and Plan of Merger (the Merger Agreement) with Energy*Solutions*, LLC (formerly known as Envirocare of Utah, LLC), a Utah limited liability company (Energy*Solutions*), and Dragon Merger Corporation, a Delaware corporation and a wholly owned subsidiary of Energy*Solutions*. Pursuant to the terms of the Merger Agreement, Energy*Solutions* will acquire all of our outstanding shares of Common Stock for an aggregate consideration of approximately $327.0 million in cash. Upon the effectiveness of this merger, each issued and outstanding share of our Common Stock will be converted into the right to receive $22.00 in cash, without interest, and each outstanding stock option, whether or not vested, will convert into the right to receive the excess, if any, of the $22.00 per share merger consideration over the per share exercise price of the option, less any tax withholding.

In addition, we have agreed, among other things and subject to certain exceptions as described in the Merger Agreement, (i) to conduct our business in the ordinary course consistent with past practice during the interim period between the execution of the Merger Agreement and consummation of this merger, (ii) not to engage in certain transactions during such period, (iii) to cause a stockholder meeting to be held to consider approval of this merger and the other transactions contemplated by the Merger Agreement, (iv) subject to certain limited exceptions to permit the board of directors to comply with their fiduciary duties, for our board of directors to recommend that the stockholders adopt the Merger Agreement and thereby approve this merger, and (v) subject to certain limited exceptions to permit the board of directors to comply with their fiduciary duties, not to solicit proposals relating to alternative business combination transactions, or to enter into discussions concerning, or to provide information in connection with, alternative business combination transactions.

Consummation of the merger is subject to a number of conditions, including stockholder approval, absence of any law or order prohibiting the consummation of this merger, expiration, or termination of the applicable Hart-Scott-Rodino Antitrust Improvements Act waiting period, and certain other customary conditions.

We expect to submit the Merger Agreement and the merger described above to stockholders for their consideration during the second quarter of 2006 and to close this merger promptly following receipt of stockholder and regulatory approval.

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DURATEK, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 2003, 2004 and 2005

Pursuant to the terms of the Merger Agreement, Energy*Solutions* and Duratek each have certain termination rights. Upon termination of the Merger Agreement under specified circumstances, we may be required to pay Energy*Solutions* a termination fee of approximately $8.6 million. In addition, if this merger cannot be closed or is delayed for longer than twelve months due to certain regulatory or legal restrictions, Energy*Solutions* has agreed to pay to us a reverse break-up fee of $5.0 million in cash and to provide a prepayment credit of $12.0 million to one of our subsidiaries for waste disposal services performed by Energy*Solutions* under an existing commercial contract between the parties.

(22) Quarterly Financial Data (Unaudited)

	Year Ended December 31, 2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(in thousands of dollars, except per share amounts)				
Revenues	$ 64,182	$ 73,555	$ 77,403	$ 71,073	$ 286,213
Gross profit	15,932	17,707	24,842	16,417	74,898
Income from operations	7,285	10,315	16,836	6,156	40,592
Net income	3,085	5,638	9,318	3,005	21,046
Net income attributable to common stockholders	3,073	5,598	9,310	3,002	20,983
Income per common share:					
Basic	$ 0.22	$ 0.40	$ 0.65	$ 0.21	$ 1.48
Diluted	$ 0.21	$ 0.38	$ 0.63	$ 0.20	$ 1.42

	Year Ended December 31, 2005				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(in thousands of dollars, except per share amounts)				
Revenues	$ 70,612	$ 74,958	$ 67,113	$ 68,529	$ 281,212
Gross profit	17,732	18,102	14,407	19,672	69,913
Income from operations	9,319	10,218	6,002	9,858	35,397
Net income	4,860	5,294	2,820	5,449	18,423
Income per common share:					
Basic	$ 0.33	$ 0.36	$ 0.19	$ 0.37	$ 1.25
Diluted	$ 0.32	$ 0.35	$ 0.18	$ 0.36	$ 1.21

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Independent Auditor s Report

The Board of Directors and Shareholder of Reactor Sites Management Company Limited

We have audited the accompanying combined balance sheets of Reactor Sites Management Company Limited (the Company) as of March 31, 2006 and 2007, and the related combined income statements, statements of changes in parent company equity, and cash flows for each of the two years in the period ended March 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Reactor Sites Management Company Limited at March 31, 2006 and 2007, and the combined results of its operations and its cash flows for each of the two years in the period ended March 31, 2007, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

London, England

September 5, 2007

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Reactor Sites Management Company Limited

Combined Balance Sheets

March 31, 2006 and 2007

	Note	2006	2007
		(in millions of pounds sterling)	
Assets			
Current assets:			
Cash and cash equivalents		1	
Restricted cash	*5*	2	2
Contract earnings receivable from the NDA	*8*	207	244
Due from affiliated company			6
Total current assets		210	252
Other receivables	*2*	6	99
Total Assets		216	351
Liabilities and parent company equity			
Current liabilities			
Accounts payable		75	74
Due to affiliated company		33	23
Accrued expenses	*6*	64	103
Deferred tax liabilities	*4*		2
Other liabilities	*6*	38	46
Total current liabilities		210	248
Liability for pension benefits	*2*	6	98
Total liabilities		216	346
Parent company equity			
Retained earnings			5
Total liabilities and parent company equity		216	351

See accompanying notes to combined financial statements.

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Reactor Sites Management Company Limited

Combined Income Statements

Years Ended March 31, 2006 and 2007

	Note	**2006**	**2007**
		(in millions of pounds sterling)	
Revenues		577	668
Cost of revenues		(548)	(633)
Gross profit		29	35
Selling, general and administrative expenses		(1)	(1)
Restructuring of pension arrangements	*3*		(8)
Income before income taxes		28	26
Income tax expense	*4*	(8)	(7)
Net income		20	19

See accompanying notes to combined financial statements.

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Reactor Sites Management Company Limited

Combined Statements of Changes in Parent Company Equity

Years Ended March 31, 2006 and 2007

	Parent Company Equity and Retained Earnings	Accumulated other comprehensive income (in millions of pounds sterling)	Total Parent Company Equity
Balances at April 1, 2005			
Net income	20		20
Distribution	(20)		(20)
Actuarial net gain		62	62
Tax on actuarial net gain		(18)	(18)
Pension liability borne by the NDA, net of tax of £18 million		(44)	(44)
Balances at March 31, 2006			
Net income	19		19
Distribution	(14)		(14)
Actuarial net loss		(114)	(114)
Tax on actuarial net loss		34	34
Pension liability borne by the NDA, net of tax of £34 million		80	80
Balances at March 31, 2007	5		5

See accompanying notes to combined financial statements.

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Reactor Sites Management Company Limited

Combined Statements of Cash flows

Years Ended March 31, 2006 and 2007

	2006	2007
	(in millions of pounds sterling)	
Cash flows from operating activities:		
Net income	20	19
Adjustments to reconcile net income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Increase in contract earnings receivable from the NDA	(51)	(37)
Increase in other receivables	58	15
(Decrease) increase in trade amounts payable	58	(1)
Increase (decrease) in other liabilities	(9)	48
Net change in pension plan liability	(58)	(22)
Increase in deferred tax liabilities		2
Net cash operating activities	18	24
Cash flows from financing activities:		
Distribution	(18)	(25)
Net cash used in financing activities	(18)	(25)
Net decrease in cash and cash equivalents		(1)
Cash and cash equivalents at beginning of year	1	1
Cash and cash equivalents at end of year	1	

See accompanying notes to combined financial statements.

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements

Years Ended March 31, 2006 and 2007

(1) Summary of Significant Accounting Policies

(a) Description of Business and Basis of Preparation

The accompanying combined financial statements prepared on a carve-out basis reflect the operations of the Reactor Sites business of the British Nuclear Fuels Plc group (BNFL) that operates four reactors at two generating nuclear power sites and manages the decommissioning of 18 reactors at eight dormant sites in the UK under a contract with, and on behalf of, their owner, the Nuclear Decommissioning Authority, a UK government body (NDA). The combined financial statements comprise the operations of Reactors Sites Management Company Limited (RSMC or we), its subsidiary, Magnox Electric Limited (Magnox), and Magnox s subsidiary, Energy Sales and Trading Limited (ESTL) (collectively, the Company or the Group). They exclude the trade, assets and liabilities of the power stations which continue to be owned by the NDA.

On June 26, 2007, BNFL, a company 100% owned by the UK government, completed the sale of the entire issued share capital of RSMC, a wholly owned subsidiary of BNFL, to the group of companies headed by Energy*Solutions*, LLC, a US based company.

Magnox, through its ESTL subsidiary, provided advisory and administration services to the NDA in respect of the trading of electricity generated by the power stations which it manages but transferred all of this business to British Energy plc with effect from March 31, 2007. The results of this operation included herein are, however, not material to these combined financial statements.

These combined financial statements reflect the management agreement between Magnox and the NDA, as described above, prepared under the carve-out basis of presentation and in accordance with US GAAP, for the fiscal years ended March 31, 2006 and 2007. However, the combined financial statements included herein may not necessarily be indicative of the continuing financial position, results of operations or cash flows had the business operated as a separate entity during the periods presented or for future periods.

These combined financial statements include allocations for various expenses, including corporate administrative expenses historically recorded by BNFL and not recorded in the accounts of the continuing Magnox business. These include, amongst other things, corporate overheads and the costs of certain compensation arrangements. The corporate overheads have been allocated based on the actual amounts incurred by BNFL and directly attributable to the continuing Magnox business. The costs of compensation arrangements, principally relating to employee bonuses, have been allocated based on the actual amounts incurred by BNFL, as these amounts relating to the business are separately identifiable. No interest expense or cash has been allocated to the business as there was no corresponding debt used to finance its operations. Management considers that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the costs had the continuing business operated as a standalone business during the periods presented. A management charge of £35 million (2006: £29 million) was paid by Magnox to BNFL. After offsetting the allocation of costs from the prior parent company, the balance of £14 million (2006: £20 million) has been recorded as a distribution payable to BNFL in these combined financial statements.

The parent company equity balance in these combined financial statements constitutes BNFL s investment in the continuing business and represents the excess of total assets over total liabilities of that business. The parent company equity balance includes the effects of the various allocations described above and the business cumulative net income, including income recognized directly in equity.

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

(b) Cash and Cash Equivalents

We consider all cash on deposit, money market accounts, and highly liquid debt instruments purchased with original maturities of three months or less to be cash and cash equivalents. We maintain cash and cash equivalents in bank deposit and other investment accounts. We have not experienced any losses in such accounts and believe we are not exposed to any significant credit risk on cash or cash equivalents.

(c) Revenue Recognition

We record revenues when all of the following conditions exist: (i) evidence of an agreement with our customer; (ii) work has actually been performed; (iii) the amount of revenues can be reasonably estimated and (iv) collection from our customer is reasonably assured.

Our services are provided under cost-reimbursable award and/or incentive-fee contracts. All revenue is earned from the contract in place with the NDA. We are reimbursed for allowable costs in accordance with contractual provisions. If our costs exceed the contract ceiling or are not allowable under the provisions of the contract, we may not be able to obtain reimbursement for such costs. We earn performance based incentive fees and efficiency saving fees in addition to cost reimbursements if we meet certain contract provisions, including schedule, budget, and safety milestones. Monthly assessments are made to measure the amount of revenues earned in accordance with established contract provisions. Performance based incentive fees and efficiency saving fees are accrued when estimable and collection is reasonably assured.

Accounting for revenues earned under the NDA contract may require assessments that include an estimate of the amount that has been earned on the contract and are usually based on the volumes that have been processed or disposed, milestones reached or the time that has elapsed under the contract. Each element of the contract is unique with regard to scope, schedule and delivery methodology. Accordingly, each element is reviewed to determine the most reliable measure of completion for revenue recognition purposes. Input measures such as costs incurred to total contract costs are used only when there are no quantifiable output measures available and represent a reasonable basis for determining the relative status of the project given that, in many cases, costs are the basis for determining the overall contract value and timing.

Revisions to revenues, costs and profit estimates or measurements of the extent of progress toward completion are changes in accounting estimates accounted for in the period of change (cumulative catch-up method). Contract earnings receivable from the NDA represent amounts recognized as revenues that have not been received from the NDA.

(d) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and generally do not bear interest. The carrying amount of accounts receivable represents estimated net realizable value. Allowances for doubtful accounts reflect management s best estimate of the amounts that will not be collected based on historical collection trends, type of customer, the age of outstanding receivables and existing economic conditions. We have not recorded an allowance for doubtful accounts as of March 31, 2006 and 2007.

(e) Income Taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying

Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We establish a valuation allowance if we determine that it is more likely than not that a deferred tax asset will not be realized.

(f) Pensions and Other Post-retirement Plans

We provide pension schemes for the benefit of the majority of our employees. The schemes are funded by contributions partly from the employees and partly from the Company.

We participate in a multi-employer scheme (the Combined Pension Scheme, CPS) which is accounted for as a defined contribution scheme. Pension charges in relation to the defined contribution scheme are charged to the combined income statement during the year.

We also participate in a defined benefit scheme for our employees (the Electricity Supply Pension Scheme, ESPS) for which payments are made to a separately administered fund. We have adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans.* SFAS No. 158 requires us to recognise the funded status of defined benefit pension and other postretirement plans as a net asset or liability and to recognise changes in that funded status in the year in which the changes occur through other comprehensive income to the extent those changes are not included in the net periodic cost. The funded status reported on the balance sheet as of March 31, 2006 and 2007 under SFAS No. 158 for the ESPS was measured as the difference between the fair value of plan assets and the benefit obligation on a plan-by-plan basis.

We believe that the assumptions utilized in recording our obligations under the plan are reasonable based on our experience and market conditions. The net periodic costs are recognised as employees render the services necessary to earn the postretirement benefits.

(g) Use of Estimates

The preparation of the combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and revenues and expenses recognized during the reporting period. Significant estimates and judgments made by management include: (i) proportion of completion on an element of our contract with the NDA, (ii) provision for a valuation allowance on deferred tax assets, (iii) provision for restructuring and (iv) contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ significantly from those estimates.

(h) Leases

We have several non-cancellable leases that cover machinery and equipment and motor vehicles. Such leases expire at various dates with, in some cases, options to extend their terms. We did not have any capital leases during March 31, 2006 and 2007. Minimum rent payments under operating leases are recognised on a straight line basis over the term of the leases.

Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

(i) Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

(j) New Accounting Pronouncements

Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2008 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not expect the provisions of this interpretation to have a material impact on our financial condition or results of operations.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have not yet completed our analysis of the impact that the implementation of SFAS No. 157 will have on our results of operations or financial condition, but we do not expect the provisions of this statement to have a material impact on our financial condition or results of operations.

The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides entities with the one-time option to measure financial instruments and certain other items at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have not yet completed our analysis of the impact that the implementation of SFAS No. 159 will have on our results of operations or financial condition, but we do not expect the provisions of this statement to have a material impact on our financial condition or results of operations.

(2) Pension and Other Post-Retirement Benefits

We provide pension schemes for the benefit of the majority of our employees. The schemes are funded by contributions partly from the employees and partly from the Company.

The Combined Pension Scheme (CPS)

We participate in the Combined Pension Scheme which is a multi-employer scheme that provides defined benefits to its members and is accounted for as a defined contribution scheme, contributions are paid to and benefits are paid by Her Majesty s Government via the Consolidated Fund.

In common with other unfunded public sector schemes the CPS does not have the attributes of typical private sector pension schemes. Any surplus of contributions made in excess of benefits paid out in any year is

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

surrendered to the Consolidated Fund and any liabilities are met from the Consolidated Fund via the annual Parliamentary vote. Her Majesty s Government does not maintain a separate fund.

We have a continuing obligation to the CPS to pay contribution rates for active members specified by the actuary in the periodic valuation reports. The pension expense, representing our contributions, included in the income statement for 2007 was £2 million *(2006: £nil)* of which £0.2 million *(2006: £nil)* was outstanding as at 31 March 2007.

The Electricity Supply Pension Scheme (ESPS)

We operate a defined benefit pension scheme, the Electricity Supply Pension Scheme. Actuarial gains and losses are generally amortized subject to the corridor, over the average remaining service life of our active employees. As unrecognised gains and losses fall within the corridor at all reporting dates, no amounts have been amortised.

The following table sets forth a reconciliation of the plan s beginning and ending balances of the benefit obligation:

	2006	2007
	(in millions of pounds sterling)	
Benefit obligation at end of prior year	1,483	1,662
Company service cost	21	26
Interest cost	79	81
Plan participants contributions	8	7
Termination benefits	14	16
Acquisitions/ divestments/ combinations		(23)
Benefits paid	(77)	(81)
Actuarial (gain)/ loss	134	55
Benefit obligation at end of year	1,662	1,743

The termination costs relate to early retirement benefits provided to employees who have left service involuntarily before normal retirement age and have been granted an unreduced early retirement pension. These are contractual termination benefits required under the Scheme rules.

The following table sets forth a reconciliation of the plan s beginning and ending balances of the fair value of plan assets:

	2006	2007
	(in millions of pounds sterling)	
Fair value of plan assets at end of prior year	1,357	1,656
Actual return on plan assets	287	41
Actual employer contributions	81	48
Actual participants contributions	8	7
Actual benefits paid	(77)	(81)
Acquisitions/ divestments/ combinations		(26)

Fair value of plan assets at end of year	1,656	1,645

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

The following table sets forth the plan s benefit obligations, fair value of plan assets, and funded status at March 31, 2006 and 2007.

	2006	2007
	(in millions of pounds sterling)	
Benefit obligation at March 31	(1,662)	(1,743)
Fair value of plan assets at March 31	1,656	1,645
Funded status at end of year	(6)	(98)
Amounts recognised in the balance sheet consist of:		
Non current liabilities	6	98

Amounts recognized in accumulated other comprehensive income consists of:

	2006	2007
	(in millions of pounds sterling)	
Actuarial net (loss) gain	62	(53)

The accumulated benefit obligation for the pension plan was £1,502 million and £1,433 million at March 31, 2006 and 2007, respectively. Net periodic benefit costs recognized in 2007 and 2006 was:

	2006	2007
	(in millions of pounds sterling)	
Service cost	21	26
Interest cost	79	81
Expected return on assets	(92)	(100)
Loss due to settlements, curtailments and terminations	14	16
	22	23

As part of the arrangements for the reorganization of the nuclear industry by the UK Government, the NDA agreed to assume the responsibility for any deficit (and obtains the benefit of any surplus) arising from the participation of Magnox employees in the Electricity Supply Pension Scheme. In order to reflect this arrangement, these financial statements include an amount recoverable from the NDA (included within other receivables) equal in amount to the recorded ESPS liability, net of tax, with a corresponding credit in either the income statement or other comprehensive income, offsetting a portion of the after tax pension charges.

Weighted average assumptions used to determine benefit obligations at March 31, 2006 and 2007 were as follows:

	2006	2007
Discount rate	4.90%	5.40%
Expected rates of return on long term assets	6.10%	6.10%
Rate of compensation increase	4.00%	4.20%
Pension increases	3.00%	3.20%
Deferred benefit increases	3.00%	3.20%
Inflation rate	3.00%	3.20%

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

Our overall expected long-term rate of return on assets is 6.10%. The overall expected long-term rate of return is based on our view of the expected long term rates of return of each major asset category taking into account the proportions of assets held in each category at the relevant reporting date. The expected rate of return for equities was determined by adding a long term equity risk premium to a risk-free rate. The equity risk premium reflects our view of expected long term returns on equities in excess of the risk free rate, taking into account historic returns and current market conditions. The expected return on debt securities is based upon an analysis of current yields on portfolios of similar quality and duration.

The asset allocation of our pension benefits at March 31, 2006 and 2007 were as follows:

	2006 (in millions of pounds sterling)	2006 %	2007 (in millions of pounds sterling)	2007 %
Asset Category:				
Equity securities	833	50.3	578	35.1
Property	120	7.2	124	7.5
Government bonds	515	31.1	763	46.4
Corporate bonds	99	6.0	93	5.7
Other	89	5.4	87	5.3
	1,656	100.0	1,645	100.0

Our investment policy is set by the Trustees of the pension scheme, after consultation with the employer. The investment policy and appointed investment managers are reviewed regularly by a sub set of the trustees who form an Investment Committee, reporting into the full Trustee body. Independent investment advice is taken by the Investment Committee. The investment policy has regard to the timing and nature of future cash flows, as well as to the risk characteristics of both the liabilities and the assets held.

The investment objective is to maximise returns subject to there being sufficient assets and cash flow available to pay members benefits as and when they fall due. The Trustees hold a diverse range of assets. As of March 31, 2007 the Trustee s investment benchmark was as follows:

UK equities	19%
Overseas equities	14%
Bonds	53%
Property, infrastructure and tactical	14%

The Trustees have a policy of cash management to ensure that sufficient liquid funds are available when divestments are required to meet benefit payment obligations as they become payable.

We expect to contribute £44 million to our defined benefit pension plan in 2008.

The benefits expected to be paid from the pension plan each year 2008 2012 are £102 million, £106 million, £109 million, £112 million and £116 million, respectively. The aggregate benefits expected to be paid in the five years from March 31, 2012 are £639 million. The expected benefits are based on the same assumptions used to measure the Company s benefit obligation at March 31, 2007 and include estimated future employee service.

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

Actuarial losses included in accumulated other comprehensive income expected to be recognised as a component of net periodic pension costs in 2008 is not material.

(3) Restructuring of Pension Arrangements

Prior to March 31, 2007, there was a single section of the ESPS in which all Magnox employees and some other BNFL group employees participated. The whole of any deficit existing in the scheme was considered to be recoverable under our contractual arrangements with the NDA and a corresponding asset recorded. Immediately prior to the year end, based on discussions with the trustees, BNFL made a payment into the pension scheme to facilitate the further sectionalisation of the pension scheme as part of the creation of and preparation for sale of the RSMC business by the BNFL Group. This resulted in a reduction in the amounts previously considered to be recoverable from the NDA. Furthermore, as of March 31, 2007, the further sectionalisation of the pension scheme took place and a surplus relating to other parts of the BNFL Group was identified. The surplus was eliminated from our financial statements giving rise to a further adjustment to the amount recoverable from the NDA. The impact of these two adjustments to the amount of the pension deficit recoverable from the NDA gave rise to an £8 million charge to the income statement and has been recorded separately as a cost of restructuring our pension arrangements.

(4) Income Taxes

Total income taxes for the years ended March 31, 2006 and 2007 were allocated as follows:

	2006	2007
	(in millions of pounds sterling)	
Income from continuing operations	8	7

Income tax expense attributable to income from the continuing operations for the years ended March 31, 2006 and 2007 consists of:

	2006	2007
	(in millions of pounds sterling)	
Current	8	5
Deferred		2
	8	7

(a) Tax Rate Reconciliation

Income tax attributable to income from continuing operations was £7 million in the year ended March 31, 2007 and £8 million in the year ended March 31, 2006 and did not differ from the amounts computed by applying the UK corporation tax rate of 30% to pretax income from continuing operations.

On March 21, 2007, it was announced that the standard rate of UK corporation tax was to be reduced to 28% but such change was not enacted prior to March 31, 2007. Therefore, for the purpose of the combined financial statements for the years ended March 31, 2006 and 2007, the standard corporation tax of 30% has been applied.

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

(b) Deferred Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2006 and 2007 are presented below.

	2006	2007
	(in millions of pounds sterling)	
Deferred tax assets current:		
Other timing differences		1
Deferred tax assets current		1
Deferred tax liabilities current:		
Other timing differences		(3)
Deferred tax liabilities current		(3)
Net deferred tax liabilities current		(2)
Deferred tax assets noncurrent:		
Pension	2	30
Deferred tax assets noncurrent	2	30
Deferred tax liabilities noncurrent		
Pension	(2)	(30)
Deferred tax liabilities noncurrent	(2)	(30)
Net deferred tax liabilities noncurrent		

In assessing our ability to realize deferred tax assets, we considered whether it was more likely than not that some portion or all of the deferred tax assets will be realized. We have determined that no valuation allowance is necessary as of March 31, 2006 or 2007.

(5) Restricted cash

Restricted cash includes cash held in relation to the Energy Sales and Trading operations which ceased trading from April 1, 2007. This cash is repayable under contract to the NDA. A liability is included in other liabilities for £2 million as at March 31, 2007 *(2006: £2 million).*

(6) Accrued Expenses and Other Liabilities

Accrued expenses as of March 31, 2006 and 2007 consist of the following:

	2006	2007
	(in millions of pounds sterling)	
Restructuring costs	11	22
Salaries and related expenses	16	26
Accrued project costs	24	11
Electricity trading supply contacts	4	40
Other taxes and social security costs	9	4
Total accrued expenses	64	103

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

The nuclear reactor sites managed by the Company undergo lifecycles which require different levels of resource. As a result we have a termination benefit accrual which is included in restructuring costs. For the year ended March 31, 2007, redundancy charges of £15 million were recorded (*2006: £8 million*) leaving a closing accrual of £17 million at March 31, 2007 (*2006:£11 million*).

For the years ended March 31, 2006 and 2007 we redeployed an element of our central functions to the local reactor sites. A redundancy charge of £7 million was booked in the year ended March 31, 2007 (*2006: £0.3 million*) relating to 35 staff. The closing accrual relating to these redundancies at March 31, 2007 was £5 million (*2006:£nil*).

Other liabilities as of March 31, 2006 and 2007 consist of the following:

	2006	**2007**
	(in millions of pounds sterling)	
Value added taxes payable	36	44
Restricted cash payable to the NDA	2	2
Total other liabilities	38	46

(7) Leases

We have several non-cancellable leases that cover machinery and equipment and motor vehicles. Such leases expire at various dates with, in some cases, options to extend their terms. We did not have any capital leases during March 31, 2006 and 2007.

Minimum rent payments under operating leases are recognised on a straight line basis over the term of the leases. Rental expense on non-cancellable operating leases was £281,000 and £103,000 for the year ended March 31, 2006 and 2007, respectively.

Future minimum annual rentals under non-cancellable operating leases as of March 31, 2007 are:

	(in thousands of pounds sterling)
Year ending March 31,	
2008	274
2009	63
2010	45
2011	24
2012	4
Total minimum lease payments	410

Our lease commitments represent a reimbursable cost which is recharged to the NDA as part of the contract for services described in note 1.

(8) Related party transactions

Undertakings under common control of Her Majesty s Government include the NDA. During the year ended March 31, 2007, we earned revenue of £668 million from the NDA for the provision of services related to the operation and decommissioning of the Magnox power stations (*2006: £577 million*). Costs under management of

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Reactor Sites Management Company Limited

Notes to Combined Financial Statements (Continued)

Years Ended March 31, 2006 and 2007

£633 million were incurred on behalf of the NDA during the year ended March 31, 2007 in relation to the costs associated with the operation and decommissioning of the power stations (*2006: £548 million*). As at March 31, 2007 there was a balance owed by the NDA to the Company of £244 million (*2006: £207 million*).

At March 31, 2007 Magnox held £2 million in restricted cash for Energy Sales and Trading Limited operations which ceased trading from April 1, 2007, which is re-payable to the NDA (*2006: £2 million*). A liability is included in other liabilities for £2 million as at March 31, 2007 (*2006: £2 million*).

As part of the arrangements for the reorganization of the nuclear industry by the UK Government, the NDA agreed to assume the responsibility for any deficit (and obtains the benefit of any surplus) arising from the participation of Magnox employees in the Electricity Supply Pension Scheme. In order to reflect this arrangement, these financial statements include an amount recoverable from the NDA of £99 million at March 31, 2007 (included within other non-current receivables) *(2006: £6 million).*

The Company was a wholly owned subsidiary of British Nuclear Fuels Plc during the year ended March 31, 2007. During the year we declared a distribution payable to British Nuclear Fuels Plc of £14 million *(2006: £20 million).* In addition we provided central services to other affiliated companies within the British Nuclear Fuels Plc group as part of our ordinary course of business and at March 31, 2007 the outstanding balance due to us from affiliated companies was £6 million *(2006: £nil)* and we owed affiliated companies £23 million *(2006: £33 million).*

(9) Legal Proceedings

We are subject to various claims and legal proceedings covering matters that arise in the ordinary course of our business activities. We believe any liability that may ultimately result from the resolution of these matters will not have a material adverse effect on our consolidated financial position, operating results and cash flows.

(10) Subsequent Events

During the year ended March 31, 2007 BNFL decided to sell RSMC. To facilitate the sale, all the issued share capital of Magnox was transferred from British Nuclear Group Limited to RSMC. The sale of RSMC to Energy*Solutions*, LLC completed on June 26, 2007.

Participation in the Combined Pension Scheme (CPS) is only available to employees of publicly owned entities, therefore as a consequence of the sale of RSMC to Energy*Solutions,* LLC all employees of RSMC and Magnox who were members of the CPS were required to transfer to an alternative scheme. With effect from June 26, 2007 direct employees of RSMC who were members of the CPS transferred to the BNFL Group Pension Scheme (GPS) and direct employees of Magnox who were members of the CPS transferred to the Combined Nuclear Pension Plan (CNPP). Under the terms of the sale and purchase agreement BNFL has agreed to meet all costs associated with the transfer of employees into the GPS. All costs associated with the transfer of employees to the CNPP will be deemed allowable under the M&O contract and recovered from the NDA.

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GLOSSARY OF DEFINED TERMS

The following defined terms are used throughout this prospectus.

AEA	Atomic Energy Act of 1954, as amended
ARO	Asset Retirement Obligation
BDAT	Best Demonstrated Available Technology
CERCLA	Comprehensive Environmental Response, Compensation and Liability Act of 1980
CoCs	(NRC) Certificates of Compliance
D&D	Decontamination and Decommissioning
DHEC	(South Carolina) Department of Health and Environmental Control
DOD	U.S. Department of Defense
DOE	U.S. Department of Energy
DRC	(Utah) Division of Radiation Control
EIS	Environmental Impact Statement
EM	Environmental Management
EPA	U.S. Environmental Protection Agency
ERA	Energy Reorganization Act of 1974
FAR	Federal Acquisitions Regulations
GAAP	Generally Accepted Accounting Principles in the United States
GAO LLRW Report	June 2004 Government Accountability Low Level Radioactive Waste Report
GNEP	Global Nuclear Energy Partnership
GTCC	Greater Than Class C
HSWA	Hazardous and Solid Waste Amendments of 1984
LIBOR	London Interbank Offer Rate
LLRW	Low-Level Radioactive Waste
MLLW	Mixed Low-Level Waste
M&O	Management and Operation
NARM	Naturally Accelerated Radioactive Material
NDA	U.K. Nuclear Decommissioning Authority
NE	Office of Nuclear Energy
NEI	Nuclear Energy Institute
NNSA	National Nuclear Security Administration
NORM	Naturally Occurring Radioactive Material
NRC	Nuclear Regulatory Commission
NWPA	Nuclear Waste Policy Act of 1982
NYSE	New York Stock Exchange
OCRWM	Office of Civilian Radioactive Waste Management
ORNL	Oak Ridge National Laboratory
OSHA	Occupational Safety and Health Administration
PRS	Paducah Remediation Services, LLC
RCRA	Resource Conservation and Recovery Act of 1976
REA	Request for Equitable Adjustment
RFP	Request for Proposal
RSMC	Reactor Sites Management Company
SAFSTOR	Safe Storage (nuclear plant in retirement)
SEC	U.S. Securities and Exchange Commission
SLC	Site License Company
SRS	Savannah River Site
TN DEC	Tennessee Department of Environment and Conservation
TSCA	Toxic Substances Control Act of 1976
WCS	Waste Control Specialists
WNA	World Nuclear Association

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