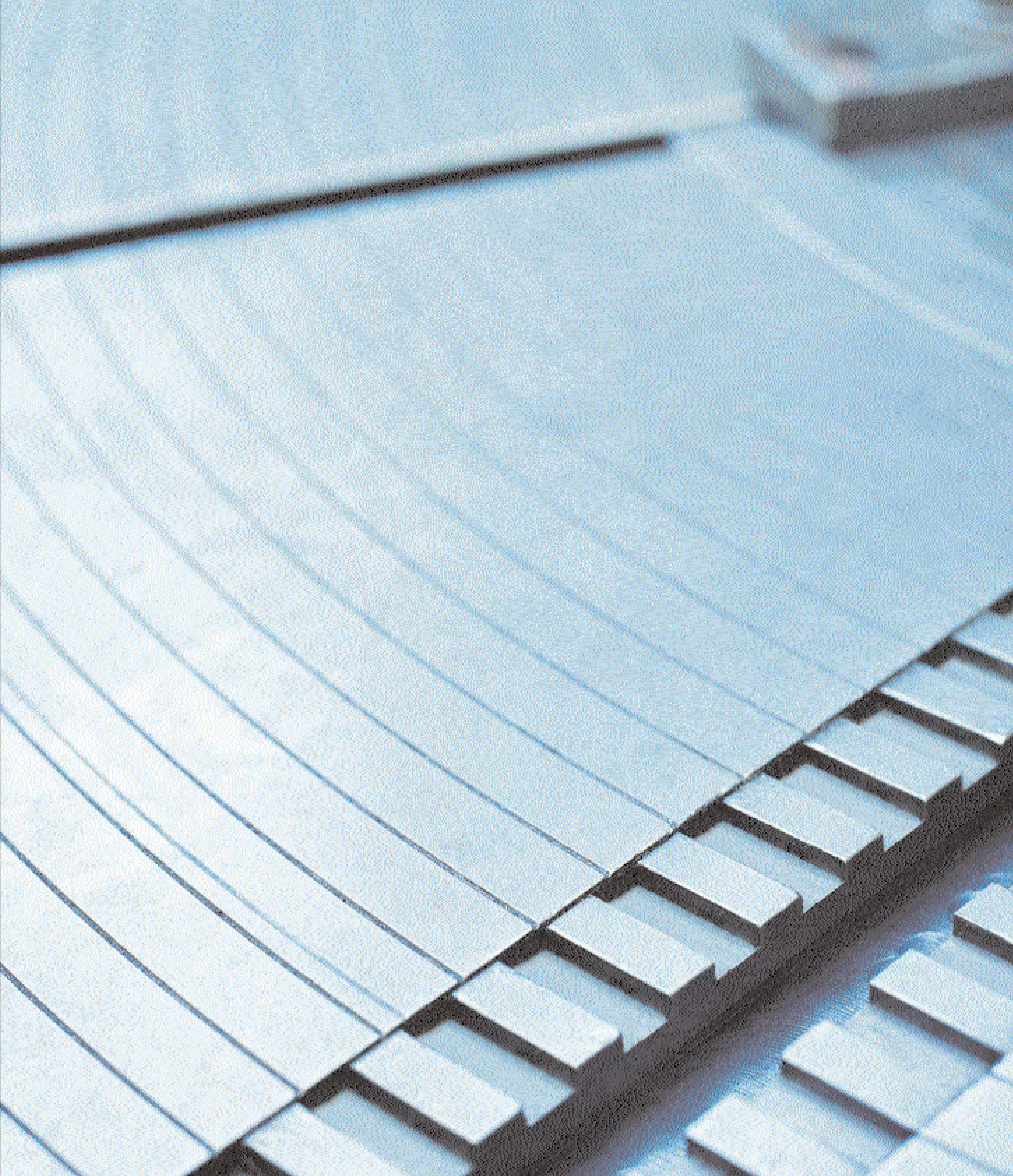
Babcock International

Engineered systems and services

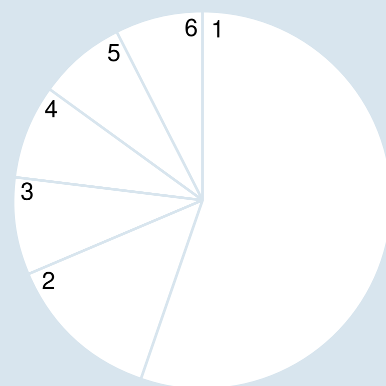
Babcock International Group PLC

Annual Report and Financial Statements 1999



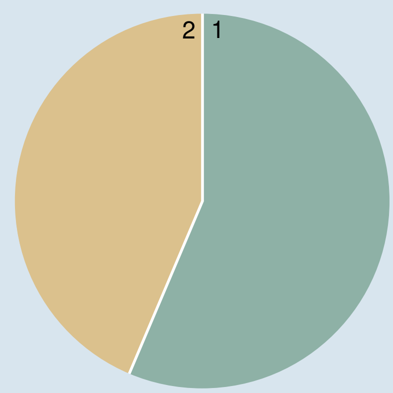
Sales by destination (%)
(continuing operations)

1 United Kingdom	55.5
2 Rest of Europe	13.3
3 North America	8.4
4 Asia	7.8
5 Africa	7.7
6 Rest of World	7.3



Sales by activity of divisions (£m)
(continuing operations)

1 BES	280.2
2 BMH	214.8



Babcock International is a multinational engineered systems and services group, headquartered in the UK. It executes business worldwide from its operations in 16 countries. BES provides engineering and technology support services to the defence, rail, marine and 'secure facilities' sectors. BMH delivers materials processing technologies and engineered systems to a range of industries.

£495m

Group turnover from continuing operations (1998: £533m)

£25.3m

Profit before tax excluding exceptional items (1998: £14.2m)

£82.1m

Net cash (1998: £21.1m)

11.44p

Earnings per share excluding exceptional items (1998: 5.93p)

Divisions at a glance

BES

Engineering and technology support services to the defence, rail, marine and 'secure facilities' sectors

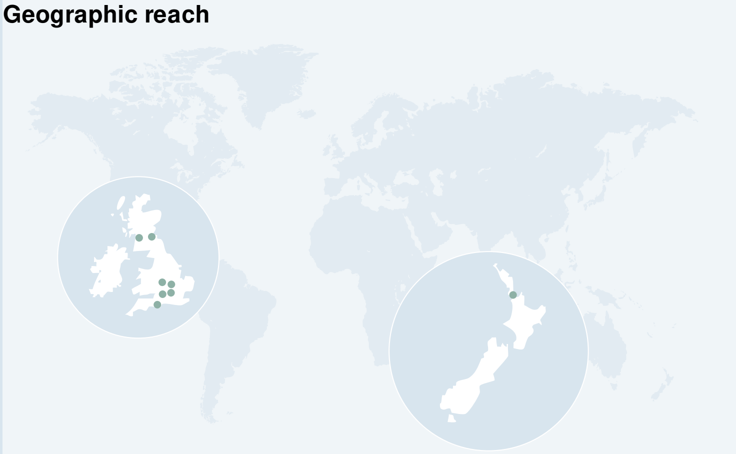
£13.3m

Operating profit

£280.2m

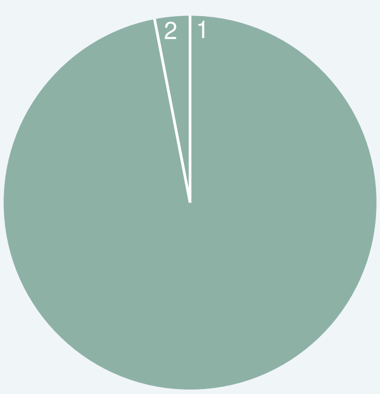
Turnover

Geographic reach



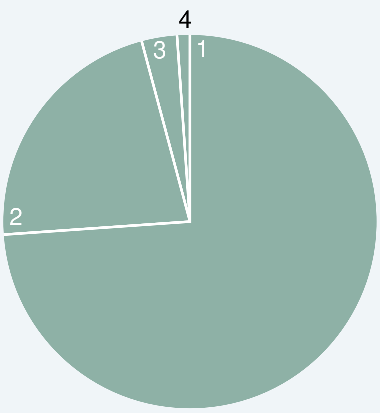
Sales by destination

1 UK	97%
2 Australasia	3%



Sales by activity

1 Defence – UK	74%
2 Rail	22%
3 Defence – non UK	3%
4 Marine	1%



BMH

Materials processing technologies and engineered systems

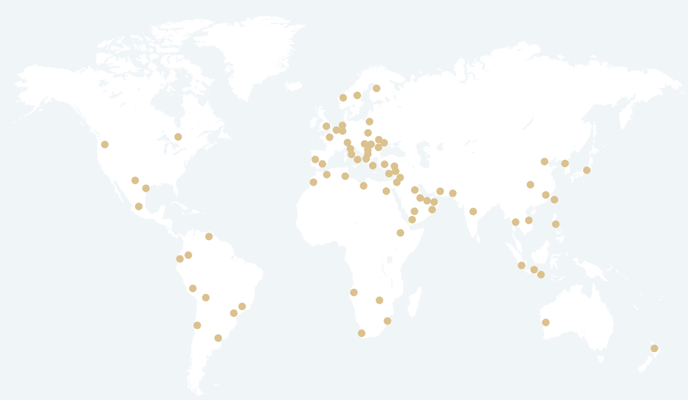
£8.4m

Operating profit

£214.8m

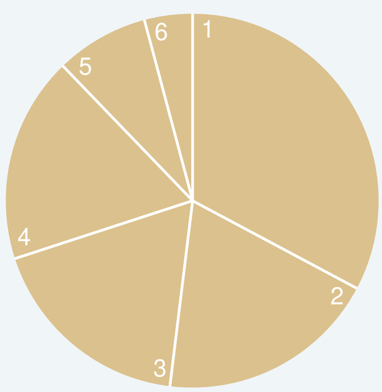
Turnover

Geographic reach



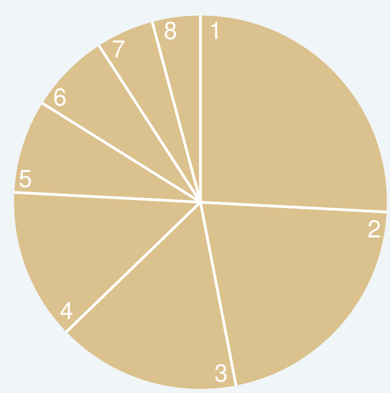
Sales by destination

1 Europe	33%
2 North America	19%
3 Africa	18%
4 Asia	18%
5 South America	8%
6 Middle East	4%



Sales by activity

1 Cement	26%
2 Marine	21%
3 South Africa	16%
4 Wallboard	13%
5 Bio-energy and wood	8%
6 Power, iron and steel	7%
7 Pipeline engineering	5%
8 Others	4%



Chairman's statement

Dramatically transformed

Overview I am delighted to report on a year of excellent progress both for the Group and its two trading divisions. Group operating profit from continuing businesses has again grown strongly, as have the Group's net cash resources. The benefits from the successful restructuring of the Group's portfolio were already apparent at this time last year but we are now also beginning to see the benefits from the strategic and performance improvement initiatives being pursued by the divisions. The Group has been dramatically transformed and is capable of generating further improvements in performance. It has significant resources to invest for growth both organically and by acquisition.

Financial summary In summary, the turnover from continuing operations was £495 million (1998: £533 million) and the corresponding trading profit was £22.2 million (1998: £17.9 million).

The turnover from all operations was £496.3 million (1998: £568.3 million) and the corresponding trading profit was £22.8 million (1998: £14 million).

Net interest receivable in the year was £2.5 million (1998: £0.2 million).

Group profit before tax and exceptional items was £25.3 million (1998: £14.2 million).

The earnings per share before exceptional items were 11.44p (1998: 5.93p) and after exceptional items were 15.07p (1998: loss per share 5.12p).

After accounting for exceptional items relating to the disposal of the Group's water engineering businesses amounting to £6.1 million, the profit before tax was £31.4 million (1998 loss: £4.5 million).

It has been a year of exceptionally strong cash generation which has resulted in a year end net cash balance of £82.1 million (1998: £21.1 million).

Dividend The Board is recommending a final dividend of 1.40p, making a total of 2.20p for the year (1998: 1.80p), an increase of 22%.

Order book The Group's year end order book for its continuing operations was £353 million (1998: £334 million).

Divisional changes and strategies
The Facilities Management Division has been re-named Babcock Engineering Services ('BES') to reflect better both the nature of its current trading activities and future development plans. In addition to the provision of engineering and technology support services to the defence, marine, rail and "secure facilities" sectors, BES's activities include materials management, logistics support and nuclear engineering services.

In order to reflect the technology shift that has taken place within the Materials Handling Division and to reflect its future development, the Division will be referred to in future by its established trading name BMH. From this year the trading results of the Group's South African activity are reported within BMH.

Our strategy for growth both organically and via acquisition remains focused upon the achievement of leadership in our main business activities and the development of new opportunities in related fields. We will continue to leverage off the core strengths of our businesses, including our global network and knowledge of international markets.

BES – engineering and technology support services to the defence, rail, marine and "secure facilities" sectors
BES achieved good progress in the year, improving its operating margins and increasing its operating profit by 28% to £13.3 million.

During the year the Division continued to improve efficiency and performance and extended its customer base and markets. Leveraging off its facilities and skills, BES is gaining access to new opportunities and alternative business streams. The Division now has a growing list of substantial expansion opportunities in the defence, rail, marine and "secure facilities" markets. In certain cases it is pursuing these opportunities as part of teaming or joint venture arrangements. Many of these opportunities, including the development, manufacture and support contract for a new towed array sonar and the management contract for the Aldermaston nuclear weapons establishment, have already been bid to the MoD. The outcome of both these bids should be known by the end of the new financial year. Other projects, such as the Mega 3 rail freight wagon, that would assist in diverting freight from our roads onto rail, should begin to generate revenue in the new year now that the final phase of pre-registration testing is within sight.

Meanwhile the Division's mainstream naval ship and nuclear submarine refitting activities in both the UK and New Zealand made excellent progress in the year. This trading performance reflected the Division's initiatives to increase efficiency and competitiveness. In addition to the refit during the year of vessels under the programme of work agreed on the privatisation of the Rosyth Dockyard, the Division undertook the refit of two competitively won vessels, HMS Argyll, a Type 23 frigate, and the 31,500 tonnes RFA Fort Victoria, the largest vessel in the fleet.

Over the next two years the naval refitting activities of the Division will be dominated by two substantial contracts totalling around £200 million to refit HMS Spartan, a nuclear powered submarine, and the aircraft carrier, HMS Ark Royal. Both of these contracts were awarded within the past four months.

Railcare, which dominates the Division's rail activities and is involved in the provision of heavy maintenance and refurbishment services, had another successful year. The outlook for that business remains positive, with opportunities such as the London Underground public private partnership offering good potential for the future.

BES, given its stable platform of refit work for the MoD and its exciting opportunities for growth, has a strong base from which to make good progress.

BMH – materials processing technologies and engineered systems
BMH, with its portfolio of materials processing technologies and engineered systems businesses, made strong progress during the year, improving its operating margins and increasing operating profit by 17% to £8.4 million.

Over the past few years the Division has successfully pursued a strategy that has transformed it from a business with a strong dependence upon material handling in the cement, pulp and paper and energy sectors to a broader portfolio of technologies and businesses where there are clear opportunities for organic growth. Similarly it has taken steps to reduce its dependence on in-house manufacturing other than that of low volume, high value-added items to protect core technologies. At the same time it has accelerated its investment in new product development and technology acquisitions as well as on-going product maintenance. BMH is now a multinational engineering house for materials processing technologies and engineered systems, with leading positions in growth markets and a global presence.

During the year BMH faced challenging trading conditions in certain geographic markets. However, its flexible and global operating structure allowed it to refocus its marketing and sales resources to address opportunities in other parts of the world. In this way BMH was able to take advantage of opportunities in Europe and North America and grow operating profits in spite of a decline in the Asian market.

The trading performance in the year again involved a high commitment to product development and new technology. Expansion in this area included the latest pneumatic grain unloading technology, which is strengthening BMH's position as a major supplier of equipment and systems to leading international marine grain terminal operators. Similarly, the Division, through the acquisition of AKI Dryer Manufacturers Inc, secured drying technology for the gypsum wallboard segment of its engineered building materials business, thereby confirming BMH as a leading supplier of gypsum wallboard process systems. The strong emphasis on engineered building materials will remain a key part of the future growth strategy of BMH, together with a continuing commitment to product development.

The Group's South African activities, which are now included within BMH, made further progress during the past year. Operating margins were ahead of those achieved in the previous year on a turnover of £33.4 million. The South African operation has been extending the range of engineering services offered to its customers and is establishing long-term partnership arrangements for the supply of repair and maintenance services.

The Division has entered the new year with a healthy order book, its business trading satisfactorily and a clear strategy for earnings growth.

Corporate development During the second half of the year the Group disposed of its 50% interest in Babcock Water Engineering Limited and its wholly owned subsidiary, Babcock Water Engineering LP (USA) to Earth Tech Inc companies for a total consideration of £13.25 million. These disposals followed the disposal of the Group's other Process interests a year earlier.

During the first half of the year the Group strengthened its market position in the wallboard and fibreboard market by acquiring the technology for grinding and calcining by-product gypsum from Delta Steel Co (USA) and for drying systems for wallboard, fibreboard and veneer through the acquisition of AKI Dryer Manufacturers Inc, in Oregon, USA, for a maximum consideration of $8 million.

Directors and officers Ian Hartigan, who has served as a non-executive Director since 1994, will be retiring at the forthcoming AGM. I would like to thank him for his support and valuable contribution to our Group Board. Meanwhile I am delighted to welcome Dipesh Shah of BP Amoco who joined the Board as a non-executive Director on 15 June 1999. Dipesh's current responsibilities for BP Amoco cover the Forties pipeline system and the Grangemouth complex. He was previously CEO of BP Solar International. We are confident that his extensive international business experience will be of considerable value to the Group.

During the year, John Allen, who had served the Group for nearly ten years, retired as Company Secretary and we thank him for his efforts on behalf of the Group. Helen Mahy has been appointed as Company Secretary and General Counsel.

Outlook The Group has an exciting year ahead and I am pleased to report that it has started well. Having moved away from large scale, heavy contracting and manufacturing risk it has been dramatically transformed and is a very different Group from that of a few years ago. It possesses a clear strategy, a competent management team and an exceptionally strong financial platform from which to develop both organically and by acquisition.

Dr T John Parker Chairman
15 June 1999

Engineering and technology support services for customers in the defence, rail, marine and ‘secure facilities’ sectors.

In defence we provide a one-stop refit capability for nuclear submarines, warships, fleet support and offshore marine vessels including their systems and equipment; logistics support and material procurement services; specialist maritime defence consultancy services. In marine we provide a range of technical support services, including equipment refurbishment and specialised sub-sea engineering. In rail we provide the design and manufacture of passenger coach interiors, the complete refit and maintenance of rail rolling stock and new concepts in rail freight transportation. In facility management we specialise in the management of secure facilities. Organic growth is driven by accessing business opportunities that leverage off our specialist skills, technology and facilities. Growth through acquisition is focused on compatible knowledge - based activities.

The Division made substantial progress in the year as it pursued its strategy. This is aimed firstly at enhancing trading performance in its strong naval vessel refitting activities in the UK and New Zealand as well as in its rail maintenance and refurbishment and marine activities. Secondly, it targets related business streams which it can access by leveraging off the considerable skills of its people and infrastructure.

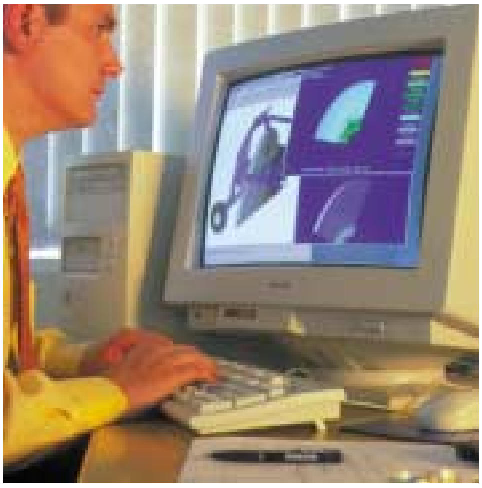
BES achieved an improved trading performance during the year. The operating profit grew by 27.8% to £13.3 million and operating margins as a percentage of sales also improved from 3.4% to 4.8% . Turnover fell due to a small reduction in hours spent in naval vessel refitting, a reduction in MoD funded dock infrastructure improvements at the Rosyth Dockyard and lower rail wheelset and bogey activity, particularly in the first half of the year. BES's order book at March 1999 was £227 million compared with £249 million a year earlier but does not include the recent award of a contract for the refit of the aircraft carrier, HMS Ark Royal, worth about £100 million.

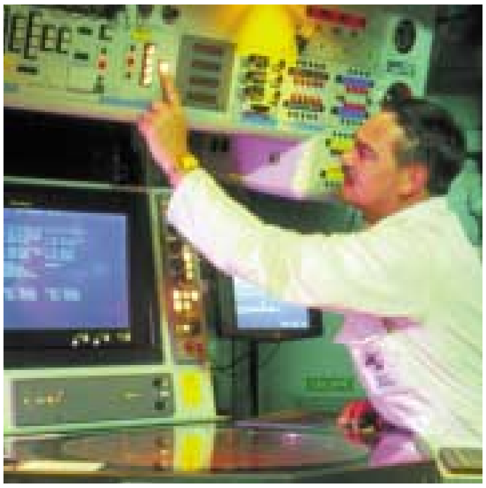
Defence Naval vessel refitting activity had a very successful year both in the UK and New Zealand.

In the UK, activity continued to be dominated by the ten-year programme of work secured at the time of the privatisation of the Rosyth Dockyard in January 1997. The Government's Strategic Defence Review, published in July 1998, left this programme of work largely unaffected.

In the year, the refit of vessels under the ten-year programme of work was carried out on schedule with the exception of the aircraft carrier HMS Ark Royal which arrived to begin its refit in May 1999, six months later than originally anticipated.

In nuclear submarine refitting there was a high level of activity. This was dominated by HMS Sceptre, which continued its 40 month refit that began in May 1997. The Rosyth Dockyard also completed the refit of HMS Superb, a repair to HMS Sovereign, the defuelling and decommissioning of HMS Repulse, and a capability update package for HMS Splendid which included the fitting of the Tomahawk cruise missile system. In March 1999 BES was awarded a two-year refit contract for HMS Spartan worth more than £100 million.





The three-year programme of major civil engineering work, funded by the MoD, to enhance the nuclear submarine refitting facilities was successfully completed during the year at Rosyth. This programme was necessary to meet the new safety standards required by the nuclear regulatory authorities in the UK, and to allow the docking down of HMS Spartan to programme in March. The Rosyth Dockyard is now credited with having the highest standard of nuclear qualified docks in the UK.

In naval ship refitting, work continued on two Type 42 destroyers, HMS Exeter, which was completed during the year, and HMS Southampton. Five minor warship refits were also completed during the same period with a further three in various stages of completion at the year end. Both the customer and the operators praised the quality and reliability of the work performed by the Rosyth Dockyard.

In addition to the above, the refits of two further vessels, won in open competition, were undertaken during the year at Rosyth Dockyard. The first was the refit of HMS Argyll, a Type 23 frigate, which commenced in June 1998 and is programmed to be completed in July 1999. The second was the 17 week refit of RFA Fort Victoria, the largest vessel in the fleet, that commenced in February 1999 and was won against strong competition from both the commercial refit yards and other dockyards. In addition, the ship life extension project on RFA Sir Bedivere was completed in the early months of the year.

The New Zealand operation returned to profit in the year as a result of restructuring actions taken in the previous year together with the renegotiation of the Commercial Management Agreement with the New Zealand Defence Force. The workload from the New Zealand Navy has continued to reduce, but there was a compensating increase in the level of commercial and other defence work. BES's strategy for New Zealand continues to focus upon improving the level of commercial activity and efforts are being made to form long-term strategic alliances with major New Zealand companies.

A major focus of BES's strategy for its naval vessel refitting activities both in the UK and New Zealand has been to improve efficiency and performance. In 1998/99 there was a systematic review of costs and business processes which resulted in major restructuring throughout the dockyards.

Left to right: Technical Apprentice Training at Rosyth; Finite element analysis using Pro/Engineer and Pro/Mechanica; Setting to work the operations room on HMS Southampton; Training for fibre optic termination inspection.

This process, which continued during the year, has generated significant improvements in cost and performance and BES is on track to meet its medium to long term cost base targets.

There was a good trading performance from the Division's defence systems business, where activities were dominated during the year by work on the Royal Navy's new towed array Sonar 2087 that is referred to below.

Rail and marine BES's rail engineering activities achieved another solid trading performance, particularly in Railcare, where wheel set and bogey activity that had been weak in the early part of the year recovered as the year progressed. In these activities there was again an important emphasis upon performance improvement, and strong investment was made in new systems to replace ageing British Rail systems that were not year 2000 compliant.

Railcare, the Division's rolling stock maintenance and refurbishment operation, has been positioning itself in the year to benefit from the significant maintenance and refurbishment opportunity offered by the Government's plans for the London Underground. In conjunction with Angel Trains, Railcare has also been developing a prototype to demonstrate the potential to modify 'swing door' rolling stock to accommodate sliding doors. The prototype is nearly complete and this initiative, driven in part by safety requirements, could offer an exciting modification and refurbishment stream of income in coming years.

The Division's modest sized marine and off-shore activities traded satisfactorily given a climate of low oil prices and, although the new year has also started quietly, there are signs that a recovery in oil prices in early 1999 will lead to some increased activity later in the year.

New business opportunities and strategy The Division continued to pursue several exciting organic business opportunities outside of its traditional activities of naval refitting. Certain of these projects are being bid by the Division alone whilst in other cases it is part of a joint venture or consortium.

Perhaps the most significant current opportunity relates to a ten-year management contract for the Government's Atomic Weapons Establishment at Aldermaston, where BES bid in early June as the leader in a consortium of WS Atkins of the UK and Scientific Applications International

Left to right: Vehicle overhaul at Railcare's Wolverton depot; HMS Spartan on new seismically isolating docking cradle in No.3 Dock; HMS Ark Royal preparing for refit; RFA Fort Victoria entering No.1 Dock.

Corporation (SAIC), supported by Mason and Hanger, of the USA. The current management contract expires in early 2000 and the MoD are running an open competition to select a new contractor. BES's experience of managing a nuclear site at Rosyth, together with its cost reduction and performance improvement expertise, were both essential elements of the bid, for which it has assembled a strong team that embraces the various skills and disciplines necessary to manage this complex operation.

In February this year BES's Babcock Defence Systems (BDS) operation submitted the bid for the Royal Navy's new towed array Sonar 2087. The contract, which is to equip the Royal Navy's 16 strong Type 23 frigate fleet, was bid in joint venture with Lockheed Martin with its world class systems integration capability. BDS is currently responding to contract clarification questions and it is expected that the MoD will announce the successful bidder before the end of the new financial year.

Over recent years BES has been reviewing ways in which it might exploit its nuclear engineering skills. As a result it has been developing its technology, and plans to dismantle decommissioned submarines at Rosyth, thus creating a further medium term stream of earnings.

The Division's radical piggyback rail freight wagon, Mega 3, has now almost completed its development phase, including some 90% of its test programme. Its certification has been delayed due to lack of access to rail routes and some fine tuning of equipment design. However, subject to obtaining the necessary access, certification is anticipated by late summer at which time discussions can be held with customers who have expressed serious interest in the wagon.

The Division's substantial naval refitting programme provides it with an excellent opportunity to develop a range of other businesses in the defence, rail, marine and 'secure facilities' sectors. Its drive to improve performance and competitiveness will allow it to execute its naval refitting programme in a cost efficient manner and compete strongly for future naval ship refits. In addition to the above organic growth opportunities, BES's strategy will include acquisitions that can enrich its business portfolio and provide complementary engineering and technology support services activities that would sit comfortably alongside its knowledge and skill base.

BMH division

Materials processing technologies and engineered systems know-how are at the heart of our services to customers worldwide.

We operate as an engineering systems house via six technology centres located in Europe and USA – each focused on their separate core products and systems know-how. We have leading market positions across a number of specialist growth sectors including: cement and high value building materials; gypsum wallboard; bio fuel systems; engineered building products; marine terminal technology; pipeline systems engineering; and engineering support services. We fuel organic growth by continuous research and product development. We market and service our customers through a global network via 16 BMH companies plus agents covering over 70 countries. Our acquisition strategy targets expansion into adjacent and attractive technologies.

During the year, BMH continued its transformation from being, primarily, a materials handling business, to a provider of materials processing technologies and engineered systems. Despite challenging market circumstances, particularly in Asia, BMH has also achieved further improvements in trading performance.

The improved trading performance saw operating profits grow by 17% to £8.4 million. Operating margins, as a percentage of sales, also improved in the year from 3.2% to 3.9% and from 3.6% to 4.3% excluding Africa. The reduction in turnover was due mainly to the adverse effect of the depreciation in the average exchange rate of the South African Rand to sterling. At £126 million BMH's order book at 31 March 1999 was £41 million higher than last year end.

Between 1996 and 1999 there has been a significant transformation in the mix of BMH's businesses as it has moved to being a multi-national engineering house for materials processing technologies and engineered systems. During that period the proportion of the Division's total revenues derived from bio-energy and wood has almost halved and those from cement have reduced by approximately 20%. New business streams, covering engineered building materials and pipeline engineering, have been introduced which now account for some 18% of BMH's revenues.

An important step in this transformation was the acquisition, in September 1998, of AKI Dryer Manufacturers, Inc. of the USA. The company has been integrated successfully in to the Division as BMH AKI Dryers Inc. (AKI) and is based in Eugene, Oregon. AKI is the North American market leader for the supply of drying technology for engineered building products, particularly wallboard, and complements ideally the wallboard plant technology of BMH Americas in Dallas. AKI also gives access to new engineered building products through its experience in this sector. A further expansion of BMH's portfolio in engineered building products was accomplished through the acquisition of chemical gypsum grinding and calcining technology from Delta Steel Co (USA). These acquisitions now provide BMH with full-line capability in the processing of natural and chemical gypsum for complete gypsum wallboard facilities.

The integration of Eagleton Engineering Company (Eagleton) into the Division was completed during the year. Eagleton is based in Houston, Texas in the USA. Its activities are pipeline engineering

and the project management of pipeline construction for liquid and gaseous products for the petroleum and petrochemical industries. Eagleton currently supplies services in Texas and its neighbouring states but offers major geographic expansion opportunities in engineering and the supply of services such as route selection, right-of-way acquisition, global positioning satellite (GPS) survey and mapping.

Using a network of international offices, BMH provides its services throughout the world. Its profound knowledge of international markets and its global marketing and service network is one of BMH's major assets. As a result of its geographic flexibility, BMH was able to redirect its market focus during the year in response to difficulties in the Far East, Russia and to some extent in South America and execute 52% of its business in European and North American markets that offered growth opportunities. BMH has retained a strong focus in Asia, the Near and Middle East and Latin America, regions which it still judges to be future growth markets despite their recent difficulties.

During the year, BMH completed various important development programmes to modernise further its existing technology portfolio and to add new product lines. A significant milestone was the award of two contracts in Asia and South America for the latest generation of cement clinker coolers, the first of which was supplied during the year. Similarly, a new, completely automated, high capacity cement packing line with a capacity of 4,000 bags per hour was successfully commissioned at Holderbank's Hover plant. Also of particular importance was the smooth start-up of a 40 million square metres per annum capacity gypsum wallboard plant for P.T. Ikad Kedaung Aneka Gypsum in Indonesia. This provides BMH with an excellent reference plant in the Far East. BMH's port terminal technology was also expanded by the successful completion of a number of product development projects, in particular for non-mineral bulk commodities such as grain. During the year, BMH extended its technical centre at Buxtehude in northern Germany. This has contributed strongly to increased turnover from mineral grinding activities.

Several particularly important contracts have been won during the year. Within the cement business a highlight was the contract secured by BMH SA for the new Hong Mai Cement Plant in Vietnam. This contract includes the provision of raw material

Left to right: Custody transfer gas metering station and scrubber in Louisiana, USA designed and executed by Eagleton Engineering Company; Floating grain transhipment terminal designed and built for Hermasa Navegação dá Amazônia S.A., Brazil, by BMH Marine; Designing engineered systems for marine technology; The new state-of-the-art cement import and dispatch terminal at Sin Heng Chan Pte Ltd, Singapore, designed and built by BMH Marine, BMH Claudius Peters and BMH Kellve.

stacking and reclaiming, a cement clinker cooler, raw meal blending, cement storage silos and the complete packing and dispatch plant. In the power, iron and steel business two significant contracts were awarded to BMH Claudius Peters for the supply of pulverized coal injection systems to Acominas Steel Mill of Brazil and Bethlehem Steel Corporation in the USA. In the same business a large order for 16 coal mills for power plants in Romania was received from IVO in Finland. The engineered building products business of BMH Americas and AKI secured very important orders for gypsum calcining and wallboard technology from customers in the USA, Brazil and Turkey. The BMH Marine business received various contracts for Siwertell ship unloaders and Nordströms self-unloading systems for bulk carriers. Of particular note were contracts in Saudi Arabia and Poland for port facilities for grain. The Polish contract is part of the city of Gdansk's project to build one of the largest, and most modern, combined export and import terminals for grain and agricultural products in the northern hemisphere.

Eagleton secured a substantial contract for three new pipelines between Mont Belvieu and Port Arthur from TE Products Pipeline Company. The contract, which started in February 1999, is for the complete installation of three parallel 12 inch diameter pipelines, approximately 67 miles in length, that will convey ethylene, propylene and natural gasoline. Eagleton is responsible for the design of the pipelines, acquisition of right-of-way easements and permits for the pipeline route, procurement of all materials and construction project management services, and final mechanical testing and completion. The activities of BMH Wood Technology's bio-energy business were concentrated mainly in Scandinavia, although wood processing technology for pulp and paper was also successfully sold outside this region, with Portugal being of particular importance.

BMH will continue to develop its engineering systems base in selected industries, and its multi-disciplinary skills and competencies, with the aim of becoming one of the leading international engineering houses. This will be accomplished by both organic growth and targeted technology and business acquisition.

Particular opportunities for organic growth are seen in the cement and high value building materials sectors, in gypsum wallboard and engineered building products systems, in the transfer of high margin marine technologies from existing to new

Left to right: BMH AKI's engineered building material drying technology at British Plaster Board in Cape Town, South Africa; BMH Claudius Peters' latest clinker cooler technology; Gamma-ray controlled blending systems for raw materials and additives; High capacity rotary cement packer for 4,000 bags per hour with automatic bag application.

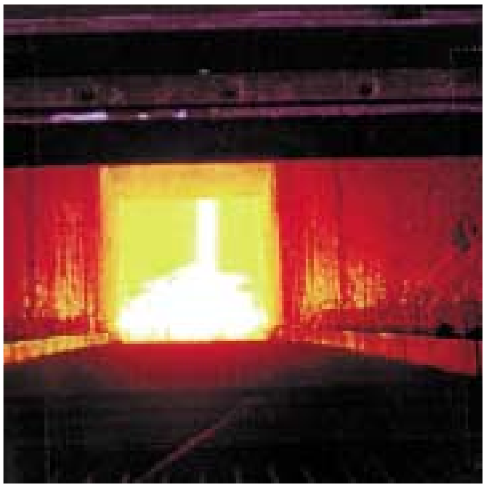
applications – such as from terminal technology for building materials to agri-products – and in pipeline engineering and services. Opportunities for growth by acquisition exist in attractive technologies, both upstream and downstream of BMH's business, as well as by exploiting opportunities where know-how, industry and market knowledge exist within the BMH organisation.

BMH will remain an organisation with limited investment in tangible fixed assets, a keen understanding of international sourcing and a commitment to manufacture in-house only those clearly defined, high value-added items necessary to protect core technologies. Capital expenditure will be focused primarily in systems and technologies. The Division will continue to invest in product maintenance, research and new product development, including technology acquisitions and technology license agreements.

Investment in employee education and training has continued to play a key part in the Division's drive to improve margins. Employee education programmes have been offered in a number of disciplines from more basic training programmes to business development and special executive management courses. Parts of the training courses were developed jointly by BMH and the International Management School at the University of St. Gallen in Switzerland.

The Division's South African activities have again seen an improvement in operating margins. This has accompanied a further reduction in Babcock Africa's mechanical construction activities and an extension in its range of engineering services to existing clients. There have been positive developments in the equipment and plant hire side of the business, which has recently acquired the agency for JCB in South Africa. Babcock Africa now has a very different risk profile from two years ago and is well positioned to make further improvements in performance despite operating in a trading climate that remains very challenging.

None of BMH's competitors now offers as broad a technology portfolio as BMH. BMH is unique in that it is strong enough to compete in engineered systems and equipment supply with the majors, and is competent to compete with niche players in their specialist markets. It enters the 1999/2000 financial year with an improved order book compared with a year ago, a strong financial position, a clear strategy and the potential to grow earnings.



Financial review

Results The results for the year reflect the strategic initiatives being pursued by the Group that have continued to generate improvements in operating margins. They also reflect a full year's contribution from the successful restructuring of the Group's portfolio of businesses completed last year.

Group operating profits have increased by 77.4% to £22.2 million on turnover of £496.3 million. Group operating profits, before goodwill amortisation, from continuing operations have increased by 26.8% to £19.8 million on turnover of £495 million. The overall operating margin, excluding goodwill amortisation, from continuing operations has increased to 4.0% from 2.9% in 1998.

Both Divisions contributed to the increase in Group operating profits, before goodwill amortisation, from continuing operations. In BES these grew by 27.8% to £13.3 million and in BMH by 17.4% to £8.4 million. Operating margins, excluding goodwill amortisation, from continuing operations also increased in both divisions. In BES they grew to 4.8% from 3.4% in 1998, and in BMH they grew to 3.9% from 3.2%.

Turnover by destination in the year shown on page 40 reflects an increasing share from Europe and North America and a decline in the Rest of the World as a result of a weakness in certain Asian markets.

A profit of £6.1 million arising in the year from the disposal of the Group's water engineering interests in Babcock Water Engineering Limited and Babcock Water Engineering LP is shown in exceptional items.

The strong increase in net interest income to £2.5 million (1998: £0.2 million) reflected the very healthy level of net cash resources throughout the year.

Taxation The Group's effective tax rate, excluding exceptional items and goodwill, was at a similar level to the previous year at 22.8% (1998: 23.4%). This is lower than the standard UK rate of 31% due to the utilisation of tax losses and surplus Advance Corporation Tax. At 31 March 1999 the Group had trading losses carried forward for tax purposes exceeding £70 million. These tax losses exist predominantly in the USA, Germany and South Africa.

Earnings per share and dividends Basic earnings per share were 15.07p (1998: loss 5.12p). Earnings per share excluding exceptional items and goodwill amortisation were 10.22p (1998: 4.78p).

The Board is recommending an increased final dividend of 1.40p bringing the total dividend for the year to 2.20p (1998: 1.80p) which is an increase of 22%.

Cash flow Improved profitability during the year and tighter working capital control have resulted in a very strong cash inflow from operations of £56.1 million (1998: £10.1 million).

The Group's free cash flow in the year was a healthy £49.8 million (1998: £0.9 million). In addition to the strong cash inflow from operations this also benefited from lower taxation payments of £0.8 million (1998: £1.5 million) and lower net capital expenditure of £5.5 million (1998: £7.7 million).

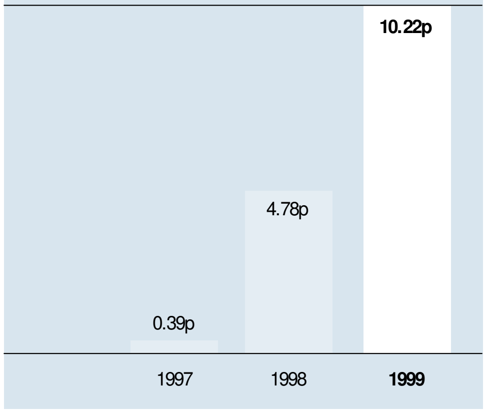
Balance sheet and financing Equity shareholders' funds increased by £21.1 million in the year to £126.8 million. The increase reflects the retained profits of £21.8 million less foreign exchange losses of £0.7 million (1998: £2.1 million) arising on the translation of the net assets and results of overseas subsidiaries into sterling.

The Group remains ungeared with net cash balances of £82.1 million (1998: £21.1 million) and a further £6.6 million (1998: £nil) of current asset investments classified as liquid resources.

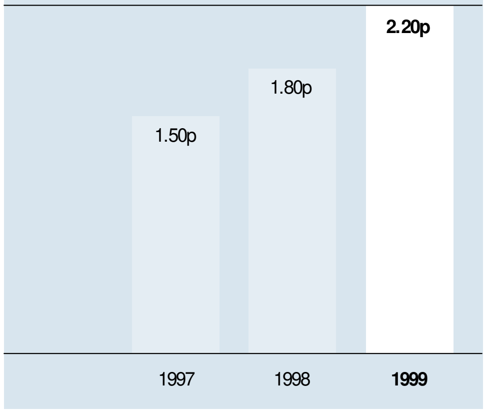
During the year all of the Group's financing requirements were met from its existing cash resources and the strong cash generation referred to above.

Acquisitions and disposals The net cash inflow from acquisitions and disposals in the year was £16.9 million (1998: outflow £2.4 million).

Basic earnings per share
(before exceptional items and goodwill amortisation)



Dividends per share



During the year the Group acquired AKI Dryer Manufacturers, Inc. in the USA for a cash consideration of $5.0 million with up to a further $2.5 million payable over the next three years depending upon that company's trading performance. The Group also made two small acquisitions in the USA and South Africa for a total consideration of £0.6 million. In addition it disposed of its water engineering businesses comprising a 50% joint venture interest in Babcock Water Engineering Limited in the UK and its wholly owned US subsidiary Babcock Water Engineering LP for a total consideration of £13.25 million. The Group also received £7.5 million of deferred consideration relating to the disposal in 1995 of the Group's former Energy division.

Further details can be found in notes 30 and 31 to the Financial Statements.

Pension schemes The Group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The total pension cost charged against the operating profits of the Group for the year was £6.2 million (1998: £5.8 million). Surpluses of £75.3 million (1998: £72.5 million) relating to the Group's principal pension schemes are carried in the balance sheet as prepayments. These prepayments are charged with the regular pension costs of the scheme members. The interest effect of these surpluses has been to reduce the gross pension charge for the year by £3.6 million (1998: £3.3 million).

Treasury Clearly established treasury policies and procedures are reviewed and approved by the Board on a regular basis. Divisional and operating company compliance with these policies and procedures is subject to periodic review by internal audit. Speculative transactions are prohibited.

Financial instruments The Group's financial instruments, other than derivatives, comprise cash and liquid resources, some short term borrowings and various items such as trade debtors and trade creditors etc. that arise directly from its operations.

The main purpose of these financial instruments is to finance the Group's operations.

The Group also enters into derivative transactions, principally forward foreign currency contracts. The purpose of these transactions is to manage the currency risks arising from foreign currency transactions. The use of derivative financial instruments other than forward foreign exchange contracts is prohibited without the prior approval of the Group Finance Director.

The main risks arising from the Group's financial instruments are foreign currency risk, liquidity risk and interest rate risk.

Foreign currency risk The Group's foreign currency exposure management policy requires subsidiaries to hedge transactional currency exposures against the currency in which their results are measured. Forward foreign exchange contracts are used to hedge selected future sales and purchases, which may be either contracted or uncontracted. Gains and losses on these contracts are recognised at the same time as the transaction to which the hedge relates.

The Group's accounting policy is to translate profits of overseas companies using average exchange rates and the net assets of overseas companies using year end exchange rates. It continues to be the Group's policy not to hedge foreign currency exposures on the translation of its overseas profits and net assets to sterling, although foreign currency borrowings are used from time to time to match foreign currency assets and liabilities.

The principal exchange rates used by the Group in translating overseas profits and net assets into sterling are set out in the table below.

If the 1999 results of foreign subsidiaries had been translated into sterling using the same average exchange rates as 1998, the Group turnover would have been £10.6 million higher and the Group operating profit £0.4 million higher.

Liquidity risk The Group invests its surplus funds in financial instruments with maturity profiles necessary to ensure the availability of those funds as required. The Group also maintains committed bank facilities available as a standby in the UK and certain overseas countries. The amount of undrawn committed facilities at 31 March 1999 is set out in note 22 to the Financial Statements.

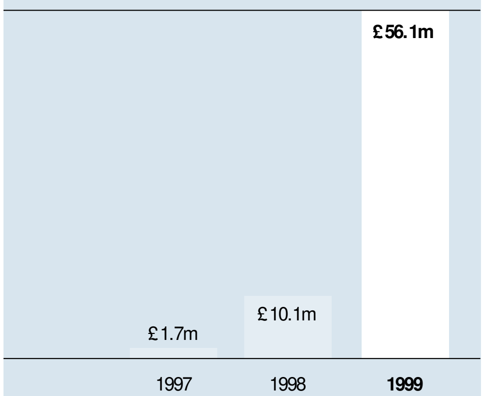
Interest rate risk The Group is exposed to interest rate risk on its short term borrowings, deposits, and other liquid financial instruments. These short term borrowings and investments are at both fixed and floating rates as set out in note 22 to the Financial Statements. The current Group policy, which has applied throughout the year, is to hedge the interest rate risk on these financial instruments as appropriate.

Credit risk The Group controls credit risk by entering into financial instruments only with highly credit-rated and authorised counterparties. Counterparty authorisations and positions are monitored on a regular basis.

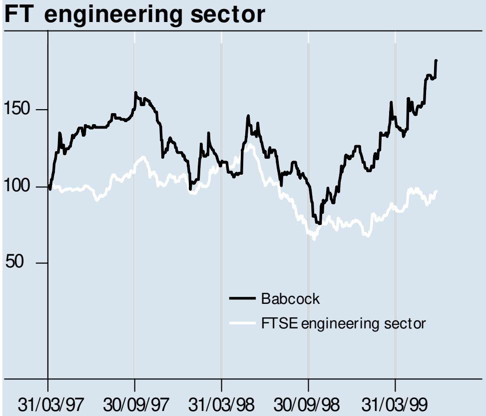
Share price performance During the past financial year the Company's share price has fluctuated between 48p and 97.5p. At market close on 15 June 1999 it stood at 114.5p which represents a market capitalisation of £194 million. The accompanying graph compares the Company's share price performance with that of the FT Engineering sector since 31 March 1997. After underperforming in earlier years the Company's share price performance has more recently exceeded that of the engineering sector as a whole.

N R Young Group Finance Director
15 June 1999

Cash flow from operating activities



Share price relative to FT engineering sector



Source: Datastream

	Average rate to £ 1999	Average rate to £ 1998	Year end rate to £ 1999	Year end rate to £ 1998
US Dollars	1.65	1.65	1.62	1.68
German Deutschmark	2.88	2.93	2.95	3.08
Finnish Markka	8.82	8.81	8.97	9.33
Swedish Krone	13.20	12.86	13.50	13.26
South African Rand	9.69	7.78	10.11	8.37

Directors and Company Secretary










	1	2
3	4	5
6	7	8
9	10	

1 **Dr T J Parker** (Age 57)
Joined the Board as Deputy Chairman and Chief Executive on 4 October 1993. Appointed Chairman on 21 July 1994. Former Chairman and Chief Executive of Harland and Wolff Holdings PLC and previously Deputy Chief Executive of the British Shipbuilders Corporation. Currently a non-executive Director of GKN plc and BG plc. Dr Parker is a Fellow of the Royal Academy of Engineering and President of the Royal Institution of Naval Architects.

2 **M S Easton** (Age 48)
Joined the Company as Managing Director of Babcock Engineering Services Division on 18 May 1997 and appointed to the Board on 31 July 1997. Former Managing Director and Chief Executive of Yarrow Shipbuilders Limited and previously Production Director at Cammell Laird Shipbuilders Limited.

3 **I G S Hartigan** (Age 65)*
Joined the Board on 1 October 1994. Retired in 1993 after 24 years' service with British Petroleum Company PLC where his positions included Managing Director of BP Shipping, President of BP North America and Regional Co-ordinator for Asia Pacific. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees. Mr Hartigan will be retiring at the 1999 Annual General Meeting.

4 **The Rt Hon Lord Hesketh KBE** (Age 48)**
Joined the Board on 6 October 1993. Appointed non-executive Deputy Chairman on 26 April 1996. A non-executive Director of British Aerospace plc and Chairman of British Mediterranean Airways Limited. Former Government Chief Whip in the House of Lords and prior to that, Industry Minister at the Department of Trade and Industry. Chairman of Babcock International Group PLC's Senior Appointments and Remuneration Committee and a member of its Audit Committee.

5 **D J Shah** (Age 46)*
Joined the Board on 15 June 1999. Mr Shah is currently employed by BP Amoco where he is responsible for their Forties Pipeline System and a General Manager for their Grangemouth complex. Formerly CEO of BP Solar International. A past Chairman of the European Solar Industry Association and a member of the DTI's Renewable Energy Advisory Committee. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

6 **Dr G Schäfer** (Age 59)
Appointed Managing Director of BMH Division on 1 September 1996 and joined the Board on 31 July 1997. Has some 20 years' experience in the Materials Handling industry and was previously Chief Executive of Claas KGaA.

7 **M J Turner CBE** (Age 50)*
Joined the Board on 5 June 1996. Mr Turner is an executive Director of British Aerospace plc and a member of the Supervisory Board of Airbus. He was President of the Society of British Aerospace Companies from 1996-1997. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

8 **A E Wheatley** (Age 61)*
Joined the Board on 1 January 1993. Non-executive Director of Legal & General Group PLC and N M Rothschild & Sons Limited. Chairman of Foreign & Colonial Special Utilities Investment Trust PLC and Deputy Chairman of Ashtead Group PLC. Trustee of the Victoria & Albert Museum and non-executive Trustee Director of V & A Enterprises Limited. Chairman of Babcock International Group PLC's Audit Committee and a member of its Senior Appointments and Remuneration Committee.

9 **N R Young** (Age 46)
Joined the Board as Group Finance Director on 31 July 1997. Former Group Finance Director of First Technology PLC and previously Group Finance Director of United Scientific Holdings PLC (now Alvis plc).

Company Secretary
10 **H M Mahy** (Age 38)
Joined the Group on 15 February 1993 and was appointed as Group Company Secretary and General Counsel on 1 February 1999. A Barrister and Chartered Insurance Practitioner, she was formerly Group Legal and Commercial Manager and previously Director – Legal and Commercial of Babcock King-Wilkinson Ltd. Prior to this she was deputy head of the commercial and legal department at Crown Agents.

* Denotes independent non-executive Director.

** Denotes senior independent non-executive Director.

Directors' report

The Directors present their Report and the audited Financial Statements of the Group for the year ended 31 March 1999.

Result and dividends The profit attributable to shareholders for the financial year was £25.5 million (1998: loss £8.7 million). An interim dividend of 0.80p per share was declared in the year (1998: 0.69p per share). The Directors propose to recommend the payment on 12 August 1999 of a final dividend of 1.40p on each of the ordinary shares of 50p entitled thereto and in issue on 9 July 1999. The retained profit for the financial year was £21.8 million (1998: loss £11.7 million).

Business review and Group structure The Operating and Financial Reviews of the Group's activities and future developments are set out on pages 6 to 19. Other matters material to an appreciation of the Group's position are contained in the Chairman's Statement on pages 4 to 5. The principal subsidiary and associated undertakings are set out on page 60.

Acquisitions and disposals Details regarding the Group's acquisitions and disposals during the course of the year are set out in notes 30 and 31 on page 58.

Research and development Product development and innovation is a continuous process. The Group continues to commit resources to research and development where this activity is necessary to the evolution and growth of its business.

Charitable and political donations During the year the Group donated £13,851 (1998: £21,695) to charitable organisations. No donations were made during the year for political purposes.

Supplier payments It is the general policy of both the Company and the Group to develop relationships with suppliers which include making payment consistent with established practices agreed with suppliers. In view of the international nature of the Group's activities there is no universal code or standard on payment practices, but subsidiary companies are expected to establish terms of trade consistent with the above policy and with the markets in which they operate, to ensure that suppliers are made aware of the terms of payment and to abide by them.

Year 2000 Although not regarding itself as having any factors in its business which would make it particularly susceptible to risks from the year 2000, the Group is aware of the problems associated with year 2000 and is acting in accordance with best practice in this area.

The Group is reviewing and correcting its computer systems, mainly by upgrading or replacing package systems, and expects to have largely completed this task by July 1999. Operations are also exposed to the failure of third party suppliers and customers to deal with their year 2000 issues, and possible liability on equipment supplied. The Group is taking all reasonably practicable steps to mitigate these risks, both in relation to past projects and those which are currently being undertaken.

Given the diversified nature of the Group, the Board has delegated detailed implementation to the Managing Directors of the Divisions and individual operating units, with suitable controls operating at a Group level. These controls consist of regular reporting on the state of compliance by the operating units, together with regular reviews to ensure that this compliance programme is adequately performed and documented at an operating company level. It has also been able to arrange insurances to cover some areas of potential risk.

The Group has in general made use of existing staff to review computer systems, so that no significant incremental costs have arisen in this review. Any changes required to provide year 2000 compliance are expected to be included as part of the normal upgrading of computer packages and equipment.

Directors The names of the present Directors, together with brief biographical notes, are shown on page 21.

The Rt Hon Lord Hesketh and Mr A E Wheatley retire by rotation under the provisions of Article 95 of the Company's Articles of Association and, being eligible, offer themselves for re-election.

Mr D J Shah who was appointed to the Board on 15 June 1999, retires under the provisions of Article 101 of the Company's Articles of Association and, being eligible, offers himself for election.

Should The Rt Hon Lord Hesketh fail to be re-elected at the forthcoming Annual General Meeting the remaining period of his appointment as a non-executive Director would be 14 months. In the case of Mr A E Wheatley the remaining period of his appointment as a non-executive Director would be five months. Should Mr D J Shah fail to be elected, his contract is terminable at will.

Mr I G S Hartigan will retire at the Annual General Meeting.

Directors' interests There is no contract or arrangement subsisting at the date of this document in which any Director of the Company is materially interested and which is significant in relation to the business of the Company and its subsidiaries taken as a whole.

Directors' interests in the shares of the Company are shown on pages 30 and 31.

Significant shareholdings The Company has been notified of the following interests in its ordinary shares which represent 3% or more of its issued ordinary share capital at 15 June 1999:

Name	No of 50p ordinary shares	%
Phillips & Drew Fund Management Limited	37,208,734	21.97
Fidelity International Limited	26,988,428	15.94
Jupiter Asset Management Limited	19,070,499	11.26
Legal & General Investment Management Limited	5,799,429	3.42

Sharesave scheme The Babcock International Sharesave Scheme was launched in December 1997 and was fully subscribed. The Group's employees now have options under the Scheme over 5,923,676 shares at an option price of 62.3p.

Personnel The Group comprises a number of companies which have developed voluntary practices and procedures for employee involvement and training appropriate to their own circumstances and needs. The Group encourages such an approach and believes that this promotes a better understanding of the issues facing the individual business in which the employee works. The performance of the Group is communicated to all staff; copies of the Annual Report and Financial Statements, together with preliminary and interim profit announcements, are made available to them.

The Group requires that a policy of providing equal opportunity for all employees, regardless of race, colour or sex, be pursued throughout the Group. Each Division in the Group is required to follow the employment laws, practices and regulations applicable in the Group company's country of operation.

The Group's policy is to give full and fair consideration to disabled applicants for employment, having regard to their particular aptitudes and abilities. If an employee becomes disabled, the objective is the continued provision of suitable employment either in the same or an alternative position, appropriate training being given if necessary. Disabled employees share in the opportunities for training, career development and promotion.

Health and safety The Group recognises that the securing of the health, safety and welfare at work of their employees is a major responsibility of management. The Group requires that all necessary steps are taken by each Division in the Group to maintain standards and procedures which discharge the duties laid down in all statutes, regulations and orders concerned with health and safety applicable in the Group company's country of operation.

The environment The Group recognises a responsibility and obligation to care for the environment and minimise any unacceptable adverse impact of its operations through positive environmental control. The maintenance of a high standard of environmental performance forms an integral part of business policy that is transmitted to employees and Company contacts. These policies are pursued throughout the Group and, as a minimum, require compliance with existing environmental legislation and regulation in the relevant country.

Annual General Meeting This year's Annual General Meeting will be held at the Barber-Surgeons' Hall, Monkwell Square, London EC2Y 5BL on Friday, 30 July 1999, at 12 noon. The notice of meeting is on pages 61 to 63 of this document.

Special business Resolutions 6(1) to 6(9) set out in the notice of Annual General Meeting constitute special business.

Resolution 6(1), which will be proposed as an Ordinary Resolution, authorises the Directors to allot unissued shares in the capital of the Company with a total nominal value of up to £28,220,000, which represents approximately one-third of the issued share capital of the Company as at 15 June 1999. This authority, which replaces the one granted on 9 May 1994, expires on 29 July 2004 unless previously revoked, renewed or varied. The Directors have no present intention to issue any shares except in connection with the Group's executive and employee share schemes.

Resolution 6(2), which will be proposed as a Special Resolution, authorises the Directors in certain circumstances to allot shares or grant rights over shares where they propose to do so for cash and otherwise than to existing shareholders pro rata to their holdings. The circumstances in question are in relation to a rights issue in favour of ordinary shareholders, or in relation to the issue of shares up to an aggregate nominal value of £4,233,002, being 5% of the issued share capital of the Company as at 15 June 1999. If given, the authority conferred by this resolution will expire on 29 July 2004 unless previously revoked, renewed or varied.

Resolution 6(3), which will be proposed as a Special Resolution, renews the general authority for the Company to make market purchases of its own ordinary shares for cancellation. The renewed authority, in respect of up to 10% of the Company's present issued share capital, is exercisable with a minimum purchase price of 50p per share and a maximum price which will not be more than 105% of the average middle market quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the ten business days preceeding the day of purchase. The authority will expire on 29 July 2000 or, if earlier, on the conclusion of the Annual General Meeting of the Company to be held in 2000. The Directors have no present intention to use this power, but would exercise the power if they were satisfied at any time that it was in the best interests of shareholders generally to do so, and that any purchase would be likely to result in an increase in earnings per share.

Resolution 6(4), which will be proposed as a Special Resolution, adopts new Articles of Association of the Company. Following a review of the Company's existing Articles of Association, your Directors consider it appropriate to make a number of changes in order to bring the Articles more into line with current practice, reflecting recent changes in legislation and the current London Stock Exchange Listing Rules. The changes which the Directors have been advised to make are sufficiently extensive to merit the adoption of a new set of Articles. The main differences between the proposed new Articles and the Company's existing Articles of Association are summarised in the Chairman's letter to shareholders accompanying this document. Other changes of a drafting, minor or technical nature have not been specifically mentioned.

Resolution 6(5), which will be proposed as an Ordinary Resolution, establishes two new executive share option schemes – The Babcock 1999 Approved Executive Share Option Scheme and The Babcock 1999 Unapproved Executive Share Option Scheme (the "UK Schemes") – as described in the Chairman's letter to shareholders accompanying this document. The Resolution also authorises the Directors to establish further schemes for non UK resident employees based on The Babcock 1999 Unapproved Executive Share Option Scheme, but modified to take account of overseas laws and regulations. Options to subscribe for shares granted under any such 'overseas' scheme will count towards the applicable overall and individual limits imposed by the UK Schemes.

Resolution 6(6), which will be proposed as an Ordinary Resolution, authorises the Directors to establish a trust for the benefit of employees of the Babcock Group ("an employees' share trust") for the purposes of facilitating the acquisition and holding of shares to be made available to employees participating in the Group's executive and employee share schemes, as described in the Chairman's letter to shareholders accompanying this document.

Resolution 6(7), which will be proposed as an Ordinary Resolution, authorises the Directors to establish a second employees' share trust – 'The Babcock Qualifying Employees' Share Trust' – which is intended to satisfy the requirements of the Finance Act 1989 (as amended) and which will be used to acquire and transfer shares to participants in the Group's savings-related share option scheme, as described in the Chairman's letter to shareholders accompanying this document.

Resolution 6(8), which will be proposed as a Special Resolution, authorises an executive Director to participate in decisions of the Board of Directors on any matters relating to the Group's executive and employee share schemes (including the proposed employees' share trusts) other than any matter relating only to his or her own participation, and relaxes the Company's Articles of Association to that extent.

Resolution 6(9), which will be proposed as an Ordinary Resolution, authorises the Directors pursuant to the Articles of Association of the Company to offer shareholders the right to elect to receive fully paid shares in the Company instead of cash dividends. This power would replace the one granted at the 1993 Annual General Meeting, which has now expired in accordance with its terms. Any such offer to shareholders would be made in a separate circular to shareholders.

Your Directors believe that each of Resolutions 6(1) to 6(9), as set out on pages 61 to 63, to be proposed at the Annual General Meeting is in the best interests of the Company and the shareholders as a whole and unanimously recommend shareholders to vote in favour of each of these Resolutions as they intend to do so in respect of their own beneficial holdings totalling 87,757 ordinary shares of 50p each, representing 0.05% of the present issued share capital of the Company.

Auditors Arthur Andersen are willing to continue in office and Resolutions will be proposed at the Annual General Meeting to reappoint them as auditors and to authorise the Directors to fix their remuneration.

Corporate governance

Statement of compliance with the Combined Code During the year ended 31 March 1999 the Company complied with the requirements of the Principles of Good Governance and Code of Best Practice (the "Combined Code").

The Company has combined the post of Chairman and Chief Executive Officer in one person. The Board considers it has a strong, independent group of non-executive Directors (including a non-executive Deputy Chairman) and is well balanced.

The Group recognises the importance of, and is committed to, high standards of corporate governance. The principles of good governance set out in Section 1 of the Combined Code have been applied in the following way:

a) Directors The Board currently comprises four executive Directors and five non-executive Directors. The Board is confident that the constitution of the Board, including the non-executive Directors, ensures a balance of power and authority, such that no one individual has unfettered powers of decision.

The Board formally met six times last financial year. All Directors have full and timely access to information.

Article 103 of the proposed new Articles of Association will ensure that all Directors must submit themselves for re-election at least every three years.

b) Directors' remuneration Full details of Directors' remuneration and a statement of the Company's policy on executive Directors' remuneration are set out on pages 27 to 31.

c) Relations with shareholders The Company maintains an active dialogue with its institutional shareholders. The Annual General Meeting is used as an important opportunity for communication with both institutional and private shareholders.

d) Accountability and audit

i) Going concern The Financial Statements have been prepared on a going concern basis as the Directors have a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future.

ii) Internal financial controls The Company, as permitted by the London Stock Exchange, has complied with the Combined Code provisions on internal control by reporting on internal financial control in accordance with the guidance for Directors on internal control and financial reporting issued in December 1994.

The Board of Directors has overall responsibility for the Group's system of internal financial controls, and for monitoring its effectiveness. Whilst no system of internal financial control can provide absolute assurance, the system established is designed to give reasonable assurance against material misstatement or loss. The key features of this system are described under the following headings.

Control environment The Group operates decentralised profit responsible units reporting through a Divisional management structure with clear delegated levels of authority and an established system of internal control.

Identification and evaluation of risks and control objectives The Board has the primary responsibility for identifying the major business risks facing the Group and developing appropriate policies to manage those risks. Given the nature of the Group's business the principal risks relate to out-turn on contracts. All tenders for significant contracts are therefore referred to Group head office for review and approval prior to tender submission to ensure that the terms of the tender meet Group criteria. Progress on all significant contracts undertaken is monitored within the Division and at least quarterly by Group head office.

Information and communication Comprehensive budgeting systems are in place to develop annual budgets covering the key aspects of each Division's business. The budgets are subject to review by central management, prior to approval by the Board. Revised forecasts for the year are prepared on a regular basis. Actual performance is compared each month with budgets, forecasts and prior year, with written commentary on significant variances from approved plans.

Control procedures The Board has adopted a schedule of matters which are required to be brought to it for decision, thus ensuring that it maintains effective control over appropriate strategic, financial, organisational and compliance issues. Financial controls and procedures are detailed in the Group Policies & Authorities Manual. These controls include defined procedures for seeking approval for both significant commitments and organisational changes.

Monitoring The internal control system is monitored and supported by an internal audit function that operates and reports to senior management and the Audit Committee on the Group's worldwide operations. The work of the internal auditors is focused on the areas of greatest risk to the Group determined by senior management and the audit department. These activities are supported by self-assessment questionnaires, quality assurance audits and regular review visits by Group management. The external auditors are engaged to express an opinion on the Group's Annual Report and Financial Statements and the results of their reviews are reported to the Audit Committee.

The Board of Directors has reviewed the effectiveness of the system of internal financial controls in place.

Statement of Directors' responsibilities Company law requires the Directors to prepare Financial Statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. In preparing those Financial Statements, the Directors are required to

- select suitable accounting policies and then apply them consistently;

- make judgements and estimates that are reasonable and prudent;

• state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and

• prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business.

The Directors are responsible for maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the Financial Statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Remuneration report

Senior Appointments and Remuneration Committee The remuneration and emoluments of the executive Directors are determined by the Senior Appointments and Remuneration Committee ("the Committee"). The Committee is comprised solely of all the non-executive Directors of the Company, namely:

The Rt Hon Lord Hesketh (Committee Chairman)
I G S Hartigan
D J Shah (effective 15 June 1999)
M J Turner
A E Wheatley

The biographical details of these Directors are set out on page 21.

The non-executive Directors exercise their judgements independently of the executive Directors, making use of independent external advice as required from a leading independent firm of compensation and benefit consultants. They do not participate in any of the Company's share option, pension or bonus schemes.

Service contracts Dr T J Parker has a service contract with the Company which was entered into upon his appointment in 1993 for an initial three year term which expired on 31 December 1996 and now continues on a one year rolling contract basis. Mr M S Easton, Dr G Schäfer and Mr N R Young each have service agreements. Mr Easton's and Mr Young's agreements are on a one year rolling basis and Dr Schäfer's agreement, which was for an initial three year term expiring on 29 July 1999, will thereafter continue on a one year rolling basis. The Committee's view is that, although it may be appropriate to provide an initially longer period of fixed notice when an individual joins the Board, the norm for a rolling notice period should be one year. Each service contract is subject to termination upon retirement.

Following the expiry of Dr Schäfer's initial three year term on 29 July 1999, no executive Directors will have separate pre-determined compensation provisions exceeding one year's salary and benefits in kind and the amount of any bonus earned in the preceding year.

Policy on executive Directors' remuneration The Company seeks to provide total reward packages that are effective in attracting, retaining and motivating, in a fair and economical manner, executive Directors of the experience and calibre required to develop its businesses profitably in the interests of shareholders, customers, employees and other stakeholders in the Company. In order to achieve this the Company must provide a competitive package of rewards and incentives linked to performance.

Directors' remuneration The total reward package for the executive Directors includes the current rewards of basic salary, benefits in kind, such as cars and medical insurance, annual bonuses, and the long-term rewards of share options and pension benefits. In determining the remuneration of the executive Directors, the Committee has considered practices in the wider market, in particular those of competitor companies. The Directors' emoluments for the year ended 31 March 1999 are set out in the table below:

Directors	Salary or fee £'000	Bonus £'000	Benefits £'000	Other[b] £'000	**Total 1999 £'000**	Total 1998 £'000
Executive						
Dr T J Parker (Chairman)	294	177	17	125	**613**	550
M S Easton[a]	160	80	11	6	**257**	114
Dr G Schäfer[a]	214	107	11	–	**332**	190
N R Young[a] (Group Finance Director)	167	84	13	11	**275**	177
Non-executive						
I G S Hartigan	20	–	–	–	**20**	20
The Rt Hon Lord Hesketh KBE	40	–	–	–	**40**	40
M J Turner CBE	20	–	–	–	**20**	20
A E Wheatley	30	–	–	–	**30**	30
Total	945	448	52	142	**1,587**	1,141

a Mr M S Easton, Dr G Schäfer and Mr N R Young joined the Board on 31 July 1997 and their 1998 remuneration is from that date onwards.
b Tax paid in respect of supplementary pension contributions over the "earnings cap".

Benefits in kind comprise mainly company car benefits and membership of the Company's Group Healthcare Scheme. Benefit levels provided to the executive Directors are consistent with those provided by other major companies. They do not form part of pensionable earnings under any of the Company's pension arrangements.

Non-executive Directors' fees are determined by the executive Directors. The basic fee paid to the non-executive Directors other than Lord Hesketh and Mr Wheatley is £20,000 per annum. Lord Hesketh's basic fee is £40,000 per annum to reflect his additional responsibilities as Deputy Chairman. Mr Wheatley's basic fee is £30,000 per annum to reflect his Chairmanship of the Audit Committee. No fees for other services were paid to non-executive Directors during the year. Non-executive Directors' fees are set at a level which will attract individuals with the necessary experience and ability to make a significant contribution to the Company's affairs. They have written terms of service and are appointed for an initial term of three years. At the Board's discretion a further term may be offered (generally for four years). They are free to resign at any time.

Directors' pension benefits Contributions to a pension scheme based on relevant annual remuneration up to the permitted maximum of £87,600 in 1998/99, the earnings cap, are exempted from income tax in the UK. The UK based executive Directors of the Company are all affected by the earnings cap. In respect of their remuneration up to the earnings cap during the year under review, Dr T J Parker, Mr M S Easton and Mr N R Young are members of the upper tier of the Babcock International Group Pension Scheme. The Babcock International Group Pension Scheme is a defined benefit scheme. In addition they are all members of the Babcock Supplementary Pension Scheme, a money purchase scheme, which provides benefits above the earnings cap. In the case of Dr T J Parker it will, in conjunction with his benefits from the upper tier of the Babcock International Group Pension Scheme and benefits from former employers' schemes, provide a target pension of 50% of his basic salary on retirement at age 60. There has been no change in the benefit provisions of the two schemes during the year 1998/99. Dr G Schäfer, who is based in Germany, has equivalent personal pension arrangements.

The following table indicates the increase in value of the retirement benefits of the three executive Directors provided by the Babcock International Group Pension Scheme. The increase in transfer value has been provided by the independent actuary appointed by the trustees of the Babcock International Group Pension Scheme.

Name	Pension at 31 March 1998 £	**Revalued pension to 31 March 1999 £**	**Pension at 31 March 1999 £**	Pension accrued during year £	Transfer value £	Members' contributions £	Transfer value in excess of members' contributions £
Dr T J Parker	6,300	**6,552**	**8,030**	1,478	27,889	13,140	14,749
N R Young	1,867	**1,941**	**4,867**	2,926	34,497	8,375	26,122
M S Easton	2,333	**2,426**	**5,353**	2,927	38,058	8,000	30,058

Notes

a) The pension at 31 March 1998 has been revalued to 31 March 1999 in the case of Dr Parker at the rate of 4%.

b) The transfer value of the pension accrued during the year is calculated on the basis agreed with the trustees of the Babcock International Group Pension Scheme and is the prescribed basis to be used for minimum funding requirement purposes.

c) The figures in the above table make no allowance for the cost of death in service benefits under the Babcock International Group Pension Scheme.

d) The figures in the above table make no allowance for any benefits in respect of earnings received in excess of the earnings cap which for 1998/99 was £87,600.

e) In calculating the pension for Mr Young and Mr Easton, no account has been taken of retained benefits. If the members have significant such benefits, the pension shown may be restricted to a lower amount and the figures may need to be correspondingly reduced.

The following table sets out the amounts of the contributions made to the Babcock Supplementary Pension Scheme and personal pension arrangements on behalf of the Directors by Group companies.

Directors	**1999 £'000**	1998 £'000
Executive		
Dr T J Parker	**188**	138
M S Easton	**9**	8
Dr G Schäfer	**19**	14
N R Young	**16**	8
Total	**232**	168

Directors' share interests The beneficial interests of the Directors, including family interests, were as follows:

Directors	**Babcock 50p ordinary shares At 31 March 1999**	Babcock 50p ordinary shares At 1 April 1998
Dr T J Parker	**27,857**	27,857
M S Easton	**10,000**	–
I G S Hartigan	**10,000**	4,000
The Rt. Hon Lord Hesketh KBE	**9,900**	9,900
Dr G Schäfer	**–**	–
M J Turner CBE	**20,000**	20,000
A E Wheatley	**10,000**	10,000
N R Young	**–**	–

There were no changes in the Directors' interests in shares between 31 March 1999 and 15 June 1999.

Long-term incentives

i) Executive share options schemes Discretionary grants of share options are the principal form of long-term incentive provided for the executive Directors and other senior executives throughout the Group and are controlled by the Committee, which considers such schemes to be an important component in the overall executive remuneration package. The exercise prices of options granted are not set at a discount to the market value of the Company's shares at the date of grant.

The aggregate value of the options granted within a ten year period to any Director must not exceed four times the value of basic emoluments. Directors may normally exercise their options between the third and tenth anniversary of the date of grant. There are no performance criteria attached to the right to exercise the options that have been granted. Options were granted in full, based on his remuneration at that time, to Dr T J Parker as part of the compensation arrangements necessary to secure his services. No Directors exercised any options during the year of account. Options held by Mr M S Easton, Dr G Schäfer and Mr N R Young were granted in the years subsequent to their appointment as Directors. There have been no changes between 31 March 1999 and 15 June 1999. The position with regard to Directors' share options at the end of the year is disclosed in the table below.

Directors	Number of options	Exercise price (p)	Exercisable from	Expiry date
Dr T J Parker	1,012,971	114.51	Dec 1996	Dec 2003
	11,878	89.00	Jul 2001	Jul 2008
M S Easton	165,680	84.50	Jun 2000	Jun 2007
	56,909	82.00	Dec 2000	Dec 2007
	239,700	89.00	Jul 2001	Jul 2008
Dr G Schäfer	304,288	77.00	Sep 1999	Sep 2006
	340,017	82.00	Dec 2000	Dec 2007
	316,614	89.00	Jul 2001	Jul 2008
N R Young	244,508	87.25	Aug 2000	Aug 2007
	250,936	89.00	Jul 2001	Jul 2008

Note: The Company's mid market share price on the London Stock Exchange Daily Official List on 31 March 1999, the last trading day of the Company's year of account, was 87p. The Company's highest and lowest mid market share price in the year to 31 March 1999 was 97.5p and 48p respectively.

Long-term incentives continued

ii) Proposed new executive share option schemes and employee share trusts The Directors intend to seek the approval of shareholders at the 1999 Annual General Meeting for the adoption of fresh executive share option schemes and the establishment of employees' share trusts to facilitate the acquisition and holding of shares in the Company for use in conjunction with the new schemes and the Babcock International Group PLC Sharesave Scheme. Further information about the new schemes and employees' share trusts is set out in the Chairman's letter to shareholders enclosed with this Annual Report and Financial Statements.

iii) Babcock International Group PLC Sharesave Scheme The scheme, which was introduced in December 1997, is linked to a save-as-you-earn contract which participants enter into with a building society nominated by the Company to save a regular monthly sum by deduction from earnings of up to £224 per month for three years. Subject to common service criteria, the scheme is open to all UK employees (including executive Directors) of the Group. Options are normally exercisable during a period of six months following the expiry of the three year savings period.

The option price is calculated by reference to the average of the mid-market quotation of a share as shown by the London Stock Exchange Daily Official List for the three business days immediately preceding 26 November 1997 ("the offer date") discounted by 20%. Details of options granted to Directors in 1997/1998 and outstanding, are set out below.

Directors	Number of options	Exercise price (p)	Grant date	Exercise period
Dr T J Parker	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001
M S Easton	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001
N R Young	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001

Annual performance related bonus scheme All senior executives in the Group participate in bonus schemes primarily related to the performance of the business or businesses with which they are involved. The executive Directors participate in a bonus scheme related to the performance of the Group and to more specific personal targets set by the Committee. Under the bonus scheme, the maximum potential bonus of Mr M S Easton, Dr G Schäfer and Mr N R Young is limited by the Committee to 50% of their base salaries. Dr T J Parker's maximum potential bonus is limited by the Committee to 60% of his base salary.

The Group performance element of their bonus is determined by the extent to which the trading performance of the Group achieves the targets and parameters set by the Committee at the beginning of each year. The Committee has absolute discretion to alter them to reflect changed circumstances, for example material changes in accounting standards or changes in the structure of the Group. Bonuses awarded under this element of the bonus scheme are included within the table on page 28.

At the beginning of the financial year under review the Committee also agreed a range of personal performance targets for the executive Directors based on the Group's overall priorities. Each Director was appraised by the Committee on progress under each target and bonuses were awarded accordingly. These are also included within the table on page 28.

Annual bonuses do not form part of pensionable earnings.

1999/2000 performance related bonuses For the year 1999/2000 the Committee have decided to continue to apply the performance related bonus schemes together with more specific personal targets, compatible with the Board's strategic and operational priorities for the year.

Approval of report Approved by the Directors on 15 June 1999.

By order of the Board

H M Mahy Secretary
15 June 1999

Auditors' report

Auditors' report to the shareholders of Babcock International Group PLC We have audited the Financial Statements on pages 33 to 60 which have been prepared under the historical cost convention and the accounting policies set out on pages 38 and 39.

Respective responsibilities of Directors and auditors The Directors are responsible for preparing the Annual Report including, as described on pages 26 and 27, the Financial Statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange, and by our profession's ethical guidance.

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

We review whether the statement on pages 25 and 26 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's corporate governance procedures or its internal controls.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited Financial Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements.

Basis of audit opinion We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Statements and of whether the accounting policies are appropriate to the circumstances of the Company and of the Group, consistently applied and adequately disclosed.

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

Opinion In our opinion the Financial Statements give a true and fair view of the state of affairs of the Company and of the Group at 31 March 1999 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen Chartered Accountants and Registered Auditors

1 Surrey Street
London WC2R 2PS

15 June 1999

Group profit and loss account

For the year ended 31 March 1999

	Notes	1999 Continuing operations £'000	1999 Discontinued operations £'000	1999 Total £'000	1998 £'000
Turnover including share of joint ventures		**494,990**	**14,423**	**509,413**	591,704
Less: share of turnover of joint ventures		**–**	**13,092**	**13,092**	23,447
Acquisitions		**13,630**	**–**	**13,630**	–
Existing operations		**481,360**	**1,331**	**482,691**	568,257
Group turnover	2	**494,990**	**1,331**	**496,321**	568,257
Cost of sales	3	**(412,564)**	**(798)**	**(413,362)**	(487,966)
Gross profit		**82,426**	**533**	**82,959**	80,291
Net operating expenses excluding goodwill amortisation	3	**(62,640)**	**(424)**	**(63,064)**	(70,095)
Group operating profit before goodwill amortisation		**19,786**	**109**	**19,895**	10,196
Goodwill amortisation	3	**2,348**	**(11)**	**2,337**	2,333
Acquisitions		**1,714**	**–**	**1,714**	–
Existing operations		**20,420**	**98**	**20,518**	12,529
Group operating profit	2	**22,134**	**98**	**22,232**	12,529
Share of operating profit of joint ventures and associates	2	**90**	**479**	**569**	1,488
Trading profit including share of joint ventures and associates	2	**22,224**	**577**	**22,801**	14,017
Profit/(loss) on the sale or termination of operations	4	**–**	**6,142**	**6,142**	(18,714)
Profit/(loss) on ordinary activities before interest		**22,224**	**6,719**	**28,943**	(4,697)
Net interest and similar charges	5			**2,501**	152
Profit/(loss) on ordinary activities before taxation	6			**31,444**	(4,545)
Tax on profit/(loss) on ordinary activities	8			**(5,295)**	(2,860)
Profit/(loss) on ordinary activities after taxation				**26,149**	(7,405)
Minority interests	28			**(637)**	(1,271)
Profit/(loss) for the financial year				**25,512**	(8,676)
Dividends paid and proposed	10			**(3,725)**	(3,048)
Retained profit/(loss) for the financial year	27			**21,787**	(11,724)
Earnings/(loss) per share					
– Basic	11			**15.07p**	(5.12p)
– Diluted	11			**14.99p**	(5.07p)

The accompanying notes are an integral part of this Group profit and loss account.

Group balance sheet

As at 31 March 1999

	Notes	1999 £'000	1999 £'000	1998 £'000	1998 £'000
Fixed assets					
Intangible assets	12				
Development costs			**183**		422
Goodwill					
– Goodwill		**21,842**		19,520	
– Negative goodwill		**(22,593)**		(26,560)	
			(751)		(7,040)
			(568)		(6,618)
Tangible assets	13		**47,824**		51,478
Investments	15				
Investments in joint ventures					
– Goodwill		**–**		1,715	
– Share of gross assets		**–**		9,816	
– Share of gross liabilities		**–**		(6,359)	
			–		5,172
Investments in associates			**558**		526
Other investments			**126**		128
			684		5,826
			47,940		50,686
Current assets					
Stocks	16		**25,835**		24,820
Debtors – due within one year	17	**105,741**		138,556	
Debtors – due after more than one year	17	**77,144**		74,012	
			182,885		212,568
Investments	18		**6,618**		–
Cash and bank balances			**89,928**		50,707
			305,266		288,095
Creditors – amounts due within one year	19		**(182,430)**		(190,162)
Net current assets			**122,836**		97,933
Total assets less current liabilities			**170,776**		148,619
Creditors – amounts due after more than one year	20		**(2,016)**		(7,646)
Provisions for liabilities and charges	23		**(32,186)**		(26,162)
Net assets			**136,574**		114,811
Capital and reserves					
Called up share capital	26		**84,660**		84,656
Share premium account	27		**67,112**		67,111
Profit and loss account	27		**(25,017)**		(46,094)
Equity shareholders' funds			**126,755**		105,673
Minority interests	28		**9,819**		9,138
			136,574		114,811

The accompanying notes are an integral part of this Group balance sheet.

Company balance sheet

As at 31 March 1999

	Notes	1999 £'000	1998 £'000
Fixed assets			
Investment in subsidiary undertakings	14	**136,301**	136,301
Current assets			
Debtors	17	**694**	2,525
Cash and bank balances		**67,105**	63,468
		67,799	65,993
Creditors – amounts due within one year	19	**(17,161)**	(16,430)
Net current assets		**50,638**	49,563
Net assets		**186,939**	185,864
Capital and reserves			
Called up share capital	26	**84,660**	84,656
Share premium account	27	**67,112**	67,111
Profit and loss account	27	**35,167**	34,097
Equity shareholders' funds		**186,939**	185,864

The accompanying notes are an integral part of this Company balance sheet.

The Financial Statements on pages 33 to 60 were approved by the Board on 15 June 1999 and signed on its behalf by:

Dr T J Parker Director

N R Young Director

Group cash flow statement

For the year ended 31 March 1999

	Notes	1999 £'000	1999 £'000	1998 £'000	1998 £'000
Cash flow from operating activities	29a		**56,136**		10,058
Dividends received from joint venture			**1,350**		–
Net interest and similar charges		**1,615**		(795)	
Dividends paid to minority shareholders		**–**		(1,160)	
Returns on investments and servicing of finance			**1,615**		(1,955)
UK corporation tax received (including ACT)		**280**		379	
Overseas tax paid		**(1,078)**		(1,835)	
Taxation			**(798)**		(1,456)
Payments to acquire tangible fixed assets		**(5,868)**		(7,964)	
Payments to acquire intangible fixed assets		**(17)**		–	
Receipts from sale of tangible fixed assets		**379**		241	
Capital expenditure and financial investment			**(5,506)**		(7,723)
Payments to acquire subsidiary undertakings	29d	**(3,182)**		–	
Receipts on sale of subsidiary undertakings and joint ventures	29d	**20,088**		(2,424)	
Receipts from minorities		**35**		61	
Acquisitions and disposals			**16,941**		(2,363)
Equity dividends paid			**(3,235)**		(2,649)
Cash inflow/(outflow) before management of liquid resources and financing			**66,503**		(6,088)
Management of liquid resources			**884**		(3,439)
Shares issued for cash		**5**		–	
Repayment of borrowings		**(5,802)**		(2,076)	
Repayments of capital element of finance lease rentals		**(443)**		(1,769)	
Financing			**(6,240)**		(3,845)
Increase/(decrease) in cash in the year	29b		**61,147**		(13,372)

The accompanying notes are an integral part of this Group cash flow statement.

Group statement of total recognised gains and losses
For the year ended 31 March 1999

	1999 £'000	1998 £'000
Profit/(loss) for the financial year	**25,512**	(8,676)
Currency translation differences on foreign currency net investments and related loans	**(710)**	(2,143)
Total recognised gains and losses relating to the year	**24,802**	(10,819)

Reconciliation of movements in shareholders' funds
For the year ended 31 March 1999

	1999 £'000	1998 £'000
Shareholders' funds at start of year	**105,673**	119,540
Shares issued in the year	**5**	–
Total recognised gains and losses relating to the year	**24,802**	(10,819)
Dividends	**(3,725)**	(3,048)
Net movement in shareholders' funds	**21,082**	(13,867)
Shareholders' funds at end of year	**126,755**	105,673

The accompanying notes are an integral part of this Group statement of total recognised gains and losses and this reconciliation of movements in shareholders' funds.

Notes to the financial statements

1) Accounting policies
Basis of accounting The Financial Statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards.

Basis of consolidation The Group Financial Statements include the Financial Statements of the Company and all of its subsidiary undertakings made up to 31 March. Acquisitions are included from the date of acquisition and the results of businesses disposed of or terminated are included in the results for the year up to the date of relinquishing control or closure and analysed as continuing or discontinued operations.

The Group Financial Statements include the appropriate share of the results and net assets of joint ventures and associated undertakings' results and net assets based on the latest available Financial Statements. Associated undertakings are those in which the Group has a long term investment in the voting equity and over which it exerts significant influence. Joint ventures are those entities in which the Group has a long term interest and shares control with another party or parties.

Acquisitions for which the consideration includes an issue of shares which are eligible for "merger relief", are stated in the Company's balance sheet at the nominal value of the shares issued together with the fair value of any other consideration given, plus the costs of the relevant acquisition.

Goodwill When the fair value of the consideration for an acquired undertaking exceeds the fair value of its separable net assets the difference is treated as purchased goodwill and is capitalised and amortised through the profit and loss account over its estimated economic life. The estimated economic life of goodwill is between ten and twenty years.

Where the fair value of the separable net assets exceeds the fair value of the consideration for an acquired undertaking the difference is treated as negative goodwill and is capitalised and amortised through the profit and loss account in the period in which the non-monetary assets acquired are recovered. In the case of fixed assets this is the period over which they are depreciated and, in the case of current assets, the period over which they are sold or otherwise realised.

Tangible fixed assets Tangible fixed assets are stated at cost less depreciation and any provision for permanent diminution in value. Depreciation is provided on a straight line basis to write off the cost of fixed assets over their estimated useful lives to their estimated residual value at the following annual rates:

Freehold land	Nil
Freehold buildings	2% to 10%
Short leasehold property	Over period of lease
Plant and machinery – heavy production	6.6%
– other	10% to 33.3%
Motor vehicles	20% to 33.3%

Leases Assets acquired under finance leases are capitalised and the outstanding capital element of instalments is included in creditors. The interest element is charged against profits so as to produce a constant periodic rate of charge on the outstanding obligations. Depreciation is calculated to write the assets off over their expected useful lives or over the lease terms where these are shorter. Rentals under operating leases are charged to the profit and loss account on a straight line basis.

Investments Fixed asset investments are stated at cost less provision for permanent diminution in value. Current asset investments that are listed on a recognised Stock Exchange are stated at market value. Other current asset investments are stated at the lower of cost and net realisable value.

Stocks and work in progress Stocks are valued at the lower of cost and net realisable value. In the case of finished goods and work in progress, cost comprises direct materials and labour and an appropriate proportion of overheads.

Long term contracts Long term contracts are those which extend over more than one accounting period.

Long term contract balances are valued at costs incurred, less amounts transferred to cost of sales, and after deducting attributable payments on account and providing for foreseeable losses.

Management reviews are conducted at least quarterly to assess the progress of each significant contract, the costs to be incurred and the expected outcome of any disputes with customers or subcontractors. Where the ultimate profitability of a contract can be assessed with reasonable certainty having made prudent allowance for future risks and uncertainties, profit is recognised in proportion to the contract work completed. Immediate provision is made for all foreseeable losses.

Research and development Development expenditure on clearly defined projects, the commercial outcome of which can be assessed with reasonable certainty, is capitalised and amortised over the shorter of the project life and three years.

All other research and development expenditure is written off in the period in which it is incurred.

Deferred taxation Provision is made for deferred taxation, using the liability method, on all timing differences, including those arising in relation to pension costs, to the extent that it is probable that a liability or asset will crystallise in the foreseeable future. No provision is made for any tax arising in the event of the distribution of profits retained by overseas subsidiaries, joint ventures and associates.

Foreign currencies Transactions denominated in foreign currencies are recorded in local currency at the rate of exchange ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the local currency at the year end exchange rates or at the rate at which they are hedged if appropriate.

Exchange gains and losses arising on foreign currency borrowings used to finance subsidiary undertakings are taken to reserves to the extent that they can be offset against the exchange differences arising on the equity investment. Except as disclosed below, assets and liabilities of foreign subsidiary undertakings are translated on consolidation into sterling at the rate of exchange ruling at the balance sheet date and the results are translated using the average exchange rate for the period. These consolidation differences on exchange are taken to reserves. All other exchange differences are dealt with in the profit and loss account.

Where it is considered that the results of an overseas undertaking are more dependent on sterling than its own reporting currency, the Financial Statements of the undertaking are consolidated using the temporal method, thereby treating all transactions as though they had been entered into by the undertaking itself in sterling.

Turnover In respect of long term contracts, turnover represents amounts transferred to cost of sales during the period plus attributed profit. Other turnover comprises the invoiced value of goods and services supplied by the Group. Turnover excludes sales taxes and intra-group transactions.

Pension costs The Group operates various pension schemes established in accordance with local conditions and practices in the countries concerned. For those schemes that operate on a defined benefit basis, contributions are based on periodic actuarial calculations and are charged so as to spread the cost of pensions over the expected service lives of the employees who are members of the scheme.

Derivative financial instruments The Group uses derivative financial instruments, principally forward foreign exchange contracts, to reduce exposure to foreign exchange risk. The Group does not hold or issue derivative financial instruments for speculative purposes.

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

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss is recognised at that time.

2) Segmental information

The segmental information reflects the current composition of the Group. The South Africa operation, previously disclosed separately, is now included in BMH Division.

	Group turnover 1999 £'000	Group operating profit 1999 £'000	Share of operating profit of joint ventures and associates 1999 £'000	Trading profit including share of joint ventures and associates 1999 £'000	Group turnover 1998 £'000	Group operating profit 1998 £'000	Share of operating profit of joint ventures and associates 1998 £'000	Trading profit including share of joint ventures and associates 1998 £'000
Continuing operations								
BES	**280,194**	**13,316**	**90**	**13,406**	309,007	10,420	(14)	10,406
BMH	**214,796**	**8,355**	**–**	**8,355**	223,997	7,119	–	7,119
Unallocated costs and other income	**–**	**(1,885)**	**–**	**(1,885)**	–	(1,933)	–	(1,933)
	494,990	**19,786**	**90**	**19,876**	533,004	15,606	(14)	15,592
Goodwill amortisation	**–**	**2,348**	**–**	**2,348**	–	2,349	–	2,349
Total continuing operations	**494,990**	**22,134**	**90**	**22,224**	533,004	17,955	(14)	17,941
Discontinued operations	**1,331**	**109**	**742**	**851**	35,253	(5,410)	1,896	(3,514)
Goodwill amortisation	**–**	**(11)**	**(263)**	**(274)**	–	(16)	(394)	(410)
Total discontinued operations	**1,331**	**98**	**479**	**577**	35,253	(5,426)	1,502	(3,924)
Group total	**496,321**	**22,232**	**569**	**22,801**	568,257	12,529	1,488	14,017

BMH includes turnover of £13.6 million and operating profit of £1.7 million arising from acquisitions.

Group turnover – by geographic area of origin	1999 Continuing operations £'000	1999 Discontinued operations £'000	1999 Total £'000	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000
United Kingdom	**275,006**	**–**	**275,006**	306,508	18,192	324,700
Rest of Europe	**124,244**	**–**	**124,244**	125,152	520	125,672
North America	**50,643**	**1,331**	**51,974**	43,110	13,814	56,924
Africa	**33,407**	**–**	**33,407**	42,971	–	42,971
Middle East	**–**	**–**	**–**	–	2,727	2,727
Rest of World	**11,690**	**–**	**11,690**	15,263	–	15,263
	494,990	**1,331**	**496,321**	533,004	35,253	568,257

Group turnover – by geographic area of destination	1999 Continuing operations £'000	1999 Discontinued operations £'000	1999 Total £'000	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000
United Kingdom	**274,851**	**–**	**274,851**	303,982	14,422	318,404
Rest of Europe	**65,921**	**–**	**65,921**	58,638	79	58,717
North America	**41,680**	**1,331**	**43,011**	28,541	12,056	40,597
Africa	**38,313**	**–**	**38,313**	46,525	903	47,428
Middle East	**8,405**	**–**	**8,405**	2,816	4,500	7,316
Rest of World	**65,820**	**–**	**65,820**	92,502	3,293	95,795
	494,990	**1,331**	**496,321**	533,004	35,253	568,257

2) **Segmental information** continued

Group operating profit – by geographic area	**1999 Continuing operations £'000**	**1999 Discontinued operations £'000**	**1999 Total £'000**	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000
United Kingdom	**11,465**	**–**	**11,465**	9,117	(4,139)	4,978
Rest of Europe	**3,958**	**–**	**3,958**	3,464	45	3,509
North America	**3,361**	**109**	**3,470**	2,770	(1,370)	1,400
Africa	**608**	**–**	**608**	633	–	633
Middle East	**–**	**–**	**–**	–	54	54
Rest of World	**394**	**–**	**394**	(378)	–	(378)
	19,786	**109**	**19,895**	15,606	(5,410)	10,196
Goodwill amortisation	**2,348**	**(11)**	**2,337**	2,349	(16)	2,333
	22,134	**98**	**22,232**	17,955	(5,426)	12,529

North America includes turnover of £13.6 million and operating profit of £1.7 million arising from acquisitions.

Operating net assets – by activity	**1999 £'000**	1998 £'000
BES	**17,908**	72,207
BMH	**17,310**	4,505
Unallocated	**27,228**	31,986
Operating net assets	**62,446**	108,698

Operating net assets – by geographic area	**1999 £'000**	1998 £'000
United Kingdom	**60,666**	120,356
Europe	**(12,391)**	(14,587)
North America	**(864)**	(4,594)
Africa	**8,308**	9,238
Rest of World	**6,727**	(1,715)
Operating net assets	**62,446**	108,698
Current asset investments	**6,618**	–
Net cash	**82,067**	21,051
Finance lease obligations	**(757)**	(1,200)
Taxation	**(10,679)**	(6,533)
Dividends	**(2,370)**	(1,880)
Net goodwill	**(751)**	(5,325)
Net assets	**136,574**	114,811

BES and the United Kingdom include £0.6 million (1998: £4.0 million) of operating net assets in respect of joint ventures and associates.

3) Cost of sales and net operating expenses

	1999 Continuing operations £'000	1999 Discontinued operations £'000	1999 Total £'000	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000
Group turnover	**494,990**	**1,331**	**496,321**	533,004	35,253	568,257
Cost of sales	**412,564**	**798**	**413,362**	455,036	32,930	487,966
Net operating expenses						
Distribution costs	**11,158**	**–**	**11,158**	10,480	–	10,480
Administration costs						
– Goodwill amortisation	**(2,348)**	**11**	**(2,337)**	(2,349)	16	(2,333)
– Other administration costs	**51,482**	**424**	**51,906**	51,882	7,733	59,615
	49,134	**435**	**49,569**	49,533	7,749	57,282
	60,292	**435**	**60,727**	60,013	7,749	67,762

Continuing operations in the current year include turnover of £13.6 million, cost of sales of £10.8 million, administration costs of £1.0 million and goodwill amortisation of £0.1 million relating to acquisitions.

4) Exceptional items

	1999 £'000	1998 £'000
Profit/(loss) on the sale or termination of operations		
– Sale of water engineering businesses	**6,142**	–
– Sale of Process Division	**–**	(18,620)
– Sale of Delta Controls	**–**	660
– Termination of North American Wood Technology operations	**–**	(754)
	6,142	(18,714)

The tax charge in respect of exceptional items amounts to £nil (1998: £nil).

5) Net interest and similar charges

	1999 £'000	1998 £'000
Interest payable and similar charges		
– Bank loans and overdrafts	**(1,108)**	(2,937)
– Finance lease interest	**(126)**	(65)
	(1,234)	(3,002)
Income from current asset investments	**475**	–
Other interest receivable and similar income	**3,233**	3,102
	3,708	3,102
Share of joint ventures	**27**	44
Share of associates	**–**	8
	2,501	152

6) Profit/(loss) on ordinary activities before taxation

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

	1999 £'000	1998 £'000
Depreciation on tangible fixed assets		
– Owned	**9,431**	9,387
– Leased assets	**252**	214
Profit on the disposal of tangible fixed assets	**(104)**	(57)
Operating lease rentals		
– Plant and machinery	**1,141**	1,673
– Land and buildings	**3,808**	4,973
– Short term plant hire	**835**	1,248
Auditors' remuneration	**379**	378
Research and development – expenditure	**2,303**	1,705
Research and development – amortisation charge (note 12)	**270**	1,074

In addition to the amounts disclosed above, the Group auditors and their associates were paid £154,000 (1998: £219,000) in relation to non audit services in the UK.

7) Employee costs

Particulars of employees, including executive Directors, are as follows:

	1999 £'000	1998 £'000
Employee costs		
– Wages and salaries	**141,929**	165,891
– Social security costs	**15,807**	16,295
– Other pension costs (note 25)	**6,233**	5,796
	163,969	187,982

The average number of people employed by the Group in each of the following categories was as follows:

	1999 Number	1998 Number
Engineering and technology	**5,729**	6,495
Administration and management	**1,252**	1,225
	6,981	7,720

The number of people employed by the Group at 31 March 1999 was 6,782 (1998: 7,620).

Information in respect of Directors' remuneration and share interests is contained within the Directors' Report on pages 27 to 31.

8) Tax on profit/(loss) on ordinary activities

	1999 £'000	1998 £'000
United Kingdom corporation tax charge at 31% (1998: 31%)	**6,612**	1,231
Double taxation relief	**(1,802)**	(1,088)
	4,810	143
Consortium relief	**(475)**	(564)
Advance corporation tax written (back)/off	**(2,287)**	263
Deferred taxation (note 24)	**1,332**	923
Overseas taxation	**1,430**	1,530
Share of joint ventures	**230**	548
Share of associates	**19**	17
Adjustments in respect of prior years	**236**	–
	5,295	2,860

No tax is payable in respect of the exceptional profit of £6.1 million due to the utilisation of tax losses.

Excluding the exceptional profit of £6.1 million and the net goodwill credit of £2.1 million the effective rate of 22.8% is lower than the standard UK rate of 31% due to the utilisation of tax losses and surplus advance corporation tax.

9) Company profit

The Company has taken advantage of the exemption granted by Section 230 of the Companies Act 1985 whereby no individual profit and loss account of the Company is disclosed. Included in the Group profit for the financial year is a profit of £4.8 million (1998: £8.3 million) dealt with in the Financial Statements of the Company.

10) Dividends

	1999 £'000	1998 £'000
Ordinary shares		
– Interim dividend paid of 0.80p per share (1998: 0.69p)	**1,355**	1,168
– Final dividend proposed of 1.40p per share (1998: 1.11p)	**2,370**	1,880
	3,725	3,048

11) Earnings per share

Earnings per ordinary share have been calculated by dividing the profit attributable to shareholders for the financial year by the weighted average number of ordinary shares in issue during the year.

	1999 £'000	1998 £'000
Weighted average number of shares in issue for basic earnings per share	**169,315,169**	169,312,544
Dilutive effect of share options	**872,014**	1,830,606
Weighted average number of shares in issue for diluted earnings per share	**170,187,183**	171,143,150

	1999 £'000	**1999 Basic (pence)**	**1999 Diluted (pence)**	1998 £'000	1998 Basic (pence)	1998 Diluted (pence)
Profit/(loss) attributable to shareholders	**25,512**	**15.07**	**14.99**	(8,676)	(5.12)	(5.07)
Less: (profit)/loss on sale or termination of a business	**(6,142)**	**(3.63)**	**(3.61)**	18,714	11.05	10.93
Profit before exceptional items	**19,370**	**11.44**	**11.38**	10,038	5.93	5.86
Less: goodwill amortisation	**(2,074)**	**(1.22)**	**(1.22)**	(1,939)	(1.15)	(1.13)
Profit before exceptional items and goodwill	**17,296**	**10.22**	**10.16**	8,099	4.78	4.73

The earnings per share figures calculated above eliminate the effect of exceptional items and goodwill amortisation.

12) Fixed assets – intangible assets

	Goodwill £'000	Negative goodwill £'000	Development costs £'000	**Total £'000**
Cost				
At 1 April 1998	27,064	(34,406)	3,255	**(4,087)**
Additions	–	–	17	**17**
On acquisition of subsidiaries (note 30)	4,488	–	–	**4,488**
Reduction in deferred consideration (note 23)	(465)	–	–	**(465)**
Exchange adjustment	–	–	95	**95**
On disposal of subsidiaries (note 31)	(164)	–	–	**(164)**
At 31 March 1999	30,923	(34,406)	3,367	**(116)**
Accumulated amortisation				
At 1 April 1998	(7,544)	7,846	(2,833)	**(2,531)**
Exchange adjustment	–	–	(81)	**(81)**
Charge for the year	(1,630)	3,967	(270)	**2,067**
On disposal of subsidiaries (note 31)	93	–	–	**93**
As at 31 March 1999	(9,081)	11,813	(3,184)	**(452)**
Net book value at 31 March 1999	21,842	(22,593)	183	**(568)**
Net book value at 31 March 1998	19,520	(26,560)	422	**(6,618)**

13) Fixed assets – tangible assets

	Freehold property £'000	Short term leasehold property £'000	Plant and machinery £'000	**Total £'000**
Group				
Cost				
At 1 April 1998	32,325	312	58,089	**90,726**
Exchange adjustments	428	(3)	(413)	**12**
On acquisition of subsidiaries	–	–	505	**505**
On disposal of subsidiaries	–	–	(38)	**(38)**
Additions	327	59	5,638	**6,024**
Disposals	(127)	–	(1,891)	**(2,018)**
Assets written off	(259)	–	(674)	**(933)**
At 31 March 1999	32,694	368	61,216	**94,278**
Accumulated depreciation				
At 1 April 1998	(7,819)	(97)	(31,332)	**(39,248)**
Exchange adjustments	(153)	3	144	**(6)**
On disposal of subsidiaries	–	–	16	**16**
Charge for the year	(2,617)	(39)	(7,027)	**(9,683)**
Disposals	25	–	1,718	**1,743**
Assets written off	259	–	465	**724**
At 31 March 1999	(10,305)	(133)	(36,016)	**(46,454)**
Net book value at 31 March 1999	22,389	235	25,200	**47,824**
Net book value at 31 March 1998	24,506	215	26,757	**51,478**

The net book value of plant and machinery includes £1.0 million (1998: £0.6 million) in respect of assets held under finance leases or hire purchase contracts, comprising cost of £1.3 million less depreciation of £0.3 million.

The net book value of freehold property includes land amounting to £4.6 million (1998: £4.8 million) which has not been depreciated.

14) Fixed assets – investment in subsidiary undertakings

	Shares £'000	Loans £'000	**Total £'000**
Cost			
At 1 April 1998 and 31 March 1999	91,851	44,450	**136,301**

Information on the principal subsidiary undertakings is given on page 60.

15) Fixed assets – investments

	Joint ventures excluding goodwill	Goodwill	Joint ventures including goodwill	Associated undertakings	Other investments	**Total**
At 1 April 1998	3,457	1,715	5,172	526	128	**5,826**
Exchange adjustment	–	–	–	–	(2)	**(2)**
Goodwill amortisation	–	(263)	(263)	–	–	**(263)**
Dividend received	(350)	–	(350)	–	–	**(350)**
Share of profits	539	–	539	32	–	**571**
Joint venture disposed of (note 31)	(3,646)	(1,452)	(5,098)	–	–	**(5,098)**
At 31 March 1999	–	–	–	558	126	**684**

Information on associated undertakings is given on page 60.

16) Stocks

	1999 £'000	**1999 £'000**	1998 £'000	1998 £'000
Long term contract balances	**124**		403	
Less: Attributable payments on account	**–**		(211)	
		124		192
Other stocks and work in progress				
– Raw materials and consumables	**11,055**		10,457	
– Work in progress	**17,686**		15,380	
– Finished goods and goods for resale	**5,151**		6,504	
	33,892		32,341	
Less: Progress payments	**(6,185)**		(6,124)	
Provisions	**(1,996)**		(1,589)	
		25,711		24,628
		25,835		24,820

17) Debtors

	Group 1999 £'000	Group 1998 £'000	**Company 1999 £'000**	Company 1998 £'000
Due within one year:				
Trade debtors	**55,029**	71,083	**–**	–
Amounts recoverable on contracts	**27,838**	33,854	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**–**	2,085
Amounts owed by joint ventures	**–**	746	**–**	–
Amounts owed by associates	**54**	–	**–**	–
Prepayments and accrued income	**7,471**	9,875	**26**	–
Pension scheme prepayments	**4,368**	4,860	**–**	–
Other debtors	**10,981**	18,138	**668**	440
	105,741	138,556	**694**	2,525
Due after more than one year:				
Trade debtors	**95**	–	**–**	–
Pension scheme prepayments	**70,964**	67,656	**–**	–
Other debtors	**6,085**	6,356	**–**	–
	77,144	74,012	**–**	–

Other debtors, due within one year, at 31 March 1999 includes £nil (1998: £7.2 million) of deferred consideration relating to the disposal of the Group's former Energy Division. Other debtors, due after more than one year, includes £4.3 million (1998: £4.1 million) relating to the same item.

18) Current asset investments

	Group 1999 £'000	Group 1998 £'000	Company 1999 £'000	Company 1998 £'000
Listed investments at market value	**6,618**	–	**–**	–

The tax liability, if listed investments were sold at market value, would be £nil (1998: £nil).

19) Creditors – amounts due within one year

	Group 1999 £'000	Group 1998 £'000	Company 1999 £'000	Company 1998 £'000
Bank overdraft (note 21)	**6,462**	22,172	**–**	–
Bank loans (note 21)	**534**	5,232	**–**	–
Other loans (note 21)	**709**	2,077	**–**	–
Obligations under finance leases (note 21)	**201**	304	**–**	–
Advance payments	**1,920**	7,498	**–**	–
Payments received in advance of turnover	**36,067**	26,652	**–**	–
Trade creditors	**33,127**	41,568	**–**	–
Contract accruals and provisions	**58,462**	42,649	**–**	–
Bills of exchange payable	**1,079**	1,248	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**14,115**	14,069
Amounts owed to joint ventures	**–**	1,983	**–**	–
Other creditors	**5,454**	12,443	**520**	481
Corporation and overseas taxes	**6,097**	2,567	**–**	–
Other taxes and social security	**6,404**	5,729	**–**	–
Accruals and deferred income	**23,544**	16,160	**156**	–
Proposed dividend	**2,370**	1,880	**2,370**	1,880
	182,430	190,162	**17,161**	16,430

20) **Creditors** – amounts due after more than one year

	Group 1999 £'000	Group 1998 £'000
Bank loans (note 21)	–	37
Other loans (note 21)	**156**	138
Obligations under finance leases (note 21)	**556**	896
Trade creditors	**85**	38
Other creditors	**1,219**	6,463
Corporation and overseas taxes	–	74
	2,016	7,646

21) Borrowings

Repayment details The total borrowings of the Group at 31 March are repayable as follows:

	1999 Bank loans and overdrafts £'000	1999 Other loans £'000	1999 Finance lease obligations £'000	1998 Bank loans and overdrafts £'000	1998 Other loans £'000	1998 Finance lease obligations £'000
Within one year	**6,996**	**709**	**201**	27,404	2,077	304
Between one and two years	–	**156**	**197**	37	19	287
Between two and five years	–	–	**359**	–	119	609
	6,996	**865**	**757**	27,441	2,215	1,200

Security arrangements	Group 1999 £'000	Group 1998 £'000
Loans and overdrafts		
Secured against specific trade debtors of subsidiary undertakings	**39**	112
Unsecured borrowings	**7,822**	29,544
	7,861	29,656

Finance lease obligations are secured against the assets to which they relate.

22) Derivatives and other financial instruments

The Financial Review on pages 18 and 19 provides an explanation of the role that financial instruments have had during the period in creating or changing the risks that the Group faces in its activities.

The numerical disclosures in this note deal with financial assets and liabilities as defined in Financial Reporting Standard 13 – Derivatives and Other Financial Instruments: Disclosure (FRS13). Certain financial assets such as investments in subsidiary, joint venture and associated undertakings are excluded from the scope of these disclosures.

As permitted by FRS13, short-term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Interest rate profile The Group's financial assets comprise cash deposits of £89.9 million (1998: £ 50.7 million) and current asset investments of £6.6 million (1998: £nil). Cash deposits are placed on money markets at call, seven-day and monthly rates. Current asset investments comprise listed fixed interest securities.

The interest rate profile of the Group's financial assets and liabilities (excluding short-term debtors and creditors) is as follows:

	Financial assets			Financial liabilities		
Currency	Total £'000	Floating rate £'000	Fixed rate £'000	Total £'000	Floating rate £'000	Fixed rate £'000
Sterling	76,516	69,898	6,618	4,937	4,937	–
Euro-zone currencies	11,618	11,618	–	1,642	1,310	332
US Dollar	7,612	7,612	–	–	–	–
South African Rand	26	26	–	1,970	1,611	359
Other currencies	774	774	–	69	3	66
	96,546	89,928	6,618	8,618	7,861	757

The weighted average interest rate of the sterling fixed rate financial assets is 7.4% and the weighted average period for which interest rates are fixed is 4.5 years.

The weighted average interest rates of the Euro-zone and Rand fixed rate financial liabilities, which comprise finance lease obligations, are 5% and 20.5% respectively. The weighted average period for which these interest rates are fixed is two years.

The interest rate on floating rate financial assets and liabilities is linked to LIBOR in the case of sterling and the relevant bank rate for those denominated in other currencies.

Borrowing facilities The Group had undrawn committed borrowing facilities at 31 March 1999, in respect of which all conditions precedent had been met, as follows:

	1999 £'000
Expiring in one year or less	**10,953**
Expiring in more than one year but not more than two years	**15,000**
	25,953

Currency exposures The Financial Review on page 19 explains that it is the Group's policy not to hedge foreign currency exposures on the translation of its overseas profits and net assets to sterling. Such movements are dealt with through the Group statement of total recognised gains and losses. It is Group policy for subsidiaries to hedge transactional currency exposures against the currency in which their results are measured.

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

22) Derivatives and other financial instruments continued

As at 31 March 1999, these exposures were as follows:

	Net foreign currency monetary assets/(liabilities)					
Functional currency of group operation	Sterling £'000	US Dollars £'000	Euro-zone currencies £'000	Swedish Krone £'000	Other £'000	Total £'000
Sterling	–	–	140	–	29	169
US Dollars	–	–	645	–	277	922
Euro-zone currencies	(19)	2,151	–	833	(31)	2,934
Swedish Krone	(10)	1,265	889	–	(72)	2,072
Other currencies	(46)	(296)	(243)	(70)	(26)	(681)
Total	(75)	3,120	1,431	763	177	5,416

The amounts shown in the above table take into account the effect of forward foreign currency contracts entered into to manage these currency exposures.

As at 31 March 1999, the Group also held open various forward foreign currency contracts that the Group had taken out to hedge expected future foreign currency movements.

Fair values Set out below is a comparison of the book and fair values of derivative financial instruments held to manage the currency profile of the Group's operations. In all other cases, the fair value of the Group's financial assets and liabilities is equal to their book value.

	1999 Book value £'000	**1999 Fair value £'000**	1998 Book value £'000	1998 Fair value £'000
Forward foreign currency contracts	**25,005**	**26,684**	17,353	18,817

Gains and losses on hedges The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies immediately the transaction occurs.

Changes in the fair value of instruments used as hedges are not recognised in the Financial Statements until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	Gains £'000	Losses £'000	Net £'000
Unrecognised gains and losses on hedges at 1 April 1998	1,967	(502)	1,465
Gains and losses arising in previous years that were recognised in the year ended 31 March 1999	(1,853)	422	(1,431)
Gains and losses arising before 1 April 1998 that were not recognised in the year ended 31 March 1999	114	(80)	34
Gains and losses arising in the year that were not recognised in the year ended 31 March 1999	1,861	(216)	1,645
Unrecognised gains and losses on hedges at 31 March 1999	1,975	(296)	1,679
Of which:			
Gains and losses expected to be recognised in the year ending 31 March 2000	1,664	(280)	1,384
Gains and losses expected to be recognised in the year ending 31 March 2001 or later	311	(16)	295

23) Provisions for liabilities and charges

	Pensions and similar obligations £'000	Deferred taxation £'000	Deferred consideration (a) £'000	Insurance provisions (b) £'000	Closure or disposal of businesses (c) £'000	Total £'000
At 1 April 1998	4,383	5,886	–	7,143	8,750	26,162
Reclassified from creditors on initial application of FRS 12	–	–	8,408	–	–	8,408
Exchange adjustments	183	(79)	96	–	49	249
Provided in the year	620	1,332	1,345	1,855	–	5,152
Movements as a result of discounting	–	–	37	–	–	37
Utilised in the year	(17)	–	(1,935)	(2,565)	(2,144)	(6,661)
Released in the year no longer required	–	–	(465)	–	–	(465)
Advance corporation tax set-off	–	(696)	–	–	–	(696)
At 31 March 1999	**5,169**	**6,443**	**7,486**	**6,433**	**6,655**	**32,186**

(a) The deferred consideration arises principally from the acquisition of the Rosyth Dockyard (£6 million). This is payable on the occurrence of the offer of a contract for the refit of a second aircraft carrier, provided that effectively 70% of the allocated programme, as set out in the privatisation agreement, has by then been awarded to Rosyth Dockyard. It is anticipated that the deferred consideration will be payable by March 2002. The remainder arises from the acquisition of AKI Dryer Manufacturers, Inc. This is payable, based on performance, over the next three years and is limited to a maximum of $2.5 million. During the year, £1.9 million of performance related consideration was paid to the previous shareholders of Eagleton Engineering Company. The balance will not be payable and has been released against the goodwill that arose on the acquisition.

(b) The insurance provisions arise in the Group's captive insurance company, Cleveland Insurance Ltd. They relate to specific claims assessed in accordance with the advice of independent actuaries.

(c) Provisions for costs relating to the closure or disposal of businesses are principally for onerous contracts in respect of vacant and partially vacant properties.

24) Deferred taxation

The major components of the provision for deferred taxation and the potential liability are as follows:

	1999 Provided £'000	1998 Provided £'000	**1999 Full potential £'000**	1998 Full potential £'000
Accelerated capital allowances	**51**	(322)	**(879)**	(441)
Reversal of pension surpluses	**12,974**	12,532	**22,652**	22,545
Other timing differences	**(223)**	(585)	**(4,891)**	(372)
Tax losses	**(5)**	(81)	**(29,650)**	(23,514)
	12,797	11,544	**(12,768)**	(1,782)
Recoverable advance corporation tax	**(6,354)**	(5,658)	**(12,784)**	(14,375)
	6,443	5,886	**(25,552)**	(16,157)

There is no unprovided deferred tax liability in the Company.

25) Pension funding

The Group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The major schemes are of the defined benefit type with assets held in separate funds. The total pension costs charged to the operating result of the Group were as follows:

	1999 £'000	1998 £'000
UK schemes	**8,381**	7,841
Overseas schemes	**1,414**	1,243
	9,795	9,084
Interest on pension scheme surpluses	**(3,562)**	(3,288)
	6,233	5,796

The Group's principal defined benefit schemes are in the UK. In each case the scheme is funded by payments to separate trustee administered funds and the pension cost is assessed in accordance with the advice of independent, qualified actuaries. The details of the latest formal actuarial valuations of these schemes are as follows:

	Railcare	Rosyth Dockyard	Babcock International Group
Date of last formal actuarial valuation	1.4.96	31.12.95	1.4.98
Number of active members at 31 March 1999	882	2,978	267
Method of funding	Attained age	Projected unit	Projected unit
Results of last formal actuarial valuation:			
– Market value of assets	£62 million	£252 million	£401 million
– Level of funding	116%	120%	118%
Principal valuation assumptions:			
– Excess of investment returns over earnings increases	2%	1.5%	2%
– Excess of investment returns over pension increases	4%	3% to 6%	4.5%
– Annual rate of dividend growth	4%	4.5%	4%

Surpluses in respect of the Group's principal pension schemes are carried as prepayments in the balance sheet at £75.3 million (1998: £72.5 million) and are being charged with the regular pension cost of scheme members. As a result of the level of surplus, the Group's contributions to each of the principal pension schemes are currently suspended.

26) Share capital

	1999 £'000	1998 £'000
Authorised		
229,000,000 (1998: 229,000,000) ordinary shares of 50p each	**114,500**	114,500
Allotted, issued and fully paid		
169,320,113 (1998:169,312,544) ordinary shares of 50p each	**84,660**	84,656

During the year, following the early exercise of options under the Sharesave Scheme, 7,569 shares were issued with a nominal value of £3,785 at a premium of £930.

Outstanding share options The Company has granted options to subscribe for ordinary shares of the Company under two Executive Share Option Schemes and the Sharesave Scheme. At 31 March 1999, the outstanding options were as follows:-

Scheme	No of shares under option	Subscription price per share	Exercise period
Executive share option schemes	13,360	280.655p	04.09.92 to 03.09.99
	11,134	226.770p	29.06.93 to 28.06.2000
	16,701	244.730p	11.07.94 to 10.07.2001
	16,701	271.675p	09.07.95 to 08.07.2002
	1,012,971	114.510p	15.12.96 to 14.12.2003
	96,000	132.500p	16.12.97 to 15.12.2004
	50,000	151.000p	03.01.99 to 02.01.2006
	304,288	77.000p	19.09.99 to 18.09.2006
	570,110	74.500p	19.12.99 to 18.12.2006
	91,409	68.500p	07.02.2000 to 06.02.2007
	160,000	62.500p	31.03.2000 to 30.03.2007
	219,328	84.500p	19.06.2000 to 18.06.2007
	104,536	84.500p	11.07.2000 to 10.07.2007
	244,508	87.250p	11.08.2000 to 10.08.2007
	396,926	82.000p	24.12.2000 to 23.12.2007
	2,994,899	89.000p	20.07.2001 to 20.07.2008
	6,302,871		
Sharesave scheme	6,042,105	62.300p	01.02.2001 to 01.08.2001
Total outstanding share options	12,344,976		

Options granted to Directors are summarised in the Directors' Report on pages 27 to 31 and are included in the outstanding options set out above.

27) Reserves

	Group Share premium account £'000	Group Profit and loss account £'000	Group Total £'000
At 1 April 1998	67,111	(46,094)	21,017
Shares issued on exercise of options (note 26)	1	–	1
Loss on foreign currency translation	–	(710)	(710)
Retained profit for the year	–	21,787	21,787
At 31 March 1999	**67,112**	**(25,017)**	**42,095**

Exchange differences of £nil (1998: £0.1 million loss) arising on the translation of foreign currency borrowings have been offset in reserves against exchange differences arising on the translation of foreign equity investments.

	Company Share premium account £'000	Company Profit and loss account £'000	Company Total £'000
At 1 April 1998	67,111	34,097	101,208
Shares issued on exercise of options (note 26)	1	–	1
Retained profit for the year	–	1,070	1,070
At 31 March 1999	**67,112**	**35,167**	**102,279**

28) Equity minority interests

	£'000
At 1 April 1998	9,138
Share of profits	637
Other movements	44
At 31 March 1999	**9,819**

29) Group cash flow statement

(a) Reconciliation of Group operating profit to net cash flow from operating activities:

	1999 £'000	1998 £'000
Group operating profit	**22,232**	12,529
Depreciation and amortisation charges	**7,616**	8,342
(Decrease)/increase in stocks	**(1,409)**	311
Decrease in debtors	**23,437**	199
Increase/(decrease) in creditors	**7,366**	(12,446)
(Decrease)/increase in provisions	**(3,068)**	1,180
Other items	**(38)**	(57)
Net cash flow from operating activities	**56,136**	10,058

29) Group cash flow statement continued

(b) Reconciliation of net cash flow to movement in net debt:

	1999 £'000	1998 £'000
Increase/(decrease) in cash in the year	**61,147**	(13,372)
Cash outflow from decrease in debt and lease financing	**6,245**	3,845
Cash flow from (decrease)/increase in liquid resources	**(884)**	3,439
Change in net funds resulting from cash flows	**66,508**	(6,088)
Loans reclassified	**–**	122
Loans and finance leases disposed of with subsidiary	**–**	753
New finance leases	**(63)**	(1,185)
Translation differences	**1,632**	(594)
Movement in net funds in year	**68,077**	(6,992)
Net funds at 1 April	**19,851**	26,843
Net funds at 31 March	**87,928**	19,851

(c) Analysis of changes in financing during the year:

	At 1 April 1998 £'000	Cash flow £'000	New finance leases £'000	Exchange movement £'000	**At 31 March 1999 £'000**
Cash in hand and at bank	43,205	45,835	–	888	**89,928**
Overdrafts	(22,172)	15,312	–	398	**(6,462)**
	21,033	61,147	–	1,286	**83,466**
Debt	(7,484)	5,802	–	283	**(1,399)**
Finance leases	(1,200)	443	(63)	63	**(757)**
	(8,684)	6,245	(63)	346	**(2,156)**
Liquid resources	7,502	(884)	–	–	**6,618**
Total	19,851	66,508	(63)	1,632	**87,928**

Liquid resources include £6.6 million (1998: £nil) of current asset investments.

(d) Analysis of the net cash flow in respect of acquisitions and disposals of subsidiaries:

	1999 Disposals £'000	**1999 Acquisitions £'000**	1998 Disposals £'000
Net cash consideration	**20,211**	**(5,608)**	213
Cash (disposed of)/acquired	**(123)**	**2,426**	1,786
Cash payments relating to onerous contracts	**–**	**–**	(4,423)
Net cash flow	**20,088**	**(3,182)**	(2,424)

(i) The net cash inflow for disposals includes the receipt of £7.5 million from Mitsui for deferred consideration following the 1995 sale of the energy business. The balance relates to the sale of the Group's interest in its water engineering businesses. Further details relating to disposals are given in note 31.

(ii) The net cash outflow relating to acquisitions comprises £1.9 million of deferred consideration for the acquisition of Eagleton Engineering Company in 1996, £0.7 million for the acquisition of AKI Dryer Manufacturers, Inc. in September 1998, after allowing for £2.4 million of net cash acquired with the business, and £0.6 million for other small bolt-on acquisitions during the year. Further details relating to acquisitions are given in note 30.

30) Acquisitions

	AKI Note (a) £'000	Other Note (b) £'000	Total £'000
Fixed assets	261	244	505
Current assets	2,356	50	2,406
Cash	2,426	–	2,426
Creditors	(4,781)	(27)	(4,808)
Book and fair value of net assets acquired	262	267	529
Fair value of consideration:			
– Cash	2,924	555	3,479
– Deferred consideration	1,345	–	1,345
– Costs	193	–	193
Fair value of consideration	4,462	555	5,017
Goodwill arising	4,200	288	4,488

(a) On 2 September 1998 the Group acquired AKI Dryer Manufacturers, Inc. (now renamed BMH AKI Dryers Inc.) of Eugene, Oregon, USA for $7.5 million. $5 million was paid on acquisition and $2.5 million is deferred to be paid over a three-year earn out period.

(b) During the year, the Group also made two small bolt-on acquisitions. These were technology for grinding and calcining by-product gypsum from Delta Steel Co (USA) on 31 July 1998 for $0.5 million and a small valve maintenance business in South Africa, from Van Brakel Valves (Pty) Ltd, on 31 January 1999 for Rand 2.6 million.

31) Disposals

On 1 December 1998 the Group sold its water engineering businesses, comprising its 50% interest in Babcock Water Engineering Ltd. and its wholly owned US subsidiary Babcock Water Engineering LP, to Earth Tech Inc companies for a total cash consideration of £13.25 million.

	Water Engineering £'000
Sale proceeds (cash)	13,250
Cost of disposal	(539)
Net cash consideration	12,711
Net assets disposed of:	
Share of joint venture	5,098
Goodwill	71
Fixed assets	22
Cash	123
Other net current assets	1,255
	6,569
Profit on sale	6,142

32) Financial commitments

Capital commitments

	1999 £'000	1998 £'000
Authorised future capital expenditure of the Group at 31 March that was contracted for but not provided for in the Financial Statements	**504**	1,139

The Company had no capital expenditure contracted for at 31 March 1999 (1998: £nil).

Operating lease commitments

Group The annual commitment of the Group under non-cancellable operating leases was as follows:

	1999 Land and buildings £'000	**1999 Plant machinery and vehicles £'000**	1998 Land and buildings £'000	1998 Plant machinery and vehicles £'000
Leases expiring:				
Within one year	**690**	**692**	172	768
Within two to five years	**1,868**	**495**	1,901	653
Thereafter	**1,549**	**57**	2,836	502
	4,107	**1,244**	4,909	1,923

Company The Company has an operating lease commitment for land and buildings as at 31 March 1999 with an annual commitment expiring after more than five years of £1.5 million (1998: £1.5 million).

33) Contingent liabilities

(a) The Company has guaranteed or has joint and several liability for bank facilities of £38.9 million (1998: £78.7 million) provided to certain Group companies.

(b) Throughout the Group, contingent liabilities exist in respect of guarantees, performance bonds and indemnities issued on behalf of Group companies by banks and insurance companies in the ordinary course of business. At 31 March 1999 these amounted to £80.5 million (1998: £75.3 million), of which the Company had counter-indemnified £47.3 million (1998: £45.4 million).

(c) In addition, the Company has given guarantees on behalf of Group companies in connection with the completion of contracts within specification, including responsibility for maintenance. These include the unlimited counter-indemnity given to FKI plc at the time of demerger in respect of guarantees given by FKI plc on behalf of companies acquired at that time.

(d) Pursuant to the Rosyth Dockyard privatisation agreement, the following charges and security interests have been granted by Rosyth Royal Dockyard Limited (RRDL) in favour of the Ministry of Defence (MoD).

(i) Strategic assets RRDL has undertaken certain obligations in respect of those fixed assets acquired at Rosyth Dockyard considered by the MoD to be of strategic importance to HM Government (known as "Strategic Assets"), including an obligation not to dispose of or destroy such assets or their replacements. In addition, in the event of the insolvency of RRDL or of Babcock Rosyth Defence Limited the MoD will have the option to repurchase from RRDL any or all of a narrower class of Strategic Assets ("Relevant Strategic Assets") at market value or, in respect of certain assets, at the lower of market value and cost. RRDL's obligations in respect of the MoD's repurchase option are secured by:

(*a)* fixed charges over those Relevant Strategic Assets consisting of interests in land; and

(b) a floating charge over the remaining Relevant Strategic Assets.

(ii) Development clawback MoD will share in the net proceeds of sale or development of the Dockyard following planning enhancement, on terms set out in the asset purchase agreement between the RRDL and the MoD dated 30 January 1997. By way of security for the MoD's rights to such share, the Company has granted a fixed charge (standard security) over the Dockyard in favour of the Authority.

(e) Litigation is in process against the Group relating to a dispute with the purchaser of a business that was formerly part of the Group who alleges that there have been breaches under the relevant sale agreement and seeks damages of £5.4 million. Liability for breach of warranties is limited to £2.5 million under the sale agreement. The litigation is being vigorously defended. The information usually required by FRS12 is not disclosed on the grounds that it could prejudice the outcome of the litigation.

Principal subsidiary and associated undertakings

BES
Engineering and technology support services to the defence, rail, marine and 'secure facilities' sectors:

Babcock Facilities Management Limited
Babcock Rosyth Defence Limited
Rosyth Royal Dockyard Limited
Babcock Defence Systems Limited
Babcock Rosyth Industries Limited
Railcare Limited (60%)
Babcock Rail Limited
Rosyth 2000 Limited (20%)*
Babcock New Zealand Holdings Limited (New Zealand)
Babcock New Zealand Limited (New Zealand)

BMH
Materials processing technologies and engineered systems:

BMH Division GmbH (Germany)
Babcock Holdings (Sweden) AB (Sweden)
BMH Wood Technology AB (Sweden)
BMH Marine AB (Sweden)
BMH Kellve AB (Sweden) (90%)
BMH Wood Technology Oy (Finland)
BMH Americas Inc (USA)
BMH Iberica SA (Spain)
BMH Italiana Srl (Italy)
BMH SA (France)
BMH Claudius Peters AG (Germany)
BMH China Ltd (Hong Kong)
BMH Asia Pacific (Pte) Limited (Singapore)
BMH Limited
BMH do Brazil Ltda (Brazil)
Eagleton Engineering Company (USA)
BMH AKI Dryers Inc (USA)
Babcock Holdings (USA), Inc (USA)
Babcock Africa (Pty) Limited (South Africa)
Babcock Africa Contracting (Pty) Limited (South Africa)

Others
Babcock Holdings Limited
Babcock Investments Limited
Babcock International Limited
Babcock International Holdings Limited
Babcock Management Limited
Cleveland Insurance Limited (Isle of Man)
Babcock Overseas Investments Limited
Babcock International Holdings BV (Netherlands)

All undertakings are wholly owned unless otherwise stated. With the exception of Babcock Holdings Limited and Babcock Investments Limited which are owned by the Company, all Group undertakings are owned by subsidiary undertakings.

Except as otherwise stated, all shares held comprise ordinary share capital.

All undertakings are incorporated, registered and operated in Great Britain unless otherwise stated. Undertakings located overseas operate principally in the country of incorporation.

*Denotes undertakings recognised and accounted for as associated undertakings.

Notice of meeting

Notice is hereby given that the tenth Annual General Meeting of the members of Babcock International Group PLC will be held at the Barber-Surgeons' Hall, Monkwell Square, London EC2Y 5BL, on Friday, 30 July 1999, at 12.00 noon for the transaction of the following business:

1 To receive and adopt the Directors' and Auditors' Reports and the audited Financial Statements of the Company for the year ended 31 March 1999.

2 To declare a final dividend for the year ended 31 March 1999.

3 (1) To re-elect The Rt Hon Lord Hesketh as a Director of the Company;

(2) To re-elect Mr A E Wheatley as a Director of the Company;

(3) To elect Mr D J Shah as a Director of the Company.

4 To reappoint Arthur Andersen as Auditors to the Company.

5 To authorise the Directors to fix the remuneration of the Auditors.

6 As special business, to consider and, if thought fit, to pass the following Resolutions:

Ordinary Resolution
(1) That the Directors be and are hereby generally and unconditionally authorised, for the purposes of Section 80 of the Companies Act 1985, to exercise all the powers of the Company to allot relevant securities (within the meaning of Section 80(2) of the said Act) up to an aggregate nominal amount of £28,220,000, this authority to expire on 29 July 2004 unless previously revoked, renewed or varied (save that the Company may before such expiry make any offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of any such offer or agreement as if the authority conferred hereby had not expired).

Special Resolution
(2) That, subject to the passing of Resolution 6(1), the Directors be and are hereby authorised to allot equity securities (as defined in Section 94 of the Companies Act 1985) for cash pursuant to the authority conferred by Resolution 6(1) above as if Section 89(1) of the said Act did not apply to any such allotment, provided that this power shall be limited:

(a) to the allotment of equity securities in connection with a rights issue in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all such shareholders are proportionate (as nearly as may be practicable having regard to the interests of the Company as a whole) to the respective numbers of ordinary shares held by them on the record date for any such allotment, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or legal or practical problems arising under or pursuant to the laws, or the requirements of any recognised regulatory body or any Stock Exchange, of any territory; and

(b) to the allotment otherwise than pursuant to subparagraph (a) above of equity securities up to an aggregate nominal value of £4,233,002.

Provided further that the authority contained in this Resolution shall, unless previously revoked, renewed or varied, expire on 29 July 2004, save that the Company may before the expiry of the power hereby conferred make any offer or agreement which might require equity securities to be allotted after the expiry of such power and the Directors may allot equity securities in pursuance of any such offer or agreement as if the power conferred hereby had not expired.

Special Resolution
(3) That the Company is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163 of the Companies Act 1985) of ordinary shares of 50p each ("ordinary shares") in the capital of the Company provided that:

(a) the maximum number of ordinary shares hereby authorised to be purchased shall be 16,932,011;

(b) the minimum price which may be paid for each ordinary share is not less than the nominal value thereof exclusive of the expenses of purchase;

(c) the maximum price which may be paid for each ordinary share shall not exceed 105% of the average middle market quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the ten business days preceding the day of purchase;

(d) the authority hereby conferred shall expire on 29 July 2000 or at the conclusion of the next Annual General Meeting of the Company (whichever is the earlier) unless such authority is renewed prior to such time; and

(e) the Company may make a contract to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make purchases of ordinary shares in pursuance of any such contract.

Special Resolution
(4) That new Articles of Association in the form contained in the draft Articles of Association, the principal terms of which are summarised in the Chairman's letter to shareholders dated 29 June 1999 and a copy of which has been produced to the meeting and initialled on the front page by the Chairman for the purposes of identification only, be adopted as the Articles of Association of the Company in substitution for and to the exclusion of all previous Articles of Association.

Ordinary Resolution
(5) That:

(a) the Babcock 1999 Approved Executive Share Option Scheme ("the Approved Scheme") and the Babcock 1999 Unapproved Executive Share Option Scheme ("the Unapproved Scheme") (together "the Schemes"), the principal terms of which are summarised in the Chairman's letter to shareholders dated 29 June 1999 and a copy of the rules of each of which has been produced to the meeting and initialled on the front page by the Chairman for the purposes of identification only, be and they are hereby approved and established;

(b) the Directors be and they are hereby authorised to make such amendments to the rules of the Schemes as may be necessary to take account of the comments of the London Stock Exchange and to ensure that the Approved Scheme is approved by the Board of Inland Revenue under section 185 and Schedule 9 to the Income and Corporation Taxes Act 1988; and

(c) the Directors be and they are hereby authorised to exercise the powers of the Company to establish further schemes based on the Unapproved Scheme but modified to take account of local tax, exchange control and securities laws, provided that any shares issued or which might be issued under such further schemes are treated as counting against the overall limitations on the issue of new shares as set out in the Unapproved Scheme.

Ordinary Resolution
(6) That the Directors be and they are hereby authorised to establish a discretionary trust for the benefit of employees and former employees of the Company and its subsidiaries and their dependants (to be known as The Babcock Employees' Share Trust) substantially in the form of the draft trust deed the principal terms of which are summarised in the Chairman's letter to shareholders dated 29 June 1999 and a copy of which has been produced to the meeting and initialled on the front page by the Chairman for the purposes of identification only.

Ordinary Resolution
(7) That the Directors be and they are hereby authorised to establish a discretionary trust for the benefit of employees and former employees of the Company and its subsidiaries intended to be a "qualifying employee share ownership trust" as mentioned in Section 67 and Schedule 5 of the Finance Act 1989 (as amended) (to be known as The Babcock Qualifying Employees' Share Trust) substantially in the form of the draft trust deed the principal terms of which are summarised in the Chairman's letter to shareholders dated 29 June 1999 and a copy of which has been produced to the meeting and initialled on the front page by the Chairman for the purposes of identification only.

Special Resolution
(8) That a Director may be counted in the quorum and vote and his vote may be counted on any matter connected with any executive or employee share option or share incentive scheme and any employees' share trust established by the Company, notwithstanding that he may be interested in the matter (except that no Director may be counted in the quorum or vote on any matter solely concerning his own participation) and the prohibitions in this regard contained in the Articles of Association of the Company be and they are hereby suspended and relaxed to that extent.

Ordinary Resolution
(9) That the Directors be and are hereby authorised:

(a) to exercise the powers contained in Article 153 of the Articles of Association (as and to the extent the new Articles of Association are adopted pursuant to Resolution 6(4), and otherwise as contained in Article 144 of the Articles of Association as in force immediately prior to the date of this Annual General Meeting) so that, to the extent determined by the Directors, the holders of ordinary shares be permitted to elect to receive any dividend declared or recommended by the Directors or payable by the Company, on or after the date of the passing of this Resolution, in whole or in part in the form of new ordinary shares of 50p each in the capital of the Company (credited as fully paid) instead of in cash alone; and

(b) to capitalise out of the amount standing to the credit of the reserves, as the Directors may determine, a sum equal to the aggregate nominal amount of the additional ordinary shares to be allotted pursuant to elections made as aforesaid and apply it in paying up in full the appropriate numbers of unissued ordinary shares and to allot such ordinary shares to the members of the Company who have validly so elected.

Provided that the authority contained in this Resolution shall, unless previously revoked, renewed or varied in accordance with the Company's Articles of Association, expire on 29 July 2004.

By order of the Board

H M Mahy Secretary
29 June 1999

Registered Office:
Badminton Court
Church Street, Amersham
Buckinghamshire HP7 0DD

Notes
1) A holder of ordinary shares is entitled to attend and vote at the meeting and may appoint a proxy to attend and, on a poll, vote on his or her behalf. The proxy need not be a member of the Company.

2) A holder of ordinary shares who holds his shareholding in uncertificated form must be entered on the relevant register of securities in respect of such shareholding not later than 48 hours before the time appointed for the meeting in order to have the right to attend and vote at the meeting.

3) A form of proxy is enclosed and, to be effective, must be completed in accordance with the instructions printed thereon and returned so as to be received by the Registrars of the Company not less than 48 hours before the time appointed for the meeting. Completion of a form of proxy will not affect the right of a member to attend and vote in person at the meeting.

4) The register of Directors' interests in the share capital of the Company, together with copies of service agreements under which Directors of the Company are employed, are available for inspection at the Company's registered office during normal business hours until the date of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

5) Copies of both the existing and proposed new Articles of Association, the rules of each of the New Schemes and the draft trust deeds of The Babcock Employees' Share Trust and The Babcock Qualifying Employees' Share Trust are available for inspection during normal business hours on weekdays (Saturdays and public holidays excepted) at the Company's registered office and at the offices of Ashurst Morris Crisp at Broadwalk House, 5 Appold Street, London EC2A 2HA up to and including the date of the Annual General Meeting and at the place of the Annual General Meeting for 15 minutes prior to and until the end of the Annual General Meeting.

Five year financial record

	1999 £m	1998 £m	1997 £m	1996 £m	1995 £m
Group turnover	**495.0**	568.3	646.0	723.4	755.1
Operating profit/(loss)	**22.8**	14.0	1.9	(19.7)	5.3
Exceptional items	**6.1**	(18.7)	(25.6)	22.3	2.4
Profit/(loss) on ordinary activities before interest	**28.9**	(4.7)	(23.7)	2.6	7.7
Net interest and similar charges	**2.5**	0.2	1.0	0.5	0.1
Profit/(loss) on ordinary activities before taxation	**31.4**	(4.5)	(22.7)	3.1	7.8
Tax on ordinary activities	**(5.3)**	(2.9)	(1.7)	(1.4)	(1.7)
Profit/(loss) on ordinary activities after taxation	**26.1**	(7.4)	(24.4)	1.7	6.1
Minority interests	**(0.6)**	(1.3)	(1.2)	(0.9)	(0.8)
Profit/(loss) attributable to shareholders	**25.5**	(8.7)	(25.6)	0.8	5.3
Fixed assets	**47.9**	50.7	55.1	62.1	64.5
Net current assets	**122.8**	97.9	102.0	105.8	81.8
Non-current liabilities and provisions	**(34.1)**	(33.8)	(28.2)	(27.1)	(20.5)
Total net assets	**136.6**	114.8	128.9	140.8	125.8
Shareholders' funds	**126.8**	105.7	119.5	133.5	125.3
Minority interests	**9.8**	9.1	9.4	7.3	0.5
	136.6	114.8	128.9	140.8	125.8
Earnings/(loss) per share – basic	**15.07p**	(5.12)p	(15.11)p	0.47p	3.20p
Dividends per share	**2.20p**	1.80p	1.50p	3.00p	2.00p

The financial record for periods prior to 1996 has not been restated for the effect of implementing FRS9 and FRS10.

Shareholder information

Financial calendar
Financial year end:
31 March 1999

1998/99 preliminary results announced:
17 June 1999

Annual General Meeting:
30 July 1999

Final dividend payment date
(record date 9 July 1999):
12 August 1999

Half year results announced:
18 November 1999

Interim dividend payable:
28 January 2000

Registered office and company number
Badminton Court
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Amersham
Buckinghamshire HP7 0DD
Company number 2342138

Registrars
Computershare Services PLC
PO Box No 82, Caxton House
Radcliffe Way, Bristol BS99 7NH

Shareholder enquiries relating to shareholding, dividend payments, change of address, loss of share certificate etc. should be addressed to Computershare Services PLC at their address given above.

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Solicitors
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Broadwalk House
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