Babcock International Group PLC
Annual report and accounts 2003

From providing, to applying. From enabling, to operating.

From old, to new.

Our transformation is on track: Babcock is now a significantly changed business.

We operate under two main business units – with the disposal of the Materials Handling businesses almost complete and the focus clearly on supplying support services, largely to the Ministry of Defence. The business is characterised now by longer term order books, with good visibility of earnings and a business which is much more service orientated and with less investment in fixed assets.

Group operating profit

+£17.5m

to £18.9m

Operating profit*

+39%

to £20.8m

Operating profit (for continuing businesses)*

+44%

to £22.9m

Profit before tax**

+34%

to £18.0m

Earnings per share

5.72p

2002: loss of 11.86p per share

Recommended dividend

+5.3%

to 3.0p per share

*Pre-goodwill
**Pre-goodwill and exceptionals

Chairman's statement

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

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

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

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

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

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

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

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

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

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

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

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

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

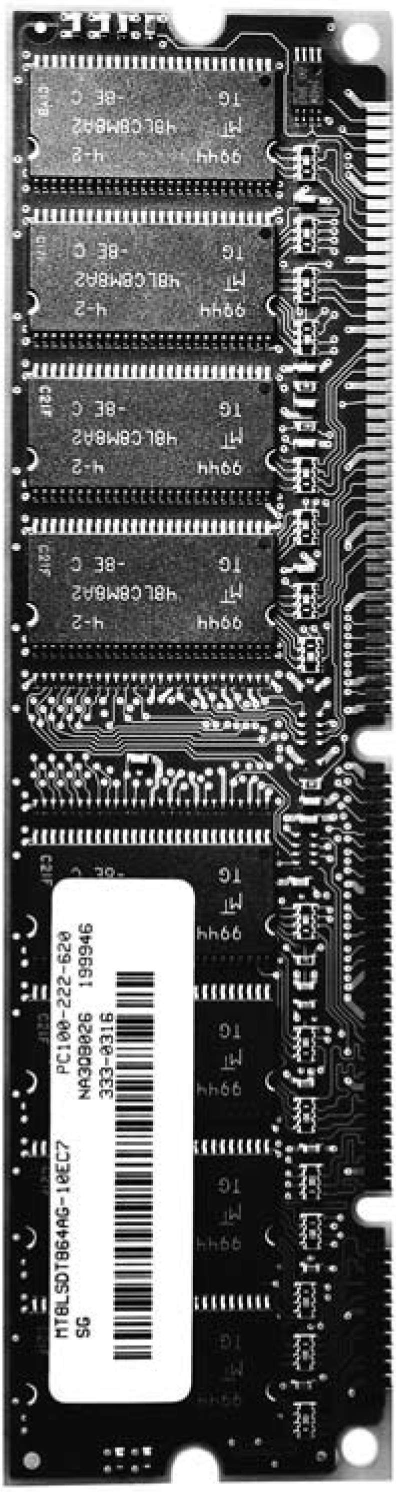
G A Campbell
Chairman

From planning,

to purifying.

Managing major projects
and developing new markets.
Babcock uses its project
management and design skills
to refit major naval vessels and
build water purification systems
for the commercial markets.

From hardware,



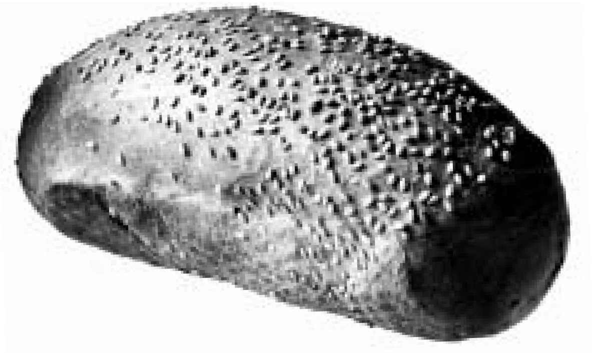
Logistics, including purchasing and distribution of electronic components.

Babcock were recently awarded a £100 million contract to purchase and distribute electronic and electrical components for the Ministry of Defence as part of the Ministry's outsourcing non-project procurement.

to everywhere.

From roof,

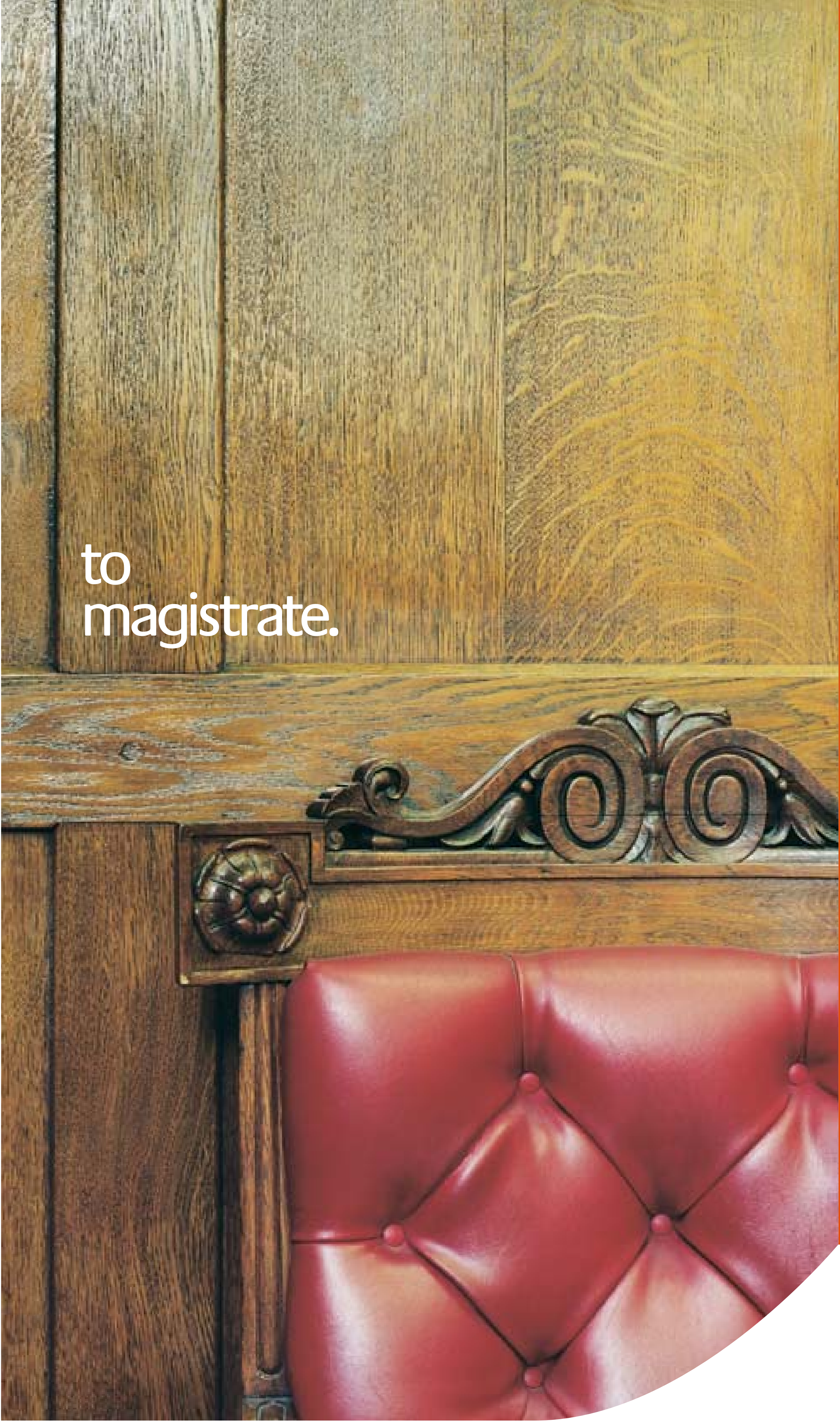
Providing accommodation and related services for the armed forces.
Babcock, directly or indirectly manages military bases from Faslane to Cranwell, to the Balkans and Afghanistan, providing services from maintenance to catering.



to roll.

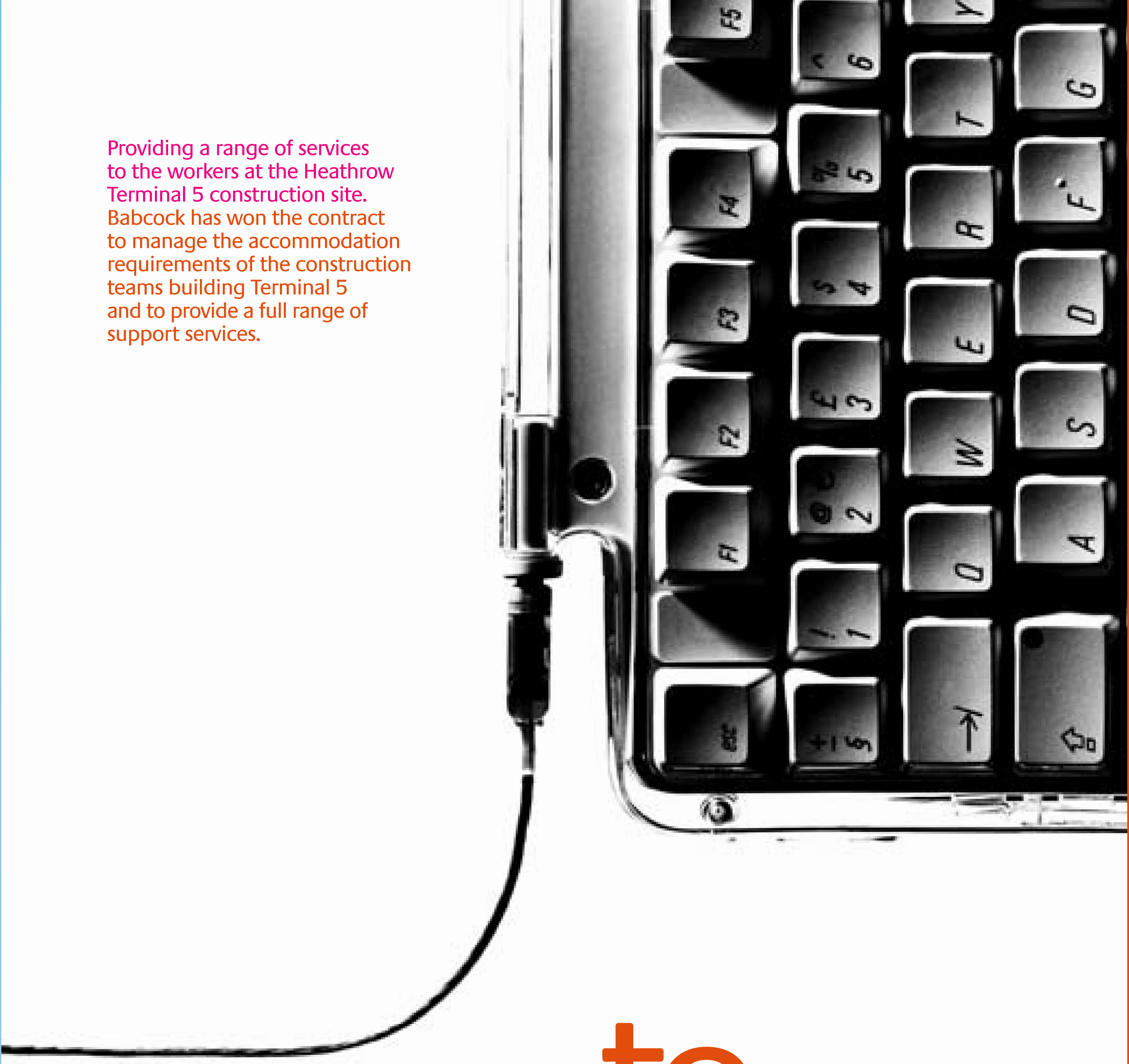
From decorate,

Estate management for schools, London Magistrates and the MoD.
Babcock manages and advises such diverse clients as local education authorities, the London Magistrates' Courts and the Ministry of Defence on their real estate. It was recently awarded, in conjunction with Bovis Lend Lease, the Single Living Accommodation Modernisation contract, worth in total, some £1 billion over a seven year period.


to
magistrate.

From on time,

Providing a range of services to the workers at the Heathrow Terminal 5 construction site. Babcock has won the contract to manage the accommodation requirements of the construction teams building Terminal 5 and to provide a full range of support services.

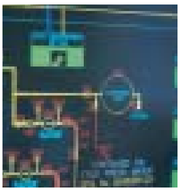


to online.

The transformation of Babcock continued during 2002/03. In the last two years 36% of the turnover which existed at the beginning of that period has been sold. This has been replaced, through organic growth or acquisition, with activities which are much more robust in terms of the markets they serve and the type of business offering that is made. The benefits of this repositioning are clear when one looks at the results of the businesses which are being taken forward compared to those which Babcock used to operate.

The results are reported in two core sectors. The first is Technical Services, which was primarily the Rosyth Dockyard but which is now managed as four semi-autonomous business units; Naval Refit, Fabrication, Design and Technology and Logistics. These businesses will be essentially stand-alone operations, enabling them to focus on new opportunities and to develop business in addition to the traditional Rosyth activities. Technical Services also includes Eagleton – the oil and gas pipeline service business in North America, FBM – the fast ferry business, Babcock New Zealand – which operates the Naval dockyard in that country, and MEF – a naval refit business on the South Coast which specialises in servicing the Royal Fleet Auxiliary. The second sector is Training and Support which is subdivided into three business areas. These are Babcock Defence Services (BDS), Babcock Naval Services (BNS) – which is the operation which now runs Her Majesty's Naval Base Clyde, and Babcock Infrastructure Services (BIS) which includes the recently acquired SGI business and operations in Southern Africa.

Because of the rapidly changing shape of Babcock, the turnover for the second half of 2002/03 is more indicative of the business going forward. In this second half, Training and Support became a larger segment than Technical Services, with sales increasing to £115 million (in the six months) compared to £49 million in the second half of 2001/02. Equally, Materials Handling has declined to 7% of turnover in this second half. The business is now characterised by long-term order books, currently standing at some £640 million, and a secure customer base with the Ministry of Defence comprising approximately 70% of turnover. Babcock has significant growth opportunities that are effectively secured, but are not included in the current order book as final contracts have not yet been signed. The business is now dependent upon the skills of our people, and there is a coherent culture based on delivering high quality service, whether it is the delivery of refitted aircraft carriers on time and on budget, achieving outstanding availability performance for 100 Squadron's Hawks, or keeping the London Magistrates' Courts operating smoothly.



Technical Services

The division maintained profits despite a 5% fall in turnover. The turnover was expected to be lower as the contract for the refitting of HMS Invincible was smaller than that of HMS Ark Royal which preceded it and, indeed, for HMS Illustrious which is following it. The programme on HMS Illustrious runs through to the end of 2004 and will provide a secure base load during that period. HMS Invincible maintained Rosyth's reputation for delivering on time and on budget and was duly returned to the Navy in January 2003. Work also continued, with equal success, on the programmes to refit the Type-23 Frigates and a number of smaller warships.

The new operating structures based around Rosyth will facilitate the winning of business outside the traditional naval work. This will be particularly true in Design and Technology, and in Fabrication where success is already being achieved. Equally, the winning of the £100 million contract to purchase and supply electrical and electronic components for the Ministry of Defence in their Non-Project Procurement programme is an example of Rosyth's skill base being applied to a new area.

After much hard work, Rosyth was named as the preferred assembly site for the new aircraft carrier programme. This, plus associated design and fabrication work, should provide Rosyth with a secure base load going through until 2015. However, there is likely to be a gap between the end of the allocated refit programme and the commencement of work on the new carriers. A major target for Rosyth will be to win additional work from the Royal Navy to bridge this gap.

MEF was acquired in August 2002 and provides a South Coast maintenance facility. MEF is working with Rosyth to develop the business, and initial results from MEF are very encouraging. The fast ferry design house, FBM, has refocused its activities on design and licensing rather than on manufacturing and, as a consequence, the results improved quite markedly. However, the performance is still not satisfactory and a higher level of activity is required.

Eagleton had a more difficult year as a result of the disruption in the US energy market but has started the current year with stronger prospects.

New Zealand had a satisfactory year and the contract to manage the New Zealand naval refit facility continues.

Training and Support

The partnership to manage Her Majesty's Naval Base Clyde (at Faslane and Coulport) duly started on 1 September 2002. This £400 million partnership contract, over a five year period, with an option to renew for a further five years, is believed to be the largest service contract awarded by the Ministry of Defence. Some 1,750 Ministry of Defence staff have been transferred to Babcock and a further 500 naval employees seconded. The contract is based on a target cost saving, and a sharing of the benefits above that figure. Good progress has been made towards achieving these cost savings and there is confidence that they can be achieved well within the five year target. The contract is expected to yield between 5%–6% return on sales over its life time, although a more conservative margin has been assumed in the first seven months.

BDS is essentially the business acquired in March 2001 and, on a level turnover, increased profits by 18% over the previous year. A major success was achieved by securing sole bidder status to manage the Royal School of Military Engineering (RSME). This business will be worth £30 million per annum over a 30 year period to BDS, thus increasing its turnover by some 50%. We are confident of meeting the affordability targets set by the Ministry of Defence and, in so doing, should move to preferred bidder status. The increase in turnover is unlikely to occur before the beginning of 2004. Elsewhere BDS had a 100% success rate in its rebids, although as a result of circumstances outside its control, two of the rebids will be at a lower level than in the past. In particular, the very significant reduction of the British Army's presence in Kosova will see that contract effectively taper to zero, but there has been success in replacing some of that turnover by similar contracts in Afghanistan, and with NATO in the Balkans. We are in the final groups of bidders for both the Armoured Vehicle Training System (AVTS) and Airside Support Services Project (ASSP). Winning either of these contracts would provide a significant boost to revenue and profits.

BIS comprises the business acquired as SGI in June 2002 and Babcock's South African operation. SGI provides estate management for the Ministry of Defence and for non-military activities. It has already won two significant bids. The Single Living Accommodation Modernisation (SLAM) contract provides for Babcock to maintain the new facilities being provided for the Armed Forces. This contract was won in a joint venture with Bovis Lend Lease who will provide the construction capability. Recently, the project to manage the accommodation requirements for the construction of Terminal 5 was awarded to BIS, and a bid has been submitted for the South West Regional Prime contract which is expected to be let by Defence Estates within the next six months. In addition to these major contract wins, the acquisition has performed in line with expectations.

Babcock Africa had an exceptional year, with sales up 45% and profits doubling. The growth came mainly from the agency for Volvo heavy construction vehicles, and as the service element of this business increases, the margins should increase to a more acceptable level.

Materials Handling/Discontinued businesses

In the year, the sale of the cement handling business in America was completed and the Chronos Richardson packaging operation was sold. The sale process for Chronos inevitably affected the operating results as management's attention was distracted, and the business made heavy losses until its sale in November 2002. The extent of the disposal programme is demonstrated by the discontinued line in the Annual Accounts which shows a reduction in turnover of £81 million.

The marine business, which made heavy losses in 2001/02, was turned around and is now operating at breakeven. The intention remains to sell this business, but until a satisfactory record of performance has been established, the sale process will be difficult.

Summary and prospects

The transformation of Babcock is almost complete, as recognised by the FTSE Index reclassifying Babcock as a support services business. In the coming year, the Materials Handling sector, even if its sale is not complete, is likely to comprise less than 5% of turnover, and the continuing businesses grew last year by 25% to £409 million. With contracts already identified and likely to move to financial close in the current year, the prospects for further growth are good. With SLAM and RSME either secured or at sole bidder stage, revenue growth in 2004 is assured. Winning any of the Regional Prime Contracts, AVTS or ASSP, all of which are well into the bid process, would provide a further significant boost. Equally, the carrier programme should provide a solid base-load at Rosyth from 2006.

The group is now well placed to take advantage of secure long-term contracts which should see earnings grow consistently over the foreseeable future.

Peter Rogers
Chief Operating Officer

Operating results

Group turnover from continuing operations was £409.0 million, up 25% from £326.8 million in 2001/02. Acquisitions made in the year contributed £19.0 million whilst the new contract at HM Naval Base Clyde at Faslane and Coulport (Faslane) generated £48.7 million in turnover in its first seven months of operation. Turnover from discontinued operations, principally the Chronos Richardson business, was £14.5 million giving total group turnover of £423.5 million against £423.0 million in 2001/02.

Group operating profit from continuing operations, before goodwill and exceptional items, increased by 44% to £22.9 million from £15.9 million last year, generating an operating margin of 5.6% (2001/02: 4.9%). On the same basis, operating profit from acquisitions and the Faslane contract contributed £2.5 million.

The net charge for amortisation of goodwill in the year was £1.9 million (2001/02: £2.1 million excluding impairment write offs). There were no operating exceptional items this year, giving a total operating profit from continuing operations of £21.1 million against £4.7 million last year. Losses from discontinued operations were £2.1 million (2001/02: £3.3 million).

Interest

Net interest payable and similar charges increased by £1.7 million to £2.7 million as a result of the additional borrowings to finance the acquisition of SGI in June 2002. Based on a monthly average of net borrowings in the year this represents an annualised cost of funds of 7.8%.

Tax

The group's underlying tax rate on continuing operations, calculated after excluding goodwill amortisation and losses on disposal, was 26% (2001/02: 25.8%). The difference between this rate and the statutory rate of 30% is primarily due to a lower effective rate of tax in respect of profits arising in other jurisdictions and prior year items. It is anticipated that this underlying rate will apply for the next financial year.

Returns to shareholders

Despite an absolute share price that varied between 86p and 127p, the group's shares outperformed the FTSE All-Share Index in the 12 months to the end of March 2003 by 20%.

Earnings per share on a fully diluted basis were 5.69p compared to a loss per share of 11.84p in 2001/02. Diluted earnings pre-goodwill amortisation and non-operating exceptional items but including losses from discontinued operations were 8.87p per share, up 94% from last year. Note 11 to the accounts sets out the calculation of these statistics.

Continuing turnover

+25%

Continuing operating profit

+44%

pre-goodwill

Earnings per share

Up to

5.69p

from (11.84p)

The Board is recommending a final dividend of 1.85p per share making a total for the year of 3.0p per share, an increase of 5.3% on last year. Based on the share price at the close of business on 31 March this represented a net yield of 3.4%. Dividend cover based on earnings pre-goodwill and non-operating exceptional items was 3.0 times (2001/02: 1.6 times).

Shareholders' funds

Total consolidated shareholders' funds increased by £6.4 million to £87.3 million including a net deficit on group profit and loss account reserves of £70.2 million (2001/02: £76.2 million). The group's ability to pay dividends is based upon the parent company's reserves not consolidated reserves and, as such, is not in any way impaired. Distributable reserves in the parent company at 31 March 2003 were £19.2 million (2001/02: £20.9 million).

Dividend growth

+5.3%

Cash flow

Net cash inflow from operating activities in the year to 31 March 2003 was £11.3 million, a decrease of £8.5 million from the previous year. Trading working capital increased by £18.6 million in the year driven by business growth in Africa and the Rosyth Naval Dockyard, the unwinding of payments in advance of turnover in BMH Marine and Babcock Eagleton and settlement of prior year accruals, all previously provided for.

The group's principal customer and therefore source of cash from operations is the UK Ministry of Defence (MoD). The scale of individual cash inflows from contracts can be very significant and materially affect period end cash and working capital depending upon the defined settlement dates and in certain cases the stage of completion of the contracts. Principal operating cash outflows are payroll and payments to subcontractors employed within the main contracts.

Cash generated from operations

£11.3m

Certain contracts undertaken at the Rosyth dockyard contain profit sharing clauses that may require the group to make repayments to the MoD depending upon the profit achieved. Such 'shareline' clauses are fully provided for in calculating declared profits although cash settlement may not occur until some time after the end of a contract. No such settlements were made during 2002/03 but payments are likely to be made under these clauses during 2003/04.

Capital expenditure on fixed assets net of disposals was £2.0 million, down from £6.4 million last year and reflecting the group's move away from capital intensive activities into service delivery.

After payment of interest and tax totalling £5.6 million (2001/02: £4.5 million) acquisitions and disposals of £26.7 million and dividends of £4.2 million (2001/02: £3.8 million) the net cash outflow in the year before financing and management of liquid resources was £28.2 million (2001/02: outflow £10.9 million).

Liquidity

In order to finance the acquisitions made during the year, the group raised financing of £20.0 million from its principal bankers under an amortising three year medium-term loan maturing in May 2005. The group also has access to short-term revolving credit facilities totalling £40.0 million as well as an overdraft line of £10.0 million to cover the intra-month cash fluctuations referred to above. These facilities are available for a further year but are due to be refinanced in June 2003 and the renewal process is expected to complete on schedule.

At 31 March 2003 the group had drawn down £46.9 million under the facilities and was comfortably within its contractual financial covenants under the loan agreement.

Treasury

Foreign currency risk: It is group policy that operating businesses maintain forward cover for foreign exchange exposure in relation to transactions in as risk averse a way as possible. Speculation on future exchange rate movements is forbidden. When foreign currency options provide the most effective means of cover for transactions, for example where flows are uncertain, these instruments may be used with the express permission of the Group Finance Director. It is not group policy to hedge foreign currency exposure on translation of profits and net assets of overseas subsidiaries.

Management of net debt: Details of sources of debt, maturity and interest rates are set out in notes 20 and 21 to the accounts. Currency borrowings are taken out in relation to overseas businesses operational requirements and as such will provide a partial hedge against the effect of currency volatility on overseas net assets and income. Surplus cash is invested with prime rated counter-parties.

Interest rate risk: All group borrowings are agreed by the Finance Committee of the Board prior to commitment and as a part of this process it is group policy that an appropriate balance of fixed and floating rate financing is in place such that the group mitigates the adverse risk of a rise in interest rates as well as enabling it to benefit from any decrease. In order to achieve this, the group has entered into an interest rate swap with one of its banking partners on its £20.0 million medium-term loan, capping the interest rate on this facility at 5%.

Many contracts for the provision of services entered into by the group require the provision of a parent company guarantee to underwrite the performance of the relevant operating subsidiaries. Such guarantees are subject to the approval of the group's executive Directors prior to commitment.

Acquisitions and disposals

The group made two acquisitions during the year for a total consideration, including costs, of £23.7 million, Service Group International (SGI) for £22.0 million and MEF Limited for £1.7 million. Deferred consideration of up to £5.0 million is payable for SGI in the event that certain contracts currently being bid are won.

After a very poor performance during the first half of the year, the disposal of the Materials Handling, Chronos Richardson business for a nominal sum was announced in November 2002. Cash outflow on disposals includes net cash transferred of £0.7 million and transaction costs of £0.6 million. The remaining £1.3 million relates to costs paid out in respect of prior year disposals and deferred consideration received.

Pensions

Pending agreement between the accounting standard setting bodies on the revised methodology for accounting for pension schemes the group continues to apply the transitional rules of FRS17 and, for valuation purposes in the financial statements, applies SSAP24. Details of the valuation of the principal defined benefit schemes operated by the group on SSAP 24 and FRS17 bases, together with the assumptions used, is set out in note 24 to the accounts.

The SSAP24 surplus on the defined benefit schemes, based upon the lastest actuarial valuations, has been included in the group balance sheet at £71.3 million. The net charge included in the group profit and loss account in respect of all defined benefit schemes was £0.1 million (2002: £0.4 million credit). Included in the net charge were interest on the pension pre-payment of £6.0 million (2002: £6.0 million) and amortisation of the pension scheme surplus of £3.7 million (2002: £5.0 million).

On an FRS17 basis, using the prescribed mark-to-market method for valuing scheme assets at 31 March 2003, the net surplus on the defined benefit schemes reduced to £2.3 million. The net credit to the group profit and loss account, had FRS17 been fully adopted, would have been £8.3 million. Such was the movement in the markets between 31 March and 30 April 2003 application of FRS17 mark-to-market principles to scheme assets as at 30 April would have increased asset values by £20.8 million, illustrating the effect of short-term volatility in markets on an essentially long-term investment.

Private Finance Initiative (PFI)

A key element of the group's strategy is to be fully involved in the bidding and operating of contracts let under the UK Government's PFI particularly in the defence market. The group is currently involved at various stages in a number of these bids. Babcock applies the principles of UITF34 in full and there are currently no bidding costs carried on the group's balance sheet.

Costs of bidding for PFI contracts are substantial and as such liquidity and financing projections are drawn up to take this into account. Approval to proceed with contract bids is reserved to the executive Directors of the Board and is given only after consideration of, amongst other factors, the ability of the group to fund both the costs of bidding and the contract investment in the event that the bid is successful.

Bill Tame
Group Finance Director

Directors and Company Secretary

Gordon Campbell (Age 56), Executive Chairman
Mr Campbell joined the Board as Group Chief Executive on 10 October 2000 and was appointed Executive Chairman on 1 January 2001. Mr Campbell is a former Chief Executive of Courtaulds plc. He is currently a non-executive Director of British Nuclear Fuels plc, Wade Allied Holdings Ltd and Jupiter Split Trust plc, and is a Trustee Director of the British Heart Foundation. He is also Vice President of the Royal Academy of Engineering. Mr Campbell was reappointed as a Director of the company at its Annual General Meeting in July 2001.

The Rt Hon Lord Alexander Hesketh KBE (Age 52), Non-Executive Deputy Chairman and Senior Non-Executive Director; Chairman of the Remuneration Committee
Lord Hesketh joined the Board on 6 October 1993 becoming non-executive Deputy Chairman on 26 April 1996. He is a non-executive Director of BAe Systems PLC and Chairman of British Mediterranean Airways Limited. He was Government Chief Whip in the House of Lords from 1991 to 1993 and, prior to that, was Industry Minister at the Department of Trade and Industry. Lord Hesketh chairs the company's Remuneration Committee and is a member of its Audit and Risk Committee. He was reappointed as a Director of the company at its Annual General Meeting in July 2002.

Peter Rogers (Age 55), Chief Operating Officer
Mr Rogers joined the group as Chief Operating Officer on 1 June 2002 and was appointed to the Board on 13 June 2002. He is a former Director of Courtaulds plc. Mr Rogers was reappointed as a Director of the company at its Annual General Meeting in July 2002.

Bill Tame (Age 48), Group Finance Director
Mr Tame joined the Board as Group Finance Director on 25 January 2002. He is a former Finance Director of Scapa Group PLC. Mr Tame was reappointed as a Director of the company at its Annual General Meeting in July 2002.

John Rennocks (Age 57), Non-Executive Director; Chairman of the Audit and Risk Committee
Mr Rennocks joined the Board as a non-executive Director on 13 June 2002. He is a former Finance Director of Corus Group PLC and is currently non-executive Chairman of KS Biomedix PLC and Deputy Chairman of Inmarsat Ventures plc and also holds several other non-executive positions. Mr Rennocks is Chairman of the company's Audit and Risk Committee and is a member of its Remuneration Committee. He was reappointed as a Director of the company at its Annual General Meeting in July 2002.

Dipesh Shah (Age 50), Non-Executive Director
Mr Shah joined the Board as a non-executive Director on 15 June 1999. He is non-executive Chairman of IT Power Limited and a non-executive Director of NAPS Systems OY (with effect from 18 June 2003) amongst other companies. A former Vice President, Acquisitions and Divestments, of BP p.l.c. and a member of the DTI's Renewable Energy Advisory Committee and UK Panel for European Environmental Awards, he is a past Chairman of the European Solar Industry Association and a former Managing Director and Chief Executive of BP Solar International. Mr Shah is a member of the company's Audit and Risk and Remuneration Committees. He was reappointed as a Director of the company at its Annual General Meeting in July 2002.

Mike Turner CBE (Age 54), Non-Executive Director
Mr Turner joined the Board as a non-executive Director on 5 June 1996. He is Chief Executive Officer of BAe Systems PLC and a member of the Supervisory Board of Airbus. He was President of the Society of British Aerospace Companies from 1996–1997. Mr Turner is a member of the company's Audit and Risk and Remuneration Committees. Having last been reappointed as a Director at the company's Annual General Meeting in 2000, Mr Turner will, as required by the company's Articles of Association, be retiring as a Director at the forthcoming AGM but, being eligible, will offer himself for re-election.

Sir Nigel Essenhigh (Age 58), Non-Executive Director
Sir Nigel Essenhigh joined the Board as a non-executive Director with effect from 4 March 2003. Until his retirement from the Royal Navy in late 2002, he was First Sea Lord and Chief of Naval Staff. He is non-executive Chairman of Defence Strategy & Solutions, a limited liability partnership. Sir Nigel is a member of the company's Audit and Risk and Remuneration Committees. Having been appointed as a Director by the Board since the last Annual General Meeting of the company, Sir Nigel will, at the forthcoming AGM, in accordance with the requirements of the company's Articles of Association, retire as a Director of the company and, being eligible, will offer himself for re-election.

Company Secretary
Albert Dungate (Age 46)
Mr Dungate was appointed as Group Company Secretary and General Counsel on 1 February 2002. A solicitor, he was formerly General Counsel and Company Secretary of Arjo Wiggins Appleton PLC. Mr Dungate is Secretary to the company's Audit and Risk and Remuneration Committees.

Directors' report

The Directors present their Report and the audited Financial Statements of the group for the year ended 31 March 2003.

Result and dividends
The profit attributable to shareholders for the financial year was £8.3 million (2002: loss £17.1 million). An interim dividend of 1.15p per 60p ordinary share was declared in the year (2002: 1.10p per 60p ordinary share). The directors propose to recommend the payment on 8 August 2003 of a final dividend of 1.85p on each of the ordinary shares of 60p entitled thereto and in issue on 11 July 2003 (2002: 1.75p per 60p ordinary share). The retained profit for the financial year was £3.9 million (2002: loss £21.3 million).

Business review and group structure
The Operations review and the Financial review on pages 14 to 21 review the group's activities and future developments. Other matters material to an appreciation of the group's position are contained in the Chairman's statement on pages 2 and 3. The principal subsidiary and associated undertakings of the company are set out on page 63.

Acquisitions and disposals
Information regarding the group's acquisitions and disposals during the course of the year is set out in note 29 on page 60 and they are also referred to in the Operations review, Financial review and Chairman's statement.

Research and development
The group commits resources to research and development where necessary for the evolution and growth of its business.

Charitable and political donations
During the year the group donated £26,105 (2002: £35,715) to charitable organisations. No donations were made during the year for political purposes.

Supplier payments
The group has a policy of making payments consistent with established practices agreed with suppliers. There is no universal code or standard on payment practices across the countries in which the group does business, 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. The company itself had no trade creditors at either 31 March 2003 or 31 March 2002.

Directors
Details of the present directors are shown on page 22.

Mr M Easton resigned and Mr A Wheatley and Dr G Schäfer retired as Directors on 31 May 2002, 26 July 2002 and 31 December 2002 respectively. Mr M Turner will retire at the company's forthcoming Annual General Meeting under the provisions of Article 92 of the company's Articles of Association and in accordance with the Combined Code, having last been reappointed as a Director at the Annual General Meeting in 2000. Being eligible, he offers himself for re-election at the forthcoming meeting. Sir Nigel Essenhigh was appointed by the Directors to the Board on 4 March 2003 and will therefore also retire as a Director at the forthcoming Annual General Meeting, under the provisions of Article 97 of the company's Articles of Association, and, being eligible, offers himself for election. Each of Mr Turner's and Sir Nigel's appointments is terminable at will. All other Directors have had their appointments voted on by shareholders at Annual General Meetings within the past three years.

Directors' interests
There is no contract or arrangement with the company or any of its subsidiaries 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.

The interests of the persons who were Directors as at the end of the financial year in the issued share capital of the company, including family interests, all of which were beneficial, were, at the dates shown, as follows:

Director	At 31 March 2003	At 1 April 2002
G A Campbell	**49,685**	49,685
P L Rogers	**20,000**	–
The Rt Hon Lord Hesketh KBE	**8,249**	8,249
W Tame	**7,113**	7,113
D J Shah	**8,333**	8,333
M J Turner CBE	**16,666**	16,666
Sir Nigel Essenhigh	**–**	–
J L Rennocks	**–**	–

Holdings are all of ordinary shares of 60p each.

There were no changes in the Directors' interests in shares between 31 March 2003 and 11 June 2003.

Details of options over shares in the company granted to Directors up to 11 June 2003 are given on page 31. Each executive Director is also interested as a potential beneficiary in the shares held by the Babcock Employees' Share Trust.

Significant shareholdings

As at 5 June 2003, the company had been notified in accordance with sections 198 to 208 of the Companies Act 1985 of the following major interests in its ordinary shares (which represent interests in 3% or more of its issued ordinary share capital).

Name	Number of 60p ordinary shares	%
UBS Global Asset Management (UK) Limited and its associates in the UK	7,274,588	4.90
Schroder Investment Management Limited	19,281,599	12.98
HSBC Asset Management (Europe) Limited	11,733,643	7.90
Fidelity International Limited	15,020,168	10.11
Zurich Financial Services	8,950,562	6.02
Lazard Freres & Co., LLC	6,838,362	4.60
Legal & General Investment Management Limited	4,844,632	3.26

Employee share schemes

The company has employee share schemes as follows:

(i) Executive share option schemes

The company has several executive share option schemes pursuant to which grants have been or may be made, at the discretion of the Remuneration Committee or as required by the terms of an individual's employment contract, to executive Directors and other senior managers of the group. The Babcock International Group PLC Approved Executive Share Option Scheme and the Babcock International Group PLC Unapproved Executive Share Option Scheme are schemes which did not provide for options to be performance-linked, and are no longer operated, although grants made under them continue to subsist. The Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme ('the 1999 Schemes') do provide for option grants to be linked to company performance, and details of the performance criteria currently used are set out in the Remuneration Report on page 28.

Options granted under the Executive Share Option Schemes are not granted at a discount to market price, with the exercise price being determined 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 the grant date. Options are normally exercisable only between the third and tenth anniversaries of their grant date, but may become exercisable earlier in certain events (for example on termination of employment or a change of control).

It is the intention of the company, subject to shareholder approval, to introduce a Long Term Incentive Plan pursuant to which performance-linked awards of shares may be made to executive Directors and other senior executives. A summary of the proposed Plan is set out on pages 65 and 66.

(ii) All Employee Share Ownership Plan ('AESOP')

This plan allows participating employees to purchase 'partnership' shares in the company in the market out of pre-tax income, and could also be used by the company to award free and/or matching shares to participants. Shares are held on behalf of participants in a tax-approved employee trust, and must generally be kept in the trust for at least three years to obtain any tax advantages, and for five years to obtain maximum tax advantages. To date, employees have been given the opportunity to acquire partnership shares, but the company has not yet made an offer of matching or free shares. The AESOP is open to all UK employees (including executive Directors) who meet common service criteria.

(iii) Babcock International Group PLC Sharesave Scheme

This scheme was introduced in December 1997. It enables the grant of share options linked to save-as-you-earn contracts. Subject to meeting common service criteria, offers to participate in the scheme must be open to all UK employees (including executive Directors) of the group. There are, however, currently no outstanding subsisting options granted under this scheme. Options granted under the scheme could be granted at a discount of up to 20% off the market price of the shares at the time of the offer to participate.

Employees

Group companies have policies or follow practices relevant to their operations to ensure that talent is recognised and improvement encouraged. This includes training and development programmes that cover employees ranging from apprentices to managers.

Communication with employees is by a variety of means including cascade briefings, Director/employee briefings, employee and union consultation, weekly newsletters, newspapers, e-mail, the Babcock website and a recently established intranet. In many group companies there are regular briefings on market prospects and company performance given to Trade Union representatives.

The group gives full consideration to disabled applicants for employment, having regard to their particular aptitudes and abilities, and they share in the opportunities for training, career development and promotion. If an employee becomes disabled, our objective is, where possible, the continued provision of suitable employment either in the same or an alternative position, with appropriate training being given if necessary.

Employee involvement in the group's performance is also encouraged via share schemes as applicable.

Health, safety and the environment
The securing of the health, safety and welfare at work of the group's employees is recognised as a major responsibility of group management. Group companies are required to ensure that all necessary steps are taken to maintain standards and procedures to discharge the duties applicable to them. Each Division in the group is required to ensure that the highest standards are maintained in compliance with this policy and to ensure that employees co-operate with management in achieving its objectives.

Group policy requires each Division to recognise its responsibilities and obligations to care for the environment and to minimise any unacceptable adverse impact of its operations through positive environmental control. The maintenance of a high standard of environmental performance is required to form an integral part of business policy that can be transmitted to employees and third parties. Each Division of the group is required, consistently with the terms of any contract under which it operates, to manage plant and facilities for which it has operational and environmental responsibility in a manner that protects the environment by seeking to minimise energy usage and waste and through reductions in emissions to air, land and water. Each Division is required to pursue policies with a view to meeting these objectives and, as a minimum, to ensure compliance with environmental legislation and regulations in relevant countries.

All operating companies have comprehensive health, safety and environmental management and training programmes, for which Divisional Managing Directors have clear responsibility. Internal audits of compliance with legal requirements and company policies are carried out. In the Technical Services Division, the operations at Rosyth have been awarded the British Safety Council 5 Star Award for their Safety Management System. Company policy is that best practice is to be communicated and shared across the group.

Health, safety and environmental matters are reported on monthly to all the company's executive Directors and Divisional Managing Directors, via the Group Risk Manager, and are reviewed at least twice a year by the full Board (though any major matters would be brought to the attention of the Board as soon as practicable). Company policy is that a main Board Director of the company has Board level responsibility for health, safety and environmental matters. Currently that Director is Mr Campbell.

Business ethics
The company insists on the highest standards of honesty and integrity in all aspects of the group's business. This includes, but is not limited to, strict compliance with the laws and standards of conduct required in the countries in which the group operates and does business. A strict ethical policy and guidance on business dealings has been issued to group employees and is kept under review. Employees are required to avoid conflicts of interest regarding group business, to act lawfully and ethically, and to be responsible for communicating in good faith non-compliance issues of which they become aware.

To ensure compliance with the Public Interest Disclosure Act 1998 in the United Kingdom, the group has a procedure for employees to bring matters to the attention of the Company Secretary if they do not feel able to approach their line managers.

Annual General Meeting
This year's Annual General Meeting will be held at The Berkeley Hotel, Wilton Place, Knightsbridge, London SW1X 7RL on Friday, 18 July 2003 at 11.00 am. The notice of meeting is on page 64 and notes on resolutions to be proposed at it as special business are set out on pages 65 and 66.

Auditors
As announced at the time of the last Annual General Meeting when Deloitte & Touche were appointed as the company's auditors following the resignation of Arthur Andersen, the Board conducted a review of the group's audit requirements following which Deloitte & Touche resigned as auditors and PricewaterhouseCoopers LLP were appointed. In accordance with the Companies Act 1985 and the company's Articles of Association, they will retire as auditors at the forthcoming Annual General Meeting where a resolution to reappoint them will be proposed as special business.

Approval of report
Approved by the Directors on 11 June 2003.

By order of the Board

A N Dungate Company Secretary
11 June 2003

Statement on Corporate Governance

The company is committed to the principles of Corporate Governance contained in the Combined Code which is appended to the Listing Rules of the Financial Services Authority and for which the Board is accountable to shareholders. The Board has noted the content of the Higgs Report on non-executive Directors and that its proposals are still under review. Once finalised, the Board will consider again the application of the Report's recommendations to the company.

Statement of compliance with the Combined Code

During the year ended 31 March 2003 the company complied with the requirements of Section 1 of the Principles of Good Governance and Code of Best Practice (the 'Combined Code').

During that year, and currently, the post of Executive Chairman was and is held by Mr Campbell. Mr Rogers as Chief Operating Officer has effective Board responsibility for day-to-day operational matters of the group. The Board considers it has a strong group of non-executive Directors (including a non-executive Deputy Chairman). The Deputy Chairman, Lord Hesketh, is recognised by the Board as the senior independent Director to whom any concerns may be conveyed by investors.

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:

Directors

The Board currently comprises three executive Directors and five non-executive Directors. The Board considers each of its non-executive Directors to be independent. The Board is confident that the constitution of the Board ensures a balance of power and authority such that no one individual has unfettered powers of decision.

The Board formally met six times in the financial year under review. All Directors have full and timely access to information. All Directors must submit themselves for re-election at least every three years.

Board Committees

The Board has an established Audit and Risk Committee consisting of all the current non-executive Directors, under the Chairmanship of Mr Rennocks. The Committee met formally twice in the year under review. In the forthcoming year the Committee intends to meet at least three times. The Committee has formal terms of reference that have been updated in light of the recommendations made in the current version of the Smith Report. Its meetings are attended by the Group Chairman, Group Finance Director and internal auditor and also by the external auditors, with the opportunity being given to Committee members to meet the auditors (internal and external) in the absence of executive Directors.

The Remuneration Committee established by the Board, which also serves as the company's nominations committee, is described in the Remuneration Report on pages 28 to 32.

Directors' remuneration

Full details of Directors' remuneration and a statement of the company's policy on executive Directors' remuneration are set out in the Remuneration report on pages 28 to 32.

Contact with shareholders

The company has regular contact with its larger shareholders, both institutional and individual. The Annual General Meeting is used as an important opportunity for communication with all shareholders. All of the company's then Directors, other than Mr Rogers, attended the 2002 Annual General Meeting, and all of the current Directors intend to attend the forthcoming Annual General Meeting. The company's website is also available for shareholders to keep themselves updated on developments. It is regularly updated with press releases and analyst presentations. Shareholders can register on the website to be sent news releases automatically.

Going concern

The Financial Statements have been prepared on a going concern basis as the Directors have, after making enquiries, a reasonable expectation that the group will have adequate resources to continue in operational existence for the foreseeable future.

Internal controls

The Board of Directors has overall responsibility for the group's system of internal controls, and for monitoring its effectiveness. There has been a process for identifying, evaluating and managing significant risks throughout the period under review and at the date of the approval of the Financial Statements. This process is in accordance with Internal Controls: Guidance for Directors on the Combined Code published in September 1999. The group's systems are designed to manage rather than to eliminate the risk of failure to achieve business objectives, recognising that any system can only provide reasonable and not absolute assurance against material misstatement or loss. The key features of this system are described below.

Control environment and procedures

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.

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

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. A group Risk Manager has been appointed to further strengthen and co-ordinate the monitoring, identification and management of risk and a Group Risk Standard has been promulgated which requires businesses and operations, in a consistent manner, to monitor, identify and clarify risks and the steps that can be taken to reduce, eliminate or manage them.

Given the nature of the group's business, the principal risks relate to out-turn on contracts and the success rate in bidding for contracts. All proposed and actual bids for significant contracts are subject to continuous monitoring and review by a 'Bid Executive', consisting of the Chief Operating Officer, Divisional Managing Directors and representatives from other central functions. It meets monthly. Its function is to ensure that group resources are properly focused on appropriate, realistic and remunerative bidding opportunities that are the most suitable having regard to the strengths of the group and its development objectives. The final submission of significant bids requires formal approval from one or more executive Directors to ensure that they meet group criteria. Progress on all significant contracts is continually monitored within the relevant Division and is reviewed 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 submission for 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.

Monitoring
For the year under review, the internal control system was monitored and supported by an internal audit function that operated and reported to senior management and the Audit and Risk Committee on the group's worldwide operations. Since the end of the financial year, Ernst & Young have been appointed to provide the internal audit service under the overall control of the Audit and Risk Committee. The work of internal auditors is focused on the areas of greatest risk to the group as determined by the Audit and Risk Committee and senior management. These activities are supplemented by quality assurance audits and regular review visits by group management. 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 and Risk Committee.

The Board of Directors has reviewed the effectiveness of the system of internal 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.

A copy of the financial statements of the company is placed on the company's website. The maintenance and integrity of this website is the responsibility of the Directors. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Remuneration report

Remuneration Committee
This report sets out the company's policy on the remuneration of its Directors which it followed for the year under review and intends to follow for the current financial year and subsequent years. It also provides details of the Directors' remuneration packages and contracts. The report will be the subject of an advisory vote at the forthcoming Annual General Meeting of the company.

Responsibility for determining and approving the remuneration packages of the executive Directors and certain other senior group executives has been delegated by the Board to a Remuneration Committee ('the Committee') consisting solely of all the non-executive directors of the company, each of whom the Board considers to be independent. Those Directors who served on the Committee for all or part of the last financial year were as follows (with those currently still on the Committee indicated in bold type), namely:

The Rt Hon Lord Hesketh (Committee Chairman)

D J Shah

M J Turner

J L Rennocks (since 13 June 2002)

Sir Nigel Essenhigh (since 4 March 2003)

A E Wheatley (until 26 July 2002)

Details of the continuing members of the Committee are set out on page 22.

Mr Campbell attends meetings of the Committee in his capacity as Group Chairman, and Mr Dungate attends as Secretary to the Committee. The Committee has access to market research on remuneration. Advice on matters affecting remuneration is sought by or on behalf of the Committee from Mr Campbell (other than in respect of his own remuneration); in connection with the structuring of share awards and share schemes from Pinsents (solicitors with recognised expertise and experience in executive and employee share schemes) and, since November 2002, for advice on executive remuneration, share option and Long Term Incentive Plans from Inbucon-Meis (remuneration consultants). Pinsents also provide legal services to group companies. Inbucon-Meis do not provide other services to group companies. Both firms were appointed for these purposes, with the Committee's approval, by the company (acting through the Group Company Secretary).

The Committee also acts as the Nomination Committee in connection with the appointment of new Directors.

Remuneration policy
Basic policy
The remuneration policy of the Committee is ordinarily to provide executive Directors and senior executives with basic remuneration packages that, looked at as a whole, are competitive having regard to the median for companies of a similar size in business sectors in which the group operates or into which it intends to develop, with the opportunity to earn upper quartile rewards for upper quartile performance, and that are sufficient to recruit, retain and motivate executives in the light of the company's needs and development objectives.

Remuneration packages consist, to varying degrees as between individuals, of fixed elements – basic salary, pension entitlements and typical benefits in kind – and performance related elements – annual bonus schemes (linked to company and/or personal performance) and share-based or share-related longer term incentive schemes. Currently the share-based schemes are share option schemes, though the company intends, with shareholders' approval (which is being sought at the forthcoming Annual General Meeting), to establish a Long-Term Incentive Plan which could use share awards. The table on page 30 shows the relative value of the fixed and performance related elements of the continuing executive Directors' emoluments for the year under review. For that year, the performance related element consisted of annual bonus-schemes, the value of which was capped, and share option awards. Their share options, having been granted within the last three years, have yet to mature.

Performance related rewards:
Annual bonus schemes: The Remuneration Committee determines a performance related annual bonus scheme for each executive Director at the beginning of each financial year. For the year ended 31 March 2003 the bonus payable was dependent on the financial performance achieved by the group against budget and, in the case of Directors other than the Chairman, on the achievement of specific personal objectives. The maximum potential annual bonus for executive Directors was 50% of basic salary; 60% in the case of Mr Campbell. In the case of Mr Campbell, his bonus was calculated on the amount of his salary plus the payment made by the company into a pension scheme on his behalf, he having been paid a lower salary to take account of this benefit. The Committee has the discretion in exceptional circumstances where it considers his performance merits it, to award up to 20% of his basic salary to Mr Campbell, notwithstanding that a bonus has not been triggered on the group's financial performance against target. Similar schemes are in place for executive Directors for the current financial year. Annual bonuses are not pensionable.

Long-term incentive schemes: Under the Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme ('the 1999 Schemes'), performance criteria have been applied to the grant of options. The current executive Directors of the company hold options only under the 1999 Schemes or under option agreements that mirror those schemes as to performance criteria.

The performance criterion for the vesting of options granted to date under the 1999 Schemes is based on comparative total shareholder return ('TSR'), with the company's performance over the three financial years beginning with the financial year in which the option was granted being assessed in relation to companies within the Engineering and Machinery section of the FTSE All Share Index. In so far as the company's TSR performance is in the top quartile, share option awards will vest in full; if the company is ranked at the first position above median 25% of the option shares will vest, with proportionate vesting for performance between those levels. In so far as the company's performance falls below the median, no options will vest. This group was chosen as then being the appropriate comparator as, at the time of the grants, the company was part of the Engineering section of the FTSE All Share Index.

Further details of the company's share option schemes are set out on pages 24 and 31. Details of share options already granted to Directors are set out in the table on page 31.

The Committee periodically reviews the company's incentive arrangements and takes advice on market practice for remunerating key employees. Following a recent review by Inbucon-Meis, the Board is seeking approval at this year's Annual General Meeting of a new long-term incentive plan for senior executives to be known as the Babcock 2003 L-TIP ('the L-TIP').

The Committee is firmly of the view that offering senior executives the opportunity to be awarded shares in the company, or cash awards linked to the value of the company's shares, is an important part of motivating and rewarding key employees so that they may participate in the future growth in value of the company. The L-TIP is intended to support this objective and to facilitate the retention of key senior executives over the longer term. Under the L-TIP, selected senior executives (including executive Directors) within the group may be awarded each year conditional entitlements to shares in the company ('Award Shares') or to a cash sum whose value is linked to a notional award of Award Shares. It is envisaged that, initially, awards will be made to the executive Directors of the company and a limited number of other senior executives. The initial market value of the shares over which any such award is made may not exceed 100% of the amount of the participant's basic annual salary at the date of grant. The number or proportion of such Award Shares which vest will be determined by reference to the extent to which pre-set targets, relating to the performance of the company over a fixed three-year period beginning with that in which the award is made, are met or exceeded.

Performance targets will be set by the Committee when an award is made, having regard to current market conditions. In relation to awards made under the L-TIP before 31 March 2004, no Award Shares will vest unless the company is at or above the median level in the table of comparator companies ranked according to total shareholder return over the three years ending 31 March 2006.

The comparator companies will be all of the UK listed companies in the FTSE All Share Index (excluding investment trusts) used for the FTSE Actuaries' Share Indices. If the company is ranked at or immediately above the 50th centile, 25% of the Award Shares will vest. If the company is ranked in the top quartile, all of the Award Shares will vest. If the company is ranked between these threshold levels, the percentage of Award Shares which will vest will be calculated on a straight-line basis between 25% and 100% respectively.

In addition, Award Shares will not vest unless the company's adjusted earnings per share pre-goodwill and exceptional items in the year ending 31 March 2006 is at least 9.27% (representing a 3% per annum compound growth rate) greater than the adjusted earnings per share pre-goodwill and exceptional items for the year ended 31 March 2003.

Awards under the L-TIP will be capable of being made by either the company, as rights to acquire shares held in treasury, or by the trustee of The Babcock Employees' Share Trust ('the Trustee') acting on the recommendation of the Remuneration Committee. Alternatively the company may make the grant in the form of a conditional award of a cash sum whose value will be determined by reference to the value of a notional award of rights to acquire Award Shares. The operation of the L-TIP will be overseen by the Remuneration Committee. Further information about the proposed L-TIP is set out on pages 65 and 66.

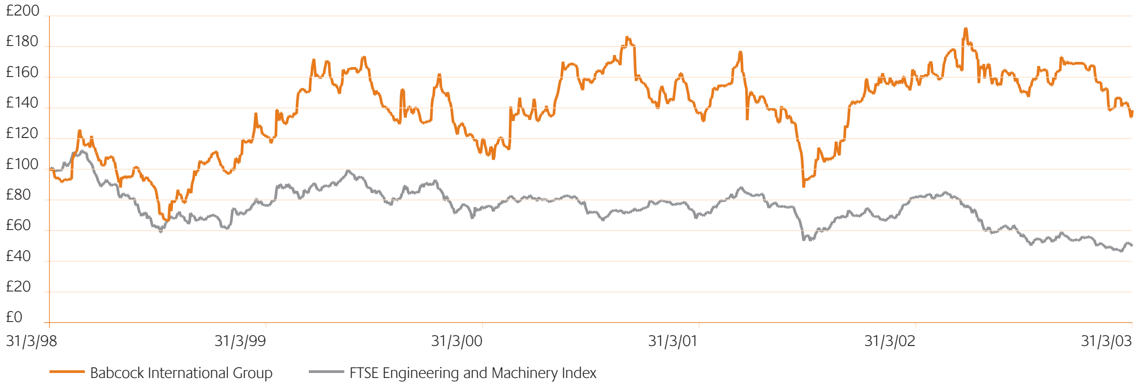
If the L-TIP is approved, it is the intention that any further share based incentives granted to executive Directors would be made under the L-TIP and not under the 1999 Schemes, and awards made under it to an executive Director or other employee would not in any year have a value in excess of his basic salary at the date of the award (save in so far as a share award may be grossed up to compensate the award holder for the cost of employer's National Insurance Contributions if the Committee exercises its discretion to require the award holder to bear that cost).

Grants of options under the 1999 schemes may continue to be made to senior executives but not, in any year, to recipients of an award under the L-TIP.

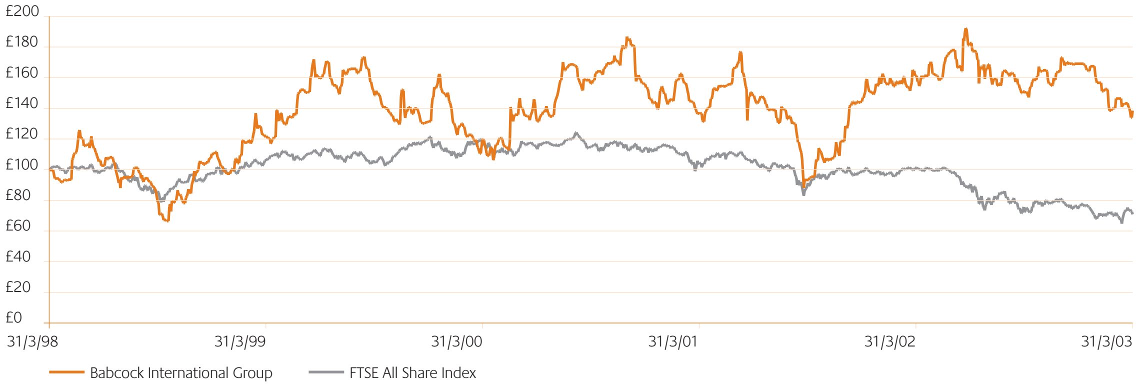
The FTSE All Share Index has been selected as the appropriate comparator group for share-based awards or grants of options made in the current financial year and reflects the fact that shareholders can choose, instead of investing in shares of the Company, to invest in any other listed shares.

Performance graphs The graphs below set out the company's cumulative TSR performance against companies in the Engineering and Machinery Sector of the FTSE All Share Index, and against companies in the FTSE All Share Index, in each case over the period from 31 March 1998 to 31 March 2003 reflecting the performance measures mentioned above. They were compiled by Inbucon-Meis.

Total Shareholder Return Monitoring: Babcock International Group vs FTSE Engineering and Machinery Index
Cumulative Total Shareholder Return Value of £100 investment on 31 March 1998



Total Shareholder Return Monitoring: Babcock International Group vs FTSE All Share Index
Cumulative Total Shareholder Return Value of £100 investment on 31 March 1998



Directors' pensions UK based executive Directors of the company are eligible for membership, by invitation, of the company's defined benefit pension plan. This would entitle them, subject to Inland Revenue limits and period of service, to a retirement pension of up to two-thirds of base salary in the 12 months prior to attaining age 60 and life assurance cover of up to four times base salary up to the earnings cap. For those eligible executive Directors invited to participate in the pension scheme whose earnings exceed the Inland Revenue earnings cap, the company will, on request, establish a Funded Unapproved Retirement Benefit Scheme (FURBS) and take out additional life assurance cover to provide additional retirement and life assurance benefits based on salary in excess of the earnings cap. The company may in lieu of membership of the defined benefit plan or a FURBS make a salary enhancement to reflect this, offer membership of a defined contribution scheme and/or make payments to a personal pension plan.

A summary of the current executive Directors' pension entitlements is set out on page 30.

Non-executive Directors It is company policy that non-executive Directors do not participate in any of the company's share, pension or bonus schemes. They are remunerated solely by fees that are reviewed against market practice at least every three years by the executive Directors, to whom the task has been delegated by the Board.

Directors' emoluments and compensation
The Directors' emoluments for the year ended 31 March 2003 are set out in the table below:

Director	Salary or fee (Fixed) £'000	Bonus (Performance related) £'000	Benefits (Fixed) £'000	Total Year-ended 31 March 2003 £'000	Total Year-ended 31 March 2002 £'000
Executive					
G A Campbell (Chairman)	384	237	1	622	626
P L Rogers† (Chief Operating Officer)	240	125	8	373	–
W Tame (Group Finance Director)	198	92	29	319	87
M Easton*†	33	–	2	35	285
Dr G Schäfer*†	202	43	15	260	270
Non-executive					
The Rt Hon Lord Hesketh KBE	51	–	–	51	50
J Rennocks†	25	–	–	25	–
D J Shah	26	–	–	26	25
M J Turner CBE	26	–	–	26	25
Sir Nigel Essenhight†	2	–	–	2	–
A E Wheatley*†	12	–	–	12	35
Total	1,199	497	55	1,751	1,403

*Former Director.
†The remuneration shown above relates to the part period of service of each Director during the year.

Bonus payments and benefits are not pensionable. Benefits comprise medical insurance, home to work expenses and accommodation expenses and FURBS life cover in respect of W Tame.

Directors' pensions
Babcock International Group Pension Scheme
Mr W Tame is and, until 31 May 2002, Mr Easton was, a member of the upper tier of the Babcock International Group Pension Scheme.
Details of the Directors' pension entitlements under the Babcock International Group Pension Scheme (defined benefit) are set out in the following table:

Director	Transfer value of the increase in accrued pension benefits during the year ended 31 March 2003 £	Transfer value of accrued pension benefits at 31 March 2003 £	Transfer value of accrued pension benefits at 31 March 2002 £	Increase in accrued pension benefits during the year ended 31 March 2003 £	Accrued pension benefits at 31 March 2003 £	Accrued pension benefits at 31 March 2002 £
W Tame	19,932	37,016	10,435	3,364	4,173	809
M S Easton*	9,367	209,744	187,019	995	16,626	15,631

*Former Director.

1) Inflation has been taken as 1.7% for the purposes of calculating increases in transfer values and pension earned.

2) The transfer value of the increase in pension accrued is calculated in accordance with Actuarial Guidance Note GN11, and is stated after deducting members' contributions.

3) The figures in the above table make no allowance for the cost of death in service benefits under the Scheme.

4) The figures in the above table make no allowance for any benefits in respect of earnings in excess of the Inland Revenue earnings cap.

5) If any member has significant benefits retained in any pension scheme provided by previous employers then the pension entitlements shown above may be restricted to a lower amount and the figures may need to be reduced accordingly. In calculating the above figures for Mr W Tame and Mr M S Easton no account has been taken of any retained benefits which they may have.

6) No payments have been made to retired Directors in excess of the retirement benefit to which they were entitled on the date the benefits first became payable or, if later, 31 March 1997.

Other pension arrangements

The amount of contributions made to the Directors' own pension plans or FURBS and former Directors' FURBS arrangements, including the cost of providing any additional life assurance cover, are set out in the table below:

Director	2003 £'000	2002 £'000
Mr G A Campbell	**29**	–
Dr G Schäfer*	**33**	17
W Tame	**11**	–
M S Easton*	**2**	15
	75	32

*Former Director.

Neither Mr Rogers nor Mr Campbell participate in any of the company's pension schemes. This is taken into consideration in setting their salaries

Contributions to a FURBS for Mr Tame are fixed such that the total cost to the company, including tax and National Insurance, is 20% of basic salary over the earnings cap plus the cost of providing additional life assurance cover for earnings above the cap.

Directors' share options

Details of Directors'/*former Directors' share options are set out in the table below:

Director	Option scheme	Number of shares subject to options at 1 April 2002	Granted during the year	Lapsed during the year	Number of shares subject to options at 31 March 2003	Exercise price (p)	Exercisable from	Expiry date
G A Campbell	e	560,975			**560,975**	123.0	Nov 2003	Nov 2010
	c	30,202			**30,202**	93.33	Jun 2004	June 2011
	d	282,573			**282,573**	93.33	Jun 2004	June 2011
	d	–	317,590		**317,590**	124.50	Jun 2005	June 2012
P L Rogers†	e	–	401,606		**401,606**	124.50	Jun 2005	June 2012
Dr G Schäfer*††	b	304,288			**304,288**	77.00	Sep 1999	Dec 2003
	b	340,017			**340,017**	82.00	Dec 2000	Dec 2003
	b	316,614			**316,614**	89.00	Jul 2001	Dec 2003
	d	180,020			**180,020**	118.00	Sep 2002	Dec 2003
	d	225,268		35,796	**189,472**	96.33	Jun 2003	Jun 2004
W Tame	c	28,754			**28,754**	104.33	Jan 2005	Jan 2012
	d	201,285			**201,285**	104.33	Jan 2005	Jan 2012
	d	–	198,125		**198,125**	124.50	Jun 2005	Jun 2012
M S Easton*††	a	35,502			**35,502**	84.50	Jun 2000	May 2003
	b	130,178			**130,178**	84.50	Jun 2000	May 2003
	b	56,909			**56,909**	82.00	Dec 2000	May 2003
	b	239,700			**239,700**	89.00	Jul 2001	May 2003
	b	179,591			**179,591**	122.50	Jul 2002	May 2003
	d	186,858		66,204	**120,654**	96.33	Jun 2003	Dec 2003
	d	75,000		51,713	**23,287**	96.33	Jun 2004	Dec 2004

where:

a = Babcock International Group PLC Approved Executive Share Option Scheme
b = Babcock International Group PLC Unapproved Executive Share Option Scheme
c = Babcock 1999 Approved Executive Share Option Scheme
d = Babcock 1999 Unapproved Executive Share Option Scheme
e = Share Option Agreement
† = Share Options at appointment as a Director
†† = Share Options at cessation of appointment as a Director which continued to be exercisable at 31 March 2003.

There were no options exercised during the year by any of the above Directors.

There were no changes in the current directors' share options between 31 March 2003 and 11 June 2003.

The company's mid-market share price at close of business on 31 March 2003 was 89p. The highest and lowest mid-market share prices in the year ended 31 March 2003 were 127p and 86p respectively.

The exercise prices of the options granted are not set at a discount to the market value of the company's shares at the date of grant.

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 options under the Babcock International Group PLC Approved Executive Share Option Scheme and the Babcock International Group PLC Unapproved Executive Share Option Scheme. There are performance criteria (as described on page 28) attaching to options granted under the Babcock 1999 Approved and Unapproved Executive Share Option Schemes.

Each of Mr Campbell and Mr Rogers were recruited on terms that provided for the issue, shortly after their respective appointments, of share option contracts with the Trustee of the Babcock Employees' Share Trust enabling them to purchase shares in the company equivalent in value (at the effective date of the contract) to twice their then rates of basic salary. These options (which are shown in the above table as being granted pursuant to a Share Option Agreement) take the form of bilateral contracts between the Trustee and Mr Campbell and the Trustee and Mr Rogers each on terms, including as to performance criteria, which mirror those governing options granted under The Babcock 1999 Unapproved Executive Share Option Scheme, save only that if the company comes under the control of another person or persons in consequence of a general takeover offer, these options granted pursuant to the option agreements become immediately exercisable in respect of all of the shares over which they are held. The performance criterion applicable under the option contracts is the TSR based criterion mentioned on page 28 as applying to existing share options granted under the 1999 schemes. The provisions of the option contracts cannot be altered to the advantage of Mr Campbell or Mr Rogers without the prior approval of the company's shareholders in general meeting. The benefits under the option contracts are not pensionable.

Service contracts

The following table sets out a summary of Directors'/former Directors' service contracts or terms of appointment.

Executive Directors

Current Directors

Name	Date of service contract	Date of appointment as a Director	Notice period
G A Campbell	5 December 2000	10 October 2000	12 months
P L Rogers	9 May 2002	13 June 2002	12 months
W Tame	20 September 2001	25 January 2002	12 months

Directors who left during the year

Name	Date of service contract	Date of cessation as a Director	Notice period
M S Easton	23 January 1997	31 May 2002	12 months
Dr G Schäfer	30 July 1996	31 December 2002	12 months

The company's policy for executive Directors' service contracts is for them to be capable of being terminated by the company on not more than 12 months' notice, and for the company to reserve the right to terminate those contracts without full notice by payment of basic salary (and, in the case of Mr Campbell, the value of contractual benefits other than pensions or bonus entitlements) in lieu of notice.

In the event of a change of control of the company, the executive Directors' contracts provide that within 90 days of the occurrence of the change of control the executive Director may terminate his employment forthwith. In that case, or if, following a change of control, the Director's appointment is terminated within 12 months, the Director is entitled to a termination payment equal to 100% of his annual salary plus an additional 40% (50% in the case of Mr Campbell) in lieu of bonus and all other benefits. Directors' service contracts terminate automatically on the Director reaching the age of 60. In the event of the termination of a Director's service contract by the company (other than following a change of control or by the exercise of the company's option to pay salary in lieu of notice) the company will have regard to all the circumstances in determining the amount of compensation, if any, payable to him in connection with that termination.

Non-executive Directors

Current Directors

Name	Date of original letter of appointment	Date of appointment as a Director	Expiry of present term of appointment
Lord Hesketh	4 October 1993	6 October 1993	31 December 2003
M J Turner	7 June 1996	5 June 1996	31 Dec 2004
D J Shah	15 June 1999	15 June 1999	15 June 2006
J L Rennocks	27 June 2002	13 June 2002	12 June 2005
Sir N Essenhigh	25 February 2003	4 March 2003	3 March 2006

Director who left during the year

Name	Date of original letter of appointment	Date of cessation as a Director
A E Wheatley	18 December 1992	26 July 2002

For non-executive Directors the company's policy is to have written terms of appointment, with initial appointments being for a three-year term, and in all cases appointments being terminable at will. Non-executive Directors are free to resign at any time.

Outside directorships

The company considers that it is often of benefit to it if a Director, executive or non-executive, holds directorships in other companies outside the group, provided that any such appointment does not conflict with the Director's duties to the company or with the group's best interests. Before taking up any outside appointment after becoming a Director of the company, a Director must first seek the approval of the Board. Any fees earned by a Director for his outside appointment are ordinarily retainable by him.

Information subject to audit

Under Part 3 of Schedule 7A of the Companies Act 1985 the following sections of this report are subject to audit: 'Directors' emoluments and compensation' including 'Directors' pensions'', 'other pension arrangements' and 'Directors' share options' on pages 30 to 32 and the 'Directors' interests' section on page 23. The other parts of the report including the performance graph on page 29 are not subject to audit.

By Order of the Board

Lord Hesketh Chairman of the Remuneration Committee
11 June 2003

Independent auditors' report to the members of Babcock International Group PLC

We have audited the Financial Statements of Babcock International Group PLC for the year ended 31 March 2003 which comprise the Profit and loss account, Balance sheets, Cash flow statement, Statement of total recognised gains and losses and Reconciliation of movement in shareholders' funds and the related notes numbered 1 to 33, which have been prepared under the accounting policies as set out therein. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' remuneration report ('the auditable part').

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities. The Directors are also responsible for preparing the Directors' remuneration report.

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

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Chairman's report, the Operations review, the Financial review, the Directors' report, the Statement on corporate governance, the Remuneration report and the Five year financial record.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group at 31 March 2003 and of its profit and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the Directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered accountants and registered auditors
1 Embankment Place
London WC2N 6RH

11 June 2003

Group profit and loss account
For the year ended 31 March 2003

	Notes	2003 Before goodwill and exceptional items £'000	2003 Goodwill and exceptional items £'000	2003 Total £'000	2002 Before goodwill and exceptional items £'000	2002 Goodwill and exceptional items £'000	2002 Total £'000
Continuing operations	2	389,968	–	389,968	326,846	–	326,846
Acquisitions		18,985	–	18,985	–	–	–
		408,953	–	408,953	326,846	–	326,846
Discontinued operations	2	14,549	–	14,549	96,138	–	96,138
Group turnover	2	423,502	–	423,502	422,984	–	422,984
Cost of sales	3	(357,842)	–	(357,842)	(348,820)	–	(348,820)
Gross profit		65,660	–	65,660	74,164	–	74,164
Net operating expenses	3	(44,847)	(1,886)	(46,733)	(59,236)	(13,507)	(72,743)
Continuing operations		21,619	(1,013)	20,606	15,909	(11,171)	4,738
Acquisitions		1,323	(873)	450	–	–	–
		22,942	(1,886)	21,056	15,909	(11,171)	4,738
Discontinued operations		(2,129)	–	(2,129)	(981)	(2,336)	(3,317)
Group operating profit	2	20,813	(1,886)	18,927	14,928	(13,507)	1,421
Share of operating loss of joint ventures and associates	2	(143)	–	(143)	(529)	–	(529)
Loss on sale of operations	5	–	(2,740)	(2,740)	–	(13,798)	(13,798)
Profit/(loss) on ordinary activities before interest		20,670	(4,626)	16,044	14,399	(27,305)	(12,906)
Net interest and similar charges	6			(2,667)			(1,004)
Profit/(loss) on ordinary activities before taxation				13,377			(13,910)
Tax on profit on ordinary activities	8			(5,087)			(3,089)
Profit/(loss) on ordinary activities after taxation				8,290			(16,999)
Minority interests	27			(7)			(143)
Profit/(loss) for the financial year				8,283			(17,142)
Dividends paid and proposed	10			(4,337)			(4,168)
Retained profit/(loss) for the financial year	26			3,946			(21,310)
Profit/(loss) per share							
– Basic	11			5.72p			(11.86)p
– Diluted	11			5.69p			(11.84)p
Earnings per share before non operating exceptional items and goodwill							
– Basic	11			8.91p			4.58p
– Diluted	11			8.87p			4.57p

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

Group balance sheet

As at 31 March 2003

	Notes	2003 £'000	2003 £'000	2002 £'000	2002 £'000
Fixed assets					
Intangible assets	12				
Development costs			**969**		1,236
Goodwill					
– Goodwill		**84,052**		66,670	
– Negative goodwill		**(6,473)**		(9,384)	
			77,579		57,286
			78,548		58,522
Tangible assets	13		**16,478**		22,396
Investments	15				
Investments in joint ventures					
Share of gross assets		**1,405**		1,831	
Share of gross liabilities		**(1,822)**		(2,119)	
Loans to joint ventures		**775**		863	
		358		575	
Investments in associates		**–**		600	
Other investments		**3,953**		3,010	
			4,311		4,185
			99,337		85,103
Current assets					
Stocks	16		**23,447**		15,143
Debtors – due within one year	17	**88,649**		71,441	
Debtors – due after more than one year	17	**69,611**		68,810	
			158,260		140,251
Cash and bank balances			**12,715**		14,142
			194,422		169,536
Creditors – amounts due within one year	18		**(159,980)**		(143,968)
Net current assets			**34,442**		25,568
Total assets less current liabilities			**133,779**		110,671
Creditors – amounts due after more than one year	19		**(18,987)**		(2,897)
Provisions for liabilities and charges	22		**(27,395)**		(26,799)
Net assets			**87,397**		80,975
Capital and reserves					
Called up equity share capital	25		**88,876**		88,571
Share premium account	26		**38,068**		37,921
Capital redemption reserve	26		**30,631**		30,631
Profit and loss account	26		**(70,238)**		(76,195)
Equity interests			**87,337**		80,928
Non-equity interests	25		**–**		–
Shareholders' funds			**87,337**		80,928
Equity minority interests	27		**60**		47
			87,397		80,975

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

Company balance sheet
As at 31 March 2003

	Notes	2003 £'000	2002 £'000
Fixed assets			
Investment in subsidiary undertakings	14	**152,294**	136,301
Investment in own shares	15	**3,857**	2,923
		156,151	139,224
Current assets			
Debtors	17	**10,869**	6,790
Cash and bank balances		**56,157**	73,867
		67,026	80,657
Creditors – amounts due within one year	18	**(28,948)**	(41,847)
Net current assets		**38,078**	38,810
Total assets less current liabilities		**194,229**	178,034
Creditors – amounts due after more than one year	19	**(17,500)**	–
Provisions for liabilities and charges	22	**2**	–
Net assets		**176,731**	178,034
Capital and reserves			
Called up share capital	25	**88,876**	88,571
Share premium account	26	**38,068**	37,921
Capital redemption reserve	26	**30,631**	30,631
Profit and loss account	26	**19,156**	20,911
Equity interests		**176,731**	178,034
Non-equity interests		**–**	–
Shareholders' funds	25	**176,731**	178,034

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

The Financial Statements on pages 34 to 62 were approved by the Board on 11 June 2003 and signed on its behalf by:

G A Campbell Director

W Tame Director

Group cash flow statement
For the year ended 31 March 2003

	Notes	2003 £'000	2003 £'000	2002 £'000	2002 £'000
Cash inflow from operating activities	28a		**11,262**		19,834
Returns on investments and servicing of finance					
Net interest and similar charges		**(2,520)**		(1,012)	
Dividends paid to B shareholders		**–**		(78)	
Net cash outflow from returns on investments and servicing of finance			**(2,520)**		(1,090)
Taxation					
UK corporation tax paid		**(2,818)**		(2,273)	
Overseas tax paid		**(223)**		(1,128)	
Net cash outflow from taxation			**(3,041)**		(3,401)
Capital expenditure and financial investment					
Payments to acquire tangible fixed assets		**(2,482)**		(6,665)	
Payments to acquire own shares		**(934)**		(1,387)	
Payments to invest in joint ventures		**–**		(707)	
Receipts from sale of tangible fixed assets		**470**		270	
Net cash outflow from capital expenditure and financial investment			**(2,946)**		(8,489)
Acquisitions and disposals					
Payments to acquire subsidiary undertakings	28d	**(24,100)**		(7,434)	
Payments on sale of subsidiary undertakings	28d	**(2,640)**		(6,473)	
Net cash outflow from acquisitions and disposals			**(26,740)**		(13,907)
Equity dividends paid			**(4,196)**		(3,823)
Cash outflow before management of liquid resources and financing			**(28,181)**		(10,876)
Management of liquid resources					
Cash placed on short-term deposit			**(181)**		(2,917)
Financing					
Shares issued for cash		**452**		1,017	
Issue of shares by group companies to minority shareholders		**–**		3,200	
Redeemable preference shares redeemed ('B' shares)		**–**		(2,768)	
Increase in borrowings		**20,675**		14,006	
Repayments of capital element of finance lease rentals		**(451)**		(537)	
Net cash inflow from financing			**20,676**		14,918
(Decrease)/increase in cash in the year	28b		**(7,686)**		1,125

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 2003

	2003 £'000	2002 £'000
Group profit/(loss) for the financial year	**8,458**	(16,542)
Loss on joint ventures and associates	**(175)**	(600)
Profit/(loss) for the financial year	**8,283**	(17,142)
Currency translation differences on foreign currency net investments and related loans	**2,011**	(1,647)
Total recognised gains and losses relating to the year	**10,294**	(18,789)

Reconciliation of movements in group shareholders' funds
For the year ended 31 March 2003

	2003 £'000	2002 £'000
Shareholders' funds at start of year	**80,928**	105,636
Ordinary shares issued in the year	**452**	1,017
Redeemable 'B' preference shares redeemed in the year	**–**	(2,768)
Total recognised gains and losses relating to the year	**10,294**	(18,789)
Dividends	**(4,337)**	(4,168)
Net movement in shareholders' funds	**6,409**	(24,708)
Shareholders' funds at end of year	**87,337**	80,928

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

Notes to the financial statements

1. Accounting policies
The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

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 are accounted for using the acquisition method.

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 10 and 20 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 impairment 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 machinery and motor vehicles	6.6% 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. A provision is made where leases are deemed to be onerous.

Investments
Fixed asset investments are stated at cost less provision for impairment in 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 and are material in aggregate to the relevant subsidiary.

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.

Amounts recoverable on contracts represent costs incurred on contracts not yet invoiced.

Research and development
Development expenditure on clearly defined projects, the commercial outcome of which can be assessed with reasonable certainty, is capitalised. Development expenditure on fast ferry designs is amortised over the shorter of the project life and seven years. Other capitalised development expenditure is amortised over the shorter of the project life and three years. All other research and development is written off in the period in which it is incurred.

Taxation
Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

Deferred tax is measured, on a non-discounted basis, at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

1. Accounting policies (continued)

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.

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.

The group has adopted the transitional disclosure requirements of Financial Reporting Standard 17: 'Retirement benefits'. FRS17 adopts a market value approach to the measurement of retirement benefits.

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 financial statements.

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.

	2003 Group turnover £'000	2003 Group operating profit/(loss) before goodwill and operating exceptional items £'000	2003 Goodwill £'000	2003 Group operating profit/(loss) £'000
Continuing operations				
Technical Services				
Continuing operations	195,332	15,850	–	15,850
Acquisitions	3,813	429	–	429
	199,145	16,279	–	16,279
Training and Support				
Continuing operations	163,628	9,164	–	9,164
Acquisitions	15,172	894	–	894
	178,800	10,058	–	10,058
Materials Handling – continuing operations	31,008	(19)	–	(19)
Unallocated costs and other income	–	(3,376)	–	(3,376)
	408,953	22,942	–	22,942
Goodwill amortisation				
Continuing operations	–	–	(1,013)	(1,013)
Acquisitions	–	–	(873)	(873)
	–	–	(1,886)	(1,886)
Total continuing operations	408,953	22,942	(1,886)	21,056
Discontinued operations	14,549	(2,129)	–	(2,129)
Group total	423,502	20,813	(1,886)	18,927

2. Segmental information (continued)

	2002 Group turnover £'000	2002 Group operating profit/(loss) before goodwill and operating exceptional items £'000	2002 Goodwill and operating exceptional items £'000	2002 Group operating profit/(loss) £'000
Continuing operations				
Technical Services	208,515	16,195	–	16,195
Training and Support	98,666	6,108	–	6,108
Materials Handling	19,665	(3,680)	(1,024)	(4,704)
Unallocated costs and other income	–	(2,714)	(625)	(3,339)
	326,846	15,909	(1,649)	14,260
Goodwill amortisation	–	–	(9,522)	(9,522)
Total continuing operations	**326,846**	**15,909**	**(11,171)**	**4,738**
Discontinued operations				
Discontinued operations	96,138	(981)	(1,900)	(2,881)
Goodwill amortisation	–	–	(436)	(436)
Total discontinued operations	**96,138**	**(981)**	**(2,336)**	**(3,317)**
Group total	**422,984**	**14,928**	**(13,507)**	**1,421**

The turnover, not included above, relating to joint ventures was £0.6 million (2002: £1.6 million) and the loss of £143,000 (2002: loss £529,000) from joint ventures and associates relate to the Technical Services segment.

The inter segment sales in 2003 and 2002 were not material.

Group turnover By geographic area of origin	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2003						
Continuing operations	**285,110**	**30,960**	**11,893**	**50,574**	**11,431**	**389,968**
Acquisitions	**18,985**	**–**	**–**	**–**	**–**	**18,985**
	304,095	**30,960**	**11,893**	**50,574**	**11,431**	**408,953**
Discontinued operations	**1,413**	**9,892**	**920**	**186**	**2,138**	**14,549**
Group total	**305,508**	**40,852**	**12,813**	**50,760**	**13,569**	**423,502**
2002						
Continuing operations	246,671	19,665	15,488	35,060	9,962	326,846
Discontinued operations	17,646	54,738	20,311	–	3,443	96,138
Group total	264,317	74,403	35,799	35,060	13,405	422,984

Group turnover By geographic area of destination	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2003						
Continuing operations	**279,647**	**20,353**	**13,145**	**53,156**	**23,667**	**389,968**
Acquisitions	**18,985**	**–**	**–**	**–**	**–**	**18,985**
	298,632	**20,353**	**13,145**	**53,156**	**23,667**	**408,953**
Discontinued operations	**1,413**	**9,892**	**920**	**186**	**2,138**	**14,549**
Group total	**300,045**	**30,245**	**14,065**	**53,342**	**25,805**	**423,502**
2002						
Continuing operations	236,146	12,957	17,476	38,395	21,872	326,846
Discontinued operations	11,636	42,707	13,858	3,356	24,581	96,138
Group total	247,782	55,664	31,334	41,751	46,453	422,984

2. Segmental information (continued)

Group operating profit/(loss) before goodwill by geographic origin	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2003						
Continuing operations	**19,700**	**(137)**	**523**	**1,282**	**251**	**21,619**
Acquisitions	**1,323**	**–**	**–**	**–**	**–**	**1,323**
	21,023	**(137)**	**523**	**1,282**	**251**	**22,942**
Discontinued operations	**(689)**	**(769)**	**(775)**	**–**	**104**	**(2,129)**
Group total	**20,334**	**(906)**	**(252)**	**1,282**	**355**	**20,813**
2002						
Continuing operations	17,146	(4,751)	877	436	552	14,260
Discontinued operations	540	(1,126)	(2,561)	–	266	(2,881)
Group total	17,686	(5,877)	(1,684)	436	818	11,379

The goodwill charge in 2003 of £1.9 million (2002: £2.1 million) relates to the UK £1.4 million (2002: £0.5 million) in the rest of Europe £nil (2002: £0.9 million) and North America £0.5 million (2002: £0.7 million).

Operating net assets – by activity	2003 £'000	2002 £'000
Technical Services	**26,497**	22,331
Training and Support	**9,653**	3,818
Materials Handling	**3,548**	3,186
Unallocated	**22,547**	17,126
Operating net assets	**62,245**	46,461
Operating net assets – by geographic area		
United Kingdom	**48,834**	46,625
Europe	**3,894**	(3,480)
North America	**135**	(4,314)
Africa	**8,573**	5,822
Rest of the World	**809**	1,808
Operating net assets	**62,245**	46,461
Investment in own shares	**3,857**	2,923
Net debt	**(35,882)**	(7,710)
Finance lease obligations	**(1,328)**	(734)
Taxation	**(16,397)**	(14,715)
Dividends	**(2,677)**	(2,536)
Net goodwill	**77,579**	57,286
Non-operating assets	**25,152**	34,514
Net assets	**87,397**	80,975

Technical Services and the United Kingdom include no operating net assets in respect of associates (2002: £0.6 million).
Technical Services and the Rest of the World includes £0.4 million (2002: £0.6 million) in respect of joint ventures.

3. Net operating expenses

	2003 Cost of sales £'000	2003 Distribution expenses £'000	2003 Administration expenses £'000	2003 Net operating expenses £'000
Continuing operations	**332,309**	**6,041**	**31,885**	**37,926**
Acquisitions	**14,425**	**–**	**3,237**	**3,237**
	346,734	**6,041**	**35,122**	**41,163**
Discontinued operations	**11,108**	**1,259**	**4,311**	**5,570**
Group total	**357,842**	**7,300**	**39,433**	**46,733**

	2002 Cost of sales £'000	2002 Distribution expenses £'000	2002 Administration expenses £'000	2002 Net operating expenses £'000
Continuing operations	280,862	6,344	35,013	41,357
Discontinued operations	67,958	9,783	21,603	31,386
Group total	348,820	16,127	56,616	72,743

In 2003, there were no operating exceptional items. In 2003, administration expenses include a goodwill charge of £1.0 million in respect of continuing operations, £0.9 million in respect of acquisitions and nil in discontinued operations.

In 2002, administration expenses includes £3.5 million of operating exceptional items comprising; £1.6 million of restructuring costs within continuing operations, £1.3 million of operating exceptional items that relate to discontinued operations of Materials Handling and £0.6 million of unallocated costs in relation to a proposed acquisition that did not proceed. In 2002, administration expenses also includes a goodwill charge of £9.6 million in continuing operations and £0.3 million in discontinued operations. The goodwill amortisation within continuing operations includes an exceptional operating item of £7.9 million for impairment write-downs of the remaining Materials Handling businesses.

4. Operating profit/(loss)

	2003 £'000	2002 £'000
Operating profit/(loss) is stated after charging/(crediting)		
Depreciation on tangible fixed assets		
– Owned	**8,539**	10,354
– Leased assets	**285**	196
Loss on the disposal and write-off of tangible fixed assets	**32**	89
Operating lease rentals		
– Plant and machinery	**2,007**	2,004
– Land and buildings	**3,793**	4,140
– Short-term plant hire	**688**	317
– Other	**321**	304
Auditors' remuneration (audit services)	**414**	612
Research and development		
– Expenditure	**484**	1,595
– Amortisation charge (note 12)	**267**	271
Net goodwill amortisation	**1,886**	9,958

In addition to the amounts disclosed above, the group auditors were paid £149,000 (2002: £281,000) in relation to non audit services in the UK.

5. Exceptional items

(a) Operating exceptional items

In 2003, there were no operating exceptional items. In 2002 operating exceptionals were as disclosed in note 3.

(b) Non-operating exceptional items

In 2003 the non-operating exceptional charge of £2.7 million for the loss on sale of operations represents the loss on the disposal of the BMH Chronos Richardson group (see note 29).

In 2002 the non-operating exceptional charge of £13.8 million for the loss on sale of operations includes a loss of £12.0 million on the disposal of Materials Handling businesses, and a provision of £1.8 million for a loss on the disposal of the business and assets of the remaining cement operations of the Materials Handling division, based in the US, which reflects the estimated impairment in the value of its goodwill (£0.5 million) and other assets (£1.3 million) held at 31 March 2002 in light of its disposal on 30 April 2002.

6. Net interest and similar charges

	2003 £'000	2002 £'000
Interest payable and similar charges		
– Bank loans and overdrafts	**(2,774)**	(1,602)
– Finance lease interest	**(163)**	(131)
– Other	**(87)**	(11)
	(3,024)	(1,744)
Other interest receivable and similar income	**389**	811
Share of joint ventures	**(32)**	(71)
	(2,667)	(1,004)

7. Employee costs

	2003 £'000	2002 £'000
Particulars of employees, including executive Directors, are as follows:		
Employee costs		
– Wages and salaries	**136,992**	138,944
– Social security costs	**11,163**	15,141
– Other pension costs (note 24)	**4,724**	1,464
	152,879	155,549

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

	2003 Number	2002 Number
Operations	**6,133**	5,635
Administration and management	**779**	1,107
	6,912	6,742

The number of people employed by the group at 31 March 2003 was 7,070 (2002: 5,901).

Information in respect of Directors' remuneration and share interests is contained within the Remuneration report on pages 28 to 32.

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

	2003 £'000	2002 £'000
United Kingdom corporation tax charge at 30%	**5,455**	5,634
Double taxation relief	**–**	(9)
	5,455	5,625
Overseas taxation	**465**	666
Adjustments in respect of prior years		
– UK current tax	**(852)**	(2,893)
– Overseas current tax	**87**	161
Group current tax charge for the period	**5,155**	3,559
Deferred taxation (note 22)	**(68)**	(252)
Overseas deferred tax adjustment in respect of prior years	**–**	(218)
	5,087	3,089

Excluding the net goodwill charge of £1.9 million, a loss in discontinued operations of £2.1 million and the non-operating exceptional loss of £2.7 million, the effective rate of 26% is lower than the standard UK rate of 30% due to the net effect of prior year items, the utilisation of overseas tax losses for which no deferred tax asset had been recognised and the difference between the UK rate and the effective overseas rate. There is no tax relief arising in respect of the exceptional loss. The tax charge includes £0.1 million (2002: £0.1 million) relating to discontinued operations.

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2003 £'000	2002 £'000
Profit/(loss) on ordinary activities before tax	**13,377**	(13,910)
Add back: share of joint ventures and associates' loss before tax	**143**	600
Group profit/(loss) on ordinary activities before tax	**13,520**	(13,310)
Tax on group profit on ordinary activities at standard UK corporation tax rate of 30% (2002: 30%)	**4,056**	(3,993)
Effects of:		
Expenses (including exceptional items and goodwill) not deductible for tax purposes	**3,164**	5,908
Current year timing differences not recognised	**486**	255
Overseas timing differences not recognised and difference in rates on overseas earnings	**(1,601)**	4,121
Adjustments to current tax charge in respect of previous periods	**(765)**	(2,732)
Utilisation of brought forward tax assets not previously recognised	**(185)**	–
Group current tax charge for period	**5,155**	3,559

The tax charge in future periods may be affected by results in overseas jurisdictions, together with overseas tax rates, permanent differences in the UK and elsewhere, and the utilisation of tax losses for which no deferred tax asset has been recognised.

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 £2.6 million (2002 profit: £1.5 million) dealt with in the Financial Statements of the company.

10. Dividends

	2003 £'000	2002 £'000
Ordinary shares		
– Interim dividend paid of 1.15p per 60p share (2002: 1.1p per 60p share)	**1,660**	1,554
– Final dividend proposed of 1.85p per 60p share (2002: 1.75p per 60p share)	**2,677**	2,536
	4,337	4,090
Preference shares		
– B preference shares 0.42p per 18p share	**–**	64
– B preference shares 0.36p per 18p share	**–**	14
	–	78
	4,337	4,168

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.

	2003 Number	2002 Number
Weighted average number of shares in issue for basic earnings per share	**144,812,194**	144,533,767
Dilutive effect of share options	**768,543**	305,350
Weighted average number of shares in issue for diluted earnings per share	**145,580,737**	144,839,117

	2003 £'000	2003 Basic (pence)	2003 Diluted (pence)	2002 £'000	2002 Basic (pence)	2002 Diluted (pence)
Profit/(loss) attributable to shareholders	**8,283**	**5.72**	**5.69**	(17,142)	(11.86)	(11.84)
Add loss on sale or termination of a business	**2,740**	**1.89**	**1.88**	13,798	9.55	9.53
Profit/(loss) before non operating exceptional items	**11,023**	**7.61**	**7.57**	(3,344)	(2.31)	(2.31)
Add net goodwill amortisation	**1,886**	**1.30**	**1.30**	9,958	6.89	6.88
Profit/(loss) before non operating exceptional items and goodwill	**12,909**	**8.91**	**8.87**	6,614	4.58	4.57

The earnings per share figures calculated above eliminate the effect of non-operating exceptional items and goodwill amortisation to give a fairer presentation of trading performance.

Last year's average share numbers have been revised to eliminate the shares held by the Babcock Employee Share Trust.

12. Fixed assets – intangible assets

	Goodwill £'000	Negative goodwill £'000	Development costs £'000	Total £'000
Group:				
Cost				
At 1 April 2002	88,815	(25,792)	2,968	**65,991**
On acquisition of subsidiaries	22,179	–	–	**22,179**
On disposal of subsidiaries (note 29)	(2,404)	–	–	**(2,404)**
At 31 March 2003	**108,590**	**(25,792)**	**2,968**	**85,766**
Accumulated amortisation				
At 1 April 2002	(22,145)	16,408	(1,732)	**(7,469)**
On disposal of subsidiaries	2,404	–	–	**2,404**
(Charge)/credit for the year	(4,797)	2,911	(267)	**(2,153)**
As at 31 March 2003	**(24,538)**	**19,319**	**(1,999)**	**(7,218)**
Net book value at 31 March 2003	**84,052**	**(6,473)**	**969**	**78,548**
Net book value at 31 March 2002	66,670	(9,384)	1,236	**58,522**

13. Fixed assets – tangible assets

	Freehold property £'000	Leasehold property £'000	Plant and machinery £'000	Total £'000
Group:				
Cost				
At 1 April 2002	15,128	957	58,383	**74,468**
Exchange adjustments	247	5	1,924	**2,176**
On acquisition of subsidiary (note 29)	–	44	384	**428**
On disposal of subsidiaries (note 29)	–	(63)	(10,336)	**(10,399)**
Additions	–	–	3,114	**3,114**
Disposals/assets written off	–	–	(2,407)	**(2,407)**
At 31 March 2003	**15,375**	**943**	**51,062**	**67,380**
Accumulated depreciation				
At 1 April 2002	(9,139)	(77)	(42,856)	**(52,072)**
Exchange adjustments	(80)	(4)	(1,051)	**(1,135)**
On disposal of subsidiaries (note 29)	–	28	9,194	**9,222**
Charge for the year	(1,460)	(85)	(7,279)	**(8,824)**
Disposals/assets written off	–	–	1,907	**1,907**
At 31 March 2003	**(10,679)**	**(138)**	**(40,085)**	**(50,902)**
Net book value at 31 March 2003	**4,696**	**805**	**10,977**	**16,478**
Net book value at 31 March 2002	5,989	880	15,527	**22,396**

The net book value of plant and machinery includes £2.2 million (2002: £1.8 million) in respect of assets held under finance leases or hire purchase contracts, comprising cost of £3.8 million less depreciation of £1.6 million.

The net book value of freehold property includes land amounting to £0.9 million (2002: £1.0 million) which has not been depreciated.

14. Fixed assets – investments in subsidiary undertakings

	Shares £'000	Loans £'000	Total £'000
Company cost			
At 1 April 2002	91,851	44,450	**136,301**
Impairment	(5,307)	–	**(5,307)**
Movement in year	–	21,300	**21,300**
At 31 March 2003	**86,544**	**65,750**	**152,294**

Information on the principal subsidiary undertakings is given on page 63.

15. Fixed assets – investments

	Group					Company
	Joint ventures £'000	Associates £'000	Investments in own shares £'000	Other investments £'000	**Total £'000**	Investments in own shares £'000
At 1 April 2002	575	600	2,923	87	**4,185**	2,923
Exchange adjustment	(42)	–	–	9	**(33)**	–
Additions	–	–	934	–	**934**	934
Disposals	–	(600)	–	–	**(600)**	–
Share of losses	(175)	–	–	–	**(175)**	–
At 31 March 2003	**358**	**–**	**3,857**	**96**	**4,311**	**3,857**

Information on associated undertakings is given on page 63.

During the year the company acquired 741,000 ordinary shares at a total cost of £934,000 through the Babcock Employee Share Trust (the 'Trust') in respect of its potential obligation under the Babcock 1999 Executive Share Option Schemes. At 31 March 2003, the Trust held 3,439,995 ordinary shares at a total market value of £3,061,596 representing 2.32% of the issued share capital at that date. The company elected to pay dividends to the Trust at the rate of 0.001p per share during the year. All the Trust's shares are under option to employees. The company meets the operating expenses of the Trust.

The Trust enables shares in the company to be purchased and made available to employees principally through the grant and exercise of rights under the Babcock 1999 Executive Share Option Schemes and may be used to grant awards made under the proposed long-term incentive plan referred to on page 65. The Trust is a discretionary settlement for the benefit of employees within the group. The company is excluded from benefiting under the Trust. The Trust is controlled and managed outside the UK and has a single corporate trustee which is an independent trustee services organisation. The right to remove the trustee and appoint a new trustee vests in the company. The trustee is required to waive both voting rights and dividends payable on any share in the company in excess of 0.001p, unless otherwise directed by the company. The Trust may not, without the approval by ordinary resolution of the members of the company, hold more than 5.0% of the ordinary shares of the company.

16. Stocks

	Group 2003 £'000	Group 2002 £'000
Stocks and work in progress		
– Raw materials and consumables	**6,718**	5,807
– Work in progress	**3,805**	6,727
– Finished goods and goods for resale	**13,877**	7,032
	24,400	19,566
Less: Progress payments	**–**	(2,719)
Provisions	**(953)**	(1,704)
	23,447	15,143

17. Debtors

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Due within one year:				
Trade debtors	39,961	44,307	586	–
Amounts recoverable on contracts	34,834	9,954	–	–
Retentions	623	–	–	–
Amounts owed by subsidiary undertakings	–	–	3,054	6,130
Group dividends	–	–	7,000	–
Prepayments and accrued income	6,982	8,774	–	–
Pension scheme prepayments	1,860	1,669	–	–
Other debtors	4,389	6,737	229	660
	88,649	71,441	10,869	6,790

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Due after more than one year:				
Pension scheme prepayments	69,420	68,810	–	–
Other debtors	191	–	–	–
	69,611	68,810	–	–

Other debtors, due within one year, at 31 March 2003 includes £28,000 of deferred consideration relating to the disposal of the BMH Chronos Richardson group and £936,000 relating to the purchase of Service Group International.

18. Creditors – amounts due within one year

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Bank overdraft (note 20)	7,905	1,832	–	–
Bank loans (note 20)	23,108	20,006	21,500	20,000
Other loans (note 20)	31	6	–	–
Obligations under finance leases (note 20)	85	285	–	–
Advance payments	816	1,609	–	–
Payments received in advance of turnover	10,245	12,619	–	–
Trade creditors	36,496	23,193	8	–
Contract accruals and provisions	46,504	42,087	–	–
Amounts owed to subsidiary undertakings	–	–	4,493	19,075
Other creditors	5,193	8,012	270	151
Corporation and overseas taxes	4,190	4,546	–	–
Other taxes and social security	5,269	5,187	–	–
Accruals and deferred income	17,461	22,050	–	85
Proposed dividend	2,677	2,536	2,677	2,536
	159,980	143,968	28,948	41,847

19. Creditors – amounts due after more than one year

	Group 2003 £'000	Group 2002 £'000	Company 2003 £'000	Company 2002 £'000
Bank loans (note 20)	**17,500**	–	**17,500**	–
Other loans (note 20)	**53**	8	**–**	–
Obligations under finance leases (note 20)	**1,243**	449	**–**	–
Contract accruals and provisions	**–**	2,069	**–**	–
Other creditors	**142**	297	**–**	–
Corporation and overseas taxes	**49**	74	**–**	–
	18,987	2,897	**17,500**	–

20. Borrowings

Repayment details

The total borrowings of the group at 31 March are repayable as follows:

	2003 Bank loans and overdrafts £'000	2003 Other loans £'000	2003 Finance lease obligations £'000
Within one year	**31,013**	**31**	**85**
Between one and two years	**2,500**	**28**	**7**
Between two and three years	**15,000**	**25**	**1,236**
	48,513	**84**	**1,328**

	2002 Bank loans and overdrafts £'000	2002 Other loans £'000	2002 Finance lease obligations £'000
Within one year	21,838	6	285
Between one and two years	–	8	449
Between two and five years	–	–	–
	21,838	14	734

Security arrangements	Group 2003 £'000	Group 2002 £'000
Loans and overdrafts		
Secured against fixed charge on freehold property of subsidiary undertaking	**–**	6
Unsecured borrowings	**48,597**	21,846
	48,597	21,852

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

21. Derivatives and other financial instruments

The group's financial instruments, other than derivatives, comprise cash, liquid resources, some short-term borrowings and various items as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial statements is to finance the group's operations.

The group controls credit risk by entering into financial derivatives only with prime rated and authorised counter-parties. Counter-party authorisations and positions are monitored on a regular basis.

The numerical disclosures in this note deal with financial assets and liabilities as defined in Financial Reporting Standard 13 – Derivatives and Other Financial Investments: Disclosure (FRS13). Certain financial assets such as investments in subsidiary, joint venture and associate companies 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.

21. Derivatives and other financial instruments (continued)

Interest rate profile

The group's financial assets comprise cash deposits of £12.7 million (2002: £14.1 million). Cash deposits are placed on money markets at call, seven-day and monthly rates.

The interest rate profile of the group's financial assets and liabilities (excluding short-term debtors and creditors), after taking into account the interest rate swaps used to manage the interest profile, is as follows:

	2003 Financial assets	2003 Financial liabilities			
Currency	Total and floating rate £'000	Total £'000	Floating rate £'000	Fixed rate £'000	No interest paid £'000
Sterling	**4,243**	**46,965**	**46,905**	**60**	–
Euro	**1,533**	–	–	–	–
US Dollar	**3,560**	**84**	–	–	**84**
South African Rand	**1,393**	**2,866**	**1,258**	**1,608**	–
Swedish Krona	**1,187**	**3**	–	**3**	–
Other currencies	**799**	**7**	–	**7**	–
	12,715	**49,925**	**48,163**	**1,678**	**84**

	2002 Financial assets	2002 Financial liabilities			
Currency	Total and floating rate £'000	Total £'000	Floating rate £'000	Fixed rate £'000	No interest paid £'000
Sterling	5,466	21,290	21,280	10	–
Euro	1,146	–	–	–	–
US Dollar	3,333	14	14	–	–
South African Rand	28	1,079	1,079	–	–
Swedish Krona	3,838	4	–	4	–
Other currencies	331	199	182	17	–
	14,142	22,586	22,555	31	–

The above tables do not include onerous lease liabilities of £3.8 million (2002: £4.2 million). The interest rate on this liability is 4.6% (2002: 4.6%) and the maturity period is between seven and 16 years.

The weighted average interest rates of the Sterling and Krona fixed rate financial liabilities, which comprise finance lease obligations, are 10.3% and 7.2% (2002: 14.5% and 7.2% respectively). The weighted average period for which these interest rates are fixed is one year. In addition, the weighted average interest rate of Rand fixed rate financial liabilities, which relate to a bank loan, is 15.25% (2002: n/a). The weighted average period for which this interest rate is fixed is one year.

The interest rate on floating rate financial assets and liabilities is linked to LIBOR in the case of sterling and the prime rate in the case of South African rand.

The group has entered into an interest rate swap to cap the LIBOR component of interest to 5.0% per annum. This is in relation to £20.0 million of floating rate term debt. The interest rate swap is effective for three years from 26 June 2003.

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 March 2003, in respect of which all conditions precedent had been met, as follows:

	2003 £'000	2002 £'000
Expiring in less than one year	**2,095**	–
Expiring in more than one year but not more than two years	**21,000**	20,000

Currency exposures

The Financial Review on page 18 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.

As at 31 March 2003, the 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 Krona £'000	Other £'000	Total £'000
Sterling	–	**372**	**1,755**	–	–	**2,127**
US Dollars	–	–	–	–	–	–
Euro	–	**1**	–	–	–	**1**
Swedish Krona	**12**	–	**(80)**	–	**(5)**	**(73)**
Other	–	–	–	–	–	–
Total	**12**	**373**	**1,675**	–	**(5)**	**2,055**

21. Derivatives and other financial instruments (continued)
As at 31 March 2002, 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 Krona £'000	Other £'000	Total £'000
Sterling	–	370	136	(7)	(30)	469
US Dollars	–	–	(27)	–	–	(27)
Euro	–	–	–	–	(3)	(3)
Swedish Krona	(7)	297	232	–	37	559
Other	–	69	–	–	–	69
Total	(7)	736	341	(7)	4	1,067

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

As at 31 March 2003, 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 interest rate and currency profile of the group's operations. In all other cases, there is no material difference between the book value and the fair value of the group's financial assets/(liabilities).

	2003 Book value £'000	**2003 Fair value £'000**	2002 Book value £'000	2002 Fair value £'000
Interest rate swaps	**142**	**142**	–	–
Forward foreign currency contracts	**(19,959)**	**(15,685)**	3,912	3,476

Changes in the value of the swap as a result of changes in interest rates are not included in the book value of the relevant asset or liability.

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 2002	412	(847)	(435)
Gains and losses arising in previous years that were recognised in the year ended 31 March 2003	(412)	782	370
Gains and losses arising before 1 April 2002 that were not recognised in the year ended 31 March 2003	–	(65)	(65)
Gains and losses arising that were not recognised in the year ended 31 March 2003	4,816	(477)	4,339
Unrecognised gains and losses on hedges at 31 March 2003	4,816	(542)	4,274
Of which:			
Gains and losses expected to be recognised in the year ending 31 March 2004	4,803	(539)	4,264
Gains and losses expected to be recognised in the year ending 31 March 2005 or later	13	(3)	10

There is no recognised or unrecognised gain or loss in respect of interest rate swaps.

22. Provisions for liabilities and charges

	Pensions and similar obligations (a) £'000	Deferred taxation (note 23) £'000	Acquisition/ deferred consideration (b) £'000	Insurance provisions (c) £'000	Closure or disposal of businesses (d) £'000	Total £'000
At 1 April 2002	4,286	10,796	750	5,975	4,992	26,799
On acquisition of subsidiaries	–	11	971	–	–	982
On disposal of subsidiaries	(3,235)	(3)	–	–	635	(2,603)
Exchange adjustments	37	(117)	–	–	(8)	(88)
Provided in the year	1,261	(68)	–	1,004	–	2,197
Utilised in the year	(207)	–	(693)	(663)	(2,396)	(3,959)
Released	–	–	–	–	–	–
Advance corporation tax utilised against current year tax liability	–	2,543	–	–	–	2,543
Transferred from/(to) creditors	–	(511)	–	–	2,035	1,524
At 31 March 2003	**2,142**	**12,651**	**1,028**	**6,316**	**5,258**	**27,395**

(a) Provisions for unfunded pension liabilities.

(b) Deferred consideration relates to the acquisition of Airpower International Limited on 29 January 2002 and is limited to a maximum of £375,000 and the acquisition of SGI.

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

(d) Provisions for costs relating to the closure or disposal of businesses are principally for onerous contracts in respect of vacant and partially vacant properties which are not expected to become payable within the next two years.

The company had a provision for deferred tax of £2,000 as at 31 March 2003.

23. Deferred taxation

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

	2003 Provided £'000	2002 Provided £'000	**2003 Full potential £'000**	2002 Full potential £'000
Accelerated capital allowances	**(2,884)**	(1,837)	**(2,884)**	(2,037)
Pension surpluses	**21,378**	21,144	**21,378**	21,144
Other timing differences	**(1,383)**	(1,895)	**(1,383)**	(2,147)
Tax losses	**–**	(124)	**(19,867)**	(22,122)
	17,111	17,288	**(2,756)**	(5,162)
Recoverable advance corporation tax	**(4,460)**	(6,492)	**(4,460)**	(6,492)
	12,651	10,796	**(7,216)**	(11,654)

There is no unprovided deferred tax liability in the company.

24. Pension arrangements

The group has continued to account for pension costs in accordance with SSAP 24. The requirement for full adoption of FRS17 – Retirement Benefits has been deferred. The transitional disclosures required by FRS17 are set out in Part (b) of this note.

(a) SSAP 24 disclosures

The pension cost, calculated in accordance with SSAP 24, included as a charge in arriving at the group operating profit was as follows:

	2003 £'000	2002 £'000
Defined benefit schemes:		
Regular costs net of variation	**6,043**	5,578
Interest on pension scheme surpluses	**(5,970)**	(6,006)
	73	(428)
Defined contribution schemes	**4,651**	1,892
	4,724	1,464

Of the above charge £3.3 million relates to the UK (2002: £0.3 million) and £1.4 million relates to overseas (2002: £1.1 million).

The group operates two principal defined benefit pension schemes for employees in the United Kingdom, the Babcock International Group Pension Scheme and the Rosyth Royal Dockyard Pension Scheme. Both schemes are funded by payments to separate trustee-administered funds and the level of the group's contributions to the schemes is assessed in accordance with the advice of independent, qualified actuaries. The details of the latest formal actuarial valuations of these two schemes are as follows:

	Babcock International Group	Rosyth Royal Dockyard
Date of last formal actuarial valuation	1 April 2001	31 March 2000
Number of active members at 31 March 2003	510	1,948
Actuarial valuation method	Projected Unit	Projected Unit
Results of last formal actuarial valuation:		
Market value of assets	£414 million	£460 million
Level of funding	132%	124%
Principal valuation assumptions:		
Excess of investment returns over earnings increases	2% to 2.5%	1.5%
Excess of investment returns over pension increases	3% to 3.5%	3.0%

As a result of the level of surplus the group's contributions to the Babcock International Group Pension Scheme and the Rosyth Royal Dockyard Pension Scheme are currently suspended until at least the next formal valuation.

Prepayments of £71.3 million (2002: £70.5 million) are carried in the balance sheet in respect of the group's principal pension schemes.

(b) FRS17 additional disclosures

Under the transitional provisions of FRS17 certain additional disclosures are required on the basis of the valuation methodology adopted by FRS17 and the additional defined benefit schemes within the group.

In addition to the two principal defined benefit pension schemes referred to above the group also operates a number of smaller defined benefit pension schemes:

The Babcock Services Pension Scheme – for employees in the HCS business who were previously members of the Principal Civil Service Pension Scheme. A full actuarial valuation of the scheme was carried out at 1 August 2000. The company made a contribution of £0.1 million during the year to 31 March 2003. As at 1 December 2002, all scheme members were transferred to the Babcock International Group Pension Scheme.

The Babcock Holdings (USA), Inc. Pension Plan – for employees of US subsidiaries of Babcock Holdings (USA), Inc. A full actuarial valuation of the scheme was carried out at 31 December 2002. The company made a contribution of £0.2 million during the year to 31 March 2003. The plan was frozen as of 31 January 2003 and, therefore, no active members existed as at 31 March 2003. There is no minimum required contribution for the plan year 1 January 2002 to 31 December 2003. The future contribution rate has not been finalised.

The FBM Marine Pension Plan – as at 30 September 2002, all scheme members transferred to the Babcock International Group Pension Scheme. The last full actuarial valuation of the scheme was carried out at 1 April 1999. No contributions were made to the scheme during the year.

The Unicorn Pension Scheme – for employees in the SGI business, acquired by the company on 19 June 2002. A full actuarial valuation of the scheme was carried out at 31 December 2000 and updated to 19 June 2002 and 31 March 2003. The scheme was closed to new members from 30 November 2002 and there is no further accrual of benefits for future service. All scheme members are in the process of transferring to the Babcock International Group Pension Scheme. The company made a contribution of £0.3 million during the year to 31 March 2003.

The BMH Chronos Richardson GmbH Main Plan and Senior Plan – these plans, for German employees of BMH Chronos Richardson GmbH, were disposed of in November 2002 as part of the sale of Chronos Holdings Limited. Both schemes were closed to new members in 1997 and were unfunded. No contributions were made to the schemes during the year.

24. Pension arrangements (continued)
For defined benefit schemes the fair values of pension scheme assets at 31 March 2003 are compared with the pension liabilities calculated under the projected unit method. The latest full actuarial valuations of the group's defined benefit pension schemes have been updated to 31 March 2003 by qualified independent actuaries using the following assumptions:

	Babcock International Group Scheme % pa		Rosyth Royal Dockyard Scheme % pa		Other schemes (weighted average) % pa	
	2003	2002	**2003**	2002	**2003**	2002
Rate of increase of future earnings	**3.5**	3.9	**3.0**	3.9	**3.6**	3.7
Discount rate	**5.4**	6.1	**5.4**	6.1	**5.6**	6.4
Expected pension increases	**3.0**	2.9	**2.5**	2.9	**2.7**	2.1
Inflation rate	**2.5**	2.9	**2.5**	2.9	**2.7**	2.8

The fair value of the assets, the present value of the liabilities and the expected rates of return of the Babcock International Group and Rosyth Royal Dockyard defined benefit schemes, together with the aggregated data for the other schemes in the group at 31 March 2003 were as follows:

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		Other schemes		Group
	Expected rate of return %	Fair value £'000	Expected rate of return %	Fair value £'000	Weighted average expected rate of return %	Fair value £'000	Fair value £'000
Equities	7.0	62,801	7.0	184,697	7.0	5,077	252,575
Property	–	–	7.0	38,804	–	–	38,804
Bonds	4.8	324,982	4.8	70,037	5.5	5,126	400,145
Cash	3.75	540	3.75	2,224	3.75	830	3,594
Fair value of assets		388,323		295,762		11,033	695,118
Present value of scheme liabilities		(345,733)		(331,354)		(15,701)	(692,788)
Surplus/(deficit) in the schemes		42,590		(35,592)		(4,668)	2,330
Irrecoverable surplus		–		–		–	–
Recognised pension asset/(liability)		42,590		(35,592)		(4,668)	2,330
Deferred tax asset/(liability)		(12,777)		10,678		1,106	(993)
Net pension asset/(liability)		29,813		(24,914)		(3,562)	1,337

The fair value of the assets, the present value of the liabilities and the expected rates of return of the Babcock International Group and Rosyth Royal Dockyard defined benefit schemes, together with the aggregated data for the other schemes in the group at 31 March 2002 were as follows:

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		Other schemes		Group
	Expected rate of return %	Fair value £'000	Expected rate of return %	Fair value £'000	Weighted average expected rate of return %	Fair value £'000	Fair value £'000
Equities	7.9	85,092	7.9	273,000	7.9	5,560	363,652
Property	7.9	–	7.9	41,000	7.9	179	41,179
Bonds	6.1	305,537	6.1	65,000	7.0	2,671	373,208
Cash	4.0	2,139	4.0	–-	4.0	369	2,508
Fair value of assets		392,768		379,000		8,779	780,547
Present value of scheme liabilities		(316,814)		(316,000)		(11,598)	(644,412)
Surplus/(deficit) in the schemes		75,954		63,000		(2,819)	136,135
Irrecoverable surplus		(2,052)		–		(235)	(2,287)
Recognised pension asset/(liability)		73,902		63,000		(3,054)	133,848
Deferred tax asset/(liability)		(22,171)		(18,900)		–	(41,071)
Net pension asset/(liability)		51,731		44,100		(3,054)	92,777

24. Pension arrangements (continued)
If the defined benefit pension and post-retirement benefit schemes had been accounted for under FRS17, the following amounts would have been recorded in the profit and loss account and statement of total recognised gains and losses for the year ended 31 March 2003.

	Babcock International Group Scheme £'000	Rosyth Royal Dockyard Scheme £'000	Other schemes £'000	Group £'000
Amounts charged to operating profit				
Current service cost	(1,876)	(5,967)	(587)	(8,430)
Effect of settlement	(1,193)	–	1,193	–
Recognition of surplus	1,193	–	–	1,193
Curtailment gain	–	–	200	200
	(1,876)	(5,967)	806	(7,037)
Amounts credited/(charged) to net interest				
Expected return on pension scheme assets	24,801	28,329	944	54,074
Interest on pension scheme liabilities	(18,724)	(19,103)	(930)	(38,757)
	6,077	9,226	14	15,317
Amounts recorded in statement of total recognised gains and losses				
Actual return less expected return on pension scheme assets	(12,540)	(99,929)	(4,062)	(116,531)
Experience gains/(losses) arising on scheme liabilities	949	5,136	(333)	5,752
Change in assumptions relating to present value of scheme liabilities	(23,951)	(7,058)	(1,509)	(32,518)
	(35,542)	(101,851)	(5,904)	(143,297)
Movements in surplus/(deficit) during year				
Surplus/(deficit) in schemes at 1 April 2002	73,902	63,000	(3,054)	133,848
Charged to operating profit	(1,876)	(5,967)	806	(7,037)
Employer contributions	29	–	670	699
Other finance income/(expense)	6,077	9,226	14	15,317
Actuarial gain/(loss) recognised in statement of total recognised gains and losses	(35,542)	(101,851)	(5,904)	(143,297)
Exceptional gain on disposal of business	–	–	2,713	2,713
Exchange adjustments	–	–	87	87
Surplus/(deficits) in schemes as at 31 March 2003	**42,590**	**(35,592)**	**(4,668)**	**2,330**
History of experience gains and losses				
Difference between the expected and actual return on scheme assets	(12,540)	(99,929)	(4,062)	(116,531)
Percentage of scheme assets at 31 March 2003	3%	34%	37%	17%
Experience gains/(losses) of scheme liabilities	949	5,136	(333)	5,752
Percentage of present value of scheme liabilities at 31 March 2003	0%	2%	2%	1%
Total amount recognised in statement of total recognised gains and losses	(35,542)	(101,851)	(5,904)	(143,297)
Percentage of present value of scheme liabilities at 31 March 2003	10%	31%	38%	21%

If the valuation basis above had been applied in the accounts instead of the SSAP 24 valuation basis, the effect on the group's net assets and profit and loss account reserve after taking into account deferred tax, would have been as follows:

	2003 £'000	2002 £'000
Net assets		
As reported	**87,397**	80,975
Add back:		
Pension prepayment under SSAP 24	**(71,280)**	(70,479)
Provision for pension costs under SSAP 24	**2,142**	4,286
Related deferred tax liability	**21,378**	21,144
Excluding pension assets	**39,637**	35,926
Net pension asset/(liability) under FRS17	**1,337**	92,777
Including pension assets	**40,974**	128,703

24. Pension arrangements (continued)

	2003 £'000	2002 £'000
Profit and loss account reserve		
As reported	**(70,238)**	(76,195)
Add back:		
Pension prepayment under SSAP 24	**(71,280)**	(70,479)
Provision for pension costs under SSAP 24	**2,142**	4,286
Related deferred tax liability	**21,378**	21,144
Excluding pension assets	**(117,998)**	(121,244)
Net pension asset/(liability) under FRS17	**1,337**	92,777
Including pension assets	**(116,661)**	(28,467)

25. Called up share capital

Authorised:	Ordinary shares of 60p Number	Redeemable 'B' preference shares of 18p Number	Unclassified shares of 30p Number	Ordinary shares of 60p £'000	Redeemable 'B' preference shares of 18p £'000	Unclassified shares of 30p £'000
At 1 April 2002	190,833,333	194,444,444	–	114,500	35,000	–
Authorised during the year	–	–	1	–	–	–
Reclassification	58,333,333	(194,444,444)	–	35,000	(35,000)	–
At 31 March 2003	**249,166,666**	**–**	**1**	**149,500**	**–**	**–**

Note: during the year the Redeemable 'B' preference shares of 18p each, all of which had been redeemed prior to 1 April 2002, were consolidated and reclassified as additional ordinary shares of 60p each.

Allotted, issued and fully paid:	Ordinary shares of 60p Number	Redeemable 'B' preference shares of 18p Number	Unclassified shares of 30p Number	Group Total £'000
At 1 April 2002	147,618,471	–	–	88,571
Ordinary 60p shares issued on exercise of options	507,995	–	–	305
As at 31 March 2003	**148,126,466**	**–**	**–**	**88,876**

Outstanding share options

The company has granted options to subscribe for ordinary shares of the company under Executive Share Option Schemes. At 31 March 2003 the outstanding options were as follows:

Scheme	Number of shares under option	Subscription price per share	Exercise period
Executive share option schemes	27,000	132.500p	16.12.1997 to 15.12.2004
	50,000	151.000p	03.01.1999 to 02.01.2006
	304,288	77.000p	19.09.1999 to 18.09.2006
	165,000	74.500p	19.12.1999 to 18.12.2006
	160,000	62.500p	31.03.2000 to 30.03.2007
	165,680	84.500p	19.06.2000 to 18.06.2007
	396,926	82.000p	24.12.2000 to 23.12.2007
	1,665,944	89.000p	20.07.2001 to 19.07.2008
	775,195	122.500p	08.07.2002 to 07.07.2009
	1,196,741	118.000p	09.09.2002 to 08.09.2009
	1,259,761	96.330p	23.06.2003 to 22.06.2010
	560,975	123.000p	22.11.2003 to 21.11.2010
	1,389,744	99.330p	25.06.2004 to 24.06.2011
	52,978	79.500p	28.11.2004 to 27.11.2011
	230,039	104.330p	31.01.2005 to 30.01.2012
	134,615	104.000p	20.02.2005 to 19.02.2012
	1,957,745	124.500p	24.06.2005 to 23.06.2012
	120,000	106.330p	27.11.2005 to 26.11.2012
Total outstanding share options	10,612,631		

Options granted to Directors are summarised in the Remuneration report on pages 28 to 32 and are included in the outstanding options set out above.

26. Reserves

	Group share premium account £'000	Group capital redemption reserve £'000	Group profit and loss account £'000
At 1 April 2002	37,921	30,631	(76,195)
Shares issued on exercise of options	147	–	–
Gain on foreign currency translation	–	–	2,011
Retained profit for the financial year	–	–	3,946
At 31 March 2003	**38,068**	**30,631**	**(70,238)**

	Company share premium account £'000	Company capital redemption reserve £'000	Company profit and loss account £'000
At 1 April 2002	37,921	30,631	20,911
Shares issued on exercise of options	147	–	–
Retained profit for the financial year	–	–	(1,755)
At 31 March 2003	**38,068**	**30,631**	**19,156**

27. Equity minority interests

	£'000
As at 1 April 2002	47
Share of profits	7
Foreign exchange	6
At 31 March 2003	**60**

28. Group cash flow statement

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

	2003 £'000	2002 £'000
Group operating profit	**18,927**	1,421
Depreciation and amortisation charges	**10,977**	12,906
Increase in stocks	**(8,833)**	(1,599)
Increase in debtors	**(20,276)**	(2,040)
Increase in creditors	**9,357**	1,623
Increase/(decrease) in provisions	**1,078**	(439)
Other items	**32**	89
Impairment of goodwill	**–**	7,873
Net cash inflow from operating activities	**11,262**	19,834
Net cash inflow from operating activities comprises:		
Continuing operating activities	**11,164**	11,959
Acquisitions	**594**	–
	11,758	11,959
Discontinued operating activities	**(496)**	7,875
	11,262	19,834

The post acquisition cash flows relating to the acquisitions contributed £0.6 million to the group's net operating cash flows, paid £nil in respect of net returns on investment and servicing of finance, paid £nil in respect of taxation and utilised £0.2 million for capital expenditure.

Companies sold in the year contributed negative £0.5 million to the group's net operating cash flows, paid £nil in respect of net returns on investment and servicing of finance, paid £nil in respect of taxation and utilised £0.2 million for capital expenditure.

28. Group cash flow statement (continued)

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

	2003 £'000	2002 £'000
(Decrease)/increase in cash in the year	**(7,686)**	1,125
Increase in liquid resources in the year	**181**	2,917
Cash flow from increase in debt and lease financing	**(20,224)**	(13,469)
Change in net funds resulting from cash flows	**(27,729)**	(9,427)
Loans and finance leases (acquired)/disposed of with subsidiaries	**(78)**	2,152
New finance leases	**(640)**	(790)
Loan from minority shareholder in subsidiary capitalised	**–**	1,214
Translation differences	**(319)**	(255)
Movement in net debt in the year	**(28,766)**	(7,106)
Net debt at 1 April	**(8,444)**	(1,338)
Net debt at 31 March	**(37,210)**	(8,444)

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

	At 1 April 2002 £'000	Cash flow £'000	New finance leases £'000	Subsidiaries disposed/acquired £'000	Exchange movement £'000	At 31 March 2003 £'000
Cash in hand and at bank	11,225	(1,613)	–	–	5	**9,617**
Overdrafts	(1,832)	(6,073)	–	–	–	**(7,905)**
	9,393	(7,686)	–	–	5	**1,712**
Debt	(20,020)	(20,675)	–	–	3	**(40,692)**
Finance leases	(734)	451	(640)	(78)	(327)	**(1,328)**
	(20,754)	(20,224)	(640)	(78)	(324)	**(42,020)**
Liquid resources	2,917	181	–	–	–	**3,098**
Total	(8,444)	(27,729)	(640)	(78)	(319)	**(37,210)**

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

	2003 Disposals £'000	2003 Acquisitions £'000	2002 Disposals £'000	2002 Acquisitions £'000
Net cash consideration	**994**	**(23,475)**	6,600	(7,258)
Net cash (disposed) of/acquired	**(685)**	**227**	(11,438)	–
Other payments	**(2,949)**	**(852)**	(1,635)	(176)
Net cash flow	**(2,640)**	**(24,100)**	(6,473)	(7,434)

(i) Disposals The cash inflow from the BMH Chronos Richardson Group disposal comprises consideration received £nil, cash disposed of £0.6 million and transaction costs of £0.4 million. The net cash outflow from the disposal of BMH Americas comprises consideration paid of £0.2 million, cash disposed of £0.1 million and costs of £0.2 million. In addition to above deferred consideration has been received in relation to businesses disposed of in prior years of £1.2 million. The other payments also include outflows on previously disposed of businesses.

(ii) Acquisitions The cash outflow in respect of acquisitions comprises: the payment of £21.3 million consideration and £0.7 million costs for the purchase of SGI; the payment of £1.8 million consideration and £0.2 million costs for the purchase of MEF; and deferred consideration of £0.4 million for the purchase of Air Power International Limited in January 2001.

The cash inflow in respect of acquisition represents the £0.2 million cash acquired with the purchase of MEF.

29. Acquisitions and disposals

(a) Acquisitions

On 19 June 2002 the group purchased the trade and certain of the assets of Service Group International (SGI), a facility and property management business providing management and professional consultancy services relating to the property estates of the MOD, Local Authorities, Central Government and the Private Sector, for cash consideration of £21.3 million. For the financial year to 31 March 2003 SGI has been classified in Training and Support. Dependent on future contract gains there is contingent consideration due of £2 million to £5 million.

On the 2 August 2002 the group also purchased MEF for the financial year to 31 March 2003. MEF has been classified in Technical Services.

The net assets acquired and the related costs were as follows:

	MEF £'000			SGI £'000			
	Acquired	Provisional fair value adjustments	Provisional fair value	Acquired	Provisional fair value adjustments	Provisional fair value	**Total £'000**
Tangible fixed assets	123	–	123	305	–	305	**428**
Current assets							
Stocks and work in progress	261	(35)	226	–	–	–	**226**
Debtors	533	(30)	503	4,506	(109)	4,397	**4,900**
Cash	227	–	227	–	–	–	**227**
Creditors	(738)	81	(657)	(3,011)	(216)	(3,227)	**(3,884)**
Finance lease	–	–	–	(78)	–	(78)	**(78)**
Provisions for liabilities and charges	(11)	–	(11)	(117)	(854)	(971)	**(982)**
Net assets	**395**	**16**	**411**	**1,605**	**(1,179)**	**426**	**837**
Fair value of consideration:							
Cash	–	–	1,800	–	–	21,300	**23,100**
Price adjustment	–	–	–	–	–	(936)	**(936)**
Costs	–	–	188	–	–	664	**852**
	–	–	1,988	–	–	21,028	**23,016**
Goodwill arising	–	–	1,577	–	–	20,602	**22,179**

There were no adjustments to acquired balance sheets as a result of differences in accounting policies. The main part of the fair value adjustment relates to an onerous lease provision in SGI. The remainder of the fair value adjustments relate to the realisable value of working capital. The goodwill arising on both acquisitions is to be written off over 20 years.

In May 2002 £0.6 million of deferred consideration was received relating to the sale of BMH AKI Dryers Inc. in January 2002. The £0.9 million price adjustment relating to the purchase of SGI was received in May 2003.

(b) Disposals

The group sold two businesses during the year.

(i) On 30 April 2002 the group sold its 100% interest in the business and assets of the last remaining part of the Materials Handling cement business, based in the US. Impairments were taken in the previous financial year. Up to the date of disposal BMH Americas generated a profit of £nil (2002: loss £0.9 million).

(ii) On 30 November 2002 the group sold its 100% interest in the BMH Chronos Richardson group of companies. Up to the date of disposal the BMH Chronos Richardson group generated a loss of £2.1 million (2002: loss £1.1 million). The loss on disposal recorded was £2.7 million.

The profits attributable to these businesses are included within discontinued operations in the profit and loss account and in the notes to the accounts.

29. Acquisitions and disposals (continued)
The net assets disposed of and the related sale proceeds were as follows:

	BMH Chronos Richardson Group and other BMH Group Companies £'000
Tangible fixed assets	**1,177**
Current assets	
Stocks and work in progress	**3,702**
Debtors	**10,080**
Cash	**685**
Creditors	**(11,022)**
Provisions for liabilities and charges	**(3,238)**
Net assets	**1,384**
Loss on sale	**(2,740)**
Net sale proceeds	**(1,356)**
Satisfied by:	
Cash	**(198)**
Deferred cash consideration	**28**
Costs	**(1,186)**
	(1,356)

30. Financial commitments
Capital commitments

	2003 £'000	2002 £'000
Authorised future capital expenditure of the group at 31 March that was contracted for but not provided for in the Financial Statements	**102**	62

The company had no capital expenditure contracted for at 31 March 2003 (2002: £nil).

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

	2003 Land and buildings £'000	2003 Plant machinery and vehicles £'000	2002 Land and buildings £'000	2002 Plant machinery and vehicles £'000
Leases expiring:				
Within one year	**204**	**690**	647	139
Within two to five years	**1,399**	**557**	1,201	1,791
Thereafter	**2,271**	**–**	2,325	–
	3,874	**1,247**	4,173	1,930

Company The company has an operating lease commitment for land and buildings as at 31 March 2003 with an annual commitment expiring after more than five years of £1.7 million (2002: £1.7 million).

31. Contingent liabilities

(a) The company has guaranteed or has joint and several liability for bank facilities of £83.4 million (2002: £60.0 million) provided to certain group companies.

(b) Throughout the group, guarantees exist in respect of performance bonds and indemnities issued on behalf of group companies by banks and insurance companies in the ordinary course of business. At 31 March 2003 these amounted to £22.5 million (2002: £38.6 million), of which the company had counter-indemnified £22.5 million (2002: £32.0 million).

(c) The company has given guarantees on behalf of group companies in connection with the completion of contracts within specification.

(d) Pursuant to the Rosyth Dockyard privatisation agreement, the 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) The company has given certain indemnities and warranties in the course of disposing of businesses and companies. The company believes that any liability in respect of these is unlikely to have a material effect on the group's financial position.

(f) The group is involved in disputes and litigation which have arisen in the course of normal trading. The Directors do not believe that the outcome of these matters will result in any material adverse change to the group's financial position.

32. Related party transactions

Details of transactions with related parties in accordance with the requirements of FRS8 Related Party Disclosures, are set out below:

(a) Transactions with joint venture
During the year a group subsidiary purchased goods from, and sold goods to, its joint venture FBMA Babcock Marine Inc. for £939,000 and £nil respectively (2002: £225,000 and £54,000). The amounts outstanding at year end on these purchases and sales were £nil and £6,000 respectively (2002: £4,000 and £nil). A group subsidiary also made loans to the joint venture. The amount outstanding at year end was £775,000 (2002: £863,000). All transactions with the joint venture arise in the normal course of business.

(b) Transactions with BAE Systems PLC
During the year group subsidiaries purchased goods from, and sold goods to, BAE Systems PLC for £262,000 and £2,440,000 respectively (2002: £242,000 and £3,120,000). The amounts outstanding at year end on these purchases and sales were £15,000 and £538,000 respectively (2002: £8,000 and £249,000). Mr M J Turner, Chief Executive Officer of BAE Systems PLC, and the Rt Hon Lord Hesketh, a non-executive Director of BAE Systems PLC, are non-executive Directors of Babcock International Group PLC. All transactions between group subsidiaries and BAE Systems PLC arise in the normal course of business and on arm's length terms.

(c) Babcock Employee Share Trust
During the year the company acquired ordinary shares through the Babcock Employee Share Trust. Further information is given in note 15 on page 48.

33. Subsequent events
There are no material events subsequent to 31 March 2003 that are required to be disclosed.

Principal subsidiary and associated undertakings

Technical Services
Technical services and secure facilities management for the MoD and related markets:

- Air Power International Limited
- Armstrong Technology Associates Limited
- Babcock Defence Systems Limited
- Babcock Engineering Services Limited
- Babcock New Zealand Holdings Limited (New Zealand)
- Babcock New Zealand Limited (New Zealand)
- Babcock Support Services Limited
- Babcock Design & Technology Limited
- Babcock Rosyth Industries Limited
- FBM Babcock Marine Holdings (UK) Limited
- FBM Babcock Marine Limited
- FBMA Babcock Marine Inc. (50%) (Philippines)*
- Rosyth Royal Dockyard Limited
- Babcock Eagleton Inc (USA)

Training and Support
Training, operating and maintenance services primarily for the MoD:

- Acetech Personnel Limited
- CMR Consultants Limited
- Hiberna FM Limited
- Babcock Africa (Pty) Limited (South Africa)
- Babcock Africa Contracting (Pty) Limited (South Africa)
- Babcock Naval Services Limited

Materials Handling
Materials processing technologies and engineered systems:

- Babcock Holdings (Sweden) AB (Sweden)
- Babcock Holdings (USA), Inc (USA)
- BMH Kellve AB (Sweden) (90%)
- BMH Marine AB (Sweden)

Others

- Babcock Employees' Trustees Limited
- Babcock Holdings Limited
- Babcock HSPS Trustees Limited
- Babcock International Holdings BV (Netherlands)
- Babcock International Holdings Limited
- Babcock International Limited
- Babcock Investments Limited
- Babcock Management Limited
- Babcock Overseas Investments Limited
- Chepstow Insurance Limited (Guernsey)
- Rosyth Royal Dockyard Pension Trustees Limited
- Babcock Support Services (Investments) Limited

All undertakings are wholly-owned unless otherwise stated. With the exception of Babcock Holdings Limited, Babcock Employees' Trustees 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 joint ventures.

Notice of meeting

Notice is hereby given that the fourteenth Annual General Meeting of the members of Babcock International Group PLC ('the company') will be held at The Berkeley Hotel, Wilton Place, Knightsbridge, London SW1X 7RL, on Friday, 18 July 2003, at 11.00 am for the transaction of the following business:

As Ordinary Business:

(1) To receive the Directors' and Auditors' reports and the audited Financial Statements of the company for the year ended 31 March 2003.

(2) To declare a final dividend for the year ended 31 March 2003.

(3) To elect Sir Nigel Essenhigh as a Director of the company.

(4) To re-elect Mr M J Turner as a Director of the company.

(5) To approve the Remuneration Report of the Directors for the year ended 31 March 2003.

As Special Business, to consider and, if thought fit, to pass the following resolutions:

Ordinary Resolutions

(6) That PricewaterhouseCoopers LLP be and are hereby reappointed as Auditors to the company to hold office from the conclusion of the meeting until the conclusion of the next general meeting at which accounts are laid.

(7) That the Directors be and they are hereby authorised to fix the remuneration of the Auditors, as they shall in their discretion see fit.

(8) That:

(a) the Babcock 2003 L-TIP ('the L-TIP') a copy of which has been produced to the meeting and signed by the Chairman for the purposes of identification and the principal terms of which are summarised on pages 65 and 66 of the company's Report and Accounts for the year ended 31 March 2003 be and is hereby approved; and

(b) the Directors are hereby authorised to establish further plans based on the L-TIP but modified to take account of local tax, exchange control or securities laws in overseas territories, provided that any shares made available under such further plans are treated as counting against the individual and overall limits on participation in the L-TIP.

(9) That, in substitution for any existing authority, 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 £29,717,751, this authority to expire on 17 July 2008 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 Resolutions

(10) That the Directors be and are hereby empowered to allot equity securities (as defined in section 94 of the Companies Act 1985) for cash pursuant to the authority conferred by resolution 9 in the notice convening this meeting as if section 89(1) of the said Act did not apply to any such allotment, provided that this power shall be limited to:

(a) allotments of equity securities where such securities have been offered (whether by way of rights issue, open offer or otherwise) to holders of ordinary shares in the capital of the company in proportion (as nearly as may be) to the respective numbers of ordinary shares held by them on the record date for any such offer, 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 a recognised regulatory body or any stock exchange, of any territory; and

(b) allotments of equity securities otherwise than pursuant to paragraph (a) above up to an aggregate nominal value of £4,457,662,

and shall, unless previously revoked, renewed or varied expire on 17 July 2008, 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.

(11) 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 60p 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 14,858,875;

(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 (exclusive of the expenses of purchase) 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 five business days preceding the day of purchase;

(d) the authority hereby conferred shall expire on 31 December 2004 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.

By order of the Board.

A N Dungate Secretary
11 June 2003
Registered Office:
2 Cavendish Square
London W1G 0PX

Notes:

(1) An explanation of the special business resolutions is given on page 65.

(2) 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.

(3) A holder of ordinary shares 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.

(4) 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.

(5) 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.

(6) A copy of the rules of the proposed L-TIP will be available for inspection at the registered office of the company and also at the offices of Pinsents, Dashwood House, 69 Old Broad Street, London EC2M 1NR during normal business hours on weekdays (Saturdays and public holidays excepted) until the close of the Annual General Meeting and also at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

Explanatory notes

Resolutions (6) to (11) set out in the notice of Annual General Meeting on page 64 constitute special business.

Resolutions (6) and (7) will be proposed as Ordinary Resolutions. Resolution (6) deals with the reappointment of PricewaterhouseCoopers LLP ('PwC') as Auditors. PwC were appointed as Auditors by the Directors to fill the casual vacancy caused by the resignation of Deloitte & Touche as Auditors on 10 January 2003 following the company's review of Auditors that was foreseen at the time of Deloitte & Touche's appointment at the last Annual General Meeting. Resolution (7) authorises the Directors to fix the Auditors' remuneration.

Resolution (8) will be proposed as an Ordinary Resolution. It seeks authority to establish a long term incentive plan in which executive Directors of the company will be eligible to participate. Details of the proposed plan are set out below and in the Remuneration report to be found on pages 28 to 32 of this document. The resolution would also authorise the establishment of equivalent plans for overseas executives.

Resolution (9), 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 £29,717,751, which represents approximately one-third of the issued share capital of the company as at 11 June 2003. This authority, which replaces the one granted on 30 July 1999, would expire on 17 July 2008 unless previously revoked, renewed or varied. The Directors have no present intention of issuing any shares except in connection with the group's executive and employee share schemes.

Resolution (10), which will be proposed as a Special Resolution, empowers 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 or other pre-emptive offer in favour of ordinary shareholders, or in relation to the issue of shares up to an aggregate nominal value of £4,457,662, being 5% of the issued share capital of the company as at 11 June 2003. If given, the power conferred by this resolution would expire on 17 July 2008 unless previously revoked, renewed or varied.

Resolution (11) will be proposed as a Special Resolution. If passed, it will renew the general authority for the company to make market purchases of its own ordinary shares. The renewed authority, in respect of up to 10% of the company's issued share capital as at 11 June 2003, would be exercisable with a minimum purchase price of 60p per share and a maximum price of not 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 five business days preceding the day of purchase.

If granted, the authority will expire on 31 December 2004 or, if earlier, at the conclusion of the Annual General Meeting of the company to be held in 2004. Shares purchased under the authority would either be cancelled or held by the company as treasury shares under the regime introduced by The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003. The Directors have no present intention of using this power, and would only 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 (except in the case of a purchase of own shares to hold as treasury shares to fulfil obligations under the company's employee share schemes) any purchase would be likely to result in an increase in earnings per share. The company has no warrants outstanding and the total number of options to subscribe for equity shares outstanding on 11 June 2003 was 10,150,342 representing 6.83% of issued share capital. If the full authority to buy back shares were to be used, these outstanding options would represent 7.59% of issued share capital.

Summary of the principal terms of The Babcock 2003 L-TIP ('the L-TIP')

(1) General
Under the L-TIP, executive Directors of the company and other selected employees may be awarded, in any year, nil-cost options to acquire shares in the company ('Share Awards'). Share Awards may be made by the company as rights to acquire shares held in treasury or by the trustee of The Babcock Employees' Share Trust ('the Trustee'), acting on the recommendation of the Remuneration Committee (the 'Committee'). Shares used to satisfy Share Awards may be purchased in the market or subscribed for by the Trustee using funds advanced on loan by the group or by the transfer by the company of shares purchased in the market and held in treasury. The L-TIP also makes provision for the award of similar cash-based awards as mentioned in paragraph 13 below. Awards under the L-TIP ('Awards') are not transferable and are not pensionable benefits.

(2) Performance Targets
Shares in respect of which an Award is made ('Award Shares') will vest only to the extent that performance conditions ('Performance Targets') relating to a fixed minimum period of three financial years beginning not earlier than that in which the Award is made ('the Performance Period') are satisfied. Such targets will be set by the Committee which will ensure that they are sufficiently challenging and align the interests of participants with those of shareholders.

(3) Grant of Awards
Awards may be made by the company or, as appropriate, the Trustee ('the Grantor') within 42 days after the L-TIP is approved by shareholders and thereafter within the period of 42 days following the announcement of the company's annual results or within 28 days of the Awardholder becoming an eligible employee, but otherwise only in circumstances judged by the Committee to be exceptional. No Award may be made more than ten years after the date on which the L-TIP is approved by shareholders in general meeting.

(4) Exercise of Awards
Insofar as an Award becomes vested, it may then be exercised in whole or part within the period ending with the tenth anniversary of the date of grant.

(5) Death and leaving the group
If an Awardholder dies in service or leaves the Babcock International group of companies ('the group') as a result of injury, ill-health, disability, redundancy, retirement on or after contractual retirement age or because the company or business by which the Awardholder is employed is sold or transferred out of the group, an Award may, to the extent that it has become vested, be exercised only within the period of 12 calendar months from the date of death or six calendar months following the date of such leaving (or if the Awardholder dies within that six month period, 12 months from the date of death).

If, within the Performance Period, the Awardholder either dies in service or leaves the group for any of the above reasons, the Grantor (with the consent of the Committee) may either:

(a) in the case of leaving the group, allow the Awardholder to keep the Award and exercise it within six months after the vesting date but only in respect of a proportion (corresponding to such proportion of the Performance Period as fell before the date of leaving) of the Award Shares; or

(b) in either case, allow an Award to be exercised only within six months thereafter (12 months in the case of death in service) in respect of a proportion (corresponding to such proportion of the Award Shares as fell before the date of leaving or date of death) of the Award Shares as the Committee shall deem vested at the date of leaving or death or, if in the opinion of the Committee the circumstances are exceptional, such greater proportion as the Grantor (acting on the recommendation of the Committee) may allow.

If an Awardholder leaves the group for any reason other than those mentioned above, an Award will lapse except that, in exceptional circumstances, the Grantor (acting on the recommendation of the Committee) may allow an Award to be exercised in respect of such proportion of the Award Shares and within such period as the Grantor may determine.

(6) Takeover of the company
In the event of a successful takeover of the company, an Award may be exercised in respect of a time-apportioned proportion of such of the Award Shares as the Committee shall deem vested at that date, or such greater proportion as the Grantor (with the consent of the Committee) may determine.

(7) Deemed vesting
Award shares are deemed to become vested in the case of death, leaving or takeover if and in so far as the Committee considers that the performance of the company, judged at the date of death, leaving or takeover, is such that the Performance Target is likely to be met to a particular extent so that the Award would be likely to become vested in respect of such given proportion of Award Shares.

(8) Reconstruction, reorganisation, amalgamation, demerger and winding-up
In the event of a reconstruction, reorganisation, amalgamation or demerger not involving a change of control of the company, Awardholders may be invited to accept a corresponding award over shares in the new holding company in exchange for the release of an Award. If such invitation is declined, the Award will lapse. In all other such events, or if a resolution is proposed for the voluntary winding-up of the company, the Grantor (with the consent of the Committee) may make appropriate provision for the variation and/or early exercise of an Award.

(9) Limit on individual participation
The maximum initial market value of shares over which Awards may be granted to an executive in any year cannot in that year exceed 100% of the amount of his rate of basic salary (excluding benefits in kind) payable at that time. For these purposes, market value is taken to be the average of the middle market quotations of a share for the three dealing days immediately preceding the date the Award is made as derived from the London Stock Exchange Daily Official List. If an Awardholder is required to bear the cost of employer's NICs arising on the exercise of a Share Award, the number of Award Shares may be grossed-up to compensate the Awardholder for this additional liability (and may to that extent exceed this limit).

(10) Limit on issue of new shares pursuant to the L-TIP
The Trustee may subscribe (at market value) or purchase shares for the purposes of satisfying Share Awards. There is a limit, of 5% of the issued share capital of the company, on the shares which may be issued or issuable for the purposes of the L-TIP and any other executive share incentive plan in any period of ten years, and a limit, of 10% of the issued share capital of the company, on the shares which may be issued or issuable for the purposes of the L-TIP and of any employees' share scheme in any period of ten years.

(11) Variation of capital
In the event of a variation of the share capital of the company, the Grantor (with the consent of the Committee) may adjust the number of shares in respect of which Awards have been made provided that, except in the case of a subdivision, consolidation or capitalisation, any such adjustment is confirmed in writing by the Auditors of the company to be, in their opinion, fair and reasonable.

(12) Amendment of the L-TIP
The Grantor, acting with the consent of the Committee, may, at any time, amend the L-TIP provided that the prior approval of the company in general meeting is obtained for amendments to the advantage of existing or new Awardholders of the provisions relating to eligibility, the overall and individual limits, the basis for determining the Awardholder's rights to acquire shares, the adjustment of such entitlements on variation of share capital and the provision governing amendments (except for minor amendments to benefit the administration of the L-TIP, to take account of any change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for Awardholders or any member of the group or associated company).

(13) Cash awards
The L-TIP makes provision for the award of deferred cash bonuses of amounts calculated by reference to the market value, at the time of exercise, of such of a notional number of Award Shares in respect of which the Award is made which become vested in consequence of Performance Targets having been met. Such cash-based Awards are subject to the same individual limits and restrictions on grant and are, in all material respects, exercisable on the same terms, as those summarised above.

The above summary of the main features of the L-TIP does not form part of the rules of the plan and should not be taken as affecting the interpretation of its detailed terms and conditions. The Directors reserve the right up to the time of the forthcoming Annual General Meeting to make such amendments and additions to the rules of the L-TIP as may be necessary or appropriate to take account of comments of the UK Listing Authority provided that such amendments do not conflict in any material respect with the above summary.

Five year financial record

	2003 £m	2002 £m	2001 £m	2000 £m	1999 £m
Group turnover	**423.5**	423.0	441.0	470.7	495.0
Operating profit/(loss)*	**18.7**	0.9	(4.8)	20.8	22.8
Exceptional items	**(2.7)**	(13.8)	(6.2)	1.0	6.1
Profit/(loss) on ordinary activities before interest	**16.0**	(12.9)	(11.0)	21.8	28.9
Net interest and similar charges	**(2.6)**	(1.0)	3.7	4.2	2.5
Profit/(loss) on ordinary activities before taxation	**13.4**	(13.9)	(7.3)	26.0	31.4
Tax on ordinary activities	**(5.1)**	(3.1)	(1.2)	(4.5)	(5.3)
Profit/(loss) on ordinary activities after taxation	**8.3**	(17.0)	(8.5)	21.5	26.1
Minority interests	**–**	(0.1)	3.2	1.0	(0.6)
Profit/(loss) attributable to shareholders	**8.3**	(17.1)	(5.3)	22.5	25.5
Fixed assets	**99.3**	85.1	114.7	58.7	47.9
Net current assets	**34.5**	25.6	33.9	129.1	122.8
Non-current liabilities and provisions	**(46.4)**	(29.7)	(39.7)	(36.0)	(34.1)
Total net assets	**87.4**	81.0	108.9	151.8	136.6
Shareholders' funds	**87.4**	81.0	105.7	143.9	126.8
Minority interests	**–**	–	3.2	7.9	9.8
	87.4	81.0	108.9	151.8	136.6
Earnings/(loss) per share – basic	**5.72p**	(11.86)p	(3.34)p	13.26p	15.07p
Dividends per share	**3.00p**	2.85p	2.65p	2.55p	2.20p

*Includes operating loss/profit of joint ventures and associates. Years prior to 2001 have not been restated following adoption of FRS19.

Shareholder information

Financial calendar

Financial year end	31 March 2003
2002/03 preliminary results announced	12 June 2003
Annual General Meeting	18 July 2003
Final dividend payment date (record date 11 July 2003)	8 August 2003

Registered office and company number
2 Cavendish Square
London W1G 0PX

Registered in England
Company number 2342138

Registrars
Computershare Investor Services PLC
PO Box No 82
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Bridgwater Road
Bristol BS99 7NH

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

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London WC2N 6RH

Principal UK bankers
The Royal Bank of Scotland plc
135 Bishopsgate
London EC2M 3UR

HSBC Bank plc
8 Canada Square
London E14 5HQ

Investment bankers
Credit Suisse First Boston (Europe) Limited
1 Cabot Square
London E14 4OJ

Stockbrokers
Cazenove Group PLC
20 Moorgate
London EC2R 6DA

Share dealing service
The company, through National Westminster Bank Plc, offers a special share dealing service to shareholders either by post or through NatWest branches. Shareholders who wish to use either of these facilities are asked to telephone 0870 600 2050 or alternatively, to write to NatWest Stockbrokers Limited, Babcock International Group Information, FREEPOST, London E1 8BR or e.mail contactces@natwest.com, please quote 'Babcock'.

Taxation
A return of capital to ordinary shareholders by way of a bonus issue of redeemable 'B' shares of 18p each, out of the company's share premium account, was approved at an Extraordinary General Meeting of the company held on 10 October 2000. A guide to the general tax position of United Kingdom shareholders under the return of capital is given in Part IV of the circular to shareholders dated 15 September 2000. Copies of the Part IV guide are available, on request, from the Company Secretary, at Babcock International Group PLC's Registered Office (see back cover).

Market values of Babcock International Group PLC new ordinary shares of 60p and 'B' Shares for the purpose of taxation of chargeable capital gains (CGT) are as follows:

	New ordinary shares	'B' shares
23 October 2000	112.5p	17.75p

1. The market values stated above are used to allocate the base cost of the existing ordinary shares, between the new ordinary shares and 'B' shares in calculating any CGT liability.

2. Being the first day of trading of the new ordinary shares and the 'B' shares.

From design, to production. Radley Yeldar (London).

From studio, to location. Photography by John Edwards, George Brooks and Richard Learoyd.

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