Babcock International Group PLC
Annual report and accounts 2005

A focused support company with a broad customer base...

Welcome to Babcock

...our five businesses share one core characteristic: the integration of systems and technologies, coupled with a proven delivery capability. Our recent acquisition has broadened our customer base and will allow Babcock to grow further.

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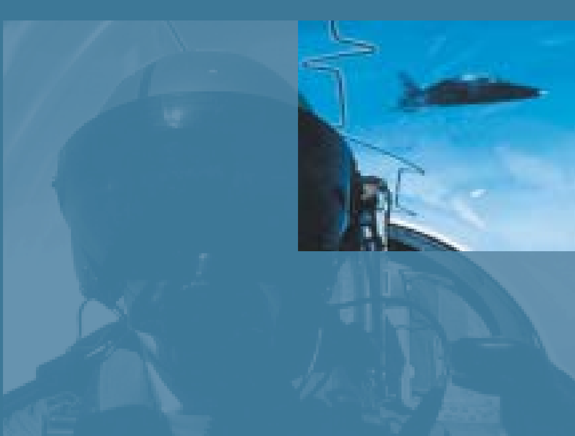


Sales	£760.0m +68%
Operating profit(1)	£41.0m +61%
Profit before tax	£28.4m +43%
Earnings per share(2)	14.20p +4.4%
Dividend	4.00p +19.4%

(1) Before goodwill amortisation (2005: £6.6 million, 2004: £3.3 million), discontinued operations losses (2005: £nil, 2004: £0.3 million) and operating exceptionals of £1.5 million credit (2004: £nil).
(2) Before exceptional items (2005: £0.3 million credit, 2004: £nil) and goodwill amortisation.

"Our results once again demonstrate the success of our strategy to build a leading support services business."

Four years ago we embarked on a process to convert Babcock from an engineering conglomerate to a support services business. I said last year, that the year ending March 2004 completed the first phase of this transformation, which was predicated upon being a major service supplier to the defence sector. The second phase was to broaden our customer base so that we were not overly reliant on any one market sector. The acquisition of Peterhouse, concluded in June 2004, marked the start of this second phase. The acquisition has been extremely successful and the businesses are now largely integrated into Babcock. The synergies anticipated were achieved as quickly as we could possibly have hoped, and hence the acquisition was earnings enhancing in the year ended March 2005, somewhat earlier than had been predicted in the Offer documents. Equally our cash management skills have reduced the debt taken on to acquire the Peterhouse business very rapidly, such that our net debt at March 2005 was only £63 million.

The results to March 2005 continue to support our strategy. Profit before tax and before goodwill and exceptional items increased by 52% following on from an increase the previous year of 28%. Operating profit, before goodwill and exceptional items, increased by 63% year on year, but this was by no means all due to the Peterhouse acquisition. The existing Babcock businesses also increased their operating profit by a reassuring 18%.

The success of the strategy is also marked by the better balance of our sales. Sales to the Ministry of Defence fell from 70% of turnover in the year to March 2004 to approximately 50% 2004/05. The defence sector remains an important part of our business but the presence in higher growth sectors such as telecommunications and power transmission gives the results more robustness. Our South African business also continues its dynamic growth, and we have positioned Rosyth to withstand the sharp decline in the refit business without undermining our ability to resource adequately Rosyth's role in the building of the new aircraft carriers.

Earnings per share, before goodwill and exceptional items, in the year to March 2005 increased by 4.4% to 14.2p per share. With a year on year comparable tax charge the increase would have been 15%. The Directors have been conscious throughout this major transformation of Babcock of the need for tight controls on cash, but with a much larger and better balanced business we feel that shareholders should be rewarded by a substantial increase in dividends whilst maintaining a conservative cover. Over the medium term we intend to target dividend cover, based on full year earnings excluding goodwill amortisation and exceptional items, in the range 2.5–3.0 times, based on current accounting principles. As a consequence, the Board is recommending a 26% increase in the final dividend to 2.65p per share, which will take the total dividend for the year up to 4p per share, an increase over last year of 19.4%.

The introduction of IFRS as the method of accounting for UK companies does not have a significant effect on the 2004/05 earnings of Babcock, although there is some redistribution between operating profit and interest. IFRS accounting will be introduced in the year ending March 2006.

The Report and Accounts shows our compliance with the Combined Code and a number of minor changes as a result of the Higgs recommendations. In the few cases where we do not comply fully with the Combined Code we explain our reasoning. However, a number of our non-executive directors have held their positions for long periods by the standards of Higgs recommendations. Notwithstanding, therefore, their outstanding contribution to the company over this period of time, we shall be implementing a programme of change amongst the non-executive directors. However, we feel it important that this be carried out in a controlled manner such that we do not lose the substantial benefit of their experience. This change will therefore be carried out progressively over the next couple of years.

In line with this Mike Turner will retire from the Board at the end of this calendar year and I wish to record my personal thanks and those of his colleagues for the major input he has had to the success of Babcock over the last nine years, both in terms of its strategic direction and its delivery.

The two most important decisions a Board can make in large companies is to choose the strategy and to identify and select the best people to implement that strategy. I think the history over the last five years suggests that we have made both decisions with some skill, and the increase in shareholder value over those five years is a testimony to that. Over the five years ending 31 March 2005, £100 invested in Babcock would have yielded a return of 124% more than a similar investment in the FTSE All-Share index.

I am sure that shareholders would wish me to thank all employees who have contributed to such an outstanding performance and I believe that, with the acquisition of Peterhouse, we shall continue to improve value for our shareholders.

Gordon Campbell

Gordon Campbell Chairman

Chief Executive's operating statement
Peter Rogers

The 2004/05 Financial Year has been both successful and highly active for Babcock. The acquisition and integration of Peterhouse, and subsequently Turner & Partners, the start of the South West Regional Prime Contract, the first year of the contract at RAF Valley, significant reorganisation in our marine-based business and movement to preferred bidder on RSME all took place during the Financial Year. The result of all this activity is that sales from continuing operations have risen by £322 million or 74% and operating profit from continuing operations before goodwill and exceptional items has risen by £15.5 million or 61%.

The integration of the former Peterhouse businesses continued to occupy significant amounts of management time but synergy benefits totalling £9 million compared to the £5.3 million contained in the Offer documents had been identified by 31 March 2005.

Most significantly the development of a better balanced portfolio of businesses, most of which are in growing markets, has laid solid foundations which should allow the company to continue double digit sales and profit growth in the coming years.

Defence Services

Sales £245.1 million (2004: £171.5 million).
Operating profit £17.8 million (2004: £11.6 million)
(32% of group Sales).

Growth in sales was largely driven by the 1 April 2004 start of the South West Regional Prime (SWRP) Contract. We expect further growth in sales during the current year as the contract will be fully operational throughout the period. Naval Services also showed some growth in turnover and margin as the scope of the contract increased and our confidence in delivering the contracted cost reduction targets improved. The announcement by the Ministry of Defence that the contract will be extended by an additional five years, which is expected imminently, will further enhance the order book.

We continue to deliver excellent service to the customer across the range of businesses. At HM Naval Base Clyde customer satisfaction surveys show that, despite the significant cost savings we are achieving, our customers rate our service as significantly better than that which was being delivered previously. Similarly, we have been complimented on our activities in relation to contracts at RAF Valley, RAF Lyneham and on SWRP on each of which we are also delivering substantial savings to the customer.

A notable step forward in the second half of the year was the award of Preferred Bidder Status on the Royal School of Military Engineering (RSME) PFI to the Holdfast consortium led by Babcock. We had been sole bidder for almost three years and internal difficulties in the Ministry of Defence (MoD) had prevented the project moving forward. We are now aiming, with the MoD, to achieve financial close during the 2006 -2007 Financial Year.

We are involved in the MoD's Marine Services PFI as part of the Starfish Marine consortium, one of two bidders for this large project. Other significant bids on which we are working include the Eastern Regional Prime Contract and Projects for managing the ministry estates in Cyprus and Gibraltar. We are also working towards submitting bids on a number of opportunities in the 'Building Schools for the Future' programme.

The major project on which we are currently bidding (again as leader of the Holdfast Consortium) is the Defence Training Review which is a PFI for the management and delivery of approximately half of the three services non-military training. The award of this contract should take place during the 2006/07 financial year.

Technical Services

Sales £160.2 million (2004: £180.0 million).
Operating profit £13.1 million* (2004: £14.8 million).
(21% of group sales).

This is the business based at Rosyth. We carried out significant reorganisation during the year in recognition of the fact that the allocated programme for warship refit is coming to an end in March 2006 and in further recognition of the fact that the market for warship refit will be somewhat smaller over the next few years. The reorganisation so far has enabled us, we believe, to become the lowest cost warship refit yard in the UK and we are therefore confident of our ability to compete in the reduced market. We won eight of the last 13 competitive bids during the year and we are confident of our ability to continue to bid both successfully and profitably.

We moved the businesses based at Rosyth from a position two years ago where they were almost wholly dependent for profits on the warship refitting programme to a position in which they would be a profitable group of businesses even in the unlikely event of the refit market dropping to zero. A regrettable consequence of this reorganisation is the reduction in the Rosyth workforce from some 1,800 people to under 1,200 by March 2006.

We are continuing to participate in the programme for construction of the new aircraft carriers. While no contracts have yet been awarded, other than for design, we remain confident that Rosyth will be the location selected for the assembly and integration of the two ships, on the grounds of the excellent facilities and the skills of the workforce. These have also played a large part in the success of the modular construction work we are carrying out for Heathrow Terminal 5.

We are participating in discussions with the MoD on the ISOLUS programme – which is a programme for the dismantling and storage of defuelled nuclear submarines. Any contract awarded under the ISOLUS programme will be for over 20 years.

The Supply Chain Services, Design and Technology and nuclear businesses are all profitable in their own right. We are continuing to bid for naval refit work and are seeking opportunities to expand the scope of the Engineered Products business.

*before exceptional charge of £5.5 million (2004: £nil).

A resilient business

"The Group benefits from the strength of our long-standing customer relationships – which guarantees a reliable revenue stream that underpins the business. We also have the ability to react to underperforming areas of the business – fulfilling potential through strong management."

Engineering and Plant Services:

The continued success of our operations in Africa puts us in a prime position to benefit from future outsourcing opportunities as and when they arise.

Engineering and Plant Services

Sales £113.0 million (2004: £86.5 million). Operating profit £5.5 million (2004: £3.5 million). (15% of group sales).

The African business has continued its outstanding progress during the year with sales at over £100 million for the first time and profits exceeding £5 million. The growth resulted mainly from the growth in the Construction Equipment business which sells Volvo equipment largely to the mining and construction industries. Our market share continued to increase and the parts aftermarket is growing as the number of Volvo vehicles on the ground continues to expand. Increasing sales in the aftermarket will give opportunities for further margin improvement.

The African engineering business continued its excellent progress with profitability again improving. The need to continue increasing both active generation capacity and infrastructure support in Africa will provide a more stable environment for the engineering business than has been the case for a number of years.

Eagleton, our pipeline business in Houston Texas, had another challenging year as the market continued at very low levels, although towards the end of the year there were clear signs of increased activity driven by the continuing high price levels for oil and gas.

Networks

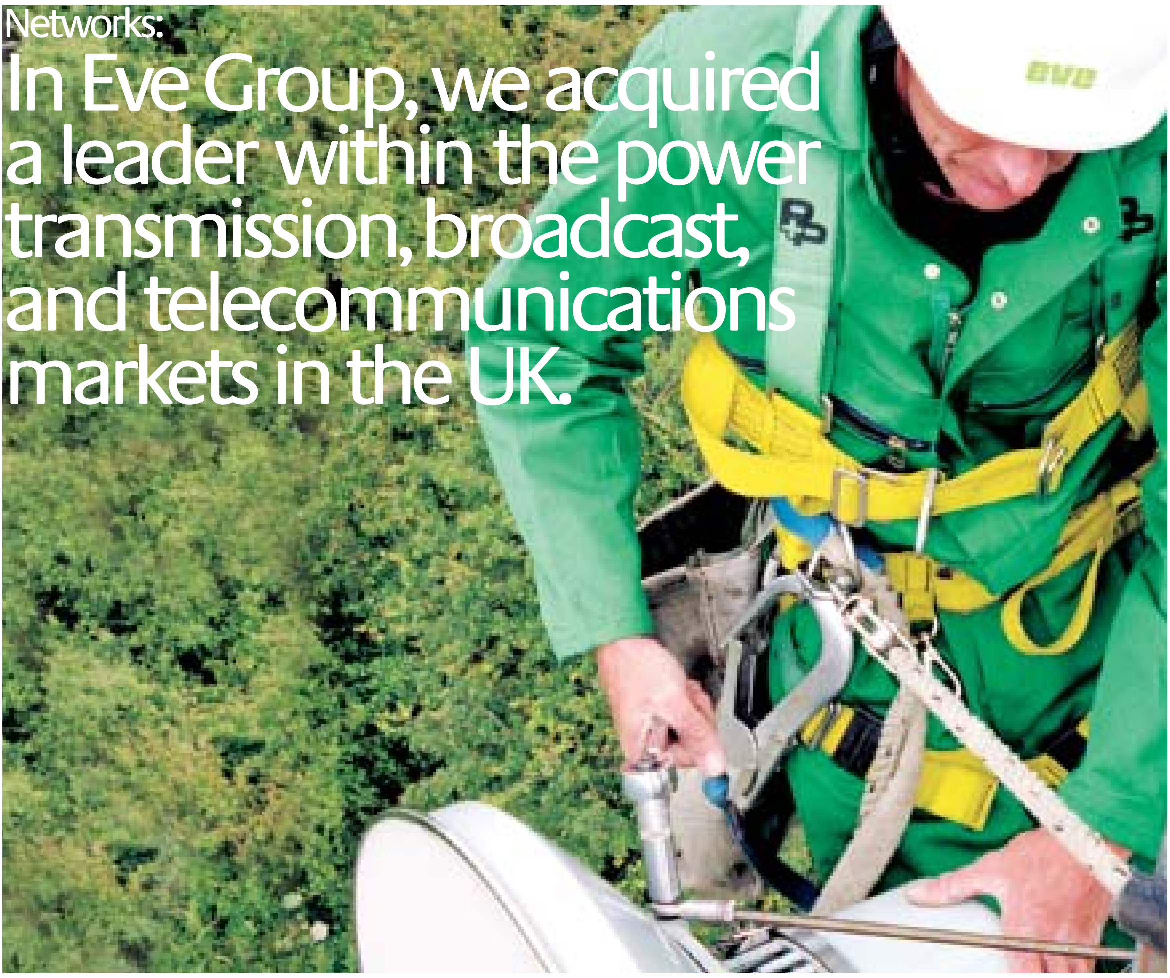
Sales £61.5 million (2004: £n/a). Operating profit £4.1 million (2004: £n/a) [for period of 9.5 months] (8% of group sales).

Since the acquisition of Peterhouse, the Networks businesses (which trade under the 'Eve' name) have performed somewhat better than we had anticipated. In the telecoms business, the launch of 3G technology by the network operators is taking place on a more gradual basis than many had expected, but has been in line with our expectations at the time of the acquisition. With the purchase of Turner and Partners we continue to win contracts for the acquisition design and construction of new sites thereby strengthening the core business as well as adding valuable skills. The combination of the skills of Eve and Turners is proving attractive to customers. A number of contracts with the major operators have been secured, including Vodafone, Orange and 3.

The transmission business continues to deliver an excellent performance with the volume of work continuing to rise, at a slightly faster rate than our original expectations. The volume of pre-sanction engineering work also continues to rise, which is usually a predictor of the volume of contracts to be let over the next two years.

Eve Trakway had a reasonable winter and spring period as its share of the industrial market grew and is now profitable. We have invested in further capacity in this business to ensure we maintain our ability to provide outstanding levels of service to our customers.

Networks:
In Eve Group, we acquired a leader within the power transmission, broadcast, and telecommunications markets in the UK.



Rail
Sales £167.0 million (2004: £n/a). Operating profit £8.3 million* (2004: £n/a) [for period of 9.5 months] (22% of group sales).

The rail business (First Engineering) has met our original expectations at the time of acquisition. Although the market for signalling was somewhat slower than we had anticipated the track renewals business remained extremely busy throughout our period of ownership. There are clear signs that the rate of placement for signalling and communication contracts will increase over the coming months while track renewals will continue to perform well. The high output renewals contract is continuing to develop well and First Engineering is now responsible for the Facilities Management (Mechanical and Electrical Maintenance) for all Network Rail's major stations.

Significant first steps have been taken to align overheads with the new structure of First Engineering following the handing back of maintenance work to Network Rail in June 2004. Further savings are planned including the consolidation of all Glasgow operations into a single building at Hamilton International Park at the end of the 2005/06 Financial Year.

Health, Safety and Environmental
Sales £13.2 million (2004: £n/a). Operating loss £1.2 million (2004: £n/a) [for period of 9.5 months] (2% of group sales).

The two smallest businesses acquired with Peterhouse are in the process of disposal. Neither IETG nor ESS (flow monitoring and safety equipment and training) is regarded as core and we are aiming for completion of the processes before the end of September.

Summary and prospects
As I said in November, credit is due to the operational management of the businesses for a strong performance, despite the inevitable distractions of the acquisition and integration of Peterhouse. The forecast integration savings have been achieved and we expect that further savings will be realised.

During the last year we have positioned Babcock to take advantage of the growing markets in which we operate. We now have a balanced portfolio of businesses and customers. We have continued to grow sales and profits in existing businesses by over 10% a year while successfully integrating a significant acquisition.

We are well placed to continue the growth in both sales and profits in the coming years and to become a major force in the public sector outsourcing markets and in other technically demanding markets.

Peter Rogers Chief Executive

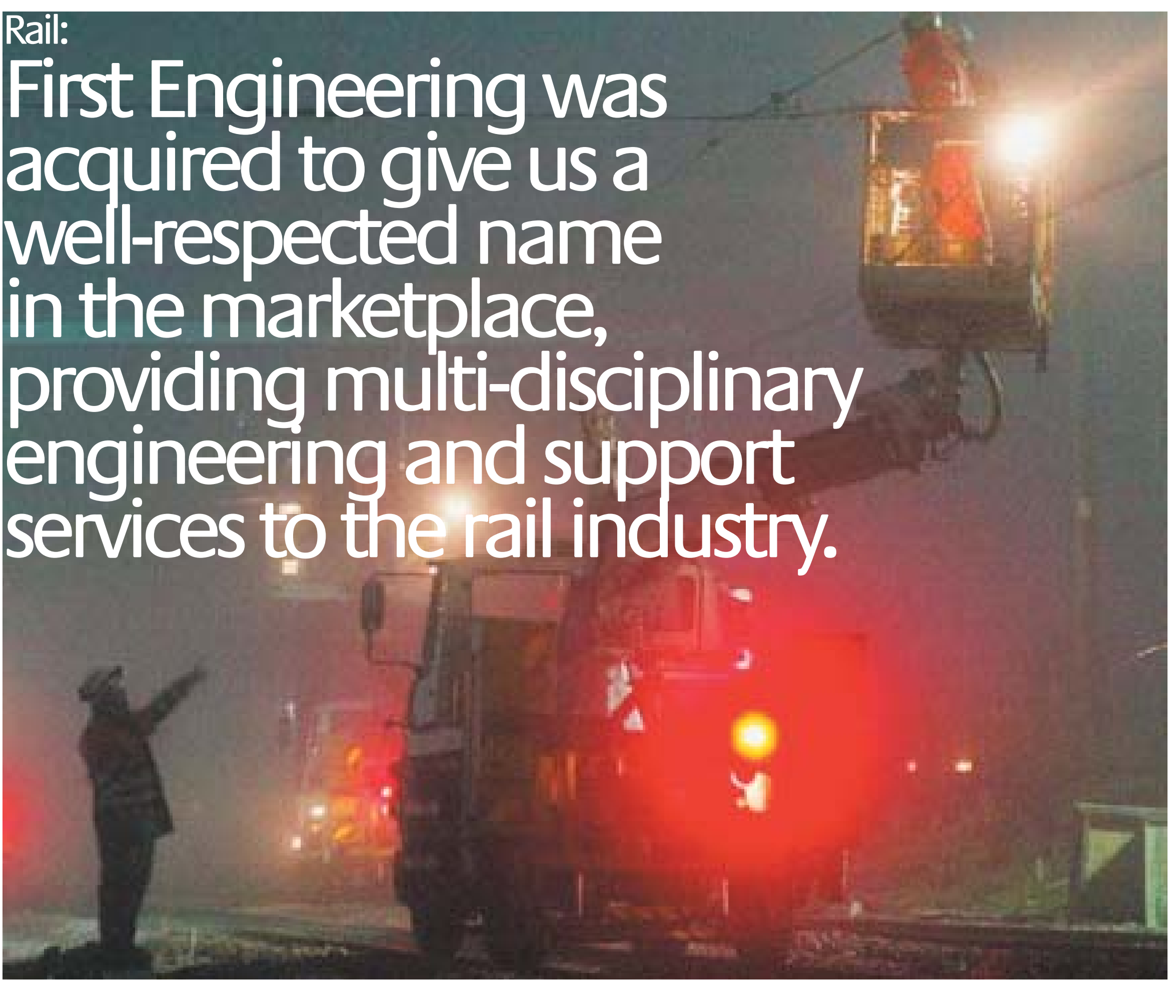
*before operating exceptional credit of £8.8 million.

Adding new areas of expertise

"The acquisition of the Eve and First Engineering businesses has benefited the Group through the specialised skill sets they have introduced."

Rail:

First Engineering was acquired to give us a well-respected name in the marketplace, providing multi-disciplinary engineering and support services to the rail industry.



Bill Tame

This review, which should be read in conjunction with the Operating statement on pages 4 to 8, is to provide a view of how key business events have impacted on the group's results during the year and its financial position at the end of the year.

Results of operations – summary analysis

To assist in understanding how events have impacted the group, we have set out in the tables on pages 13 and 14 an analysis of existing and acquired operations, as such all operating profit numbers quoted in the table are before charging goodwill amortisation and operating and non-operating exceptional items.

Sales and operating profits from continuing businesses were substantially increased from those of last year as a result of both organic and acquisition related growth and, as we reported at the interim stage, the performance of the existing businesses and that of the newly acquired Peterhouse businesses has been strong. The acquired businesses met our expectations for the nine months that they formed part of the Babcock group.

Turnover was 68% above that of the previous year or 18% up after excluding the effect of acquisitions. Operating profit increased by 63% to £41 million, representing a net margin of 5.4% against 5.6% last year. On existing businesses, operating profit increased 18% with margins in line with last year at 5.8%.

Existing businesses

Within the existing businesses, Defence Services performed strongly both in turnover and operating profit with net margins up from 6.8% to 7.3% driven by a combination of the start of South West Regional Prime and further growth in the HM Naval Base Clyde contract. Conversely and as anticipated, revenues declined in Technical Services in the face of lower naval re-fit activity but timely realignment of the cost base enabled margins to be sustained at 8.2%. Continued strong growth in the African operations on improved margins yielded turnover in excess of £100 million and an operating profit improvement of over 50%.

Acquisitions

The former Peterhouse businesses, included for nine months, added £11 million in operating profit on £242 million of turnover, a net margin of 4.6%. The Networks business benefited from ongoing growth in both the high voltage power supply market and the mobile phone transmission market and operating margins totalled 6.7%. The latter included a contribution to operating profit of £0.5 million from Turner and Partners, which was acquired in September 2004. In Rail the strong growth recorded in track renewals more than offset any softness in other rail activities to deliver turnover of £167 million and, following adjustment of the cost base (post the transfer of rail maintenance work to Network Rail in June 2004) an operating margin of 5%. Conversely, the performance of the non-core Health, Safety and Environmental businesses was worse than anticipated, losing £1.2 million in market conditions weakened by delays in expenditure on the regulated assets of the utility companies that are the division's key customers.

"We continue to underpin good and improving profit performances with strong cash generation."

Reconciliation to statutory profit and loss

The table on page 14 reconciles the results quoted above to the figures reported in the statutory accounts.

Exceptional items

The following have been treated as exceptional charges to operating profit.

	Cash £m	Non-cash £m	Total £m
Reorganisation of marine design and goodwill impairment	(0.8)	(4.7)	(5.5)
Exceptional gain on termination of rail maintenance contracts	8.8		8.8
Peterhouse rationalisation costs	(1.8)		(1.8)
Disposals – non-operating	(1.2)	(0.4)	(1.6)
	5.0	(5.1)	(0.1)

Reorganisation costs and goodwill impairment charges of £5.5 million were incurred in respect of the marine design businesses within Technical Services following the decision to scale down and refocus this division's operations.

Agreement was reached with Network Rail for compensation and other payments to be made by them in respect of the early termination and hand back of rail maintenance contracts formerly run by First Engineering, the Peterhouse subsidiary responsible for rail operations. The net gain after costs of redundancies and other restructuring charges totalled £8.8 million.

Costs incurred in restructuring and integrating the Peterhouse businesses into the group totalled £1.8 million.

Costs totalling £1.6 million in respect of disposals have been charged as a non-operating exceptional item in the year.

Goodwill

Additions to goodwill arose in respect of the acquisitions of Peterhouse Group plc (£81.0 million) and Turner and Partners (£7.0 million). Amounts amortised and written off as a result of impairment were £6.6 million and £4.7 million respectively. The impairment write off was made as a result of a scaling down of the activities of the marine design businesses.

Interest and taxation

	2004/05 £m	2003/04 £m
Profit on ordinary activities before interest	34.6	20.3
Interest	(6.2)	(2.2)
Exceptional gain on financial asset	–	1.7
Net interest and similar income/(charges)	(6.2)	(0.5)
Profit before tax	28.4	19.8
Taxation	(7.7)	(3.4)
Profit after tax	20.7	16.4

The net interest charge rose to £6.2 million following an increase in net debt arising on acquisition of Peterhouse and for which a new £140 million financing facility was arranged. The total interest charge was covered over six times by operating profit before goodwill amortisation and exceptional items.

Pre-tax profit increased 43% to £28.4 million and by 52% to £35.1 million excluding goodwill amortisation and exceptional items.

The group's effective tax rate for the year was 24%. This compares to a rate of 15.7% last year, which benefited from the utilisation of prior year's tax losses. The expected rate for 2005/06 is approximately 26%.

Earnings per share

Basic earnings per share, before goodwill and exceptional items, increased 4.4% to 14.20p, despite a significantly higher tax charge and an enlarged issued share capital. After adjusting for the effect of the larger tax charge, underlying growth in earnings per share was 15%.

Cash flow

We continue to underpin good and improving profit performances with strong cash generation and one of our key performance indicators for all operations is the conversion rate of operating profit into cash from operations, after taking into account capital expenditure. The conversion rate for 2004/05 was 115% compared to 120% last year.

After interest and tax payments free cash flow was £30.5 million, (2004: £24.4 million). Capital expenditure, before receipts from assets sold, totalled £5.7 million or less than 1% of turnover and less than one times depreciation. On average over the medium term we target to spend no more than 1.5% of turnover or one times depreciation, whichever is the greater, on capital assets.

Net debt increased to £62.9 million from £15.4 million last year principally as a result of the acquisition of Peterhouse (cash impact £64.7 million) and Turner and Partners (£4 million) although higher interest payments (£6.1 million against £0.4 million last year) and tax payments (£4.7 million against £1.6 million) both of which benefited from one off gains last year, also impacted. The group has access to a £140 million three year credit line arranged at the time of the Peterhouse acquisition of which £78 million had been drawn down at 31 March 2005.

Strong performance

"The success of the Group's operational strategies are reflected by the continuing growth in our financial performance – and the value we are able to pass on to our shareholders ."

Results of operations

	Turnover		Operating profit		Net margin		Growth	
	2004/05 £m	2003/04 £m	2004/05 £m	2003/04 £m	2004/05 %	2003/04 %	Turnover %	Operating profit %
Defence Services	245.1	171.5	17.8	11.6	7.3	6.8	43	53
Technical Services	160.2	180.0	13.1	14.8	8.2	8.2	(11)	(12)
Engineering and Plant Services	113.0	86.5	5.5	3.5	4.9	4.0	31	57
Unallocated			(6.4)	(4.4)				
Existing	518.3	438.0	30.0	25.5	5.8	5.8	18	18
Networks	61.5	–	4.1	–	6.7	–	–	–
Rail	167.0	–	8.3	–	5.0	–	–	–
HS&E	13.2	–	(1.2)	–	–	–	–	–
Unallocated			(0.2)					
Acquisitions	241.7	–	11.0	–	4.6	–	–	–
Disposals	–	14.0	–	(0.3)	–	–	–	–
Total pre-goodwill and exceptional items	760.0	452.0	41.0	25.2	5.4	5.6	68	63

Cost of capital and return on investment
The group's weighted average cost of capital, which for 2004/05 was 8.7%, is used as one measure in assessing the financial viability of its investments. The after-tax return before goodwill amortisation and exceptional items for 2004/05 was 16%, compared with 20% last year, a decline arising principally from the inclusion of less than a full years operating profit for Peterhouse and Turner and Partners.

Pensions
The group maintains a number of defined benefit pension schemes some of which were acquired with the Peterhouse businesses. In accounting for these schemes the group applies SSAP24 in its consolidated accounts and the transitional rules of FRS17 for disclosure purposes. The balance sheet position under both SSAP24 and FRS17 at 31 March 2005 is as set out in the following table.

	SSAP24		FRS17	
	2004/05 £m	2003/04 £m	2004/05 £m	2003/04 £m
Balance sheet surplus/(deficit)	98.2	67.2	(20.4)	2.0
Related tax (liability)/asset	(29.9)	(20.7)	5.8	(0.9)
Net surplus/(deficit)	68.3	46.5	(14.6)	1.1

Since last year end the inclusion of schemes taken on from Peterhouse has increased the SSAP24 balance sheet surplus substantially with the net surplus standing at £68.3 million at the end of this year. Conversely, under FRS17 the net position has deteriorated from a small surplus last year to a net deficit of £14.6 million at 31 March 2005. The contrast in the valuation status reflects the fundamental difference in assumptions between the two bases; whereas SSAP24 adopts a long-term view of funding, FRS17 takes a fair or market value approach to pension fund assets and liabilities, which is likely to lead to increased volatility in balance sheet values. Details of scheme valuations and the assumptions used can be found at note 25 to the accounts. All of the group's principal defined benefit schemes were in actuarial surplus for funding purposes at the last valuation dates. The methodology and assumptions used to calculate the pension assets and liabilities under FRS17 are substantially consistent with the requirements of IAS19, which will be adopted by the group with effect from 1 April 2005.

Treasury
The group's policies, which have been reviewed and approved by the Board, cover all significant areas of treasury activity including foreign exchange, interest rates, liquidity and credit risk. The Treasury Committee, which comprises the Group's Chief Executive, Finance Director and Financial Controller, with authorities delegated by the Board, is responsible for ensuring that the Group operates within the policies agreed by the Board.

Reconciliation to statutory profit and loss

	Turnover		Operating profit		Net margin		Growth	
	2004/05 £m	2003/04 £m	2004/05 £m	2003/04 £m	2004/05 %	2003/04 %	Turnover %	Operating profit %
Total pre-goodwill and exceptional items	760.0	452.0	41.0	25.2	5.4	5.6	68	63
Operating exceptional items:								
On acquisitions			7.0	–				
On existing			(5.5)	–				
Total			1.5	–				
Amortisation of goodwill:								
On acquisitions			(3.4)	–				
On exisiting			(3.2)	(3.3)				
Total			(6.6)	(3.3)				
Statutory operating results	760.0	452.0	35.9	21.9	4.7	4.8	68	64
Share of joint ventures			0.3	0.1				
Non-operating exceptional items			(1.6)	(1.7)				
Profit on ordinary activities before interest			34.6	20.3				

The group finances its operations through a combination of retained profits, new equity and bank borrowings. It is policy to ensure that the group has sufficient financial resources to support the business and to leave a comfortable margin between those facilities and likely peak borrowings during the year. As such, substantial committed facilities are maintained and are currently a £140 million bank facility, which has a maturity date of June 2007.

Interest rate risk is managed through the maintenance of a mixture of fixed and floating rate debt and interest rate caps, each being reviewed on a regular basis to ensure the appropriate mix is maintained.

The group's main exposures to foreign currency fluctuation arise through its activities in South Africa where both translational and transactional exposures exist. It is group policy not to cover the effects of exchange rate fluctuation on translation of the results of foreign subsidiaries into the group's base currency, sterling. All material transactional exposures arising through trading in currencies other than the operation's base currency must be eliminated by the use of forward currency cover contracts as soon as they are known of.

All treasury transactions are carried out only with prime rated counterparties as are investments of cash and cash equivalents. The group's revenue is derived mainly from government or government backed institutions or blue chip corporates and as such credit risk is considered small.

International Financial reporting standards (IFRS)

Under European legislation, we are required to adopt IAS and IFRS in preparing our Financial Statements from 1 April 2005 onwards. As a result, these Financial Statements are the last prepared under UK Generally Accepted Accounting Principles (UK GAAP).

Application of a particular standard issued by the International Accounting Standards Board (IASB) is dependent on the European Union endorsing that standard. To the extent that some standards may remain to be endorsed we have assumed that they will be so endorsed when applying them in the restatement of results for 2004/05.

The group has issued a separate announcement to the Stock Exchange summarising the effects of the adoption of the new standards on key elements of the group's Profit and Loss Account and on group net assets. This announcement is also available on our website at www.babcock.co.uk.

Although the majority of the work on the transition from UK GAAP to IAS/IFRS has been completed, certain areas of the standards are still subject to change. Consequently, further and more detailed information on the impact on Profit and Loss Account and Balance Sheet line items will be given within the next two months. The estimates provided in the announcement have not been audited.

Delivery

"We place great emphasis on the delivery aspect of the services we provide. We achieve this through careful planning and design, sharing and adapting knowledge across our business areas through the quality of our people."

The major areas of impact were outlined in our 2003/04 Financial Review and were identified as pensions accounting, goodwill and intangibles with particular reference to acquisition accounting, deferred tax, finance leases and foreign exchange hedging. Further analysis since then has shown that finance leases and foreign exchange hedging are unlikely to have a material impact but accounting for share based payments will affect earnings although not necessarily to a significant extent.

The key points to note are that the group's cash flow and its ability to pay dividends will be unaffected but that there is likely to be more volatility in the balance sheet as a result of the use of the fair value concept, particularly in applying the new standard relating to pensions, which will also result in a realignment of operating profit and interest income.

Although the presentational requirements of IFRS will differ from those currently applied under UK GAAP, the Group will continue to provide details of underlying earnings, which under IFRS will be defined as earnings before significant non-recurring items and before amortisation of acquired intangibles.

Bill Tame Group Finance Director

Directors and Company Secretary

Gordon Campbell (Age 58), Chairman
Mr Campbell has served on the Board since 10 October 2000 when he was appointed as Group Chief Executive, becoming Executive Chairman on 1 January 2001. With the separation of the roles of Chief Executive and Chairman on 1 August 2003 he became part-time Chairman. Mr Campbell is Chairman of British Nuclear Fuels plc and Chairman of Jupiter Second Split Trust plc. He is also a non-executive Director of Senior plc and a Trustee Director of the British Heart Foundation. Mr Campbell was reappointed as a Director of the company at its Annual General Meeting in July 2004. He is Chairman of the Nominations Committee of the Board.

The Rt Hon Lord Alexander Hesketh KBE (Age 54), Non-Executive Deputy Chairman
Lord Hesketh joined the Board on 6 October 1993 becoming non-executive Deputy Chairman on 26 April 1996. He is Chairman of British Mediterranean Airways Limited and is also a Director of a number of other private companies. Until very recently, he was a non-executive Director of BAE Systems PLC. 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. Throughout the year to 31 March 2005 Lord Hesketh chaired the company's Remuneration Committee, was a member of its Audit and Risk, and Nominations Committees and was its nominated Senior Independent Director. However, with effect from the forthcoming Annual General Meeting he will stand down from these committees and cease to be the nominated Senior Independent Director. He was reappointed as a Director of the company at its Annual General Meeting in July 2004 and, in accordance with the Combined Code on Corporate Governance, having served as a Director for more than nine years, he will be retiring and offering himself for re-election at the company's forthcoming Annual General Meeting in July 2005.

Peter Rogers (Age 57), Group Chief Executive Officer
Mr Rogers joined the group as Chief Operating Officer on 1 June 2002 and was appointed to the Board on 13 June 2002. On 1 August 2003 he became Group Chief Executive. He is a former Director of Courtaulds plc and Acordis BV. Mr Rogers was last reappointed as a Director of the company at its Annual General Meeting in July 2002 and will, therefore, in accordance with the company's Articles of Association, be retiring as a Director at the forthcoming Annual General Meeting in July 2005 where, being eligible to do so, he will offer himself for re-election.

William Tame (Age 50), 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 last reappointed as a Director of the company at its Annual General Meeting in July 2002 and will, therefore, in accordance with the company's Articles of Association, be retiring as a Director at the forthcoming Annual General Meeting in July 2005 where, being eligible to do so, he will offer himself for re-election.

John Rennocks (Age 59), Non-Executive Director; Chairman of the Audit and Risk Committee and nominated Senior Independent Director designate.
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 a non-executive Director of Diploma Plc, Foreign & Colonial Investment Trust PLC, JP Fleming Overseas Investment Trust PLC, Wagon PLC and Xenova Group PLC. He is Chairman of Nestor Healthcare Group PLC. Mr Rennocks is Chairman of the company's Audit and Risk Committee and is a member of its Remuneration Committee and Nominations Committee. He was last reappointed as a Director of the company at its Annual General Meeting in July 2002 and will, therefore, in accordance with the company's Articles of Association, be retiring as a Director at the forthcoming Annual General Meeting in July 2005 where, being eligible to do so, he will offer himself for re-election. With effect from the Annual General Meeting, Mr Rennocks will become the nominated Senior Independent Director.

Dipesh Shah (Age 52), Non-Executive Director
Mr Shah joined the Board as a non-executive Director on 15 June 1999. He is the Chief Executive Officer of the United Kingdom Atomic Energy Authority, and is non-executive Chairman of Viridian Group PLC. He is also a non-executive Director of IT Power Limited. He was formerly Chief Executive Officer of various businesses within BP and was a member of the DTI's Renewable Energy Advisory Committee and UK Panel for European Environmental Awards. Mr Shah is a member of the company's Audit and Risk, Remuneration and Nominations Committees. He was last reappointed as a Director of the company at its Annual General Meeting in July 2002 and will, therefore, in accordance with the company's Articles of Association, be retiring as a Director at the forthcoming Annual General Meeting in July 2005 where, being eligible to do so, he will offer himself for re-election.

Michael Turner CBE (Age 56), 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 Airbus Shareholders Committee. He is a former President of the AeroSpace and Defence Industries of Europe (ASD). Mr Turner was reappointed as a Director of the company at its Annual General Meeting in July 2003. He will be retiring as a Director on 31 December 2005, and will be standing down from the Remuneration, Nominations and Audit and Risk Committees of the Board with effect from the forthcoming Annual General Meeting in July.

Sir Nigel Essenhigh GCB (Age 60), Non-Executive Director
Sir Nigel Essenhigh joined the Board as a non-executive Director with effect from 4 March 2003 and is a member of the company's Audit and Risk, Remuneration and Nominations Committees. Until his retirement from the Royal Navy in late 2002, he was First Sea Lord and Chief of Naval Staff. He acts as an advisor to Defence Strategy & Solutions LLP and as a consultant to the Northrop Grumman Corporation. Sir Nigel was reappointed as a Director of the company at its Annual General Meeting in July 2003.

Company Secretary
Albert Dungate (Age 48)
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, Remuneration and Nominations Committees.

Directors' report

The Directors present their Report and the audited Financial Statements of the group for the year ended 31 March 2005.

Result and dividends
The profit attributable to shareholders for the financial year was £20.6 million (2004: £16.4 million). An interim dividend of 1.35p per 60p ordinary share was declared in the year (2004: 1.25p per 60p ordinary share). The Directors propose to recommend the payment on 8 August 2005 of a final dividend of 2.65p (2004: 2.1p per 60p ordinary share) on each of the ordinary shares of 60p entitled thereto and in issue on 8 July 2005.

Business review and group structure
The Chief Executive's operating statement and the Financial review on pages 4 to 15 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 62.

Acquisitions and disposals
Information regarding the group's acquisitions and disposals during the course of the year are set out in note 30 on page 59 and are also referred to in the Chief Executive's operating statement, the 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 £51,658 (2004: £38,230) 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 2005 or 31 March 2004.

Directors
Details of the present Directors are shown on page 16.

Messrs P Rogers, W Tame, D Shah and J Rennocks will retire at the company's forthcoming Annual General Meeting under the provisions of Article 92 of the company's Articles of Association, having last been reappointed as Directors at the company's Annual General Meeting in 2002. Being eligible, each offers himself for re-election at the forthcoming meeting. Lord Hesketh, having first been appointed as a Director in 1993, in accordance with the Combined Code submits himself for re-election on an annual basis and will therefore retire at the forthcoming Annual General Meeting and, being eligible, will offer himself for re-election.

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. Mr Turner is, and until 4 May 2005 Lord Hesketh was, a Director of BAE Systems plc and details of the company's transactions with that company or its subsidiaries in the year are disclosed in note 33 on page 61.

The interests of the Directors 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 2005	At 1 April 2004
G A Campbell	**49,685**	49,685
P L Rogers	**100,000**	20,000
The Rt Hon Lord Hesketh KBE	**8,249**	8,249
W Tame	**17,113**	12,113
D J Shah	**8,333**	8,333
M J Turner CBE	**16,666**	16,666
Sir Nigel Essenhigh GCB	**–**	–
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 2005 and 25 May 2005.

Details of options and awards over shares in the company granted to Directors up to 25 May 2005 are given on pages 28 and 29. Each Director holding share options or share awards is also deemed to be interested, for the purposes of sections 324 to 328 of the Companies Act 1985, in the shares held by the Babcock Employees' Share Trust, being potential beneficiaries of that trust.

Significant shareholdings
As at 25 May 2005, 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	%
Schroder Investment Management Limited	37,086,105	17.80%
Fidelity Investment Services Limited	23,843,703	11.44%
Capital Group	16,983,800	8.15%
Legal & General Investment Management Limited	7,567,698	3.63%
Mineworkers Pension Scheme	6,777,549	3.25%
Lansdowne Partners Limited	6,300,000	3.02%

Employee share schemes
In addition to the 1999 executive share option schemes and 2003 Babcock Long-Term Incentive Plan which are described in more detail in the Remuneration Report, the company has the following employee share schemes:

(i) All Employee Share Ownership Plan
This plan is open to all UK employees (including executive Directors) who meet common service criteria. It allows 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. A tax-approved employee trust holds shares on behalf of participants. The shares must generally be kept in trust for at least three years to obtain any tax advantages, and for five years to obtain maximum tax advantages. To date the company has not made an offer of free or matching shares.

(ii) Babcock International Group PLC Sharesave Scheme
This scheme was introduced in December 1997. It enables share options to be granted linked to save-as-you-earn contracts. Offers to participate must be made to all UK employees (including executive Directors). There are currently no outstanding options under the scheme. Options could be granted at a discount of up to 20% off the market price of the shares at the time of the offer.

(iii) The Babcock International Group PLC and Unapproved Executive Share Option Schemes
Grants under these schemes were not performance-linked. They are no longer operated. Options granted under them, however, continue to subsist, but no current Directors hold any. The Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme ('the 1999 Schemes') which replaced these schemes do provide for option grants to be linked to company performance, and are described in more detail in the Remuneration Report.

Employees
Further information concerning the company's approach to employee matters (including public interest disclosure and ethical standards, and its policy on disabled employees and employee involvement) is included in the company's Corporate and Social Responsibility Review appearing on pages 19 and 20.

Authority to purchase own shares
At the company's Annual General Meeting in July 2004, the shareholders authorised the company to make market purchases of up to 15 million of its own ordinary shares of 60p each. That authority will expire at the forthcoming Annual General Meeting in July 2005. Although no ordinary shares have been purchased by the company during the period from 16 July 2004 (the date of the last Annual General Meeting) to the date of this report, a resolution will be put to shareholders at the forthcoming Annual General Meeting to renew the authority to make market purchases of the company's shares up to a maximum of 10% of the company's issued share capital.

Annual General Meeting
This year's Annual General Meeting will be held at The London Marriott Marble Arch Hotel, 134 George Street, London W1H 5DN on Tuesday, 19 July 2005, at 11.30 am. The notice of meeting is on page 63 and notes on the resolutions to be proposed at it as special business are set out on page 65.

Auditors
PricewaterhouseCoopers LLP are willing to continue in office as Auditors, and resolutions to reappoint them will be proposed at the forthcoming Annual General Meeting.

Approval of report
Approved by the Directors on 25 May 2005

By Order of the Board

A N Dungate Company Secretary
25 May 2005

Corporate and Social Responsibility Review

Introduction
As a socially responsible employer Babcock recognises that effective management of business risks, service quality, health, safety and environmental impact is integral to its success and the short-term and long-term value of the group, and is of great importance to its stakeholders.

Overview
The Board takes regular account of these matters in a variety of ways.

Particular projects requiring Board approval: in evaluating these projects the Board considers, at a strategic level, the implications for the group generally, and this will include the above matters where they appear to be relevant.

The risk management process: this is described in more detail in our corporate governance report on page 23 which should be read together with this review statement. The group risk standard and risk registers address a wide range of risks – short-term, ongoing and long-term – that have implications either for particular businesses or for the group as a whole. Those risks directly or indirectly address social, environmental and ethical matters. This process is increasingly embedded within group management practices, with named individuals taking responsibility for identified risks. Principal risks, and the process itself, are regularly reviewed by the Board through the Audit Committee in the presence of both internal and external auditors who are invited to comment on the risk management process.

Policies: there are group-wide divisional policies covering employment issues, health, safety and environmental matters and ethical conduct, supplemented by division-specific policies or procedures.

Our bonus schemes are used to set objectives for key executives and relevant staff to focus attention on matters that may, if not addressed, present risks to the group's interests or on dealing with any identified weaknesses in our risk management processes; they can and do include requirements for acceptable health and safety performance.

We seek to have real and effective engagement with stakeholders: most of our businesses have a customer base that consists of a limited number of large customers with whom they maintain a continuous dialogue in which concerns about social, environmental and ethical matters can be and are raised; dialogue is maintained with our employees in a variety of ways; new whistle-blowing arrangements are in place; and our businesses seek to cultivate open and constructive relationships with relevant regulatory bodies or authorities, including the Health and Safety Executive and environmental protection agencies.

In our Corporate Governance Statement we identify out-turn on contracts and the success rate in bidding for contracts as the principal risks to the long-term value of the group. This in turn is a function not only of our ability to identify remunerative contracting opportunities and to put together successful bids (which requires close management and evaluation of the bids and appropriate training), but also of the many other factors that go to make us an attractive business partner or service provider: our reputation, our contractual performance generally, our health, safety and environmental performance and our ethical conduct. We must also keep abreast of and sensitive to our customers needs and resources and the factors influencing their decision-making processes. We must ensure that our voice is heard and an appropriate group profile maintained in discussions that could have far-reaching effects for our industries as a whole (such as the review of possibilities for the restructuring of the naval surface ship and submarine building, maintenance and refit industry that is underway in the UK – a review in which we are playing a significant part through our divisional and central business development teams).

Health and Safety
The successful management of Health and Safety is a key management objective. Our intent is to achieve the highest standards in the management of Health and Safety in all areas of our operations, not only for own employees, but also for the benefit of contractors, customers, agents, visitors and the general public. We strive to provide safe and healthy working conditions, equipment and systems of work. Where relevant, accreditation to appropriate standards is sought for each operation.

The group is fully aware of its obligations under the Health and Safety at Work etc Act 1974 and related legislation, and is fully committed to meeting those obligations. In all cases, compliance with legislative requirements is considered the minimum threshold of acceptability, with higher standards being introduced where possible and reasonably practicable.

The Board has delegated to a Corporate Safety Steering Group ('the CSSG') responsibility for the strategic overview of Health and Safety matters. The Committee also considers environmental matters. The CSSG is intended to create a mechanism for cross-business discussion of group Health and Safety Policy execution, and is charged with: creating the conditions necessary to enable the aims of the group Health and Safety Policy Statement to be achieved; keeping workplace arrangements relating to Health and Safety under review; considering new legislation and its impact on the group; reviewing serious incidents and their implications and reviewing the implementation of overall and specific Health and Safety policies. The CSSG meets three or four times a year, is staffed with senior Health and Safety representatives from the divisions and is chaired or attended by the Group Chief Executive. Divisional Managing Directors will be invited to attend certain meetings.

At the operational level, each operation is required to develop and keep up-to-date detailed Health and Safety procedures appropriate to its operations, local environment and customer base and to provide appropriate training for personnel and for non-employees where appropriate. Each division has its own specialist Health and Safety teams and advisers, and Divisional Managing Directors have overall responsibility at a divisional level for ensuring that Health and Safety management arrangements are properly carried out and resourced.

Babcock's commitment to Health and Safety can be seen in the many awards won and other recognition gained by our operations around the world, for example:

- Our BES operations at Rosyth were awarded the prestigious 'British Safety Council Sword of Honour' in 2003 and again in 2004. They have also received the British Safety Council Health and Safety Management 5 star rating as well as several British and Scottish safety awards.
- Our BIS operations have been awarded the Royal Society for the Prevention of Accidents ('RoSPA') President's Award for Health and Safety for four years running: this award is itself only given following 10 years of winning the RoSPA Golden Medal for Health and Safety.
- First Engineering won two highly commended awards at the National Rail Awards 2004, related to engineering innovation and safety management. The innovation award related to the development and design of a non-intrusive crossing system (NICS) that will deliver efficiency and safety benefits to the industry. In addition, the business was recognised for its Annual Safety Roadshow that is presented by the operational Directors of the business to every employee within the business. Also during the year, First Engineering renewed its Contractors Assurance Case with Network Rail and expanded the scope of its Railway Safety Case with Her Majesty's Railway Inspectorate (H.M.R.I.) to include High Output Track Renewals replacement activity.
- Outside the UK, our Africa operations have received awards from the National Occupational Safety Association, gaining a Gold Award in 2003 and have also received safety awards, including best SHE achievement and first place in 'excellence in safety' awards, from ESKOM, its major customer for power station services.

The environment
Babcock recognises its responsibility to be mindful of the environment and to endeavour to minimise adverse impacts of its operations through positive environmental controls. We aim to achieve the highest standards in the management of environmental matters and seek accreditation to appropriate standards where appropriate.

Operational managers are required to devise and implement policies and practices appropriate to their businesses in respect of matters over which they have operational control. As a support services provider, many of our operations are carried out on customer sites with customers retaining responsibility for environmental matters, either generally or for historical environmental conditions. At these sites we work to the environmental service levels required by customers. In other cases, customers may require us to manage operations in, or bring them into, compliance with the customer's own bespoke environmental management policies on timescales chosen by the customer.

On those sites that we do effectively own and control, such as Rosyth, we have made significant advances in environmental management. For example, since taking over management of the Rosyth Dockyard (and, later, ownership) we have spearheaded an energy efficiency campaign resulting in a 40% reduction in electricity costs at the site, a reduction year-on-year of gas consumption costs of nearly 20% despite significant price rises and a reduction in water consumption of some 35%. In South Africa we are taking steps to be in a position to obtain OHSAS18000 (Occupational Health & Safety specification) together with ISO90001 (Quality) and ISO14001 (Environmental) certificates, by the end of 2005.

Ethical conduct and whistle-blowing
We insist on the highest standards of honesty and integrity in all aspects of the group's business. This includes 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, which we believe complies with international standards, is issued to relevant group employees. Employees are required to avoid conflicts of interest regarding group business, to act lawfully and ethically and to communicate non-compliance issues of which they become aware.

During the year we carried out a review of our whistle-blowing arrangements both to ensure ongoing compliance with the Public Interest Disclosure Act 1988 in the UK, and also as part of a review of our internal control procedures. As a result we have implemented new group-wide arrangements for employees to be able to communicate concerns in confidence about possible improprieties in matters of financial reporting and other matters. An external provider has been retained to provide a confidential telephone hotline service. All employees are provided with the number of this service at which they can leave recorded messages, which may be anonymous. The message is relayed as soon as possible to senior group management in head office who will follow up the matter. Where appropriate, a reply can be provided to the employee via the service with the employee calling in to receive the recorded response in a way that will maintain the employee's anonymity.

Employees
In common with all businesses, ensuring that we have high quality, suitably trained management is a key risk management objective. Historically, management training and development programmes were organised at business level, but following a major review of management development needs for our senior and middle managers we will this year be fully implementing externally-provided, but group administered, management development programmes to ensure that we have a consistent and focused approach to meeting the future needs of our businesses. Our divisional businesses will continue to supplement this training and organise business-specific training through their own programmes.

We continue to use and develop a variety of means to improve communications with our employees. As well as using traditional cascade briefings and divisional newsletters, we issue group-wide publications giving an overview of the progress of and significant issues affecting our individual businesses. In the UK, we have also established a group-wide Employee Forum for Consultation and Information that will be up and running during this financial year. The Forum will be a means for keeping employees informed of major developments and issues affecting the group and for hearing their views, with elected representatives attending from our UK operations.

As a group we have non-discriminatory employment policies. Full consideration is given 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, wherever possible, the continued provision of suitable employment either in the same or an alternative position, with appropriate training being given if necessary.

In the year ended 31 March 2005 Babcock International Group PLC employed an average of 9,088 staff worldwide, of whom approximately 89.7% were located in the United Kingdom.

Babcock in the community
Our business divisions and group headquarters support a range of charitable and community projects in their local areas.

For example, in South Africa our business is involved in a training programme for previously disadvantaged children leading to qualification as equipment mechanics, with the trainees being employed in the business throughout their training and having the opportunity upon qualification to remain with the company. Babcock Africa is also reviewing the possibility of establishing a social responsibility fund to focus on health and education for the disadvantaged. In Scotland, our Babcock Naval Services business has established a Community Investment Group with a view to supporting the local community in education, regeneration and environmental areas. It is also on the Steering Committee of the Dunbartonshire 'Enterprise in Education through Business Links' programme and supports Young Enterprise Programmes in local schools.

P L Rogers Group Chief Executive
25 May 2005

Statement on Corporate Governance

Statement of compliance with the Combined Code

During the year ended 31 March 2005 the company complied with the provisions of section 1 of The Combined Code on Corporate Governance 2003 (the 'Combined Code') considering as it did that all its non-executive Directors were to be regarded as independent in that year. Set out in the Statement on Corporate Governance in the company's financial statements for the year ended 31 March 2004 were the reasons why the Board took the view that, despite his having served on the Board for over nine years. Lord Hesketh was nonetheless regarded by them as independent; namely that '[he is] a man of considerable and robust independence of thought and expression with no connections with the executive Directors'. Lord Hesketh served on the Remuneration Committee (of which he was Chairman) and also the Audit Committee throughout the year. However, although the Combined Code itself does not deem a Director with service of more than nine years to be non-independent in all cases, the Board is aware that some shareholders adopt a different view. In recognition of that view, Lord Hesketh, with effect from the forthcoming Annual General Meeting, will stand down from membership of those Committees and will no longer be nominated as the Senior Independent Director. Mr Turner, who will shortly achieve nine years of service, will be retiring as a Director on 31 December 2005 and in the meantime will stand down from membership of Board committees with effect from the forthcoming Annual General Meeting.

This statement sets out how the principles of good governance in the Combined Code have been implemented.

Board, Directors and Independence

Chairman and Chief Executive Functions; Senior Independent Director

There is a clear division of responsibilities between the Chairman and Group Chief Executive which is set out in a statement of their respective roles and responsibilities approved by the Board. During the year Lord Hesketh was recognised by the Board as the Senior Independent Director to whom concerns could be conveyed by shareholders if they had concerns which had not been resolved through the normal channels of Chairman, Chief Executive or Finance Director. For the reasons stated above, from the forthcoming Annual General Meeting the role of Senior Independent Director will be assumed by Mr John Rennocks.

The Board

It is a main principle of the Combined Code that Boards should be balanced between executives and non-executives (and, in particular, independent non-executives) such that no individual or small group of individuals can dominate the Board's decision taking, and also that there should be progressive refreshing of the Board. The Board considers that it complies with both principles.

Refreshing of the Board

In the past five years the executive team has changed completely, a long-standing independent non-executive Director retired in 2002, two new independent non-executive Directors have been appointed, one in 2002 the other in 2003 and a further long-standing non-executive Director, Mr Turner, will be retiring at the end of 2005. It is the intention to appoint a new non-executive Director as soon as possible.

Board Balance

During the year under review the Board comprised of a part-time Chairman, two full-time executive Directors and five non-executive Directors four of whom were independent even if Lord Hesketh were not to be so regarded. The Board believes that it has an appropriate balance of Directors with longer, medium and shorter term service and that their respective backgrounds and experience are such as to provide an appropriate range of skills, knowledge and experience to the Board.

Five board members will be offering themselves for re-election at the forthcoming Annual General Meeting. Three of them are non-executive Directors including Lord Hesketh who, if re-elected, will continue to offer himself for re-election annually as required by the Combined Code in view of his length of service. The Board sets out in the Accompanying Notes to the Notice of Annual General Meeting on page 65 why it is recommending re-election of those non-executive Directors and the Chairman confirms in those notes, as required by the Combined Code, that, having formally evaluated their performance, the Board is of the view that they continue to be effective and to demonstrate commitment to their roles, including commitment of time for Board and, where applicable, committee meetings and other duties.

Independent non-executives

As for the non-executive Directors other than Lord Hesketh (whose position is dealt with above) the Board considered Mr Turner, Mr Shah, Sir Nigel Essenhigh and John Rennocks, to be independent. Mr Turner is an executive Director of BAE Systems plc and until 4 May 2005, Lord Hesketh was a non-executive Director of that company. The Directors (and in particular the other non-executive Directors) do not consider this common directorship to have in any way affected the independence of Lord Hesketh or Mr Turner in their capacities as non-executive Directors of the company.

All Directors have full and timely access to information.

The company's Articles of Association require that each Director must submit himself for re-election at least every three years. It is the company's policy to review rigorously the re-appointment of non-executive Directors who have served more than six years on the Board.

There were seven scheduled Board meetings in the financial year under review. Lord Hesketh was unable to attend on one occasion and Mr Rennocks on two occasions, the other Directors attended all such meetings. In addition to the scheduled formal Board meetings, there are ad hoc meetings of Board Committees of two or more Directors established for particular matters (for example in connection with the acquisition of Peterhouse Group plc) or to deal with matters in accordance with delegated authorities.

Before each scheduled Board meeting, the Chairman usually chairs a meeting at which only he and the non-executive Directors are present so as to be able to discuss matters without executive management present.

An evaluation of the performance of the Board as a whole, its committees and individual Directors for the year under review has been undertaken. An independent facilitator was retained to conduct individual confidential interviews with each of the Board members and the company secretary. The views expressed in those interviews were summarised and reported to the Chairman who in turn transmitted them to the Board for discussion. The performance of the Chairman was evaluated during the year by the non-executive Directors, led by the Senior Independent Director.

Change in Chairman's significant external commitments

During the year Mr Campbell became the Chairman of British Nuclear Fuels plc, of which he was already a non-executive Director, and was appointed as a non-executive Director of Senior plc. Since the year-end he has resigned from the Board of iti Scotland Limited of which he was Chairman.

Board Committees – the Audit and Risk Committee

For the year under review, the Board's Audit and Risk Committee consisted throughout the year of all the non-executive Directors considered by the Board to be independent:

Committee membership

J L Rennocks (Committee Chairman)
D J Shah
M J Turner
Sir Nigel Essenhigh
The Rt Hon Lord Hesketh

The Chairman, Mr Rennocks, is a former Finance Director of Corus Group PLC, and is considered by the Board to have the necessary recent and relevant financial experience for the role.

Biographical details of the members of the Committee are set out on page 16.

The Committee has formal terms of reference that are available on the company's website. Committee meetings are attended, at the invitation of the Committee, by the Group Chairman, Group Chief Executive Officer and the Group Finance Director and also by staff from the Group Finance department. The Company Secretary acts as secretary to the Committee. The Group Risk Manager is invited to attend meetings for discussion of group risk reports and related items. Ernst & Young LLP, who provide internal audit services to the company, and PricewaterhouseCoopers LLP, the group's external auditors, attend for the whole of the meetings. Committee members have the opportunity to meet the auditors (internal and external) in the absence of executive Directors and group employees, and the Committee Chairman has during the year met PricewaterhouseCoopers LLP in the absence of executive management.

The Committee met formally four times in the year under review. Mr Turner and Lord Hesketh were each unable to attend two of those meetings. Mr Rennocks, Mr Shah and Sir Nigel Essenhigh attended all committee meetings. At its meetings for the year ended 31 March 2005, the Committee:

- reviewed the preliminary and interim results and the proposed announcements relating to them;
- reviewed the Financial Statements for the year ended 31 March 2004 and the half-year ended 30 September 2004, and internal and external auditors' comments in connection with them;
- evaluated the effectiveness of internal controls, and their extension to the companies acquired on the acquisition of Peterhouse Group plc;
- considered the impact of and state of planning and readiness for the introduction of International Financial Reporting Standards;
- considered internal audit reports from Ernst & Young LLP and external audit/review reports from PricewaterhouseCoopers LLP;
- considered the levels of audit fees and non-audit fees paid to auditors;
- agreed internal and external audit plans;
- reviewed controls for access to IT systems;
- reviewed generally (and, for selected matters, in depth), the group risk standard and its implementation, together with group risk reports;
- conducted a going concern review.

Whistle-blowing

During the year, new arrangements for staff to raise concerns in confidence about possible improprieties in matters of financial reporting and other matters were introduced. These arrangements have been reviewed by the Committee and are described in the Corporate and Social Responsibility Review on page 20.

Non-audit fees

In order to safeguard the objectivity and independence of the company's external auditors, the Audit and Risk Committee Chairman must expressly authorise any engagement of those auditors on non-audit work that would entail their being paid fees in excess of 20% of the audit fee in any year. Careful consideration is given on each occasion as to potential conflicts and the possibility of actual or perceived threats to the independence of the external auditors before instructing them in connection with non-audit work. Instructions are given only when the company considers it to be in its best interests to use the external auditors other than in connection with pure audit services.

Board Committees – the Remuneration Committee and the Nominations Committee

Full details of the membership of the Remuneration Committee and its report for the year under review are set out in the Remuneration Report on page 24. Throughout the year the Committee comprised of all the non-executive Directors considered by the Board to be independent, with Lord Hesketh as Chairman. The Committee met formally on three occasions in the year. Lord Hesketh and John Rennocks were unable to attend one meeting but otherwise each of the Committee members attended all of these meetings although attendance at one by Mr Turner was for only part of the time. Until January 2005 the Remuneration Committee also encompassed within its terms of reference (available on the company's website) the role of a Nominations Committee. In January 2005 the Board established a separate Nominations Committee. Membership of this Committee is open to all the non-executive Directors provided there is a majority of independent non-executive Directors. The group Chairman chairs the Committee. Its terms of reference are available on the company's website. Mr Turner and Lord Hesketh will step down from membership of the Committee with effect from the forthcoming Annual General Meeting. During the year there were no new Board appointments or changes to the roles of the Directors that needed consideration by a Nominations Committee and no separate meetings of the new Nominations Committee were held between its establishment in January and 31 March 2005. The Board has requested that a full succession planning review be carried out, initially by management, for review by the Nominations Committee in the first half of the current financial year in order to satisfy itself that succession plans are up-to-date following the acquisition of the Peterhouse Group.

Contact with shareholders

The company has regular contact with its shareholders, both institutional and individual, typically involving the Chairman and/or the Group Chief Executive Officer and/or the Group Finance Director. Reports of these meetings and general feedback from investors or the market are made to the Board and non-executive Directors are provided with copies of analysts' and brokers' reports. The Annual General Meeting is used as an important opportunity for communication with shareholders. All of the company's Directors other than Lord Hesketh and John Rennocks attended the 2004 Annual General Meeting. The company's website is also available for shareholders to keep themselves advised of developments. It is regularly updated with press releases and analyst presentations. Shareholders can register on the website to be sent news releases automatically.

Information and training for Directors

It is the company's practice to arrange for new non-executive Directors to make induction visits to the group's principal operations or to be provided with information about them. Non-executive Directors may at any time make visits to group businesses or operational sites. Detailed presentations on each of the group's divisions are made on a rolling basis to the Group Board, and non-executive Directors receive copies of all minutes of meetings of the Group Executive Committee and of the monthly operating reports sent to the group head office by the business operations. General Director training is arranged on request and non-executive Directors are from time to time advised of seminars or briefings run by external providers that are considered to be of potential interest or relevance, for which the company is willing to pay. Non-executive Directors who serve or who have served on boards of other public companies are also exposed to a broad range of experience of the performance of the duties of a non-executive Director.

Accountability and audit

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 are written statements as to matters that have been delegated by the Board to committees or particular Directors. Whilst delegating certain of its day-to-day powers to executive management including powers, within prescribed limits, to authorise borrowings and give guarantees, the Board retains responsibility for major matters such as setting overall strategy, approving annual budgets, equity investments, business acquisitions and disposals, significant contracts outside the ordinary course of business and treasury policy. The retention of such powers is with a view to ensuring that the Board and/or its Committees maintain effective control over appropriate strategic, financial, organisational and compliance issues.

There has been a process for identifying, evaluating and managing significant risks throughout the period under review and up to the date of the approval of the Financial Statements for that year, and the Audit Committee has reviewed the effectiveness of this process. 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 has an established system of internal control comprising principally of:

- a risk identification, evaluation and management process (described below);
- clear delegations and limits of authority;
- clear authorisation and review procedures;
- internal audits;
- regular review by the Audit Committee of risk registers and internal and external audit reports;
- regular divisional operating reviews attended by group executive management;
- regular contract review meetings.

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. The group has a Group Risk Manager, reporting directly to the Group Finance Director, who oversees a group Risk Standard that has been promulgated across the organisation requiring 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. Group risk registers are compiled from this information and are regularly reviewed by the Audit and Risk Committee. The Committee has also requested that major risks be reported upon in more detail on a rolling basis.

Given the nature of the group's businesses, the principal business 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 Group Chief Executive Officer, Group Finance Director, Divisional Managing Directors and representatives from other central functions. It usually meets monthly, but will also meet on an ad hoc basis if needed. 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 quarterly by group Head Office. In addition to the Bid Executive meetings, there are regular monthly meetings of a Group Executive Committee consisting of the Group Chief Executive Officer, the Group Finance Director, Divisional Managing Directors, the Company Secretary and General Counsel and the Group Business Development Director. It considers the ongoing conduct and performance of the group's business and reviews key commercial issues and other key matters, including a high level review of health and safety performance.

Information and communication

Comprehensive budgeting systems are in place to develop annual budgets and medium term financial plans. The budgets are subject to review by central management prior to submission to the Board for approval. Updated forecasts for the year are prepared on a regular basis. Actual performance is compared each month with budgets, forecasts and the prior year, with written commentary on significant variances from approved plans.

Monitoring

For the year under review, the internal control system was monitored by means of review visits from group management supplemented by an internal audit service provided by Ernst & Young LLP acting under the overall control of the Audit and Risk Committee, which determines its areas of focus.

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. The work carried out by the auditors does not include consideration of these matters, and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Remuneration report

Remuneration report
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 submitted for approval at the forthcoming Annual General Meeting of the company.

Remuneration Committee
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 considered to be independent by the Board. Those Directors who served on the Committee during the year under review (in each case they served for the whole year), were:

The Rt Hon Lord Hesketh (Committee Chairman)
D J Shah
M J Turner
J L Rennocks
Sir Nigel Essenhigh

Lord Hesketh and Mr Turner will stand down from the Committee with effect from the forthcoming Annual General Meeting in July.

Biographical details of the members of the Committee are set out on page 16.

The Committee invites Mr Campbell and Mr Rogers to attend meetings in their capacities as Chairman and Group Chief Executive respectively, but neither is present when their own remuneration is under discussion. The Company Secretary 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 and Mr Rogers (other than in respect of their own remuneration), in connection with the structuring and operation of share awards and share schemes from Pinsent Masons (solicitors with recognised expertise and experience in executive and employee share schemes) and, for advice on executive Director remuneration (including in relation to share options and long-term incentive plans) from Inbucon Limited (remuneration consultants). Pinsent Masons also provide legal services to group companies. Inbucon Limited does not provide other services to group companies. Both firms have been appointed for these purposes, with the Committee's approval, by the company (acting through the Group Company Secretary).

Remuneration policy

Basic policy
The remuneration policy of the Committee is normally to provide executive Directors and senior executives with basic remuneration packages that, looked at as a whole, are competitive having regard to companies of a similar size in business sectors in which the group operates. The policy provides an opportunity to earn upper quartile rewards for upper quartile performance, and facilitates the recruitment, retention and motivation of executives in the light of the company's needs and development objectives.

Remuneration packages for executive Directors 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 long-term incentive schemes, including grants of options under share option schemes and awards of shares under the 2003 Long-Term Incentive Plan (L-TIP). This report describes the various elements of the packages for each of Mr Campbell, Mr Rogers and Mr Tame for the year under review.

The company required extra services from Mr Campbell during the year, significantly beyond his contractual requirements, in connection with the offer process for the acquisition of Peterhouse Group plc and the subsequent initial stages of the merger. The Committee determined to compensate him for those additional services in the amount of £250,000.

For the year, the performance-related elements of their packages consisted, for Mr Rogers and Mr Tame, of annual bonus schemes (the value of which was capped as described below) and, for each of Mr Campbell, Mr Rogers and Mr Tame, share awards under the L-TIP. Remuneration advice from Inbucon Limited indicates that our remuneration structure for executive Directors is consistent with mid-market practice amongst UK companies of comparable size. The Committee is sensitive to the need to set Directors' remuneration having regard to pay and conditions in the group as a whole and is satisfied that the approach taken by the company is fair and reasonable, compatible with current market practice and in the best interest of the shareholders.

The Board encourages executive Directors to use company shares acquired under option or LTIP schemes, over time, to build and maintain a personal holding of shares equivalent in value to around a year's basic salary.

Performance-related rewards:

Annual bonus schemes:
The Remuneration Committee determines a performance-related annual bonus scheme for Mr Rogers and Mr Tame at the beginning of each financial year. For the year ended 31 March 2005 the annual bonus payable to them was dependent on the profit before tax (pre-exceptionals and goodwill amortisation) achieved by the group against budget. A 15% bonus is awarded for on-target performance rising to a maximum of 40% according to the level of out-performance of target. A bonus of up to 10% of salary is also payable for personal performance and achievement of non-financial personal objectives. The maximum potential annual bonus for each of them is, therefore, 50% of basic salary. The financial targets were adjusted to take account of the acquisition of Peterhouse Group Plc towards the end of the first quarter of the year under review. Similar schemes are in place for Mr Rogers and Mr Tame for the current financial year. Annual bonuses are not pensionable. Mr Campbell has no contractual entitlement to an annual bonus.

Long-term incentives:
Since 1 April 2003 executive share options are no longer granted to executive Directors: they receive awards under the L-TIP, further information about which appears below.

Share options:
Executive Directors hold share options granted before April 2003 under the Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme ('the 1999 Schemes') and, in the case of Mr Campbell and Mr Rogers, under option agreements (described further on page 28) which were subject to performance criteria as described below.

Details of executive share options and share awards under the L-TIP already granted to Directors are set out in the tables on pages 28 and 29.

Relative importance of variable and fixed pay
Variable, performance-related remuneration represents approximately one-third of the total remuneration package for Mr Rogers and Mr Tame, and one-fifth for Mr Campbell, if the company achieves its financial performance target for a given year and if share awards made in that year vest at minimum. If maximum annual bonus is achieved due to out-performance of target for a given year and there is full vesting of the share award made for that year, the proportions increase to approximately two-thirds and a half respectively. This assumes that the value of vested shares remains the same as on the date of award. To the extent that those shares increase in value the proportion of variable pay will increase.

Long-Term Incentive Plan (L-TIP)

In 2003 shareholders approved the establishment of a long-term incentive plan (L-TIP) under which share-based awards may be made to executive Directors and other senior executives. Awards made under the L-TIP can be made as rights (structured as nil-cost options) to acquire shares granted either by the company or by the trustees of The Babcock Employees' Share Trust or the Peterhouse Employee Benefit Trust acting on the recommendation of the Committee.

Under the L-TIP, executive Directors and other selected senior executives 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 policy that such awards are made only to executive Directors of the company and a limited number of other senior executives who are key to the group. The initial market value of the shares over which any such award is made in any year may be up to 100% of the amount of the participant's basic annual salary at the date of grant (save as may be adjusted to reflect the payment of employer's National Insurance).

Performance Targets: L-TIP share awards and option grants under the 1999 Schemes

Performance targets are set by the Committee when options are granted or share awards made, having regard to current market conditions and in the light of the need to ensure that such awards serve the purpose of motivating and retaining key staff. Vesting of share awards or option grants is according to the extent to which those targets are met or exceeded.

For both share awards under the L-TIP and option grants under the 1999 Schemes the performance period is effectively a period of three financial years commencing with the financial year in which the award is made or option granted, and performance is measured as at the end of that period. There is no retesting of performance.

Review of performance measures

Options granted under the 1999 Schemes were made subject to a comparative Total Shareholder Return ('TSR') performance measure requiring the company's TSR performance over the performance period to be compared to that of a specified comparator group. For options granted before 2003 the comparator group was the companies who at the date of grant comprised the FTSE Engineering and Machinery Sector, in which the company then appeared. For grants in 2003 and 2004 the comparator group was all those companies comprising the FTSE All Share Index (other than investment trusts) on the date of grant. The performance test provided that there would be no vesting unless the company's ranking at the end of the performance period was at least immediately above median in which case 25% of the options would vest, with 100% vesting for top quartile ranking and proportionate vesting on a straight-line basis for a ranking between those points.

For the 2003 and 2004 L-TIP awards an additional precondition to vesting was imposed – there could be no vesting unless the company's earnings per share (pre-goodwill amortisation and exceptional items) in the third year of the performance period was at least 9.27% (representing a 3% per annum compound growth rate) greater than the basic earnings per share (pre-goodwill and exceptional items) for the financial year immediately preceding the financial year in which the award was made.

At the time of the share awards and option grants in 2003 and 2004 the Remuneration Committee considered that using the companies comprising the FTSE All-Share Index (other than investment trusts) as the comparator group was an appropriate measure. When those awards were made the company had moved from its classification in the FTSE Engineering and Machinery Index at the end of 2002, but had a support services offering that was fairly narrowly defined with a heavy reliance on business with the Ministry of Defence. It was not easy to compare the company with other support sector companies as it had not fully completed and integrated the further strategic acquisition in support services that had been under consideration for some time (which was realised with the acquisition of Peterhouse Group plc only shortly before the 2004 awards were made).

With the integration of the Peterhouse businesses, the Remuneration Committee sought advice from Inbucon Limited as to new appropriate performance measures to be attached to both L-TIP share awards and share option grants, given the need both to align Directors' and senior executives' interests with shareholders and to make them genuinely helpful in incentivising and retaining those Directors and senior executives. The company believed that completion of the Peterhouse acquisition, which broadened the company's support services offering, allowed for a more appropriately defined list of comparator companies to be identified.

The review concluded that the objectives of retention and motivation and alignment with shareholder interests can be served by having share awards under the L-TIP vest partly according to comparative performance measured against a group of companies with similar businesses (see below) and partly according to challenging growth in earnings per share ('eps'). This approach will be taken with any share awards made under the L-TIP in the current financial year and the same approach will be applied to the awards made in 2004 (which are only one-third of the way through their performance period and were made almost simultaneously with the completion of the Peterhouse acquisition). 50% of the Award Shares will vest according to comparative TSR performance and 50% according to eps growth. In each case the performance period will be the period of three financial years commencing with the financial year in which the award is made, and performance will be measured as at the end of the period.

To the extent that vesting depends on comparative TSR performance a ranking immediately above the median level in the comparator table will result in 25% of the relevant Award Shares vesting and a ranking in the top quartile would result in 100% vesting. Rankings between these threshold levels would result in proportionate vesting calculated on a straight-line basis between 25% and 100%. The comparator group of listed companies for the 2004 awards and any awards made in the current financial year is:

AEA Technology, W.S. Atkins, Aggreko, Amec, Bodycote, Capita, Carillion, Cobham, Interserve, Laing (John), Mitie, Mouchel-Parkman, PHS Group, Rentokil Initial, Serco, VT Group, and WSP Group.

These companies were selected in consultation with Inbucon Limited as being an appropriate range of support services providers against which to compare the company given the nature of its and their businesses.

To the extent that vesting depends on eps growth, 25% of the award will vest if eps growth (adjusted to exclude exceptional items and goodwill amortisation), over the performance period, is equivalent to a real compound annual growth rate of 4%, with full vesting if this reaches 8%. Vesting will be on a straight-line basis between these two points. International Financial Reporting Standards will be taken into account in both the opening position (which may have to be restated) and the assessment of performance.

The review also concluded that share options granted in the current financial year and those granted in 2004 should have a performance test consisting solely of the above eps test, rather than a TSR performance measure. This does not affect executive Directors as no such options were or will be granted to them.

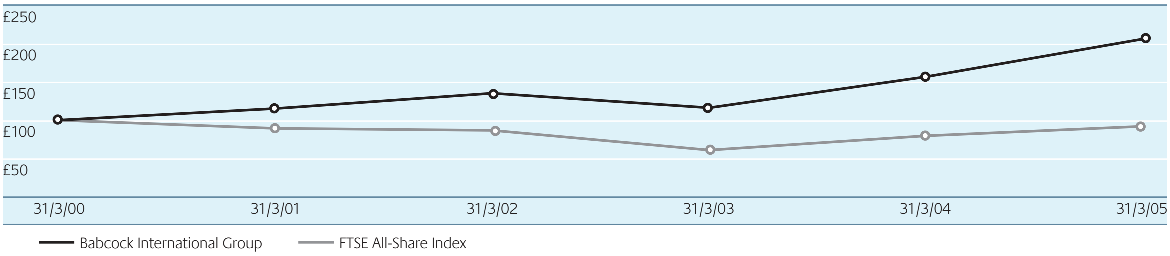
Further details of the rules of the L-TIP and the 1999 Schemes are set out below the tables on pages 28 and 29.

Performance graph

The graph below, compiled by Inbucon Limited, shows the total shareholder return for a holding in the company's shares for the period from 31 March 2000 to 31 March 2005 relative to a holding of shares representing the FTSE All-Share Index (excluding investment trusts). This is the same index as has been used for this purpose in earlier Remuneration Reports, being a broad index that allows comparison of the company's performance against the performance of the stock market as a whole.

Total Shareholder Return: Babcock International Group vs FTSE All-Share Index (excluding Investment Trusts) and FTSE Services Index

Cumulative Total Shareholder Return Value of £100 investment on 31 March 2000



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 their 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. Mr Tame is currently a member of the company's defined benefit scheme and benefits from a FURBS. Neither Mr Campbell nor Mr Rogers receive pensions benefits from the company, and their salaries take this into account.

The company is aware of the proposed changes to the taxation of pensions that will come into effect in April 2006. The company's policy is to remain competitive in the marketplace to attract and retain the calibre of employee it needs. Subject to that, it is not the company's policy to compensate employees for tax changes.

A summary of Directors' pension entitlements is set out at page 27.

Non-executive Directors

It is currently 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 (audited)

The Directors' emoluments for the year ended 31 March 2005 are set out in the table below:

Director	Salary or fee £'000	Annual bonus* £'000	Benefits** in kind £'000	Total Year ended 31 March 2005 £'000	Total Year ended 31 March 2004 £'000
Executive					
G A Campbell (Chairman, part-time from 1 August 2003)	218	250	1	469	289
P L Rogers (Chief Executive Officer)	378	177	22	577	526
W Tame (Group Finance Director)	228	103	20	351	343
Non-executive					
The Rt Hon Lord Hesketh KBE	52	–	–	52	52
J Rennocks	32	–	–	32	32
D J Shah	27	–	–	27	27
M J Turner CBE	27	–	–	27	27
Sir Nigel Essenhigh	27	–	2	29	28
Total	989	530	45	1,564	1,324

*The amount shown for Mr Campbell represents extra remuneration for the additional services he provided in respect of the acquisition and integration of Peterhouse Group Plc as explained on page 24 which does not form part of his regular remuneration.
**Benefits comprised medical insurance, home to work expenses and accommodation expenses for Mr Rogers and for Mr Tame. In addition Mr Tame had contributions to FURBS. Mr Campbell had home to work expenses reimbursed.

The fees for Lord Hesketh reflect his additional duties as Deputy Chairman and as Chairman of the Remuneration Committee. Mr Rennocks' fees reflect his additional duties as Chairman of the Audit and Risk Committee.

Bonus payments and benefits in kind are not pensionable.

Directors' pensions (audited)

Babcock International Group Pension Scheme
Mr Tame is a member of the upper tier of the Babcock International Group Pension Scheme.

Directors' pension entitlements under the Babcock International Group Pension Scheme (defined benefit) are set out in the following table:

Director	Accrued pension at 31 March 2005 £ pa	Increase in accrued benefits excluding inflation during the year ended 31 March 2005 £ pa	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2004 £	Transfer value at 31 March 2005 £	Transfer value of increase in accrued benefits less director's contributions £	Increase in transfer value less director's contributions £
W Tame	**11,178**	**3,629**	3,395	86,511	**138,863**	29,276	42,102

(1) Inflation has been taken as 3.1% 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 no account has been taken of any retained benefits which he 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 (audited)

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	2005 £'000	2004 £'000
W Tame	**11**	10

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 (audited)

Details of Directors' share options are set out in the table below and the notes beneath it:

Director	Option scheme	Number of shares subject to options at 1 April 2004	Granted during the year	Exercised during the year	Lapsed during the year	**Number of shares subject to options at 31 March 2005***	Exercise price (pence)	Exercisable (subject to vesting where not yet vested) from	Expiry date
G A Campbell	a	560,975	–	–	–	***560,975***	123.00	Nov 2003	Nov 2010
	b	30,202	–	–	7,853	***22,349***	99.33	Jun 2004	Jun 2011
	c	282,573	–	–	73,469	***209,104***	99.33	Jun 2004	Jun 2011
	c	317,590	–	–	–	**317,590**	124.50	Jun 2005	Jun 2012
P L Rogers	a	401,606	–	–	–	**401,606**	124.50	Jun 2005	Jun 2012
W Tame	b	28,754	–	–	7,476	***21,278***	104.33	Jan 2005	Jan 2012
	c	201,285	–	–	52,334	***148,951***	104.33	Jan 2005	Jan 2012
	c	198,125	–	–	–	**198,125**	124.50	Jun 2005	Jun 2012

*Those shown in italics are vested.
Where:
a = Share Option Agreement.
b = Babcock 1999 Approved Executive Share Option Scheme.
c = Babcock 1999 Unapproved Executive Share Option Scheme.
During the year, a former Director, Mr M Easton, exercised the outstanding options held by him of 17,232 shares at an option exercise price of 99.33p per share. The mid-market closing price for the shares on the date he exercised the options was 133.0p.

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

The exercise prices of the options granted under the company's executive share options schemes were not set at a discount to the market value of the company's shares at the date of grant, 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 dealing days immediately preceding the grant date.

Directors may, subject to vesting in accordance with the applicable performance criteria, exercise options granted under the 1999 Schemes between the third and tenth anniversary of the date of grant. Subject to the rules of the schemes, options may be exercised earlier in other circumstances such as on leaving the group in certain circumstances or in the event of a change of control, but normally of not more than a time-apportioned proportion and then only having regard to the company's performance.

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 (comparator group: Engineering and Machinery section of the FTSE All-Share Index mentioned on page 26 above as applying to share options granted under the 1999 schemes before 2003). 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.

Directors' share awards Under the L-TIP (audited)
Details of share awards made to Directors are set out in the table below:

Director	Number of shares subject to award at 1 April 2004	Granted during the year	Exercised during the year	Lapsed during the year	**Number of shares subject to award at 31 March 2005**	Market value of each share at date of award	Exercisable (subject to vesting) from	Expiry date
G A Campbell	167,400	–	–	–	**167,400**	113.5	Jul 2006	Jul 2013
	–	158,730	–	–	**158,730**	126.0	Jul 2007	Jul 2014
P L Rogers	255,506	–	–	–	**255,506**	113.5	Jul 2006	Jul 2013
	–	281,746	–	–	**281,746**	126.0	Jul 2007	Jul 2014
W Tame	171,806	–	–		**171,806**	113.5	Jul 2006	Jul 2013
	–	162,698	–	–	**162,698**	126.0	Jul 2007	Jul 2014

None of the awards have so far vested.

The awards were made, by the trustee of the Babcock Employee Share Trust, as conditional rights to acquire shares (effectively nil cost options), and the number of shares awarded was based on the average of the mid-market closing price of the company's shares for the three business days preceding the date of the award. For each of Mr Rogers and Mr Tame the value of the awards on grant was equivalent to his annual salary at the date of grant. For Mr Campbell the award in 2003 was equivalent to his anticipated annual salary as part-time Chairman which took effect on 1 August 2003. The value of his award in 2004 was equivalent to his annual salary at the date of the award. Subject to satisfaction of the performance criteria (see page 25) attached to the awards, the Directors may call for the release to them of the shares subject to the award during the above shown exercise periods. Subject to the rules of the plan, an earlier release of shares may be allowed by the Remuneration Committee (for example, in the event of a cessation of employment or a change in control) but normally of not more than a time-apportioned proportion and then only having regard to the company's performance.

There were no changes in the current Directors' share options or share awards between 31 March 2005 and 25 May 2005.

The company's mid-market share price at close of business on 31 March 2005 was 149.0p. The highest and lowest mid-market share prices in the year ended 31 March 2005 were 151.0p and 104.25p respectively.

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

Executive Directors

Name	Date of service contract	Unexpired term	Notice period
G A Campbell	31 July 2003 (amended by letter dated 5 May 2004)	12 months	12 months from company, six months from Director
P L Rogers	31 July 2003 (amended by letter dated 5 May 2004)	12 months	12 months from company, six months from Director
W Tame	20 September 2001 (amended by letter dated 5 May 2004)	12 months	12 months from company, six months from Director

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 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, in the case of Mr Rogers and Mr Tame, an additional 40% in lieu of bonus and all other benefits). If, however, the Director exercises his right to terminate his employment contract within 90 days of a change of control, he will only be entitled to be paid, for up to a period of 12 months, on a monthly basis, his basic salary (plus, in the case of Mr Rogers and Mr Tame, 40% in lieu of bonus and all other contractual entitlements) but any amount that they receive by way of income from other sources within that 12 month period, if it exceeds 10% of their salary, that they would not have been able to earn had they continued in employment with the company is deductible from the amounts otherwise payable by the company. 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. Save as mentioned above, the contracts do not contain provisions for contractual payments on termination.

Non-executive Directors

Name	Date of appointment as a Director	Expiry of present term of appointment*
Lord Hesketh	6 October 1993	AGM for 2006
M J Turner	5 June 1996	31 December 2005
D J Shah	15 June 1999	AGM for 2007
J L Rennocks	13 June 2002	AGM for 2008
Sir Nigel Essenhigh	4 March 2003	AGM for 2007

*Subject in each case to re-election as required by the company's Articles of Association and/or the Combined Code.

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. All non-executive Directors (other than Mr Turner) now have terms of appointment expiring at an Annual General Meeting. Non-executive Directors are free to resign at any time. The written terms of appointment are available for inspection at the company's registered office and at the company's Annual General Meeting. The expected time commitment of non-executive Directors is either set out in their current written terms of appointment (if they have recently been issued to them) or is known, by experience, to the Directors concerned.

Outside directorships

The company considers that it can often be 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. Neither Mr Rogers nor Mr Tame have yet been released by the company to work as non-executive Directors elsewhere. Mr Campbell is employed by the company in a part-time capacity only and his earnings from any non-executive directorships in other companies held by him are earned in time not committed to the company.

This report has been approved by the Board and signed on its behalf by

Lord Hesketh Chairman of the Remuneration Committee
25 May 2005

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

We have audited the Financial Statements of Babcock International Group PLC which comprise the Profit and loss account, Balance sheet, the Cash flow statement, the Statement of total recognised gains and losses and Reconciliation of movement in shareholders' funds and the related notes numbered 1 to 34, 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 nine provisions of the 2003 FRC 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 and the auditable part of the Directors' remuneration report 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 2005 and of the profit and cash flows of the group 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
Embankment Place
London WC2N 6RH

25 May 2005

Group profit and loss account

For the year ended 31 March 2005

	Notes	2005 Before goodwill and exceptional items £m	2005 Goodwill and exceptional items £m	2005 Total £m	2004 Before goodwill and exceptional items £m	2004 Goodwill and exceptional items £m	2004 Total £m
Existing operations		**518.3**	**–**	**518.3**	438.0	–	438.0
Acquisitions		**241.7**	**–**	**241.7**	–	–	–
Continuing operations	2	**760.0**	**–**	**760.0**	438.0	–	438.0
Discontinued operations	2	**–**	**–**	**–**	14.0	–	14.0
Group turnover	2	**760.0**	**–**	**760.0**	452.0	–	452.0
Cost of sales	3	**(647.7)**	**–**	**(647.7)**	(385.0)	–	(385.0)
Gross profit		**112.3**	**–**	**112.3**	67.0	–	67.0
Net operating expenses	3	**(71.3)**	**(5.1)**	**(76.4)**	(41.8)	(3.3)	(45.1)
Existing operations		**30.0**	**(8.7)**	**21.3**	25.5	(3.3)	22.2
Acquisitions		**11.0**	**3.6**	**14.6**	–	–	–
Continuing operations		**41.0**	**(5.1)**	**35.9**	25.5	(3.3)	22.2
Discontinued operations		**–**	**–**	**–**	(0.3)	–	(0.3)
Group operating profit	2	**41.0**	**(5.1)**	**35.9**	25.2	(3.3)	21.9
Share of operating profit of joint ventures	2	**0.3**	**–**	**0.3**	0.1	–	0.1
Loss on sale of operations	5	**–**	**(1.6)**	**(1.6)**	–	(1.7)	(1.7)
Profit on ordinary activities before interest		**41.3**	**(6.7)**	**34.6**	25.3	(5.0)	20.3
Net interest and similar (charges)/income	6	**(6.2)**	**–**	**(6.2)**	(2.2)	1.7	(0.5)
Profit on ordinary activities before taxation		**35.1**	**(6.7)**	**28.4**	23.1	(3.3)	19.8
Tax on profit on ordinary activities	8	**(8.1)**	**0.4**	**(7.7)**	(3.4)	–	(3.4)
Profit on ordinary activities for the financial year		**27.0**	**(6.3)**	**20.7**	19.7	(3.3)	16.4
Equity minority interests	28			**(0.1)**			–
Profit for the financial year				**20.6**			16.4
Equity dividends paid and proposed	10			**(9.4)**			(4.9)
Retained profit for the financial year	27			**11.2**			11.5
Earnings per share							
– Basic	11			**10.87p**			11.31p
– Diluted	11			**10.86p**			11.28p
Earnings per share before exceptional items and goodwill							
– Basic	11			**14.20p**			13.60p
– Diluted	11			**14.18p**			13.57p

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

Group balance sheet
At 31 March 2005

	Notes	2005 £m	2005 £m	2004 (as restated) £m	2004 (as restated) £m
Fixed assets					
Intangible assets	13				
Development costs			**0.2**		0.7
Goodwill					
– Goodwill		**156.1**		81.5	
– Negative goodwill		**(2.9)**		(4.7)	
			153.2		76.8
			153.4		77.5
Tangible assets	14		**37.9**		12.2
Investments	16				
Investments in joint ventures					
Share of gross assets		**4.8**		2.4	
Share of gross liabilities		**(4.4)**		(2.7)	
Loans to joint ventures		**0.2**		0.9	
		0.6		0.6	
Other investments		**0.1**		0.1	
			0.7		0.7
			192.0		90.4
Current assets					
Stocks	17		**41.3**		29.7
Debtors – due within one year	18	**180.4**		75.2	
Debtors – due after more than one year	18	**98.1**		64.0	
			278.5		139.2
Cash and bank balances			**33.1**		17.5
			352.9		186.4
Creditors – amounts due within one year	19		**(307.5)**		(134.7)
Net current assets			**45.4**		51.7
Total assets less current liabilities			**237.4**		142.1
Creditors – amounts due after more than one year	20		**(8.4)**		(16.0)
Provisions for liabilities and charges	23		**(55.0)**		(29.0)
Net assets			**174.0**		97.1
Capital and reserves					
Called up equity share capital	26		**125.0**		90.1
Share premium account	27		**69.3**		38.6
Capital redemption reserve	27		**30.6**		30.6
Profit and loss account	27		**(51.0)**		(62.2)
Shareholders' funds – equity interests			**173.9**		97.1
Equity minority interests	28		**0.1**		–
			174.0		97.1

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

Company balance sheet
At 31 March 2005

	Notes	2005 £m	2004 (as restated) £m
Fixed assets			
Investment in subsidiary undertakings	15	**308.0**	152.3
Tangible fixed assets	14	**0.4**	–
		308.4	152.3
Current assets			
Debtors	18	**43.0**	20.7
Cash and bank balances		**26.3**	42.0
		69.3	62.7
Creditors – amounts due within one year	19	**(118.4)**	(30.5)
Net current assets		**(49.1)**	32.2
Total assets less current liabilities		**259.3**	184.5
Creditors – amounts due after more than one year	20	**–**	(15.0)
Provisions for liabilities and charges	23	**(3.5)**	–
Net assets		**255.8**	169.5
Capital and reserves			
Called up share capital	26	**125.0**	90.1
Share premium account	27	**69.3**	38.6
Capital redemption reserve	27	**30.6**	30.6
Profit and loss account	27	**30.9**	10.2
Shareholders' funds – equity interests		**255.8**	169.5

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

The Financial Statements on pages 32 to 61 were approved by the Board on 25 May 2005 and signed on its behalf by:

G A Campbell Director
W Tame Director

Group cash flow statement
For the year ended 31 March 2005

	Notes	2005 £m	2005 £m	2004 (as restated) £m	2004 (as restated) £m
Cash inflow from operating activities	29a		**43.2**		28.0
Returns on investments and servicing of finance					
Net interest and similar charges		**(6.1)**		(2.1)	
Exceptional finance income	5	**–**		1.7	
Net cash outflow from returns on investments and servicing of finance			**(6.1)**		(0.4)
Taxation					
UK corporation tax paid		**(3.6)**		(1.4)	
Overseas tax paid		**(1.1)**		(0.2)	
Net cash outflow from taxation			**(4.7)**		(1.6)
Capital expenditure and financial investment					
Payments to acquire tangible fixed assets		**(5.7)**		(2.6)	
Payments to acquire intangible fixed assets		**(0.2)**		–	
Payments to invest in joint ventures		**–**		(0.3)	
Receipts from sale of tangible fixed assets		**4.9**		1.1	
Receipts from sale of other investments		**4.9**		–	
Net cash outflow from capital expenditure and financial investment			**3.9**		(1.8)
Acquisitions and disposals					
(Payments)/receipts to acquire subsidiary undertakings	29d	**(26.5)**		0.3	
(Payments)/receipts on sale of subsidiary undertakings	29d	**(3.2)**		1.1	
Net cash (outflow)/inflow from acquisitions and disposals			**(29.7)**		1.4
Equity dividends paid			**(7.0)**		(4.5)
Cash (outflow)/inflow before management of liquid resources and financing			**(0.4)**		21.1
Management of liquid resources					
Cash placed on short-term deposit			**(5.6)**		0.2
Financing					
Shares issued for cash		**1.1**		1.7	
Expense of share issue		**(1.0)**		–	
Increase/(decrease) in borrowings		**23.1**		(20.1)	
Repayments of capital element of finance lease rentals		**(3.3)**		(0.4)	
Payments to acquire own shares		**0.7**		(0.4)	
Net cash inflow/(outflow) from financing			**20.6**		(19.2)
Increase in cash in the year	29b		**14.6**		2.1

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 2005

	2005 £m	2004 £m
Group profit for the financial year	**20.3**	16.4
Profit/(loss) on joint ventures and associates	**0.3**	–
Profit for the financial year	**20.6**	16.4
Currency translation differences on foreign currency net investments and related loans	**–**	0.6
Total recognised gains and losses relating to the year	**20.6**	17.0

Reconciliation of movements in group shareholders' funds

For the year ended 31 March 2005

	2005 £m	2004 (as restated) £m
Shareholders' funds at start of year, as previously reported	**101.1**	87.3
Prior year adjustment (note 12)	**(4.0)**	(3.9)
Shareholders' funds at start of year, as restated	**97.1**	83.4
Ordinary shares issued in the year	**65.6**	1.7
Total recognised gains and losses relating to the year	**20.6**	17.0
Dividends	**(9.4)**	(4.9)
Movement on Employee Share Ownership Plan	**–**	(0.1)
Net movement in shareholders' funds	**76.8**	13.7
Shareholders' funds at end of year	**173.9**	97.1

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.

1. Accounting policies

The principal accounting policies are summarised below. UITF38 'Accounting for ESOP Trusts' has been adopted with effect from 1 April 2004 and the prior year results have been adjusted accordingly, as explained in note 12. All other accounting policies have 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 and in compliance with the Companies Act 1985.

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 recorded turnover on long-term contracts in excess of payment on account.

Research and development

Development expenditure on clearly defined projects, the commercial outcome of which can be assessed with reasonable certainty, is capitalised and is amortised over the project life. 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 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 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. Deferred tax is measured on a non-discounted basis.

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 month of the applicable results. 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.

	2005 Group turnover £m	2005 Group operating profit/(loss) before goodwill and exceptional items £m	2005 Goodwill and exceptional items £m	2005 Group operating profit/(loss) £m
Existing operations				
Defence Services	**245.1**	**17.8**	**–**	**17.8**
Technical Services	**160.2**	**13.1**	**(5.5)**	**7.6**
Engineering and Plant Services	**113.0**	**5.5**	**–**	**5.5**
Unallocated costs, other income and goodwill amortisation	**–**	**(6.4)**	**(3.2)**	**(9.6)**
	518.3	**30.0**	**(8.7)**	**21.3**
Acquisitions				
Networks	**61.5**	**4.1**	**–**	**4.1**
Rail	**167.0**	**8.3**	**8.8**	**17.1**
HS&E	**13.2**	**(1.2)**	**–**	**(1.2)**
Unallocated costs, other income and goodwill amortisation	**–**	**(0.2)**	**(5.2)**	**(5.4)**
	241.7	**11.0**	**3.6**	**14.6**
Total continuing operations	**760.0**	**41.0**	**(5.1)**	**35.9**

2. Segmental information (continued)

	2004 Group turnover £m	2004 Group operating profit/(loss) before goodwill and exceptional items £m	2004 Goodwill and exceptional items £m	2004 Group operating profit/(loss) £m
Existing operations				
Defence Services	171.5	11.6	–	11.6
Technical Services	180.0	14.8	–	14.8
Engineering and Plant Services	86.5	3.5	–	3.5
Unallocated costs, other income and goodwill amortisation	–	(4.4)	(3.3)	(7.7)
Total continuing operations	438.0	25.5	(3.3)	22.2
Discontinued operations	14.0	(0.3)	–	(0.3)
Group total	452.0	25.2	(3.3)	21.9

The turnover, not included above, relating to joint ventures was £3.1 million (2004: £3.5 million). The share of operating profit of £0.3 million (2004: profit £0.1 million) from joint ventures represents a profit of £0.2 million within the Technical Services segment (2004: loss £0.1 million), a profit within the Defence Services segment of £0.2 million (2004: profit £0.2 million) and a loss of £0.1 million from the Networks segment (2004: £nil).

The inter-segment sales in 2005 and 2004 were not material.

Group turnover By geographic area of origin	**United Kingdom £m**	**Rest of Europe £m**	**North America £m**	**Africa £m**	**Rest of the World £m**	**Group Total £m**
2005						
Existing operations	**401.1**	**–**	**3.8**	**109.2**	**4.2**	**518.3**
Acquisitions	**234.0**	**7.7**	**–**	**–**	**–**	**241.7**
Continuing operations	**635.1**	**7.7**	**3.8**	**109.2**	**4.2**	**760.0**
Discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**
Group total	**635.1**	**7.7**	**3.8**	**109.2**	**4.2**	**760.0**
2004						
Continuing operations	337.8	0.6	6.2	81.5	11.9	438.0
Discontinued operations	–	14.0	–	–	–	14.0
Group total	337.8	14.6	6.2	81.5	11.9	452.0

Group turnover By geographic area of destination	**United Kingdom £m**	**Rest of Europe £m**	**North America £m**	**Africa £m**	**Rest of the World £m**	**Group Total £m**
2005						
Existing operations	**390.3**	**3.9**	**7.5**	**109.5**	**7.1**	**518.3**
Acquisitions	**233.4**	**8.3**	**–**	**–**	**–**	**241.7**
Continuing operations	**623.7**	**12.2**	**7.5**	**109.5**	**7.1**	**760.0**
Discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**
Group total	**623.7**	**12.2**	**7.5**	**109.5**	**7.1**	**760.0**
2004						
Continuing operations	332.6	4.9	6.2	81.8	12.5	438.0
Discontinued operations	0.2	5.1	1.1	0.5	7.1	14.0
Group total	332.8	10.0	7.3	82.3	19.6	452.0

2. Segmental information (continued)

Group operating profit/(loss) before goodwill by geographic origin	United Kingdom £m	Rest of Europe £m	North America £m	Africa £m	Rest of the World £m	Group Total £m
2005						
Existing operations	**24.4**	**(0.2)**	**(0.3)**	**5.8**	**0.3**	**30.0**
Acquisitions	**10.9**	**0.1**	**–**	**–**	**–**	**11.0**
Continuing operations	**35.3**	**(0.1)**	**(0.3)**	**5.8**	**0.3**	**41.0**
Discontinued operations	**–**	**–**	**–**	**–**	**–**	**–**
Group total	**35.3**	**(0.1)**	**(0.3)**	**5.8**	**0.3**	**41.0**
2004						
Continuing operations	22.1	(0.4)	(0.3)	3.8	0.3	25.5
Discontinued operations	–	(0.3)	–	–	–	(0.3)
Group total	22.1	(0.7)	(0.3)	3.8	0.3	25.2

The goodwill charge of £6.6 million in 2005 (2004: £3.3 million) relates to the UK £6.1 million (2004: £2.8 million) and North America £0.5 million (2004: £0.5 million).

	2005 £m	2004 (as restated) £m
Operating net assets – by activity		
Defence Services	**(6.8)**	(3.2)
Technical Services	**24.8**	22.0
Engineering and Plant Services	**14.8**	10.4
Networks	**21.7**	–
Rail	**7.1**	–
HS&E	**7.0**	–
Unallocated	**46.3**	27.8
Operating net assets	**114.9**	57.0
Operating net assets – by geographic area		
United Kingdom	**100.1**	45.7
Europe	**0.2**	1.0
North America	**(0.4)**	(0.3)
Africa	**14.4**	10.2
Rest of the World	**0.6**	0.4
Operating net assets	**114.9**	57.0
Net borrowings	**(54.3)**	(14.3)
Finance lease obligations	**(8.5)**	(1.1)
Taxation	**(25.9)**	(18.2)
Dividends	**(5.4)**	(3.1)
Net goodwill	**153.2**	76.8
Non-operating assets	**59.1**	40.1
Net assets	**174.0**	97.1

Technical Services and the United Kingdom include operating net assets in respect of joint ventures of £nil (2004: £0.2 million).

Defence Services and the Rest of the World includes operating net assets of £0.5 million (2004: £0.4 million) in respect of joint ventures.

Networks and the United Kingdom includes operating net assets of £0.1 million (2004: £nil) in respect of joint ventures.

3. Net operating expenses

	2005 Cost of sales £m	2005 Distribution expenses £m	2005 Administration expenses £m	2005 Net operating expenses £m
Existing operations	**452.6**	**0.9**	**43.8**	**44.7**
Acquisitions	**195.1**	**0.6**	**31.1**	**31.7**
Continuing operations	**647.7**	**1.5**	**74.9**	**76.4**
Discontinued operations	**–**	**–**	**–**	**–**
Group total	**647.7**	**1.5**	**74.9**	**76.4**

	2004 Cost of sales £m	2004 Distribution expenses £m	2004 Administration expenses £m	2004 Net operating expenses £m
Continuing operations	375.5	1.8	38.5	40.3
Discontinued operations	9.5	3.4	1.4	4.8
Group total	385.0	5.2	39.9	45.1

In 2005, administration expenses include a goodwill charge of £3.2 million in respect of existing operations and £3.4 million in respect of acquisitions, an operating exceptional charge of £5.5 million for existing operations and credit of £7.0 million in respect of acquisitions.

In 2004, administration expenses include a goodwill charge of £3.3 million in respect of existing operations.

4. Operating profit

	2005 £m	2004 £m
Operating profit is stated after charging/(crediting)		
Depreciation on tangible fixed assets		
– Owned	**6.2**	4.4
– Leased assets	**1.4**	0.3
(Loss)/profit on the disposal and write-off of tangible fixed assets	**(0.9)**	0.2
Operating lease rentals		
– Plant and machinery	**5.1**	1.2
– Land and buildings	**4.9**	3.9
– Short-term plant hire	**1.0**	0.3
– Other	**0.5**	0.3
Auditors' remuneration (audit services)	**0.7**	0.4
Research and development		
– Expenditure	**0.2**	0.2
– Amortisation charge (note 13)	**–**	0.3
Net goodwill amortisation	**6.6**	3.3

In addition to the amounts disclosed above, the group auditors and their associates were paid £172,013 (2004: £333,000) in relation to non audit services in the UK and £7,054 (2004: £13,000) for services outside the UK. For the UK Services £57,000 related to the Peterhouse Whitewash.

5. Exceptional items and goodwill

Within existing businesses an operating exceptional loss of £5.5 million was realised representing £0.8 million of restructuring costs and £4.7 million of goodwill write-off on the downsizing of the group's marine design subsidiaries. Within acquired businesses an operating exceptional profit of £7.0 million is made up of £8.8 million income from the transfer of rail maintenance contracts back to Network Rail offset by costs of the transfer and restructuring costs within the rail business, and £1.8 million of operating exceptional costs for the closure of the Peterhouse head office.

The regular goodwill amortisation (excluding exceptional charges) is £6.6 million (2004: £3.3 million).

In 2005 the non-operating exceptional loss of £1.6 million is made up of the following; a loss of £1.2 million provided in the period for disposal costs of previously disposed of businesses, and a loss of £0.4 million recognised on the sale of CMR Consultants Limited and a write-down of the carrying value of FBMA which was sold on 10 October 2004. Tax includes an exceptional credit of £0.4 million relating to the above.

In 2004 the non-operating exceptional charge of £1.7 million was made up of a loss on sale of Swedish Materials Handling businesses of £2.5 million, offset by a profit on the sale of a non trading subsidiary containing a financial asset of £0.8 million. Net interest and similar income/(charges) includes an exceptional gain of £1.7 million arising on the disposal of a financial asset.

6. Net interest and similar income/(charges)

	2005 £m	2004 £m
Interest payable and similar charges		
– Bank loans and overdrafts	**(8.0)**	(2.3)
– Finance lease interest	**(0.4)**	(0.1)
– Other	**(0.1)**	(0.1)
	(8.5)	(2.5)
Other interest receivable and similar income	**2.3**	0.3
Share of joint ventures	**–**	–
	(6.2)	(2.2)
Exceptional gain arising on disposal of financial asset	**–**	1.7
Total group interest charge	**(6.2)**	(0.5)

7. Employee costs

	2005 £m	2004 £m
Particulars of employees, including executive Directors, are as follows:		
Employee costs		
– Wages and salaries	**227.4**	139.2
– Social security costs	**20.3**	12.3
– Other pension costs (note 25)	**10.6**	9.4
	258.3	160.9

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

	2005 Number	2004 Number
Operations	**7,990**	5,767
Administration and management	**1,098**	589
	9,088	6,356

The number of people employed by the group at 31 March 2005 was 9,106 (2004: 6,110).

Information in respect of Directors' remuneration and share interests is contained within the Remuneration report on pages 24 to 30.

8. Tax on profit on ordinary activities

	2005 £m	2004 £m
United Kingdom corporation tax charge at 30%	2.1	3.1
Adjustments in respect of previous periods	(0.2)	(0.8)
	1.9	2.3
Overseas taxation – current period	2.7	1.4
	4.6	3.7
Share of joint ventures	0.1	0.1
Total current tax	4.7	3.8
Deferred taxation:		
Origination and reversal of timing differences	3.0	(0.4)
	7.7	3.4

Excluding the net goodwill charge of £6.6 million, and the exceptional loss of £0.1 million, the effective rate of 24% is lower than the standard UK rate of 30% due to the net effect of permanent differences and the difference between the UK rate and the effective overseas rate. There is a tax credit of £0.4 million arising in respect of the exceptional loss.

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:

	2005 £m	2004 £m
Profit on ordinary activities before tax	28.4	19.8
Deduct: share of joint ventures and associates profit before tax	(0.3)	(0.1)
Group profit on ordinary activities before taxation	28.1	19.7
Tax on group profit on ordinary activities at standard UK corporation tax rate of 30% (2004: 30%)	8.4	6.0
Effects of:		
Expenses (including exceptional items and goodwill) not deductible for tax purposes	2.2	2.0
Current year and prior year timing differences	(2.4)	0.2
Overseas timing differences not recognised and difference in rates on overseas earnings	(3.1)	(0.3)
Adjustments to current tax charge in respect of previous periods	(0.2)	(0.8)
Utilisation of brought forward tax assets not previously recognised	(0.2)	(3.3)
Group current tax charge for period	4.7	3.8

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 £29.5 million (2004: loss £0.1 million) dealt with in the Financial Statements of the company.

10. Equity dividends

	2005 £m	2004 £m
Ordinary shares		
– Additional final dividend for 2004	1.2	–
– Interim dividend paid of 1.35p per 60p share (2004: 1.25p per 60p share)	2.8	1.8
– Final dividend proposed of 2.65p per 60p share (2004 2.10p per 60p share)	5.4	3.1
	9.4	4.9

The final dividend for the year ended 31 March 2004 exceeded the amount accrued by £1.2 million as a result of the additional shares issued following the acquisition of Peterhouse Group PLC.

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.

	2005 Number	2004 Number
Weighted average number of shares in issue for basic earnings per share	**189,193,887**	145,022,090
Dilutive effect of share options	**258,810**	353,923
Weighted average number of shares in issue for diluted earnings per share	**189,452,697**	145,376,013

The weighted average number of shares excludes the weighted average number of shares held in the Babcock Employee Share Trust and the Peterhouse Employee Share Trust.

	2005 £m	2005 Basic (pence)	2005 Diluted (pence)	2004 £m	2004 Basic (pence)	2004 Diluted (pence)
Profit attributable to shareholders	**20.6**	**10.87**	**10.86**	16.4	11.31	11.28
Exceptional items	**(0.3)**	**(0.16)**	**(0.16)**	–	0.03	0.04
Profit before exceptional items	**20.3**	**10.71**	**10.70**	16.4	11.34	11.32
Add net goodwill amortisation	**6.6**	**3.49**	**3.48**	3.3	2.26	2.25
Profit before exceptional items and goodwill	**26.9**	**14.20**	**14.18**	19.7	13.60	13.57

The earnings per share figures calculated above eliminate the effect of exceptional items and goodwill amortisation to give a more meaningful presentation of trading performance.

12. Prior year adjustment

The Financial Statements for the year ended 31 March 2004 have been restated following the adoption of UITF Abstract 38 'Accounting for ESOP Trusts'. Shares held by the Babcock International Group PLC ESOP Trust, previously shown in the balance sheet as fixed asset investments, are now required to be shown as a deduction from shareholders' funds.

The impact of the treatment above is to reduce investments by £4.0 million at 31 March 2004.

The consolidated cash flow statement has been restated to reflect the reallocation of the cash payments for the purchase of shares from 'capital expenditure and financial investments' to 'financing'. (There is no material impact on profit before tax in either the current or prior period.)

13. Fixed assets – intangible assets

	Goodwill £m	Negative goodwill £m	Development costs £m	Total £m
Group:				
Cost				
At 1 April 2004	98.1	(25.8)	3.0	**75.3**
On acquisition of subsidiaries (note 30)	88.0	–	–	**88.0**
On disposal of subsidiaries	(0.4)	–	–	**(0.4)**
Additions	–	–	0.2	**0.2**
Impairment/write-off	(5.9)	–	–	**(5.9)**
At 31 March 2005	**179.8**	**(25.8)**	**3.2**	**157.2**
Accumulated amortisation				
At 1 April 2004	(16.6)	21.1	(2.3)	**2.2**
On disposal of subsidiaries	–	–	–	**–**
(Charge)/credit for the year	(8.4)	1.8	–	**(6.6)**
Impairment/write-off	1.3	–	(0.7)	**0.6**
At 31 March 2005	**(23.7)**	**22.9**	**(3.0)**	**(3.8)**
Net book value at 31 March 2005	**156.1**	**(2.9)**	**0.2**	**153.4**
Net book value at 31 March 2004	81.5	(4.7)	0.7	**77.5**

14. Fixed assets – tangible assets

	Group				Company
	Freehold property £m	Leasehold property £m	Plant and machinery £m	**Total £m**	Leasehold property £m
Group:					
Cost					
At 1 April 2004	12.6	0.9	41.3	**54.8**	–
Exchange adjustments	–	–	(0.3)	**(0.3)**	–
On acquisition of subsidiaries (note 30)	4.3	1.2	27.3	**32.8**	–
On disposal of subsidiaries (note 30)	–	–	(0.3)	**(0.3)**	–
Additions	0.2	0.1	6.4	**6.7**	0.4
Disposals/assets written off	(1.8)	(0.1)	(11.4)	**(13.3)**	–
Reclassification	–	0.1	(0.1)	**–**	–
At 31 March 2005	**15.3**	**2.2**	**62.9**	**80.4**	**0.4**
Accumulated depreciation					
At 1 April 2004	(10.1)	(0.2)	(32.3)	**(42.6)**	–
Exchange adjustments	–	–	0.1	**0.1**	–
On disposal subsidiaries (note 30)	–	–	0.2	**0.2**	–
Charge for the year	(0.4)	(0.2)	(7.0)	**(7.6)**	–
Disposals/assets written off	0.4	–	7.0	**7.4**	–
At 31 March 2005	**(10.1)**	**(0.4)**	**(32.0)**	**(42.5)**	**–**
Net book value at 31 March 2005	**5.2**	**1.8**	**30.9**	**37.9**	**0.4**
Net book value at 31 March 2004	2.5	0.7	9.0	**12.2**	–

The net book value of plant and machinery includes £13.5 million (2004: £2.1 million) in respect of assets held under finance leases or hire purchase contracts, comprising cost of £19.5 million (2004: £3.9 million) less depreciation of £6.0 million (2004: £1.8 million).

15. Fixed assets – investments in subsidiary undertakings

	Shares £m	Loans £m	**Total £m**
Company cost			
At 1 April 2004	86.5	65.8	**152.3**
Additions	329.0	–	**329.0**
Disposals	(107.5)	–	**(107.5)**
Repayments	–	(65.8)	**(65.8)**
At 31 March 2005	**308.0**	**–**	**308.0**

During the year the company acquired the Peterhouse Group and Turners. It then sold both to other group companies. The company also increased its investments in group subsidiaries.

Information on the principal subsidiary undertakings is given on page 62.

16. Fixed assets – investments

	Group				Company
	Joint ventures £m	Investments in own shares £m	Other investments £m	**Total £m**	Investments in own shares £m
At 1 April 2004, as previously reported	0.6	4.0	0.1	**4.7**	4.0
Prior year adjustment	–	(4.0)	–	**(4.0)**	(4.0)
At 1 April 2004, restated	0.6	–	0.1	**(0.7)**	–
On acquisition of subsidiaries	0.2	–	–	**0.2**	–
Additions	0.1	–	0.1	**0.2**	–
Disposals	(0.5)	–	(0.1)	**(0.6)**	–
Share of profits	0.2	–	–	**0.2**	–
At 31 March 2005	**0.6**	**–**	**0.1**	**0.7**	–

17. Stocks

	Group 2005 £m	Group 2004 £m
Stocks and work in progress		
– Raw materials and consumables	**6.0**	3.2
– Work in progress	**5.3**	5.1
– Finished goods and goods for resale	**33.9**	24.7
	45.2	33.0
Less: Progress payments	**–**	(0.6)
Provisions	**(3.9)**	(2.7)
	41.3	29.7

18. Debtors

	Group 2005 £m	Group 2004 £m	**Company 2005 £m**	Company 2004 £m
Due within one year:				
Trade debtors	**45.0**	32.1	**0.4**	0.1
Amounts recoverable on contracts	**110.5**	25.2	**–**	–
Retentions	**2.5**	0.1	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**41.2**	17.4
Pension scheme prepayments	**2.1**	5.4	**–**	–
Other debtors	**6.2**	4.1	**0.1**	0.7
Prepayments and accrued income	**14.1**	8.3	**1.3**	2.5
	180.4	75.2	**43.0**	20.7

	Group 2005 £m	Group 2004 £m	**Company 2005 £m**	Company 2004 £m
Due after more than one year:				
Pension scheme prepayments	**97.8**	63.6	**–**	–
Other debtors	**0.3**	0.4	**–**	–
	98.1	64.0	**–**	–

19. Creditors – amounts due within one year

	Group 2005 £m	Group 2004 £m	Company 2005 £m	Company 2004 £m
Bank overdraft (note 21)	**6.7**	11.3	**–**	–
Bank loans (note 21)	**78.7**	5.5	**78.2**	5.5
Obligations under finance leases (note 21)	**2.3**	0.4	**–**	–
Payments on account	**22.5**	11.2	**–**	–
Trade creditors	**70.9**	36.6	**–**	–
Contract accruals and provisions	**73.0**	37.3	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**34.6**	19.9
Other creditors	**12.6**	8.0	**0.2**	2.0
Corporation and overseas taxes	**6.2**	6.1	**–**	–
Other taxes and social security	**9.7**	4.1	**–**	–
Accruals and deferred income	**19.5**	11.1	**–**	–
Proposed dividend	**5.4**	3.1	**5.4**	3.1
	307.5	134.7	**118.4**	30.5

20. Creditors – amounts due after more than one year

	Group 2005 £m	Group 2004 £m	Company 2005 £m	Company 2004 £m
Bank loans (note 21)	**2.1**	15.0	**–**	15.0
Obligations under finance leases (note 21)	**6.2**	0.7	**–**	–
Other creditors	**0.1**	0.1	**–**	–
Corporation and overseas taxes	**–**	0.2	**–**	–
	8.4	16.0	**–**	15.0

21. Borrowings

Repayment details

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

	2005 Bank loans and overdrafts £m	2005 Finance lease obligations £m
Within one year	**85.4**	**2.3**
Between one and two years	**0.5**	**1.3**
Between two and five years	**1.6**	**0.9**
Greater than five years	**–**	**4.0**
	87.5	**8.5**

	2004 Bank loans and overdrafts £m	2004 Finance lease obligations £m
Within one year	16.8	0.4
Between one and two years	15.0	0.4
Between two and five years	–	0.3
	31.8	1.1

21. Borrowings (continued)

Security arrangements	Group 2005 £m	Group 2004 £m
Loans and overdrafts		
Secured against floating charge on the assets of subsidiary undertaking	**2.3**	–
Unsecured borrowings	**85.2**	31.8
	87.5	31.8

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

22. Derivatives and other financial instruments

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

Interest rate profile

The group's financial assets comprise cash deposits of £33.1 million (2004: £17.5 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 of the interest rate swaps used to manage the interest profile, is as follows:

	2005 Financial assets				2005 Financial liabilities
Currency	Total and floating rate £m	Total £m	Floating rate £m	Fixed rate £m	No interest paid £m
Sterling	**24.0**	**91.6**	**89.1**	**2.5**	**–**
Euro	**2.5**	**–**	**–**	**–**	**–**
US Dollar	**3.6**	**–**	**–**	**–**	**–**
South African Rand	**1.8**	**1.5**	**1.5**	**–**	**–**
Swedish Krona	**0.5**	**–**	**–**	**–**	**–**
Other currencies	**0.7**	**2.9**	**2.9**	**–**	**–**
	33.1	**96.0**	**93.5**	**2.5**	**–**

	2004 Financial assets				2004 Financial liabilities
Currency	Total and floating rate £m	Total £m	Floating rate £m	Fixed rate £m	No interest paid £m
Sterling	13.4	31.0	31.0	–	–
Euro	0.7	–	–	–	–
US Dollar	2.4	–	–	–	–
South African Rand	–	1.9	1.9	–	–
Swedish Krona	0.1	–	–	–	–
Other currencies	0.9	–	–	–	–
	17.5	32.9	32.9	–	–

The above tables do not include onerous lease liabilities of £6.1 million (2004: £4.3 million). The interest rate on this liability is 6.0% (2004: 6.0%) and the maturity period is between seven and 23 years.

The weighted average interest rates of the Sterling fixed rate financial liabilities, which comprise finance lease obligations, are 6.2% (2004: nil). The weighted average period for which these interest rates are fixed is seven years.

The floating rate on financial assets and liabilities is linked to LIBOR in the case of sterling, the prime rate in the case of South African rand and the local prime rate for other currencies.

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 debt. The interest rate swap is effective for three years from 26 June 2003.

22. Derivatives and other financial instruments (continued)

The group acquired two swaps from LIBOR to fixed rate with Peterhouse described below:

	Amount £m	Fixed %	Maturity
	10	**4.89**	**29.11.07**
	20	**4.72**	**29.11.05**

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 March 2005, in respect of which all conditions precedent had been met, as follows:

	2005 £m	2004 £m
Expiring in less than one year	**16.9**	–
Expiring in more than one year but not more than two years	**62.0**	47.0

Currency exposures

The Financial Review on page 14 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 2005, these exposures were as follows:

	Net foreign currency monetary assets/(liabilities)					
Functional currency of group operation	Sterling £m	US Dollars £m	Euro-zone currencies £m	Swedish Krona £m	Other £m	Total £m
Sterling	–	**0.9**	**1.7**	–	**0.4**	**3.0**
US Dollars	–	–	–	–	–	–
Euro	–	–	–	–	–	–
Swedish Krona	–	–	**0.5**	–	–	**0.5**
Other	–	–	–	–	–	–
Total	–	**0.9**	**2.2**	–	**0.4**	**3.5**

As at 31 March 2004, these exposures were as follows:

	Net foreign currency monetary assets/(liabilities)					
Functional currency of group operation	Sterling £m	US Dollars £m	Euro-zone currencies £m	Swedish Krona £m	Other £m	Total £m
Sterling	–	0.3	0.7	–	0.1	1.1
US Dollars	–	–	–	–	–	–
Euro	–	–	–	–	–	–
Swedish Krona	–	–	0.6	–	–	0.6
Other	–	–	–	–	–	–
Total	–	0.3	1.3	–	0.1	1.7

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 2005, the group also held open various forward foreign currency contracts that the group had taken out to hedge expected future foreign currency movements.

22. Derivatives and other financial instruments (continued)

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).

	2005 Book value £m	2005 Fair value £m	2004 Book value £m	2004 Fair value £m
Interest rate swaps	**0.3**	**0.1**	0.1	0.1
Forward foreign currency contracts	**–**	**(0.5)**	–	(5.0)

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

The book value and the fair value of the group's borrowings and cash at bank are the same and are therefore not reflected in the above table.

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 £m	Losses £m	Net £m
Unrecognised gains and losses on hedges at 1 April 2004	0.4	(5.4)	(5.0)
Gains and losses arising in previous years that were recognised in the year ended 31 March 2005	(0.4)	5.2	4.8
Gains and losses arising before 1 April 2004 that were not recognised in the year ended 31 March 2005	–	(0.2)	(0.2)
Gains and losses arising that were not recognised in the year ended 31 March 2005	0.5	(0.8)	(0.3)
Unrecognised gains and losses on hedges at 31 March 2005	0.5	(1.0)	(0.5)
Of which:			
Gains and losses expected to be recognised in the year ending 31 March 2006	0.5	(1.0)	(0.5)

In addition there is an unrecognised loss in respect of interest rate swaps of £0.2 million. The above represents the gains and losses on the hedging instruments.

23. Provisions for liabilities and charges

	Pensions and similar obligations (a) £m	Deferred taxation (note 24) £m	Acquisition/ deferred consideration (b) £m	Insurance provisions (c) £m	Reorganisation or disposal of businesses (d) £m	Property and other (e) £m	Total £m
At 1 April 2004	2.8	12.3	2.6	5.7	5.6	–	29.0
On acquisition of subsidiaries	0.3	4.6	3.3	4.5	4.8	4.4	21.9
Provided in the year	–	3.0	1.8	0.8	2.7	2.8	11.1
Utilised in the year	(0.2)	–	(2.1)	(1.0)	(3.3)	(0.4)	(7.0)
At 31 March 2005	**2.9**	**19.9**	**5.6**	**10.0**	**9.8**	**6.8**	**55.0**

(a) Provisions for pension liabilities, payable within two to five years.

(b) Acquisition/deferred consideration relates to the contingent consideration for Turners, remaining costs and consideration for SGI, and certain other provisions set up on the acquisition of Peterhouse, the main part of which is payable within two to five years.

(c) The insurance provisions arise in the group's captive insurance companies, Chepstow Insurance Ltd and Peterhouse Insurance Limited. They relate to specific claims assessed in accordance with the advice of independent actuaries, the main part of which is payable after one year.

(d) Provisions for costs relating to the reorganisation 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, redundancy provisions and claims and litigation, which are likely to be payable within one year.

(e) Property and other in the main relate to provisions for onerous leases for continuing businesses within the acquired Peterhouse Group, the main part of which is payable after five years.

The company had a provision for contingent consideration of £3.5 million (2004: £nil).

24. Deferred taxation

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

	2005 Provided £m	2004 Provided £m	2005 Full potential £m	2004 Full potential £m
Accelerated capital allowances	**(3.3)**	(2.3)	**(3.3)**	(2.3)
Pension surpluses	**29.9**	20.7	**29.9**	20.7
Other timing differences	**(2.1)**	(1.6)	**(2.2)**	(1.6)
Tax losses	**(0.1)**	–	**(20.4)**	(21.4)
	24.4	16.8	**4.0**	(4.6)
Recoverable advance corporation tax	**(4.5)**	(4.5)	**(4.5)**	(4.5)
	19.9	12.3	**(0.5)**	(9.1)

There is no unprovided deferred tax liability in the company.

25. Pension arrangements

The group has continued to account for pension costs in accordance with SSAP 24. Full adoption of the requirements 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:

	2005 £m	2004 £m
Defined benefit schemes:		
Regular costs net of variation	**9.1**	6.8
Interest on pension scheme surpluses	**(5.9)**	(4.3)
	3.2	2.5
Defined contribution schemes	**7.4**	6.9
	10.6	9.4

Of the above charge £9.6 million relates to the UK (2004: £8.0 million) and £1.0 million relates to overseas (2004: £1.4 million).

The group operates four principal defined benefit pension schemes for employees in the United Kingdom, the Babcock International Group Pension Scheme, the Rosyth Royal Dockyard Pension Scheme, the First Engineering Shared Cost Section of the Railways Pension Scheme and the Eve Pension Fund. All four 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 four schemes are as follows:

	Babcock International Group	Rosyth Royal Dockyard	First Engineering	Eve Group
Date of last formal actuarial valuation	01.04.04	31.03.03	31.12.01	31.03.04
Number of active members at 31 March 2005	484	1,482	894	47
Actuarial valuation method	Projected unit	Projected unit	Projected unit	Projected unit
Results of last formal actuarial valuation:				
Value of assets	£404.8m	£355.1m	£168.4m	£29.2m
Level of funding	114%	107%	108%	114%
Principal valuation assumptions:				
Excess of investment returns over earnings increases	1%–2.5%	1.5%	1.5%–2.3%	0%–2%
Excess of investment returns over pension increases	2.5%–4%	3%	3%–3.8%	2%–4%

As a result of the level of surplus the group's contributions to the Babcock International Group Pension Scheme is currently suspended until at least the results of the formal valuation are available.

Prepayments of £99.9 million (2004: £69.0 million) are carried in the balance sheet in respect of the group's principal pension schemes.

25. Pension arrangements (continued)

(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 four principal defined benefit pension schemes referred to above, the group also operates a number of smaller defined benefit pension schemes:

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 2004. The company made a contribution of £0.1 million during the year to 31 March 2005. The plan was frozen as of 31 January 2003 and, therefore, no active members existed as at 31 March 2005.

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 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 no contribution to the scheme during the year to 31 March 2005.

As part of the Peterhouse acquisition three smaller defined benefit schemes were acquired: Jackson Group plc Pension & Life Assurance Scheme, Shorco Group Pension Scheme and AMT International Limited Pension Scheme. All three schemes had no active members. £150,000 was contributed to the Jackson Group Scheme during the year.

The last actuarial valuation dates were:

Jackson Group plc Pension & Life Assurance Scheme	31.01.2002
Shorco Group Pension Scheme	01.10.2002
AMT International Limited Pension Scheme	31.10.2003

For defined benefit schemes the fair values of pension scheme assets at 31 March 2005 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 2005 by qualified independent actuaries using the following assumptions:

	Babcock International Group Scheme % pa			Rosyth Royal Dockyard Scheme % pa			First Engineering Scheme % pa			Eve Group Scheme % pa			Other schemes (weighted average) % pa		
	2005	2004	2003	**2005**	2004	2003	**2005**	2004	2003	**2005**	2004	2003	**2005**	2004	2003
Rate of increase of future earnings	**4.0**	3.83	3.5	**3.0 - 3.5**	2.83 - 3.33	3.0	**4.0**	–	–	**4.0**	–	–	**–**	3.83	3.6
Discount rate	**5.43**	5.54	5.4	**5.43**	5.54	5.4	**5.43**	–	–	**5.43**	–	–	**5.45**	6.0	5.6
Expected pension increases	**3.0**	3.0	3.0	**3.0**	2.83	2.5	**–**	–	–	**–**	–	–	**3.1**	3.7	2.7
Inflation rate	**3.0**	2.83	2.5	**3.0**	2.83	2.5	**3.0**	–	–	**3.0**	–	–	**3.1**	3.7	2.7

The fair value of the assets, the present value of the liabilities and the expected rates of return of the Babcock International Group, Rosyth Royal Dockyard, First Engineering and Eve Group defined benefit schemes, together with the aggregated data for the other schemes in the Group at 31 March 2005 were as follows:

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		First Engineering Scheme		Eve Group Schemes		Other schemes		Group
	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m	Weighted average expected rate %	Fair value £m	Fair value £m
Equities	8.0	52.5	8.0	224.8	8.0	94.5	8.0	18.5	8.0	12.6	402.9
Property	–	–	7.5	57.5	7.5	11.0	7.5	0.7	7.5	0.1	69.3
Bonds – corporate	5.5	135.8	5.5	42.2	–	–	–	–	5.5	1.8	179.8
Bonds – government	4.7	211.4	4.7	47.4	4.7	12.3	4.7	11.2	4.7	6.1	288.4
Cash	4.75	7.1	4.75	3.7	4.75	6.0	4.75	0.1	4.75	0.1	17.0
Fair value assets		406.8		375.6		123.8		30.5		20.7	957.4
Present value of scheme liabilities		(376.7)		(428.2)		(117.9)		(25.1)		(29.9)	(977.8)
Recognised pension asset/(liability)		30.1		(52.6)		5.9		5.4		(9.2)	(20.4)
Deferred tax asset/(liability)		(9.0)		15.8		(1.8)		(1.6)		2.4	5.8
Net pension asset/(liability)		21.1		(36.8)		4.1		3.8		(6.8)	(14.6)

25. Pension arrangements (continued)

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 2004 were as follows:

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		Other schemes		Group
	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m	Weighted average expected rate of return %	Fair value £m	Fair value £m
Equities	8.0	85.3	8.0	229.9	8.0	1.8	317.0
Property	–	–	7.0	40.8	–	–	40.8
Bonds	4.8	313.6	4.8	72.6	6.4	3.4	389.6
Cash	4.0	2.7	4.0	1.2	4.0	0.1	4.0
Fair value of assets		401.6		344.5		5.3	751.4
Present value of scheme liabilities		(356.3)		(390.2)		(2.9)	(749.4)
Recognised pension asset/(liability)		45.3		(45.7)		2.4	2.0
Deferred tax asset/(liability)		(13.6)		13.7		(1.0)	(0.9)
Net pension asset/(liability)		31.7		(32.0)		1.4	1.1

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 £m	Expected rate of return %	Fair value £m	Weighted average expected rate of return %	Fair value £m	Fair value £m
Equities	7.0	62.8	7.0	184.7	7.0	5.1	252.6
Property	–	–	7.0	38.8	–	–	38.8
Bonds	4.8	325.0	4.8	70.0	5.5	5.1	400.1
Cash	3.75	0.6	3.75	2.2	3.75	0.8	3.6
Fair value of assets		388.4		295.7		11.00	695.1
Present value of scheme liabilities		(345.8)		(331.3)		(15.7)	(692.8)
Recognised pension asset/(liability)		42.6		(35.6)		(4.7)	2.3
Deferred tax asset/(liability)		(12.8)		10.7		1.1	(1.0)
Net pension asset/(liability)		29.8		(24.9)		(3.6)	1.3

25. Pensions 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 2005.

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Group £m
Amounts charged to operating profit						
Current service cost	(3.3)	(6.1)	(2.7)	(0.4)	–	(12.5)
Past service cost	–	–	–	–	–	–
Effect of settlement	–	–	–	–	–	–
Recognition of surplus	–	–	–	–	–	–
Curtailment gain	–	5.6	–	–	–	5.6
	(3.3)	(0.5)	(2.7)	(0.4)	–	(6.9)
Amounts credited/(charged) to net interest						
Expected return on pension scheme assets	22.3	24.8	6.8	1.5	1.2	56.6
Interest on pension scheme liabilities	(19.3)	(21.4)	(4.8)	(1.0)	(1.3)	(47.8)
	3.0	3.4	2.0	0.5	(0.1)	8.8
Amounts recorded in statement of total recognised gains and losses						
Actual return less expected return on pension scheme assets	3.7	19.6	8.1	1.3	0.6	33.3
Experience losses arising on scheme liabilities	2.2	(7.4)	(0.9)	–	(5.1)	(11.2)
Change in assumptions relating to present value of scheme liabilities	(21.0)	(24.8)	(7.1)	(1.3)	(2.0)	(56.2)
	(15.1)	(12.6)	0.1	–	(6.5)	(34.1)
Movements in surplus/(deficit) during year						
Surplus/(deficit) in schemes at 1 April 2004	45.3	(45.6)	–	–	2.3	2.0
Upon acquisition	–	–	5.5	5.2	(4.9)	5.8
Charged to operating profit	(3.3)	(0.5)	(2.7)	(0.4)	–	(6.9)
Employer contributions	–	2.6	1.0	0.2	0.2	4.0
Other finance income/(expense)	3.0	3.4	2.0	0.5	(0.1)	8.8
Actuarial gain/(loss) recognised in statement of total recognised gains and losses	(15.1)	(12.6)	0.1	–	(6.5)	(34.1)
Exchange adjustments	–	–	–	–	–	–
Surplus/(deficit) in schemes as at 31 March 2005	**29.9**	**(52.7)**	**5.9**	**5.5**	**(9.0)**	**(20.4)**
History of experience gains and losses						
Difference between the expected and actual return on scheme assets	3.7	19.6	8.1	1.3	0.6	33.3
Percentage of scheme assets at 31 March 2005	1%	5%	7%	4%	3%	3%
Experience gains/(losses) of scheme liabilities	2.2	(7.4)	(0.9)	–	(5.1)	(11.2)
Percentage of present value of scheme liabilities at 31 March 2005	1%	2%	1%	0%	18%	1%
Total amount recognised in statement of total recognised gains and losses	(15.1)	(12.6)	0.1	–	(6.5)	(34.1)
Percentage of present value of scheme liabilities at 31 March 2005	4%	3%	0%	0%	23%	4%

25. Pensions arrangements (continued)

If the defined benefit 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 recognised gains and losses for the year ended 31 March 2004.

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	Other schemes £m	Group £m
Amounts charged to operating profit				
Current service cost	(3.2)	(6.5)	–	(9.7)
Past service costs	–	–	(0.2)	(0.2)
Effect of settlement	(6.4)	–	6.4	–
Recognition of surplus	–	–	–	–
Curtailment gain	–	–	0.2	0.2
	(9.6)	(6.5)	6.4	(9.7)
Amounts credited/(charged) to net interest				
Expected return on pension scheme assets	19.5	18.7	0.6	38.8
Interest on pension scheme liabilities	(18.2)	(17.7)	(0.8)	(36.7)
	1.3	1.0	(0.2)	2.1
Amounts recorded in statement of total recognised gains and losses				
Actual return less expected return on pension scheme assets	9.1	43.1	1.4	53.6
Experience losses arising on scheme liabilities	(0.7)	(38.0)	–	(38.7)
Change in assumptions relating to present value of scheme liabilities	2.6	(9.7)	(0.7)	(7.8)
	11.0	(4.6)	0.7	7.1
Movements in surplus/(deficit) during year				
Surplus/(deficit) in schemes at 1 April 2003	42.6	(35.6)	(4.7)	2.3
Charged to operating profit	(9.6)	(6.5)	6.4	(9.7)
Employer contributions	–	–	0.1	0.1
Other finance income/(expense)	1.3	1.0	(0.2)	2.1
Actuarial gain/(loss) recognised in statement of total recognised gains and losses	11.0	(4.6)	0.7	7.1
Exchange adjustments	–	–	0.1	0.1
Surplus/(deficit) in schemes as at 31 March 2004	45.3	(45.7)	2.4	2.0
History of experience gains and losses				
Difference between the expected and actual return on scheme assets	9.1	43.1	1.4	53.6
Percentage of scheme assets at 31 March 2004	2%	12%	27%	7%
Experience gains/(losses) of scheme liabilities	(0.7)	(38.0)	–	(38.7)
Percentage of present value of scheme liabilities at 31 March 2004	0%	10%	0%	5%
Total amount recognised in statement of total recognised gains and losses	11.0	(4.6)	0.7	7.1
Percentage of present value of scheme liabilities at 31 March 2004	3%	1%	24%	1%

25. Pension arrangements (continued)
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:

	2005 £m	2004 as restated £m
Net Assets		
As reported	174.0	97.1
Add back:		
Pension prepayment under SSAP 24	(99.9)	(69.0)
Provision for pension costs under SSAP 24	1.7	1.8
Related deferred tax asset	29.9	20.7
Excluding pension assets	105.7	50.6
Net pension (liability)/asset under FRS17	(14.6)	1.1
Including pension (liability)/asset	91.1	51.7

	2005 £m	2004 as restated £m
Profit and loss account reserve		
As reported	(51.0)	(62.2)
Add back:		
Pension prepayment under SSAP 24	(99.9)	(69.0)
Provision for pension costs under SSAP 24	1.7	1.8
Related deferred tax liability	29.9	20.7
Excluding pension assets	(119.3)	(108.7)
Net pension (liability)/asset under FRS17	(14.6)	1.1
Including pension (liability)/asset	(133.9)	(107.6)

26. Called up share capital

Authorised:	Ordinary shares of 60p Number	Unclassified shares of 30p Number	Ordinary shares of 60p £m	Unclassified shares of 30p £m
At 1 April 2004	249,166,666	1	149.5	–
Authorised during the year	57,052,346	–	34.2	–
At 31 March 2005	**306,219,012**	**1**	**183.7**	**–**

Allotted, issued and fully paid:	Ordinary shares of 60p Number	Company and Group total £m
At 1 April 2004	150,249,029	90.1
Ordinary 60p shares issued on exercise of options	1,086,441	0.7
Ordinary 60p shares issued as consideration for purchase of Peterhouse	57,019,732	34.2
At 31 March 2005	**208,355,202**	**125.0**

26. Called up share capital (continued)

Outstanding share options

The table below shows options existing over the company's shares as at 31 March 2005. They represent outstanding options granted under all the company's Executive Share Options Schemes. Of the total number of shares shown, 2,972,868 are in respect of options granted by the trustee of the Babcock Employee Share Trust and 797,925 are in respect of options granted by the trustee of the Peterhouse Employee Share Trust, both are options to acquire shares already purchased or intended to be purchased in the market by the respective trustees. The balance of 2,600,654 shares is in respect of options granted by the company to subscribe for newly issued shares.

Scheme	Number of shares under option	Subscription price per share	Exercise period
Executive share option schemes	50,000	151.00	03.01.1999 to 02.01.2006
	20,000	74.50	19.12.1999 to 18.12.2006
	171,404	89.00	20.07.2001 to 19.07.2008
	120,216	122.50	08.07.2002 to 07.07.2009
	76,350	118.00	09.09.2002 to 08.09.2009
	183,664	96.33	23.06.2003 to 22.06.2010
	560,975	123.00	22.11.2003 to 21.11.2010
	544,412	99.33	25.06.2004 to 24.06.2011
	39,204	79.50	28.11.2004 to 27.11.2011
	170,229	104.33	31.01.2005 to 30.01.2012
	134,615	104.00	20.02.2005 to 19.02.2012
	1,852,453	124.50	24.06.2005 to 23.06.2012
	120,000	106.33	27.11.2005 to 26.11.2012
	750,000	115.60	30.06.2006 to 29.06.2013
	1,577,925	126.00	06.07.2007 to 05.07.2014
Total outstanding share options	6,371,447		

Options granted to Directors are summarised in the Remuneration report on pages 24 to 30 and are included in the outstanding options set out above.

27. Reserves

	Group share premium account £m	Group capital redemption reserve £m	Group profit and loss account £m
At 1 April 2004 as previously reported	38.6	30.6	(58.2)
Prior year adjustment (note 12)	–	–	(4.0)
At 1 April 2004 as restated	38.6	30.6	(62.2)
Shares issued on exercise of options	0.4	–	–
Shares issued as consideration for purchase of Peterhouse	31.3	–	–
Share issue costs	(1.0)	–	–
Currency translation differences on foreign currency net investments and related loans	–	–	–
Movement on Employee Share Ownership Plans	–	–	–
Retained profit for the financial year	–	–	11.2
At 31 March 2005	**69.3**	**30.6**	**(51.0)**

	Company share premium account £m	Company capital redemption reserve £m	Company profit and loss account £m
At 1 April 2004 as previously reported	38.6	30.6	14.2
Prior year adjustment (note 12)	–	–	(4.0)
At 1 April 2004, as restated	38.6	30.6	10.2
Shares issued on exercise of options	0.4	–	–
Shares issued as consideration for Peterhouse acquisition	31.3	–	–
Share issue costs	(1.0)	–	–
Movement on Employee Share Ownership Plan	–	–	0.6
Retained profit for the financial year	–	–	20.1
At 31 March 2005	**69.3**	**30.6**	**30.9**

27. Reserves (continued)

During the year the company acquired no ordinary shares through the Babcock Employee Share Trust (the 'Trust') in respect of its potential obligation under the Babcock 1999 Executive Share Option Schemes and the Babcock 2003 L-TIP. During the year ended 31 March 2005 193,528 shares were disposed of resulting from options exercised. At 31 March 2005, the Trust held 3,574,439 ordinary shares at a total market value of £5,325,914 representing 1.72% 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 provision represents an allowance for future L-TIP vesting.

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 long-term incentive plan referred to on page 25. 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 rests 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 issued ordinary shares of the company.

During the year the company acquired Peterhouse Group plc for a consideration of cash and shares in the company. As a consequence, the Trustee of the Peterhouse Group PLC 1998 Employee Trust ('the Trust'), acquired 622,640 Babcock ordinary shares. The trustee subsequently agreed to operate the Trust in conjunction with the Babcock 1999 Approved Executive Share Option Plan and the Babcock 1999 Unapproved Share Option Plan and granted options over 622,640 shares to employees under the terms of those two plans.

The trust enables shares in the company to be purchased and made available to employees of the Peterhouse subsidiary mainly through the grant of options over the shares under the terms of the above two Plans.

The Trustee does not have the power to waive dividends due on Babcock ordinary shares and therefore receives the full amount of any dividends declared.

The company is excluded from benefiting under the Trust. The Trust is controlled and managed outside of the UK and has a single corporate trustee, Royal Bank of Canada Trust Company (Jersey) Limited.

28. Equity minority interests

	2005 £m	2004 £m
As at 1 April 2004	–	–
Profit for the year	0.1	–
At 31 March 2005	0.1	–

29. Group cash flow statement

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

	2005 £m	2004 £m
Group operating profit	35.9	21.9
Depreciation, amortisation and impairment charges	19.7	8.2
Increase in stocks	(5.0)	(8.5)
(Increase)/decrease in debtors	(22.2)	13.7
Increase/(decrease) in creditors	8.6	(7.1)
Increase/(decrease) in provisions	5.3	(0.1)
Loss/(profit) on sale of fixed assets	0.9	(0.1)
Net cash inflow from operating activities	43.2	28.0
Net cash inflow from operating activities comprises:		
Existing operations	25.9	27.9
Acquisitions	17.3	–
Continuing operating activities	43.2	27.9
Discontinued operating activities	–	0.1
	43.2	28.0

(b) Movement in net debt:

	2005 £m	2004 £m
Increase in cash in the year	14.6	2.1
Increase/(decrease) in liquid resources in the year	5.6	(0.2)
Cash flow from (increase)/decrease in debt and lease financing	(19.8)	20.5
Change in net funds resulting from cash flows	0.4	22.4
Loans and finance leases acquired with subsidiaries	(47.2)	–
New finance leases	(0.9)	(0.1)
Translation differences	0.2	(0.5)
Movement in net debt in the year	(47.5)	21.8
Net debt at 1 April	(15.4)	(37.2)
Net debt at 31 March	(62.9)	(15.4)

29. Group cash flow statement (continued)

(c) Changes in net debt:

	At 1 April 2004 £m	Cash flow £m	New finance leases £m	Subsidiaries disposed/ acquired £m	Exchange movement £m	**At 31 March 2005 £m**
Cash in hand and at bank	14.6	(17.9)	–	27.9	–	**24.6**
Overdrafts	(11.3)	15.2	–	(10.6)	–	**(6.7)**
	3.3	(2.7)	–	17.3	–	**17.9**
Debt	(20.5)	(23.1)	–	(37.3)	0.1	**(80.8)**
Finance leases	(1.1)	3.3	(0.9)	(9.9)	0.1	**(8.5)**
	(21.6)	(19.8)	(0.9)	(47.2)	0.2	**(89.3)**
Liquid resources	2.9	5.6	–	–	–	**8.5**
Total	(15.4)	(16.9)	(0.9)	(29.9)	0.2	**(62.9)**

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

	2005 Disposals £m	**2005 Acquisitions £m**	2004 Disposals £m	2004 Acquisitions £m
Net cash consideration	**–**	**(40.2)**	2.6	0.6
Net cash (disposed) of/acquired	**0.1**	**17.0**	–	–
Other payments and receipts	**(3.3)**	**(3.3)**	(1.5)	(0.3)
Net cash flow	**(3.2)**	**(26.5)**	1.1	0.3

i. Disposals

The inflow from net cash disposed of represents the overdraft disposed of within CMR. Other payments and receipts are cash flows relating to previously disposed of businesses.

ii. Acquisitions

The cash outflow in respect of acquisitions represents consideration of £31.7 million for Peterhouse, £2.8 million for TCM, £3.9 million for Turners and deferred consideration paid of £1.8 million for SGI purchased on 19 June 2002. The cash acquired relates to the Peterhouse acquisition. Other payments represent costs in Peterhouse of £3.0 million, Turners of £0.2 million and further costs for SGI.

30. Acquisitions and disposals

(a) Acquisitions

On 14 June 2004 Babcock acquired Peterhouse Group Plc, the following is a summary of the provisional acquisition balance sheet:

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

	Peterhouse book value £m	Peterhouse Provisional fair value adjustments £m	Peterhouse Provisional fair value £m
Tangible fixed assets	37.8	(7.7)	30.1
Investments	5.1	–	5.1
Total fixed assets	**42.9**	**(7.7)**	**35.2**
Stocks	5.2	1.6	6.8
Debtors	104.8	12.7	117.5
Cash	27.8	–	27.8
Creditors	(103.0)	(0.3)	(103.3)
Finance lease	(9.9)	–	(9.9)
Borrowings	(37.3)	–	(37.3)
Net current assets	(12.4)	14.0	(1.6)
Provisions for liabilities and charges	(14.8)	(3.6)	(18.4)
Net assets acquired	**15.7**	**2.7**	**18.4**
Fair value of consideration:			
Cash			31.7
Shares			64.7
Costs			3.0
			99.4
Goodwill arising (amortised over 20 years)			81.0

Included within finance leases is £6.8 million due after more than one year.

The fair value adjustments include impairment of fixed assets for under performing businesses, offset by upward property revaluations. In addition stocks and fixed assets include upward revaluations to reflect realised values on asset sales post acquisition. Included within debtors, the principal upward adjustment is in relation to defined benefit pension scheme SSAP 24 surpluses, offset by write downs in relation to debtor recoverability. The fair value adjustments to provisions is in relation to legal claims and onerous leases, offset by the deferred tax on the SSAP 24 pension surpluses referred to above.

30. Acquisitions and disposals (continued)
On 14 June 2004 the percentage of acceptances received was 55.7% with the remaining acceptances received over the following months. The change in percentage ownership in this period did not materially affect the fair value of assets acquired or the resultant goodwill reflected above.

From 1 January 2004 to 13 June 2004 Peterhouse Group Plc had sales of £208.2 million and a trading profit of £3.0 million; loss before taxation was £2.1 million and taxation £1.1 million. The loss after tax for Peterhouse Group Plc for the year to 31 December 2003 was £10.5 million. There is no material difference between profit after tax and to recognised gains and losses for the period to 13 June 2004.

On 10 September 2004 the group acquired Turner and Partners. Turner and Partners has been classified in Networks.

On 1 November 2004 the group acquired TCM. TCM has been classified within Engineering and Plant Services.

	Turner and Partners book and fair value £m	Other acquisitions book and fair value £m
Tangible fixed assets	0.1	2.6
Stocks	–	0.1
Debtors	1.4	0.3
Cash	0.1	–
Creditors	(1.2)	(0.2)
Finance lease	–	–
Borrowings	–	–
Provisions for liabilities and charges	–	–
Net assets acquired	**0.4**	**2.8**
Fair value of consideration:		
Cash	3.9	2.8
Contingent consideration	3.3	–
Costs	0.2	–
	7.4	2.8
Goodwill arising	7.0	–

(b) Disposals
On 13 July 2004 the group sold CMR Consultants Limited and on 10 June 2004 the group sold Babcock Defence Services Australia Pty Limited.

	Total disposals £m
Tangible fixed assets	0.1
Stocks and work in progress	–
Debtors	0.5
Cash	0.1
Creditors	(0.3)
Borrowings	(0.3)
Net assets disposed	**0.1**
Loss on sale	**(0.1)**
Net sale proceeds	**–**

31. Financial commitments

Capital commitments

	2005 £m	2004 £m
Authorised future capital expenditure of the group at 31 March that was contracted for but not provided for in the Financial Statements	–	0.1

The company had no capital expenditure contracted for at 31 March 2005 (2004: £nil).

Operating lease commitments

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

	2005 Land and buildings £m	2005 Plant machinery and vehicles £m	2004 Land and buildings £m	2004 Plant machinery and vehicles £m
Leases expiring:				
Within one year	**0.6**	**2.0**	0.4	0.2
Within two to five years	**2.1**	**3.4**	1.0	0.6
Thereafter	**4.8**	**–**	2.5	–
	7.5	**5.4**	3.9	0.8

Company The company has an operating lease commitment for land and buildings as at 31 March 2005 with an annual commitment expiring after more than five years of £2.2 million (2004: £1.7 million).

32. Contingent liabilities

(a) The company has guaranteed or has joint and several liability for bank facilities of £179.5 million (2004: £88.5 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 2005 these amounted to £22.9 million (2004: £6.5 million), of which the company had counter-indemnified £15.0 million (2004: £6.0 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.

33. 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 ventures

(i) During the year a group subsidiary sold services to, its joint venture Debut Services Limited for £74,977,000 (2004: £nil). The amounts outstanding at year end on these sales were £78,000. All transactions with the joint venture arise in the normal course of business.

(ii) During the year a group subsidiary sold goods to its joint venture DynCorp-Hiberna Limited for £176,000 (2004: £305,000). The amount outstanding at year end was £97,000 (2004: £56,000). A group subsidiary also made loans to the joint venture. The amount outstanding at year end was £138,000 (2004: £267,000). All transactions with the joint venture arise in the normal course of business.

(iii) During the year a group subsidiary sold services and purchased services from its joint venture One Network Solutions Limited for £146,000 and £107,000 respectively (2004: £nil). The amounts outstanding at year end on these sales and purchases were £32,000 and £61,000 respectively (2004: £nil and £nil). All transactions with the joint venture arise in the normal course of business.

(iv) During the year a group subsidiary sold services to, and purchased services from, its joint venture 40 Seven Limited for £54,000 and £116,000 respectively (2004: £nil). The amounts outstanding at year end on these sales and purchases were £1,000 and £10,000 respectively (2004: £nil). All transactions with the joint venture arise in the normal course of business.

(v) During the year a group subsidiary sold services to First Swietelsky Operation and Maintenance for £4,646,000 (2004: £nil). The amounts outstanding at year end on these sales were £773,000 (2004: £nil). All transactions with the joint venture arise in the normal course of business.

(vi) During the year a group subsidiary sold services to First Swietelsky Joint Venture High Output for £7,154,000 (2004: £nil). The amounts outstanding at year end on these sales were £2,744,000 (2004: £nil). 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 from, and sold to BAE Systems PLC for £1,068,449 and £2,553,853 respectively (2004: £122,000 and £470,000). The amounts outstanding at year end on these purchases and sales were £56,724 and £717,034 respectively (2004: £117,000 and £370,000). 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 sold ordinary shares through the Babcock Employee Share Trust. Further information is given in note 27 on page 58.

34. Subsequent events

There are no material events subsequent to 31 March 2005 that are required to be disclosed.

Principal subsidiary and associated undertakings

Defence Services

Babcock Naval Services Limited
Air Power International Limited

Technical Services

Babcock Design & Technology Limited
Babcock Support Services Limited
Hiberna FM Limited
Marine Engineering & Fabrications Limited
Rosyth Royal Dockyard Limited

Engineering and Plant Services

Babcock Africa (Pty) Limited (South Africa)
Babcock Africa Services (Pty) Limited (South Africa)
Babcock Eagleton Inc. (USA)
Babcock Ntuthuko (Pty) (Limited) (South Africa)

Rail

First Engineering Holdings Limited
First Projects Limited

Networks

Eve Group Limited
Eve Trakway Limited
Eve GmbH (Germany)
Turner and Partners Technical Services Limited

Health Safety and Environmental

Integrated Environmental Tech Group Limited
Integrated Safety Services Group Limited
Pivotal Services Limited

Others

Acetech Personnel Limited
Babcock Holdings Limited
Babcock Holdings (USA) Inc. (USA)
Babcock International Holdings BV (Netherlands)
Babcock International Limited
Babcock Investments Limited
Babcock Management Limited
Babcock Overseas Investments Limited
Babcock Support Services (Investments) Limited
Chepstow Insurance Limited (Guernsey)
Peterhouse Group Limited
PHG Insurance Limited

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

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

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

Notice of meeting

Notice is hereby given that the sixteenth Annual General Meeting of the members of Babcock International Group PLC ('the company') will be held at The London Marriott Marble Arch Hotel, 134 George Street, London W1H 5DN, on Tuesday 19 July 2005, at 11.30 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 2005.

(2) To declare a final dividend for the year ended 31 March 2005 as recommended by the Directors.

(3) To re-elect Mr P L Rogers as a Director of the company.

(4) To re-elect Mr W Tame as a Director of the company.

(5) To re-elect Mr D Shah as a Director of the company.

(6) To re-elect Mr J Rennocks as a Director of the company.

(7) To re-elect Lord Hesketh as a Director of the company.

(8) To approve the Remuneration Report of the Directors for the year ended 31 March 2005.

(9) To reappoint PricewaterhouseCoopers LLP as Auditors.

(10) To authorise the Directors to set the remuneration of the Auditors, as they shall in their discretion see fit.

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

Ordinary Resolutions

(11) That, in substitution for any existing authority, the Directors are hereby authorised, for the purposes of section 80 of the Companies Act 1985 ('the Act'), to exercise all the powers of the company to allot relevant securities (within the meaning of section 80(2) of the Act) up to an aggregate nominal amount of £41,671,040, this authority to expire on 18 July 2010 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).

(12) That the company is hereby authorised to make Donations to EU Political Organisations and incur EU Political Expenditure during the period from the date of this resolution until the date of the company's Annual General Meeting in 2008 provided that the aggregate amount of such donations and expenditure made by the company and any other company authorised by a resolution of the shareholders of the company during that period shall not exceed £150,000 (one hundred and fifty thousand pounds). For the purposes of this resolution, 'Donations', 'EU Political Organisations' and 'EU Political Expenditure' have the meanings set out in Part XA of the Companies Act 1985.

(13) That Babcock Support Services Limited, being a wholly owned subsidiary of the company, is hereby authorised to make Donations to EU Political Organisations and incur EU Political Expenditure during the period from the date of this resolution until the date of the company's Annual General Meeting in 2008 provided that the aggregate amount of such donations and expenditure made by Babcock Support Services Limited and any other company authorised by a resolution of the shareholders of the company during that period shall not exceed £150,000 (one hundred and fifty thousand pounds). For the purposes of this resolution, 'Donations', 'EU Political Organisations' and 'EU Political Expenditure' have the meanings set out in Part XA of the Companies Act 1985.

(14) That Babcock Naval Services Limited, being a wholly owned subsidiary of the company, is hereby authorised to make Donations to EU Political Organisations and incur EU Political Expenditure on the terms set out in resolution 13 in the notice of this meeting, replacing the name Babcock Support Services Limited with Babcock Naval Services Limited.

(15) That Eve Group Limited, being a wholly owned subsidiary of the company, is hereby authorised to make Donations to EU Political Organisations and incur EU Political Expenditure on the terms set out in resolution 13 in the notice of this meeting, replacing the name Babcock Support Services Limited with Eve Group Limited.

(16) That First Engineering Limited, being a wholly owned subsidiary of the company, is hereby authorised to make Donations to EU Political Organisations and incur EU Political Expenditure on the terms set out in resolution 13 in the notice of this meeting, replacing the name Babcock Support Services Limited with Eve Group Limited.

Special Resolutions

(17) That the Directors are hereby empowered to allot equity securities (as defined in section 94 of the Companies Act 1985 ('the Act')) for cash pursuant to the authority conferred by resolution 11 in the notice of this meeting as if section 89(1) of the 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 £6,250,656,

and shall, unless previously revoked, renewed or varied, expire on 18 July 2010, 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.

This power applies in relation to a sale of shares which is an allotment of equity securities by virtue of section 94(3A) of the Act as if in the first paragraph of this resolution the words 'pursuant to the authority conferred by resolution 11' were omitted.

(18) That the company is hereby 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 20,800,000;

(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 2006 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
16 June 2005
Registered Office: 2 Cavendish Square, London W1G 0PX

Notes:

(1) As required by the Combined Code, the reasons why the Board of the company believes that the non-executive Directors standing for re-election (Lord Hesketh, Mr Shah and Mr Rennocks) should be elected are set out in the Accompanying Notes on page 65.

(2) An explanation of the special business resolutions is given in the Explanatory Notes on page 65.

(3) 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.

(4) 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.

(5) 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.

(6) The register of Directors' interests in the share capital of the company, together with copies of service agreements or terms of appointment under which Directors of the company are engaged, 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.

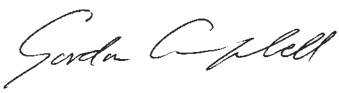
Accompanying Notes
The Combined Code requires the Board to set out the reasons why it believes that the non-executive Directors standing for election (Lord Hesketh, Mr Shah and Mr Rennocks) should be elected. These are as follows:

Lord Hesketh: Whilst he has been a non-executive Director since 1993, any concerns about the non-independent status of Lord Hesketh have now been addressed, in that if he were to be re-elected he would no longer be a member of the company's Remuneration and Audit and Risk Committees, nor would he be the nominated senior independent Director. However, the Board still values highly the contribution that he is able to bring to its meetings, the counsel that he gives and his insights into the operation of government and the political world, all of which are matters of particular relevance to many of the group's businesses.

Dipesh Shah: Mr Shah has been a valued member of the Board since 1999. The Board appreciates his active commitment to and participation in all its meetings and those of its committees. He brings a range of valuable experience and insight from other business operations in which he has or had a leading role.

John Rennocks: Mr Rennocks is one of the company's more recently appointed non-executive Directors. Being a former finance director of public companies, he is well qualified to continue in the role of Chairman of the company's Audit and Risk Committee, having recent and relevant financial experience, which is well supplemented by the ongoing knowledge and experience he gains from his other directorships.

Note from The Chairman:
"I can confirm, as required by the Combined Code, that having fully evaluated their performance, the Board is of the view that each of Lord Hesketh, Mr Shah and Mr Rennocks continues to be effective and to demonstrate commitment to their roles, including commitment of time, for Board and, where applicable, Committee Meetings and other duties."



Gordon Campbell

Explanatory Notes

Resolution 11, 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 £41,671,040, which represents approximately one-third of the issued share capital of the company as at 1 June 2005. This authority, which replaces the ones granted on 18 July 2003 and 4 May 2004, would expire on 18 July 2010 unless previously revoked, renewed or varied. The Directors have no present intention of issuing any shares except, possibly, in connection with the group's executive and employee share schemes.

Resolutions 12 to 16 will be proposed as Ordinary Resolutions. The Companies Act 1985 requires companies to obtain shareholder authority before they can make donations to EU political organisations (which includes UK political parties). The definition of political donations used in the Act is very broad and, as a result, it may have the effect of covering a number of normal business activities that would not be thought to be political donations in the usual sense. To avoid any possibility of inadvertently contravening the Act, the directors consider that it would be prudent to follow the procedures specified in the Act to obtain shareholder approval for the company and its wholly owned subsidiaries Babcock Support Services Limited, Babcock Naval Services Limited, Eve Group Limited and First Engineering Limited to make donations to EU political organisations and incur EU political expenditure of up to £150,000 in total over the period of three years from the date of the 2005 Annual General Meeting. This would replace a similar authority taken at the 2002 Annual General Meeting. The company's policy remains that it does not, directly or through any subsidiary, make what are commonly regarded as donations to any political party and the authority being requested from shareholders is not designed to change this policy.

Resolution 17, which will be proposed as a Special Resolution, empowers the Directors in certain circumstances to allot or grant rights over shares and also to sell shares held by the company as treasury 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 £6,250,656, being 5% of the issued share capital of the company as at 1 June 2005. If given, the power conferred by this resolution would expire on 18 July 2010 unless previously revoked, renewed or varied.

Resolution 18, which will be proposed as a Special Resolution, will renew the general authority for the company to make market purchases of its own ordinary shares. The renewed authority, in respect of a little under 10% of the company's issued share capital as at 1 June 2005, 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 would expire on 31 December 2006 or, if earlier, at the conclusion of the Annual General Meeting of the company to be held in 2006. Shares purchased under the authority would either be cancelled or held by the company as treasury shares. 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 be held as treasury shares to fulfil obligations under the company's executive or 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 1 June 2005 (being the latest practicable date before publication of the notice of meeting) was 2,584,654 representing 1.24% of issued share capital as at 1 June 2005. If the full authority to buy back shares were to be used, and the shares cancelled, these outstanding options would represent 1.38% of issued share capital.

Five year financial record

	2005 £m	2004 (as restated) £m	2003 £m	2002 £m	2001 £m
Group turnover	**760.0**	452.0	423.5	423.0	441.0
Operating profit/(loss)*	**36.2**	22.0	18.7	0.9	(4.8)
Exceptional items	**(1.6)**	(1.7)	(2.7)	(13.8)	(6.2)
Profit/(loss) on ordinary activities before interest	**34.6**	20.3	16.0	(12.9)	(11.0)
Net interest and similar charges	**(6.2)**	(0.5)	(2.6)	(1.0)	3.7
Profit/(loss) on ordinary activities before taxation	**28.4**	19.8	13.4	(13.9)	(7.3)
Tax on ordinary activities	**(7.7)**	(3.4)	(5.1)	(3.1)	(1.2)
Profit/(loss) on ordinary activities after taxation	**20.7**	16.4	8.3	(17.0)	(8.5)
Minority interests	**(0.1)**	–	–	(0.1)	3.2
Profit/(loss) attributable to shareholders	**20.6**	16.4	8.3	(17.1)	(5.3)
Fixed assets	**192.0**	90.4	99.3	85.1	114.7
Net current assets	**45.4**	51.7	34.5	25.6	33.9
Non-current liabilities and provisions	**(63.4)**	(45.0)	(46.4)	(29.7)	(39.7)
Total net assets	**174.0**	97.1	87.4	81.0	108.9
Shareholders' funds	**173.9**	97.1	87.3	81.0	105.7
Minority interests	**0.1**	–	0.1	–	3.2
	174.0	97.1	87.4	81.0	108.9
Earnings/(loss) per share – basic	**10.87p**	11.31p	5.72p	(11.86)p	(3.34)p
Dividends per share	**4.00p**	3.35p	3.00p	2.85p	2.65p

*Includes operating loss/profit of joint ventures and associates.

International financial reporting standards – update

Following the EU's adoption of Regulation No. 1606/2002 on the use of International Financial Reporting Standards (IFRS) by EU-listed companies, the group is implementing IFRS from 1 April 2005. The first financial information to be reported by the group in accordance with IFRS will be for the six months ending 30 September 2005 but the requirement to present comparative information means that a balance sheet as at 31 March 2004 and primary statements for 2005 prepared in accordance with IFRS will also be required. The group has continued to report its consolidated accounts in accordance with UK GAAP for 2005.

Interpretation of the standards is still evolving, consequently information given is subject to change. However, in order to assist stakeholders in understanding the potential impact of application of the standards the following provides guidance as to the main areas affected by the transition to IFRS.

(a) Share based payments

Under IFRS 2 'Share based payments', share options and other share based remuneration are expensed through the profit and loss account based on their fair value at the date of grant to employees and spread over the vesting period, taking into account the number expected to vest. Under UK GAAP only the intrinsic value is expensed. As a result additional expense will be recognised in the IFRS income statement.

(b) Pension schemes

Under UK GAAP, the group currently accounts for defined benefit pension schemes in accordance with SSAP 24 'Accounting for Pension Costs' (SSAP 24). The group also reports the transitional disclosures required in accordance with FRS17 Retirement Benefits (FRS17).

The methodology and assumptions used to calculate the value of pension assets and liabilities under FRS17 are substantially consistent with the requirements of IAS 19 'Employee Benefits' (IAS 19). In accordance with the requirements of IAS 19, the group will be reviewing the allocation of the IAS pension deficit/surplus to the underlying group subsidiary companies.

The above adjustments reflect a full balance sheet recognition interpretation of the Standard whereby the full pension deficit/surplus is reflected within the balance sheet with actuarial movements going through the Statement of Recognised Income and Expense. The group will finalise its policy in this area when further clarity emerges as to generally adopted accounting practice.

Under IAS 19 any significant change in the active pension population will result in either a curtailment gain or loss. During the year a number of redundancies in one of the subsidiaries has resulted in an exceptional curtailment gain.

(c) Goodwill

Babcock has elected to utilise the exemption under IFRS 1 'First Time Adoption of International Financial Reporting Standards' to not restate business combinations prior to the transition date. Goodwill arising before 31 March 2004 will not therefore be restated with the exception of negative goodwill. Under IFRS 3 'Business Combinations', negative goodwill is credited to reserves. This means that the previously held negative goodwill is eliminated on the transition to IFRS. Under IFRS, goodwill is no longer amortised and, is instead assessed annually for impairment.

(d) Intangibles

Other intangible assets arising from acquisitions after 1 April 2004 are separately identified and will be amortised over their useful economic lives. These intangibles represent the estimated value of contracts and relationships which previously formed part of general goodwill.
The exceptional gain realised on the early termination of the Rail Maintenance contracts is valued in the acquisition balance sheet as an intangible asset and fully amortised in the year.

(e) Dividends

Under SSAP 17 'Post Balance Sheet Events', proposed dividends are accrued for as an adjusting post balance sheet event in the accounting period to which they relate. Under IAS 10 'Events after the balance sheet date', dividends are recognised in the accounting period in which they are declared. The final dividend accrual is therefore reversed in the consolidated IFRS accounts for the period.

(f) Other

(i) Holiday pay

As a result of further more prescriptive guidance in IAS 19, holiday pay accruals and prepayments are required.

(ii) Long-term contracts

Under IFRS all contracts which are in progress at a reporting date are accounted for as long-term contracts. Under UK GAAP only 'significant' contracts are accounted for as long term. This results in a small profit change due to the difference in timing. Additionally, disclosure and balance sheet classifications differ under IFRS, although not creating net asset changes.

(iii) Discounting debtors

Under IAS 18 'Revenue', account must be taken of any inbuilt financing within extended payment terms. Where payment terms are deemed to fall into this category the related debtor is stated at the present value after discounting at prevailing interest rates. The deemed financing element of the debt is credited to profit and loss, as interest income, as the discount unwinds. Application of this standard will result in a small adjustment to profit before tax and net assets for extended credit in non-UK subsidiaries. This adjustment is a timing difference only.

(iv) Financial instruments

Babcock has elected to utilise the exemption under IFRS 1 'First Time adoption of International Financial Reporting Standards' to not restate comparatives for IAS 32 'Financial Instruments: disclosure and presentation' and IAS 39 'Financial Instruments: recognition and measurement'. These reporting standards will be implemented from 1 April 2005 onwards.

(v) Joint ventures

Under IFRS 31 'Financial Reporting of Interests in Joint Ventures' the group has the option of adopting the equity investment method or proportional consolidation method for reporting interests in joint ventures. The treatment will be reviewed and a firm policy adopted prior to the reporting of the interim results.

(vi) Tax

Under IAS 12 'Income Taxes' certain temporary differences, some of which were not recognised under UK GAAP, will be recognised.

Shareholder information

Financial calendar	
Financial year end	31 March 2005
2004/05 preliminary results announced	26 May 2005
Annual General Meeting	19 July 2005
Final dividend payment date (record date 8 July 2005)	8 August 2005*

*See also 'Results and Dividends' on page 17.

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Share dealing service
The following share dealing services are available through our Registrars, Computershare Investor Services PLC:

Internet share dealing
This service provides shareholders with an easy way to buy or sell Babcock International Group PLC ordinary shares on the London Stock Exchange. The commission is 0.5%, subject to a minimum charge of £15.00. In addition stamp duty, currently 0.5%, is payable on purchases. There is no need to open an account in order to deal. Real time dealing is available during market hours. In addition there is a facility to place your order outside of market hours. Up to 90 day limit orders are available for sales. To access the service log on to www.computershare.com/dealing/uk. Shareholders should have their Shareholder Reference Number (SRN) available. The SRN appears on share certificates. A bank debit card will be required for purchases. Please note that, at present, this service is only available to shareholders in certain European jurisdictions. Please refer to the website for an up-to-date list of these countries.

Telephone share dealing
Please note that this service is, at present, only available to shareholders resident in the UK and Ireland. The commission is 1%, subject to a minimum charge of £15.00. In addition, stamp duty, currently 0.5%, is payable on purchases. The service is available from 8.00 am to 4.30 pm Monday to Friday, excluding bank holidays, on telephone number 0870 703 0084. Shareholders should have their Shareholder Reference Number (SRN) ready when making the call. The SRN appears on share certificates. A bank debit card will be required for purchases. Detailed terms and conditions are available on request by telephoning 0870 703 0119.

These services are offered on an execution only basis and subject to the applicable terms and conditions. This is not a recommendation to buy, sell or hold shares in Babcock International Group PLC. Shareholders who are unsure of what action to take should obtain independent financial advice. Share values may go down as well as up which may result in a shareholder receiving less than he/she originally invested.

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