Babcock International Group PLC
Annual report and accounts 2006

Welcome to Babcock

Babcock International Group PLC is an asset management business. We manage fixed infrastructure and mobile assets. Babcock integrates labour, technical capabilities, systems and supply chain partners to meet the outsourcing needs of customers for 'mission-critical' capabilities.

Delivering consistently strong performance and excellent shareholder value.

Statutory

Revenue	Operating profit
£836.7m +15%	£46.6m +32%

Profit before tax	Continuing earnings per share
£41.3m +40%	16.06p +43%

Dividend proposal	Net debt
6.00p +50%	£38.2m

Underlying (before amortisation of acquired intangibles and exceptionals)

Operating profit	Profit before tax
£49.9m +20%	£44.6m +25%

Continuing earnings per share	
17.18p +19%	

Business highlights

- Record results: revenue up 15%, underlying PBT up 25%
- Significant contracts secured, supporting further growth:
  Eastern Regional Prime, Network Rail High Output and contract extension for management of HM Naval Base Clyde
- Order book of £2.3bn provides excellent visibility
- Strong balance sheet – year end net debt £38.2m, overall pension surplus
- Excellent growth opportunities in all our markets, including defence, rail, telecoms and transmission
- Further major opportunities include:
  Royal School of Military Engineering contract – financial close expected in mid 2007
  Defence Training Review – decision expected in October 2006

Chairman's statement

With a highly visible order book, of the order of three times this year's turnover, Babcock is well placed to deliver strong growth in both turnover, earnings and shareholder value.

The year ending March 2006 was another record year for Babcock with profit before tax, before amortisation of acquired intangibles and exceptional items, increasing by 25% following a very strong performance in the previous year. This was achieved on an increase in turnover of 15% to £840 million and resulted in a further increase of 19% in earnings per share (on the same basis) to 17.2p per share. The Board are recommending a final dividend of 4.25p per share giving a total dividend for the year of 6.0p per share an increase of 50% on the previous year. This reflects the increased earnings, our confidence in Babcock's future prospects and our previous guidance that we intended to reduce the cover progressively to between three and two and a half times.

There was an equally strong performance in cash conversion and the net debt at the 31 March 2006 was only £38.2 million having peaked at the time of the Peterhouse acquisition in June 2004 at £104.5 million.

Our consistent strategy over the last five years has been to transform Babcock into a support services business in the more technically demanding environments. We essentially manage other people's assets utilising our well-qualified human resources. We now have a balanced customer base of national and international blue chip businesses, including the Ministry of Defence, Network Rail, the major telecommunication companies and National Grid, and we have an outstanding growth in South Africa supplying similar reputable companies.

The growth in turnover has been achieved by the careful and considered acquisition of a number of businesses, which have in themselves grown organically under the Babcock management. Having fully integrated the Peterhouse acquisition, we announced the purchase of Alstec Group Limited in May 2006. We are confident that this business fits our criteria, both in terms of its skill base and markets which it serves. We anticipate that it will be as successful as some of our earlier acquisitions. However, we have balanced some of these acquisitions with appropriate disposals where those businesses did not fit our vision for Babcock.

Babcock has been in discussion with industry participants and with the Ministry of Defence about various options for both submarine and surface ship support in relation to the restructuring of the UK maritime sector, and fully supports this initiative insofar as it is value adding for Babcock's shareholders. With the declining market for surface ship refit Babcock has downsized its marine operation so that it now comprises less than 20% of the Babcock business. However, we believe that the Rosyth asset will increase in value due to its strategic importance for the building and maintenance of the new aircraft carriers. We shall continue discussions with other industry participants to investigate the best structure to achieve the Ministry's requirements and maximise value for Babcock shareholders. The Board does not believe that a sale of Babcock, which was a possibility raised by VT and BAE Systems, is the way to achieve this.

Foremost in our minds has been delivering returns to shareholders and £100 invested in Babcock on the 31 March 2001 was worth £391 on 31 March 2006, compared to £131 had it been invested in the FTSE-All Share Index (excluding investment trusts). This significant increase in shareholder value results from the implementation of the above strategy and the Board believes that Babcock will continue to outperform its peer group. Such outstanding performance requires high quality management and our shareholders have been well served in this respect.

The Report and Accounts shows our compliance with the combined code. In the few cases where we do not comply fully with the combined code, we explain our reasoning. In particular, we continue to refresh the Board with appropriate skills and new insights. I am therefore pleased that Justin Crookenden, a former investment banker, has agreed to join the Board as an independent, non-executive Director and having joined the Board during the year he will offer himself for election at the forthcoming Annual General Meeting. Justin has already made a major contribution to the Board, and we look forward to his continuing to do so.

Whilst the short distraction of a possible offer for Babcock was unhelpful, I believe that it has caused a valuable reappraisal of the worth of the Babcock business. With a highly visible order book, of the order of three times this year's turnover, Babcock is well placed to deliver strong growth in both turnover, earnings and shareholder value. Such growth however depends on the hard work and commitment of our entire workforce, and I am sure that you would wish me to thank them for their contribution to an outstandingly successful year. I look forward to a continuation of that commitment which will deliver further growth in shareholder value.

Gordon Campbell Chairman

Each of our businesses is highly rated in its respective market and is therefore well placed to take a substantial share of the growth opportunities available to it.

Above:
Peter Rogers Group Chief Executive
Bill Tame Group Finance Director

Business profile

Babcock International Group PLC is an asset management business. We manage fixed infrastructure and mobile assets. Babcock integrates labour, technical capabilities, systems and supply chain partners to meet the outsourcing needs of customers for 'mission-critical' capabilities.

The group operates across five core business segments:

Defence Services

Defence Services supplies facilities management, equipment support and training services to the armed forces. It provides a range of logistic and equipment support services for the Royal Navy, British Army and RAF. It also helps customers maintain, operate and improve their estates. Typical customers are public sector organisations with complex infrastructure portfolios to service. Babcock is the only company to have been awarded two of the Ministry of Defence Regional Prime contracts, following its win last year of the South West Prime Contract with Bovis Lend Lease, and more recently the Regional Prime Contract East (RPCE) with DynCorp.

It holds a long-term partnering contract with the Ministry of Defence to operate HM Naval Base Clyde, key to the British submarine-borne nuclear deterrent. The division is responsible for engineering and a variety of associated support services at Faslane and Coulport, which make up HM Naval Base Clyde. In June 2005 an early extension to the partnering agreement was awarded, extending the relationship until 2013.

Technical Services

Technical Services supports the activities of customers in the oil and gas, defence, marine and supply chain service markets. The division maintains and refits Royal Navy warships and has the contract to provide electrical equipment to all three armed services.

It has been contracted to provide expert engineering support for the new NATO submarine rescue system. Defence Services will operate and maintain the project worldwide.

The Engineered Products business applies our engineering capabilities to the design construction, testing and commissioning of specialist modules and systems for major projects, notably as part of the Heathrow Terminal 5 alliance. It also supports the marine business and will have a major part to play in the construction of the new aircraft carrier (CVF).

Engineering and Plant Services

Engineering and Plant Services supplies design, installation and maintenance support to the energy sector in Africa and the US. It also holds the Volvo franchise for construction equipment in South Africa.

Networks

Networks is an industry leader in the power and telecommunications sectors. It provides services in industries, which include mobile and fixed line telecoms, broadcasting, leisure and power transmission. Key clients include National Grid and Scottish Power and leading mobile phone companies.

Rail

Rail focuses on multi-disciplinary rail infrastructure work, and it is unique with its range of services covering track renewals, signalling and control technology and rail power systems.

Reconciliation to statutory profit and loss

	Revenue 2006 £m	Revenue 2005 £m	Operating profit 2006 £m	Operating profit 2005 £m	Net margin 2006 %	Net margin 2005 %	Growth Revenue 2006 %	Growth Operating profit 2006 %
Total statutory	836.7	729.0	46.6	35.3	5.6	4.8	15	32
Amortisation of acquired intangibles			3.1	4.4				
Exceptional items			0.2	1.8				
Total underlying	836.7	729.0	49.9	41.5	6.0	5.7	15	20

Segmental Analysis

	Revenue 2006 £m	Revenue 2005 £m	Revenue Growth %	*Operating profit/Return on revenue 2006 £m	*Operating profit/Return on revenue 2005 £m	*Operating profit/Return on revenue Growth %
Defence Services	271.7	245.1	11	21.8	16.8	30
				8.0%	6.9%	
Technical Services	130.5	159.0	(18)	9.0	14.3	(37)
				6.9%	9.0%	
Engineering and Plant Services	144.2	112.7	28	9.7	4.8	102
				6.7%	4.3%	
Networks	73.0	45.2	62	6.4	2.9	117
				8.6%	6.4%	
Rail	217.3	167.0	30	8.8	8.4	5
				4.0%	5.0%	
Unallocated				(5.8)	(5.7)	
Total Continuing	836.7	729.0	15	49.9	41.5	20

*Before amortisation of acquired intangibles and exceptional items

Review of the year

In this review, unless otherwise stated, revenue ('turnover'), operating profit, operating margin, profit before tax and earnings per share refer to results from continuing operations, before amortisation of acquired intangibles and exceptional items. We believe that these adjusted results provide a better comparison of underlying performance. An analysis of amortisation of acquired intangibles, exceptional items and discontinued businesses is presented in separate sections of the review. The financial statements and accompanying notes have been prepared under International Financial Reporting Standards and comparative numbers for financial year 2005 have been restated accordingly. Details of how the 2005 prior year results were adjusted are included in the notes to the group financial statements.

The 2005/06 Financial Year continued the successful trend set in previous years with turnover growing by a further 15% and operating profits (before amortisation of acquired intangibles and exceptional items) by 20%. Earnings per share increased to 17.18p, an increase of 19% compared to last year.

The improvement in operating profit is particularly pleasing given the previously forecast fall off in contribution from Technical Services (£9.0 million compared to £14.3 million in 2005).

Operating profit growth across our other divisions (including a full year contribution from the Peterhouse businesses) was £13.7 million or 50%.

Contract wins in Eastern Regional Prime, Network Rail High Output and the extension to the contract for the management of HM Naval Base Clyde give us confidence that growth will be sustained.

The contract for the Royal School of Military Engineering is now in the final stages of its approval process within the Military of Defence and we expect to move to financial close in mid 2007. We continue in the high quality bid submitted for the Defence Training Review where a decision on the preferred bidder is expected in October 2006. These two contracts would add an estimated £100 million to turnover in a full year.

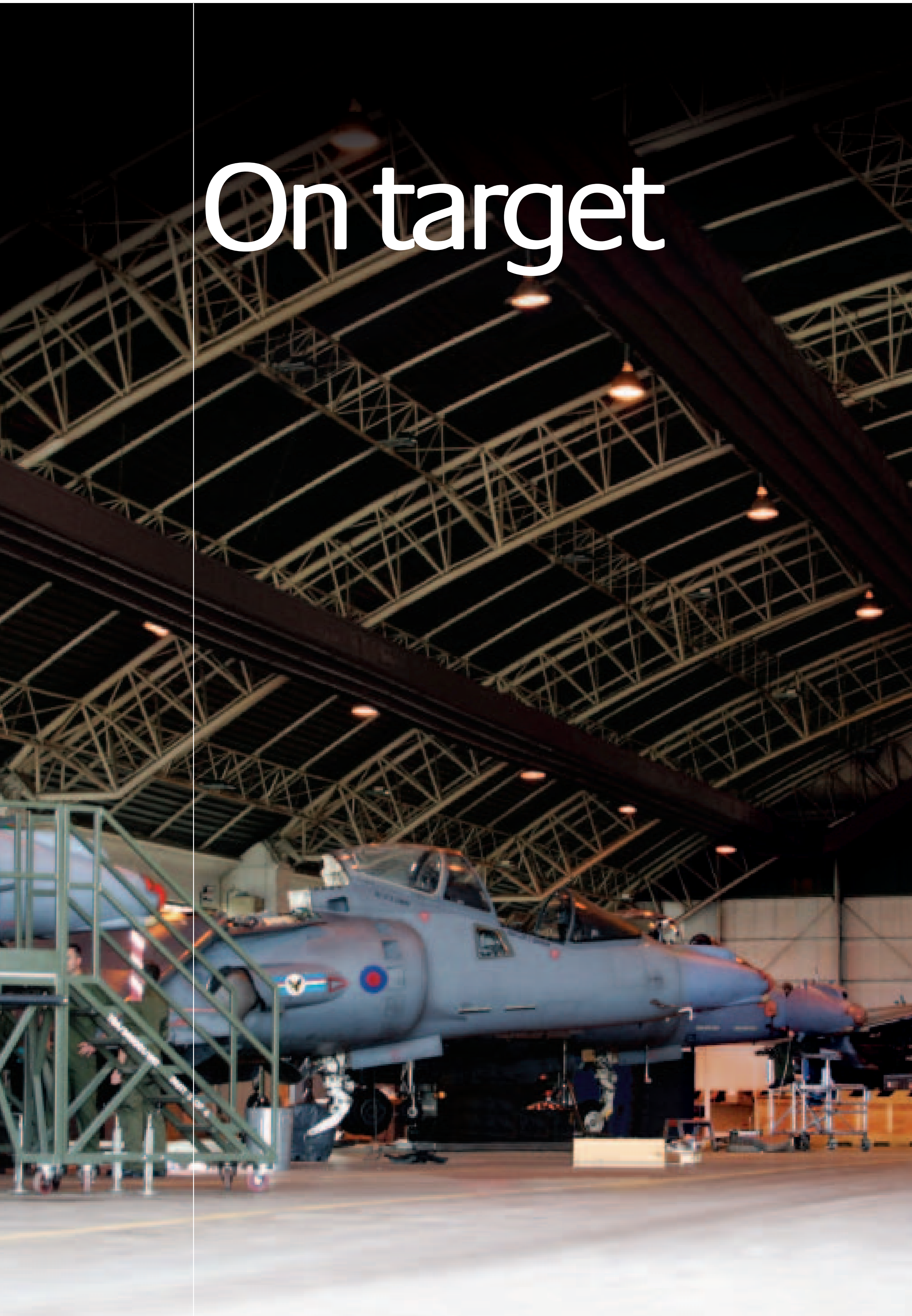
During 2005/06, and shortly after year end, we disposed of the remaining non-core businesses acquired with the Peterhouse Group, and subsequent to the year end, we acquired the Alstec business, which is addressed within Acquisitions in this Business review.

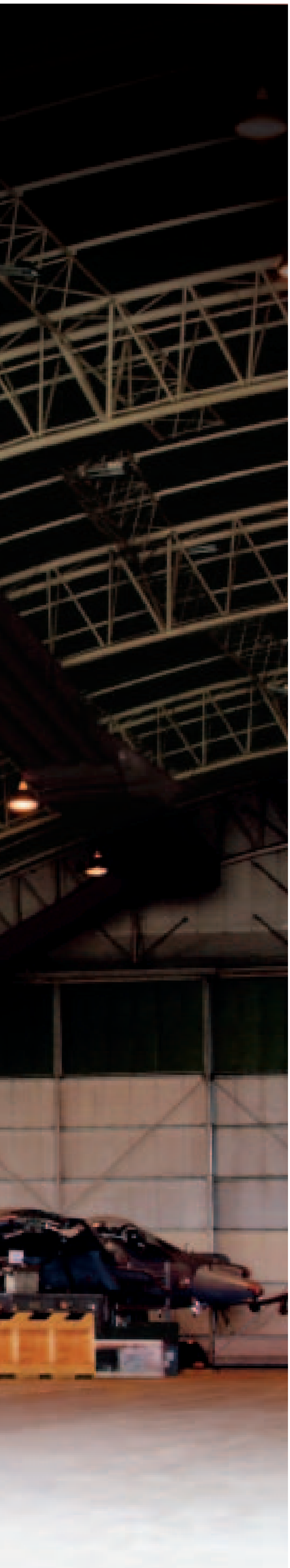
Each of the businesses, which we now operate, is highly rated in its respective market and is therefore well placed to take a substantial share of the growth opportunities available to it.

Operations

Over the following pages we look at the operational performance of our business segments.

On target



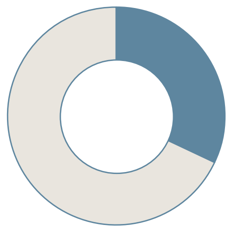


Defence Services

Turnover	Operating profit
£271.7m 2005: £245.1m	£21.8m 2005: £16.8m

Contribution to group turnover

32%



2005/06 was an excellent year for Defence Services, with turnover increasing by 11% and operating profit by 30%.

Looking forward, the securing of the Regional Prime East Contract (where delivery of service began only in March 2006) and the extension to the contract for HM Naval Base Clyde, give us confidence that growth will continue in 2006/07. Revenues from these two contracts are in excess of £120 million a year. We are also confident that an extension will be granted for the Single Living Accommodation Modernisation (SLAM) programme which will further strengthen Babcock's position as the leading supplier of built infrastructure support to the Ministry of Defence.

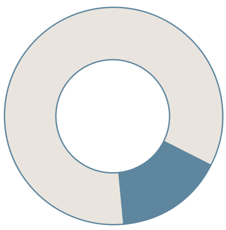
We continue to obtain additional revenue from Prime Contracts and are in active negotiation with Defence Estates on a number of additional projects, which we expect will increase revenue and profits on each of the South-West and Eastern Prime Contracts.

Technical Services

Turnover	Operating profit
£130.5m 2005: £159.0m	£9.0m 2005: £14.3m

Contribution to group turnover

16%

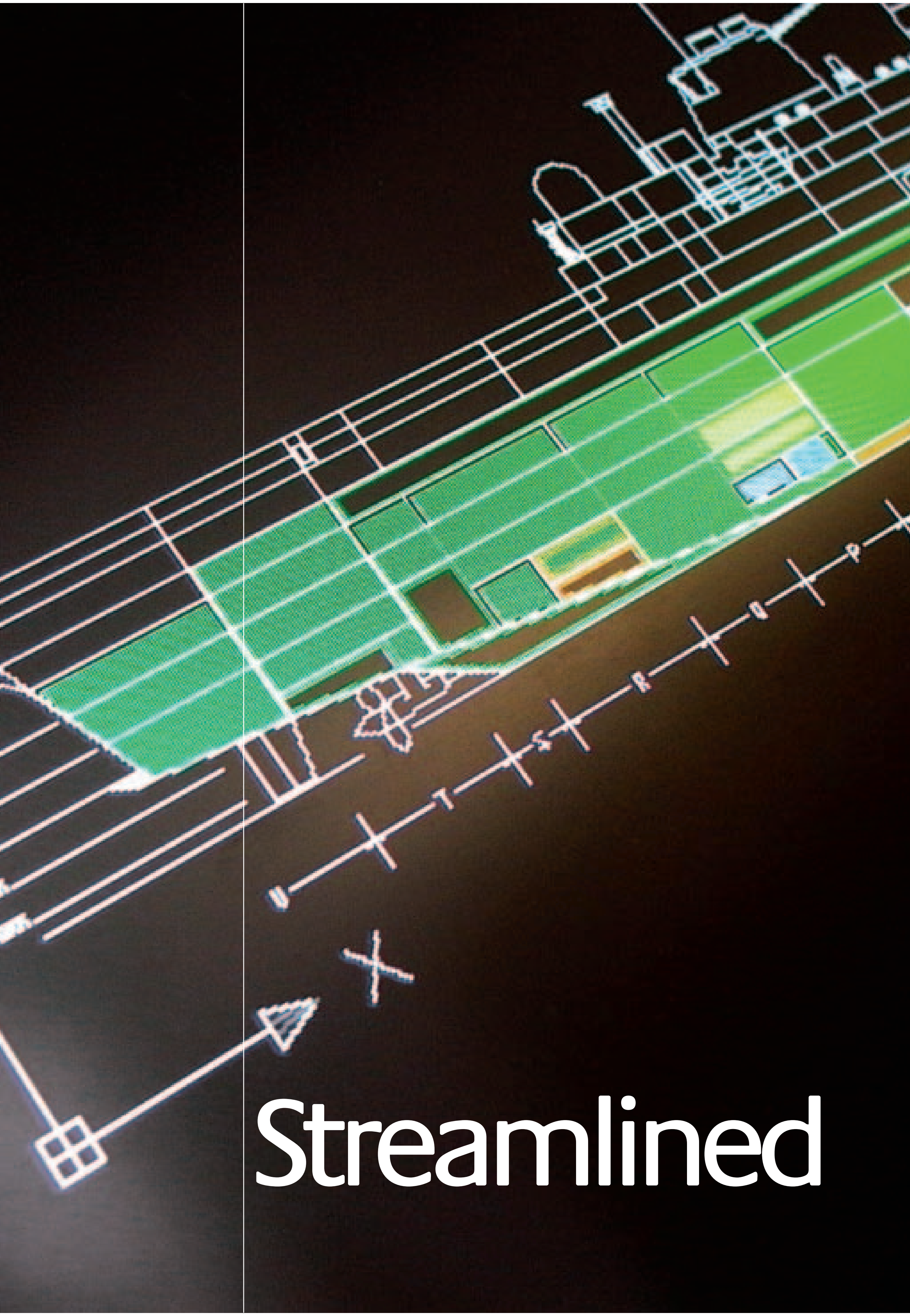


We have continued to manage the expected temporary decline in warship refit activity at Rosyth and have succeeded in retaining a profitable business. The Design and Technology businesses, Supply Chain Services and the Nuclear Decommissioning businesses each made excellent profit contributions during the year and are well placed to deliver future growth. In the current year only 40% of revenue is expected to be provided by the warship refit business.

Recent allocations of ship refit work will provide a greater volume of work than had been previously anticipated for the current financial year and as an expression of its confidence in the Rosyth business, the Ministry of Defence has agreed to extend its responsibility for redundancy costs at Rosyth until March 2007.

The Secretary of State for Defence has confirmed Rosyth as the site for the final assembly and integration of the CVF (future aircraft carrier) and we are participating fully in the Aircraft Carrier Alliance. We have already been awarded an initial contract for the early production design and planning stages of the project. Whilst the Ministry of Defence has not yet indicated a start date for construction, we would expect this to be in 2008/09.

The moves by the Ministry of Defence away from direct competition in the warship refit market in favour of establishing an industry alliance are also expected to bring benefits to Rosyth in terms of workload and margin predictability.



Streamlined

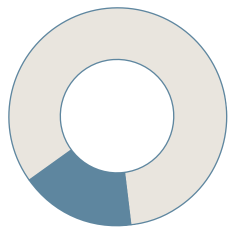
Growing

Engineering and Plant Services

Turnover	Operating profit
£144.2m 2005: £112.7m	£9.7m 2005: £4.8m

Contribution to group turnover

17%



The African business continued its outstanding growth record and won the Volvo International Dealer of the Year Award for the third successive year. Margins further improved and exceeded 6%.

The economy in South Africa continues to be in robust health and spending on infrastructure is forecast to underpin future economic growth. In particular, the expenditure on electrical generation and transmission will provide very significant opportunities over the next five years for our engineering business. Similarly basic infrastructure investment on roads and urban development will continue to generate a strong demand for the Volvo product. Sales of replacement parts for Volvo are growing in line with our expectations and at very satisfactory margins.

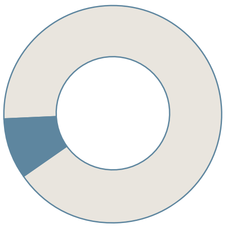
Eagleton, the small US based pipeline business returned to profitability during the year and prospects for the business are now better than at any time in the last three years, as activity in the US petrochemical industry continues to rise, reflecting increased oil prices.

Networks

Turnover	Operating profit
£73.0m 2005: £45.2m	£6.4m 2005: £2.9m

Contribution to group turnover

9%

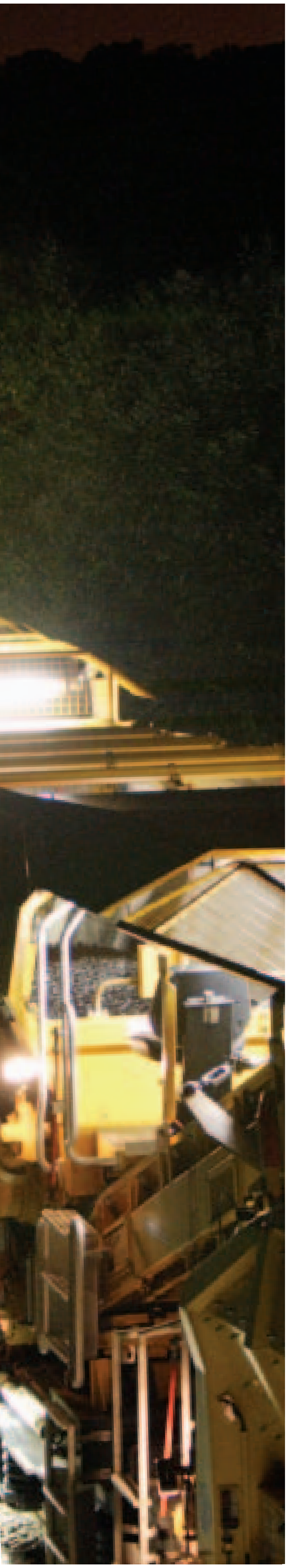


Networks had an excellent year as 3G roll-out and high voltage network projects continued at good levels. Activity in the transmission market rose above the prior year and the level of bidding activity for work in the 2006 – 2008 period now clearly supports our view that the total size of the market will double from current levels during that period. The current value of tenders under preparation or submitted for work during the period is approximately £500 million.

The skills in our networks businesses – both white and blue collar – remain scarce and we are investing significant amounts in training people for the future increase in workflow. The CARE predictive deterioration model continues to be well received by National Grid and the system is now being modified to widen its application to mobile telephone infrastructure.


Stronger

Well positioned

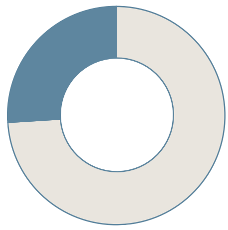


Rail

Turnover	Operating profit
£217.3m 2005: £167.0m	£8.8m 2005: £8.4m

Contribution to group turnover

26%



Our rail business continued to make good progress during the period with growth in the track business and the long awaited return of high volumes in the signalling market resulting in increases in both turnover and profits. Secured business for 2007 at £157 million is 148% ahead of the position at this stage last year.

Margins in the rail business continue to be lower than in our other businesses but we are addressing this through the replacement of the outdated IT systems inherited with the Peterhouse acquisition. The replacement of these systems is now largely complete and we expect to make significant savings in overheads in the Rail business over the next twelve months.

Network Rail continues to improve the performance of the infrastructure and has secured funding over the next three years and the probability is that the regulator will be prepared to continue funding at current levels for a significant period. We continue to work with Network Rail to improve efficiencies and productivity.

Finance review

The group's key financial performance indicators are:

- Operating return on revenue
- Revenue growth
- Return on invested capital
- Operating cash flow conversion rate
- Interest cover
- Gearing ratio

These metrics are discussed in the relevant sections below.

Turnover and operating profit

At £837 million, turnover increased 15% on 2005 (£729 million) including significant growth in Defence Services, up 11% and Networks, up 62%. Similarly turnover in Rail was higher by 30% and Engineering and Plant Services 28%. Group operating profit increased 20% to £49.9 million from £41.5 million last year, with Defence Services, Networks and Engineering and Plant Services businesses all continuing to increase their respective operating margins. Despite the anticipated decline in activity levels and margins in Technical Services, the group's operating margin increased further to 6.0%, up from 5.7% in 2005. The above includes the results of the Peterhouse acquisition for twelve months (2005: nine and a half months).

Interest and profit before tax

Net finance costs (interest payable) were £5.2 million (2005: £6.0 million) following strong cash generation in the second half of the year. At this level, net finance costs were covered over nine times by operating profit (2005: seven times).

After charging net finance costs, profit before tax was £44.6 million (2005: £35.7 million) an increase of 25% year-on-year.

Cash flow

Cash conversion, defined as cash generated from operations as a percentage of operating profit, was 119%, and continued to exceed our target of over 80% conversion over the medium-term. Expenditure on capital assets, excluding intangibles, totalled £6.8 million or one times depreciation and 0.8% of turnover.

	2006	2005
Net debt £m	38.2	62.9
Interest £m	5.2	6.0
Interest cover (x)	9.6	6.9
Net debt/EBITDA	0.7	1.3
Gearing (%)	22	56
Cash conversion (%)	119	126

Our focus on cash management reduced net debt to £38.2 million at the year-end, representing gearing of 22%, down from £62.9 million at 31 March 2005, £52.3 million at 30 September 2005 and pro forma debt at the completion of the acquisition of Peterhouse of £104.5 million.

Additionally during the year, we successfully renegotiated our £140 million revolving credit facility on to a five-year term at significantly lower interest rates. When combined with its strong balance sheet position, this gives the group significant headroom to continue to pursue its successful organic and acquisitive growth strategy.

Pensions

We continue to manage the assets and liabilities of the group's defined benefit pension schemes closely and at the end of the year the schemes were in net IAS19 surplus of £29.3 million (2005: deficit £20.3 million) before the related deferred tax liability, a position that compares very favourably to that of many other companies.

Amortisation and exceptional items

	2006 £m	2005 £m
Acquired intangibles amortisation	(3.1)	(4.4)
Exceptional items	(0.2)	(1.8)
Loss on disposal & impairment	(3.3)	(1.6)
Related tax credit	1.7	–
Sub Total	(4.9)	(7.8)
Trading loss on discontinued operations net of tax	(0.6)	(0.5)
Total	(5.5)	(8.3)

Amortisation of acquired intangibles charged to profit was £3.1 million (2005: £4.4 million) and operating exceptional charges totalled £0.2 million (2005: £1.8 million). Operating exceptional charges comprised restructuring costs of £1.5 million, largely offset by a £1.3 million pensions curtailment gain, in the Technical Services business. After amortisation of acquired intangibles and operating exceptional items, profit before tax was £41.3 million (2005: £29.5 million), up 40% year-on-year.

Taxation

The group tax charge on continuing operations at £9.2 million represented an effective rate of 20.6%, down from 23.1% in 2005 as a result of lower tax rates applied to overseas earnings.

Discontinued operations

The group sold three of its four non-core businesses during the year to 31 March 2006 and in April 2006 completed the full disposal programme with the sale of the remaining business. The results of all of these businesses have been included in discontinued operations, which net of tax lost £0.6 million in the year. The loss on disposals in the year totalled £0.2 million and the net asset impairment on the business sold subsequent to the year-end was £1.8 million.

Earnings per share and dividends

	2006	2005	Growth
Underlying basic EPS	17.18p	14.48p	19%
Dividend (interim and recommended final)	6.0p	4.0p	50%
Dividend cover (x)	2.9	3.6	

Basic earnings per share from continuing operations rose to 17.18p (2005: 14.48p), an increase of 19%. After charging amortisation of acquired intangibles and exceptional items, basic earnings per share was 16.06p (2005: 11.20p) representing an increase of 43%. After including discontinued operations, post amortisation of intangibles and exceptional items, current year earnings per share was 14.49p against 10.08p last year.

The group's policy, as stated in last year's preliminary results announcement, is to target dividend cover over the medium-term in the range of two and a half to three times, measured using profits after tax from continuing operations, before amortisation of acquired intangibles and exceptional items. On the basis of the significant growth in earnings per share and further strong cash flows this year, the Directors are pleased to recommend a final dividend of 4.25p per share (2005: 2.65p). The proposed full year dividend is therefore 6.0p per share, an increase of 50% as compared to 4.0 p per share last year.

Cost of capital and return on investment

The group's weighted average cost of capital, against which investment opportunities are judged, was 8.0% (2004/05: 8.7%). Based on profit after-tax the return on invested capital (equity plus net borrowings), was 17% (2004/05: 16%) well in excess of the group's cost of capital.

Treasury

The group's treasury policies, which have been approved by the Board, cover all significant areas of treasury activity including foreign exchange, interest rates, liquidity and credit risk and it is the responsibility of the Treasury Committee, comprising the group's Chief Executive, Finance Director and Financial Controller, to ensure that these policies are adhered to.

Historically the group has financed its operations and transactions through a combination of retained earnings, new equity and bank borrowings. It is the group's policy to ensure that it has sufficient financial resources to support the business and to leave a comfortable margin between those facilities and likely peak borrowings during the year. Thus, the group's bank facilities, which were refinanced during the year, total £155 million, of which £56 million had been utilised at 31 March 2006. £140 million of these facilities have a final maturity date of June 2010, the balance being available as overdraft facilities.

Interest rate risk is managed by the use of a mixture of fixed and floating rate debt and interest rate caps, which are regularly reviewed to ensure an appropriate mix is maintained.

The group's main exposures to foreign currency movements remain its businesses in South Africa where exposure to both translation and transaction rate movements exists. The group's policy is not to cover the exposure arising on translation of the South African business into the group's base currency, Sterling, by way of derivatives but to use, where possible, local borrowings to fund its operations. All material exposure arising from trading in currencies other than the business base currency is covered by the use of forward currency cover contracts. Treasury transactions are carried out with prime-rated counter-parties including any investment of cash or cash equivalents.

The group's income is mainly from government or government-backed institutions or blue-chip corporates. Where this is not the case, credit checks are performed and where necessary, security is requested and as such customer credit risk is considered to be low.

Acquisitions

Subsequent to the year end (9 May) the group acquired Alstec Group Limited ("Alstec") for a net cash consideration of £44.9 million.

Alstec operates in three distinct support services markets that are very familiar to Babcock; nuclear, airports and defence systems. Within each of these markets Alstec provides a range of services and engineered solutions for its customers' operationally complex and critical activities. Babcock provides high value, technically based services to large public sector and blue chip customers operating in complex environments. Alstec's operations are entirely consistent with this model.

Alstec reported turnover of £82.6 million in the year ended 31 March 2006 and profit before interest and tax was £3.7 million after charging £1 million in respect of legacy claims not transferring to Babcock. The business had a total order book of in excess of £67 million. The recent award of additional contracts in nuclear and an extension of operations in the airports business together with a reduced level of ongoing costs offer excellent prospects for growth in Alstec's profits in the current year.

In nuclear, with turnover of £40 million in the year to 31 March 2006, Alstec provides technical expertise associated with the reactor island at many UK nuclear power stations including nuclear fuel handling equipment, remote inspection, instrumentation and safety systems. Alstec provides decommissioning and waste management services at the Atomic Weapons Establishment, Aldermaston and for the UKAEA and reactor outage support for British Energy with which Alstec holds 'critical supplier' status.

Alstec supplies design, installation and commissioning services for reactor protection systems to British Energy and British Nuclear Group and is also involved in a number of long-term alliance contracts with other key suppliers to the nuclear industry. This business will provide a natural extension to Babcock's existing nuclear clean up and facilities management contracts at Rosyth and HM Naval Base, Clyde.

Alstec's airports services business, with turnover of £34 million in the year to 31 March 2006, provides operations and maintenance services for BAA PLC's automated baggage sorting system at Heathrow airport. The business also operates and maintains the inter-terminal transfer facilities between all terminals. Opportunities to expand the provision of these services at Heathrow into the proposed central terminal area redevelopment and the new T5 facilities together with the possibility of similar service provision at other airports offer excellent growth prospects.

Alstec also operates a small defence business (turnover in the year to 31 March 2006 of £9 million) for the design, supply, maintenance and upgrade of equipment for the Ministry of Defence and its equipment suppliers for submarines, surface ships and aircraft. In particular it designs, supplies and maintains key reactor components for the Vanguard and Astute class submarines and is the design authority for the hydroplane and rudder actuators for Astute. Alstec's defence business has also been selected as supplier and systems integrator for the award winning weapons handling system for the future aircraft carriers and has been working in partnership with Babcock at Rosyth on a number of other aircraft carrier opportunities over the past 12 months.

The combination of Alstec's skills and track record with those of Babcock creates exciting new opportunities in two major growth markets: nuclear decommissioning and airport management as well as augmenting Babcock's existing strong position in the maintenance of submarines, surface ships and on the new carrier programme.

Health and safety

Health and Safety is a top priority for our management. We strive to maintain continuous improvement in our health and safety record. We seek accreditation to appropriate standards for our operations.

A Corporate Safety Steering Group ("the CSSG") has been given responsibility by the Board for the strategic overview of Health and Safety matters. The CSSG also considers environmental matters. It provides a means to foster cross-business discussion of group health and safety policy management. It has responsibility for: creating the conditions necessary to enable the aims of the group Health and Safety Policy Statement to be achieved; keeping workplace arrangements relating to heath 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. It meets three or four times a year and is made up of senior health and safety representatives from the divisions. The group Chief Executive chairs the CSSG's meetings, and Divisional Managing Directors are expected to attend from time to time. Monthly reports on health, safety and environmental performance are reviewed by the group's Executive Committee, and twice a year by the Board.

Each of our businesses is required to develop and keep up-to-date detailed Health and Safety procedures appropriate to its operations, the local environment and its customer base.

They provide appropriate training for their personnel and for non-employees.

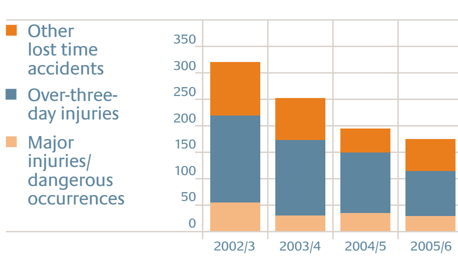
Each division also has its own specialist Health and Safety team or advisers. Divisional Managing Directors have overall operational responsibility within their divisions for ensuring that Health and Safety management arrangements are properly carried out and resourced.

The Company'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:

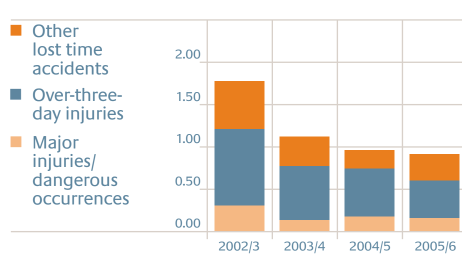
- Our Babcock Engineering Services operations at Rosyth were awarded the prestigious 'British Safety Council Sword of Honour' in 2003 and again in 2004. They have also received the British Safety Council Health and Safety Management five star rating from 2002 – 2005 (inclusive) as well as several British and Scottish safety awards.
- Eve Group, our Power and Telecommunications service division, has achieved a Royal Society for the Prevention of Accidents (RoSPA) Gold award on its first application. This award is judged by experts in the safety field and is presented for achieving high health and safety standards. The review panel examines accident and incident data and the management systems that support safety activities across the business. Eve Group also achieved the highest recorded score of any company of its type in an industry benchmark audit.
- Our Babcock Infrastructure Services operation has been awarded RoSPA Gold Awards for 15 consecutive years and has recently been awarded RoSPA's "Order of Distinction" in recognition of this achievement.
- 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.

	Number of incidents				Incidents per 100,000 hours worked			
	2002/03	2003/04	2004/05	2005/06	2002/03	2003/04	2004/05	2005/06
Fatalities	1	–	1	2	0.01	0.00	0.00	0.01
Major injuries/ dangerous occurrences	54	29	34	28	0.30	0.13	0.17	0.15
Over-three-day injuries	165	144	115	86	0.91	0.64	0.57	0.45
Other lost time accidents	102	79	45	60	0.57	0.35	0.22	0.31

Accident numbers



Accident rates per 100,000 hours worked



- Our Babcock Naval Services business, in partnership with the Ministry of Defence, at the Clyde Naval Base has secured both Gold and Silver Scotland's Health at Work Awards. Its RIDDOR reportable accidents have reduced, with "health and safety" through awareness campaigns, improved training and the introduction of an occupational health service.
- Our First Engineering business reduced its RIDDOR reportable accidents by over 40% during the year. It has launched a behavioural safety campaign, 'One Team Safety', with line management supervisors being identified as the initial target audience. The campaign will include all employees as part of Annual Safety Roadshow events. A new 'Day 1' accident and incident reporting procedure was introduced to ensure immediate visibility of all significant accidents or incidents within the business at the most senior level.

In partnership with Network Rail, the business supported the introduction of the industry 'Safety Bus' initiative with First Engineering representatives operating the bus, on behalf of the client, for a number of months.

We monitor accidents, incidents and near misses monthly and measure the incident frequency rate on a per 100,000 hours worked basis. The total number of incidents continues to decrease and injuries resulting in lost time exceeding three days have reduced each year since 2002. The 2005 rate represents a 51% reduction on 2002.

The table on page 21 shows our incident history since April 2002, representing all group companies throughout the period. Over the period we have seen a 45% reduction in the number of incidents and a 48% incident rate reduction.

The three fatalities in the last two years have been in South Africa. One was as a result of an incident in the year to 31 March 2005 at a power station, and working procedures have been changed in the light of the lessons learned from the incident. The two fatalities in the year to 31 March 2006 were the result of a single road traffic accident.

The environment

The company recognises its responsibility to minimise so far as reasonably possible the potential for adverse impacts from its operations. We aim to achieve the highest standards in environmental management and seek accreditation to appropriate standards where appropriate.

Operational managers are required to devise and implement appropriate environmental protection policies and practices for matters over which they have operational control. As a support services provider, many of our operations are carried out on customer sites where the customer retains responsibility for environmental matters, either generally or for historical environmental conditions. In other cases, customers ask us to manage operations to environmental standards and within budgets and timescales that they set for us.

On those sites that we do own and control, such as Rosyth, we have made significant advances in environmental management. At Rosyth Dockyard there have been significant improvements over time in the efficient use of energy and in water consumption.

Our First Engineering rail business is currently undertaking a major campaign to promote environmental awareness that directly targets and aims to educate its workforce about environmental issues and how the environmental impact of its operations can be reduced.

Our Naval Services business, working in partnership with the Ministry of Defence, has secured ISO14001 for HM Naval Base Clyde – the only Ministry of Defence organisation of this size and complexity to have done so.

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 who reports to the Group Finance Director and he also reports to the Audit and Risk Committee. The Group Risk Manager oversees a group Risk Standard that requires businesses and operations, in a consistent manner, to identify, evaluate and monitor 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 reviews individual major risks 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, Group Business Development 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 having regard to the group's strengths 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 kept under review 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. This Committee 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 monthly health and safety performance.

Another key issue for the group is the management of the group's pension funds, in respect of which external advice is taken regularly on the management of associated risks where possible and appropriate.

Outlook

The trading environment for the Babcock businesses remains excellent. In the UK, the Ministry of Defence continues with major outsourcing programmes, Network Rail funding remains secure and the expenditure on renewing the high voltage network is rising rapidly. The South African economy continues to expand and the need to renew infrastructure and programmes for increased power generation will bring significant business opportunities to Babcock for the next five years.

We believe that the RSME project will move to financial close sufficiently early to provide revenues in the 2007/08 financial year and await the result of our bid for the Defence Training Review, which, if we are successful, will add to revenues in the 2008/09 financial year.

We are progressing our plans for further acquisitions and we anticipate that we can extend our track record of successful identification, acquisition and integration of other businesses in the technically sophisticated area of support services in which we operate. We expect that further businesses will be acquired during the current year. The strength of the balance sheet and continuing excellent cash management will ensure that the required resources are available. We will continue to apply rigorous financial discipline in the assessment of potential acquisitions to ensure that shareholder value continues to be enhanced.

We remain confident that, with an order book totalling approximately £2.3 billion, our momentum can be sustained. Overall, the clear visibility provided by the order book gives us confidence that both the short and medium term prospects for the group are excellent.

Peter Rogers Group Chief Executive

Bill Tame Group Finance Director

Directors and Company Secretary

Gordon Campbell (Age 59), 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 HSS Hire Service Group plc, Accsys Technologies plc and Jsst Securities Limited. He was a Vice President of the Royal Academy of Engineering. Mr Campbell was reappointed as a Director of the company at its Annual General Meeting in July 2004. He is Chairman of the Nominations Committee of the Board.

The Rt Hon Lord Alexander Hesketh KBE (Age 55), 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. 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. Between 1 April 2005 and 19 July 2005 he was a member of the Remuneration Committee and the Audit and Risk Committees. Until 4 May 2005 he was a Non-Executive Director of BAE Systems plc. He was reappointed as a Director of the company at its Annual General Meeting in July 2005 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 reappointment at the company's forthcoming Annual General Meeting in July 2006.

Peter Rogers (Age 58), 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 2005.

William Tame (Age 51), 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 and is currently a non-executive director of Carclo PLC. Mr Tame was last reappointed as a Director of the company at its Annual General Meeting in July 2005.

John Rennocks (Age 60), Independent non-executive Director; Chairman of the Audit and Risk Committee and nominated Senior Independent Director
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 Chairman of Diploma Plc, and a non-executive director of Foreign & Colonial Investment Trust PLC, JP Fleming Overseas Investment Trust PLC, Wagon PLC and Inmarsat plc. He is Chairman of Nestor Healthcare Group PLC. As well as being Chairman of the Audit and Risk Committee, Mr Rennocks 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 2005.

Dipesh Shah (Age 53), Independent non-executive Director, Chairman of the Remuneration Committee
Mr Shah joined the Board as a non-executive Director on 15 June 1999. He is the Chief Executive of the United Kingdom Atomic Energy Authority, and is non-executive Chairman of Viridian Group PLC. He is also a non-executive Director of Oxfordshire Economic Partnership 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. As well as being Chairman of the Remuneration Committee, Mr Shah is a member of the company's Audit and Risk, and Nominations Committees. He was last reappointed as a Director of the company at its Annual General Meeting in July 2005.

Sir Nigel Essenhigh GCB (Age 61), Independent 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 is a non-executive Director of the Defence Science and Technology Laboratory and acts as an advisor to the Northrop Grumman Corporation. Sir Nigel was last reappointed as a Director of the company at its Annual General Meeting in July 2003 and will, therefore, in accordance with the company's Articles of Association be retiring at the forthcoming Annual General Meeting of the company in July 2006 where, being eligible, he will offer himself for reappointment.

Justin Crookenden (Age 43), Independent non-executive Director
Mr Crookenden joined the Board as a non-executive Director with effect from 1 December 2005. As a qualified Chartered Accountant, he spent 17 years in investment banking, initially with UBS, moving to Barclays de Zoete Wedd in 1990, which was acquired by Credit Suisse First Boston ('CSFB'). During his career he headed the teams responsible for International Equity Execution and UK M&A and his last role at CSFB was as Managing Director UK Investment Banking. Mr Crookenden is a member of the company's Remuneration, Audit and Risk and Nominations Committees. Having been appointed during the year, Mr Crookenden will, in accordance with the company's Articles of Association, offer himself for reappointment at the company's forthcoming Annual General Meeting in July 2006.

Company Secretary
Albert Dungate (Age 49)
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 and company for the year ended 31 March 2006.

Result and dividends
The profit attributable to shareholders for the financial year was £29.7 million (2005: £19.1 million). An interim dividend of 1.75p per 60p ordinary share was declared in the year (2005: 1.35p per 60p ordinary share). The Directors propose to recommend the payment on 7 August 2006 of a final dividend of 4.25p (2005: 2.65p per 60p ordinary share) on each of the ordinary shares of 60p entitled thereto and in issue on 7 July 2005.

Business review and group structure
The Business review on pages 4 to 23 reviews the group's activities and likely future developments and forms part of this report. That review also addresses use of financial instruments and describes important events since 31 March 2006. The principal subsidiary and associated undertakings of the company are set out on page 84.

Acquisitions and disposals
Information regarding the group's acquisitions and disposals during the course of the year are set out in note 31 on page 71 and are also referred to in the Business review.

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 £54,587 (2005: £51,658) 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 2006 or 31 March 2005.

Directors
Details of the present Directors are shown on page 24.

Sir Nigel Essenhigh will retire at the company's forthcoming Annual General Meeting in July 2006 under the provisions of Article 92 of the company's Articles of Association, having last been reappointed as a Director at the company's Annual General Meeting in 2003. Being eligible, he will offer himself for reappointment. Lord Hesketh, having first been appointed as a Director in 1993, in accordance with the Combined Code submits himself for reappointment on an annual basis and will therefore retire at the Annual General Meeting and, being eligible, will offer himself for reappointment. Mr Crookenden having been appointed by the Board with effect from 1 December 2005 will, in accordance with Article 97 of the Company's Articles of Association, retire and offer himself for reappointment at the Annual General Meeting.

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 Mike Turner (who retired as a Director of the company on 31 December 2005) 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 35 on page 72.

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 2006	At 1 April 2005
G A Campbell	49,685	49,685
P L Rogers	100,000	100,000
The Rt Hon Lord Hesketh KBE	8,249	8,249
W Tame	26,189	21,189*
D J Shah	8,333	8,333
M J Turner CBE (retired 31 December 2005)	–	16,666
Sir Nigel Essenhigh GCB	–	–
J L Rennocks	–	–
J N A Crookenden (appointed 1 December 2005)	–	–

Holdings are all of ordinary shares of 60p each.

*(Reported at the time as 17,113, the number inadvertently omitted shares acquired through the Company's AESOP scheme (described on page 26). A correction was published through a Regulatory News Service on 24 June 2005.)

Mr Turner disposed of his entire share holding on 16 December 2005, at a price of 226p per share. He retired from the Board on 31 December 2005.

There were no changes in the Directors' interests in shares between 31 March 2006 and 22 May 2006.

Details of options and awards over shares in the company granted to Directors up to 22 May 2006 (and any exercise of them during the year) are given on page 37. 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 22 May 2006, 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	%
Schroders Investment Management Limited	44,334,883	21.20
Fidelity International	8,096,205	3.87
Capital Group Companies	7,924,431	3.80
Barclays PLC	6,344,236	3.03
Deutsche Bank	6,312,840	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 Approved 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 such options. (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 27 and 28.

Authority to purchase own shares

At the company's Annual General Meeting in July 2005, the shareholders authorised the company to make market purchases of up to 20.8 million of its own ordinary shares of 60p each. That authority will expire at the forthcoming Annual General Meeting in July 2006. Although no ordinary shares have been purchased by the company during the period from 19 July 2005 (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 ordinary shares up to a maximum of just under 10% of the company's issued share capital.

Disclosure of relevant audit information

So far as the directors who are in office at the time of the approval of this report are aware, there is no relevant audit information (namely, information needed by the company's auditors in connection with the preparation of their auditors' report) of which the auditors are unaware and each such Director has taken all reasonable steps to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

Qualifying third party indemnity provisions

Under their respective Articles of Association, the Directors of the company are, and were during the year to 31 March 2006, entitled to be indemnified by the company and those UK subsidiaries of which they are or were Directors against liabilities and costs incurred in connection with the execution of their duties or the exercise of their powers, to the extent permitted by the Companies Act 1985.

Annual General Meeting

This year's Annual General Meeting will be held at The Royal Society of Medicine, 1 Wimpole Street, London W1G OAE on Friday, 14 July 2006, at 11.30 am. The notice of meeting is on page 85 and a note on the resolution to be proposed at it as special business is set out on page 86.

Auditors

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

Approval of report

Approved by the Directors on 22 May 2006

By Order of the Board

A N Dungate Company Secretary
22 May 2006

Corporate and Social Responsibility review

Introduction

The Company recognises that how it manages business risk and the impact of its operations on the environment and on the heath and safety of its employees and others is fundamental to its success and the value of the group. Winning bids for contracts is our main value driver. In large part that success depends upon our being a company with whom our customers and partners want to do business and for whom our employees want to work. This places a premium on our reputation, our performance, our approach to health, safety and environmental matters and our ethical conduct.

Overview

The Board addresses these matters in various ways.

When evaluating projects the Board considers these matters at a strategic level to the extent that they are relevant to the project.

Risk management process: Babcock's risk management process is described in more detail in the corporate governance report on pages 31 and 32. It looks at a wide range of risks that could have short-or long-term implications for particular businesses or the group as a whole. The risks reviewed, directly or indirectly, encompass social, environmental and ethical matters. The process is now well established as part of group management practice, and named individuals take responsibility for particular risks. The Board, through the Audit and Risk Committee, regularly reviews the process itself as well as particular major risks and invites internal and external auditors to comment on the process.

Policies: there are group-wide and divisional policies covering employment issues, health, safety and environmental matters and ethical conduct.

Bonus schemes include requirements for acceptable health and safety performance.

We engage with our stakeholders. Most of our businesses have a customer base made up of a few, large customers. We maintain a continuous dialogue with them that will cover social, environmental and ethical matters relevant to their operations. We cultivate open and constructive relationships with relevant regulatory bodies, including the Health and Safety Executive and environmental protection agencies. We participate in community initiatives at both a local and national level. We seek an open and honest dialogue with our employees. We seek to play an important role in market developments relevant to our businesses.

Health and safety

Health and safety is addressed within the Business review.

The environment

The environment is addressed within the Business review.

Ethical conduct and whistle-blowing

We insist on the highest standards of honesty and integrity in all aspects of our 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.

We have a group-wide arrangement for employees to communicate concerns in confidence about possible improprieties in matters of financial reporting and other matters. An independent company is retained to provide a confidential telephone hotline service. Employees have the number of this service and it is advertised on notice boards. The service allows an employee to leave a recorded message, which may be anonymous if they wish. The message is relayed as soon as possible, usually within 24 hours, to senior group management in group head office who will ensure the matter is followed up and, if appropriate, reported to the Board. A reply can be provided to the employee via the service by means of a recorded response.

Employees

Having high quality, suitably trained and motivated management is a key objective. The past year has seen the launch of the Babcock Academy in conjunction with the University of Strathclyde Business School. Our senior management team has been through the Academy and our middle management teams are also attending. The Academy has been designed to encourage development of tools and ideas that we believe will be valuable to the continued growth of the group and to ensure that we share a common business language across our operations. The Academy courses cover strategic planning, financial matters, leadership, human resources and project management. Our divisional businesses continue to supplement this training with business-specific training through their own programmes. For instance, several of our businesses have in the past year been implementing behavioural safety training programmes.

We are also committed to attracting talented people into the group. We have developed graduate development programmes to attract innovative and enthusiastic young people, and we have a specialist recruitment internet site through which we have been able to attract high calibre candidates. We have also developed skills retention programmes and flexible working patterns in order to retain valued employees.

We continue to develop our skills in the successful integration of employees who transfer to us as a result of contract wins. This gives us what we consider to be an enviable skills base that enhances our contract performance and allows us to deliver flexible and reliable services to our expanding customer base.

We communicate with our employees in a variety of ways. “The BIG Picture” is a group-wide publication issued several times a year that keeps employees informed of what is happening in other divisions as well as their own, and reports on significant developments for the group. In the UK, we have a group-wide Employee Forum for Consultation and Information as a means of 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 2006 Babcock International Group PLC employed an average of 8,391 staff worldwide, of whom approximately 91% 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.

Amongst others:

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. It has also established a social responsibility fund to focus on health and education for the disadvantaged, and has begun by sponsoring four disadvantaged children through high school for five years. In addition to funding their education, the business will mentor the children to help them make the social adjustment in moving from their disadvantaged backgrounds.

In Scotland, our Babcock Naval Services business has a Community Investment Group that supports the local community in education, regeneration and environmental areas. It has made over 20 awards to a variety of community groups. In addition to financial support, the business has been active in providing physical support to a number of groups including the Children's Hospice Association Scotland and The Princess Royal Trust. Apprentices from the naval base have helped refurbish offices for charitable organisations and supported workshops for school pupils and children with special needs. The business is also on the Steering Committee of the Dunbartonshire "Enterprise in Education through Business Links" programme and supports Young Enterprise Programmes in local schools. Our Babcock Engineering Services business at Rosyth sponsors a number of engineering and wider education projects with local schools.

Our Eve Group business is currently involved in a "young offenders" programme in conjunction with National Grid and other industry contractors. The programme seeks to rehabilitate young offenders into society and the workplace through professional vocational training and exposure to the working environment.

P L Rogers Group Chief Executive
22 May 2006

Statement on Corporate Governance

Statement of compliance with the Combined Code

During the year ended 31 March 2006 the company complied with the provisions of section 1 of The Combined Code on Corporate Governance 2003 (the 'Combined Code') save to the extent explained in this report.

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.

Whilst the Board believes Lord Hesketh to be independent, it recognised last year that, due to his length of service, some shareholders take the view that this is not the case and, accordingly, Lord Hesketh stood down from his membership of the Audit and Risk Committee and the Remuneration Committee (of which he was Chairman) on 19 July 2005 (the date of last year's Annual General Meeting). Mr Turner, who achieved nine years of service on the Board on 5 June 2005, also stood down from membership of those committees at the same time, and subsequently retired as a Director on 31 December 2005. Mr Rennocks replaced Lord Hesketh as Senior Independent Director with effect from 19 July 2005. To the extent that Lord Hesketh may not have been recognised by shareholders as an independent non-executive, a view not shared by the Board, there was, whilst he sat on the Audit and Risk and Remuneration Committees and whilst he was nominated as the Senior Independent Director, a 'non-compliance' with the Combined Code from 1 April to 18 July 2005.

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

Since late 2000, the executive Director team has changed completely. There have also been significant changes in the non-executive directorships. A long-standing independent non-executive Director retired in 2002, and Mr Turner retired at the end of 2005. Three new independent non-executive Directors have been appointed over that period, one in 2002, one in 2003 and the other in 2005.

Board balance

The Board currently has a Chairman, two full-time executive Directors and five non-executive Directors, four of whom are recognised by the Board as clearly independent (assuming Lord Hesketh is not so regarded by others). 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. The appointment of Mr Crookenden to the Board has brought welcome new perspectives and experience to its deliberations.

The Company's Articles of Association require each Director to be reappointed by the Annual General meeting if appointed by the Board during the year, and thereafter to offer himself for reappointment at least every three years. Three Board members will be offering themselves for reappointment at the forthcoming Annual General Meeting: Lord Hesketh, Sir Nigel Essenhigh and Mr Crookenden. Lord Hesketh will, if reappointed, continue to offer himself for reappointment annually as required by the Combined Code in view of his length of service. Sir Nigel Essenhigh offers himself for reappointment as he was last appointed three years ago in July 2003. Mr Crookenden is offering himself for reappointment for the first time having been appointed by the Board during the year. The Board sets out in the Accompanying Notes to the Notice of Annual General Meeting on page 86 why it is recommending reappointment of these 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 considers Mr Turner (who retired on 31 December 2005), Mr Shah, Sir Nigel Essenhigh, Mr Rennocks and Mr Crookenden (appointed 1 December 2005) 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.

It is the company's policy to review rigorously the reappointment of non-executive Directors who have served more than six years on the Board.

Board procedures

There were eight scheduled Board meetings in the financial year under review. Sir Nigel Essenhigh was unable to attend one of those meetings due to family illness. All other Directors in post at the time of the meetings attended them. Apart from scheduled formal Board meetings, the Board has authorised the holding of ad hoc meetings of two or more Directors either for particular matters or to deal with matters in accordance with delegated authorities approved by the Board.

It is the Chairman's usual practice before each scheduled Board meeting to hold 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. Early in the year, an independent facilitator was retained to conduct individual confidential interviews with each of the Board members and the Company Secretary which established a baseline assessment of performance. That report was then updated at the year-end by means of the Company Secretary conducting separate interviews with each of the Directors in turn covering matters discussed in the independent facilitator's report and seeking to identify any new matters and views on the performance of individual Directors. The views expressed in those interviews were summarised and reported to the Chairman. The performance of the Chairman was evaluated during the year by the Remuneration Committee at a meeting also attended by Lord Hesketh. These reviews were all positive.

All Directors have full and timely access to information.

Change in Chairman's significant external commitments

During the year Mr Campbell resigned from the Board of iti Scotland Limited of which he was Chairman. He also resigned his non-executive directorship of Senior plc and was appointed a non-executive director of HSS Hire Service Holdings plc and Accsys Technologies plc.

Board Committees – the Audit and Risk Committee
For the year under review, the Board's Audit and Risk Committee consisted of:

J L Rennocks (Committee Chairman)
D J Shah
Sir Nigel Essenhigh
The Rt. Hon Lord Hesketh (Chairman and member of the Committee 1 April – 18 July 2005)
M J Turner (1 April – 18 July 2005)
J N A Crookenden (from 1 December 2005)

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 continuing members of the Committee are set out on page 24.

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. Non-executive Directors not sitting on the committee are also welcome to attend. 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, usually attend 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 in the absence of executive management.

The Committee met formally five times in the year under review. Sir Nigel Essenhigh was unable to attend one of those meetings due to family illness, but otherwise all Committee members in post at the relevant time attended the meetings. At its meetings for the year ended 31 March 2006, the Committee:

- reviewed the preliminary and interim statements of results and the proposed announcements relating to them;
- reviewed the Financial Statements for the year ended 31 March 2005 and the half-year ended 30 September 2005 and internal and external auditors' comments in connection with them;
- evaluated the effectiveness of internal controls;
- considered the implementation of International Financial Reporting Standards;
- reviewed 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 the requirements for an Operating and Financial review and Business review including consideration of key performance indicators;
- reviewed the arrangements for confidential "whistle-blowing";
- 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
These arrangements are dealt with in the Corporate and Social Responsibility review on page 27.

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
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 33. The Committee met formally twice in the year. Each Committee member in post at the relevant time attended both meetings, apart from Sir Nigel Essenhigh who was unable to attend one meeting due to family illness.

Board Committees – Nominations Committee

For the year under review, the Nominations Committee consisted of:

G A Campbell (Committee Chairman)
D J Shah
J L Rennocks
Sir Nigel Essenhigh
The Rt Hon Lord Hesketh (Chairman and member of the Committee 1 April – 18 July 2005)
M J Turner (1 April – 18 July 2005)
J N A Crookenden (from 1 December 2005)

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. The Committee had intended to review management succession plans, but in the event the full Board reviewed them, not just members of the Committee. During the year the Committee (with all members present) met formally in connection with the appointment of a new non-executive Director, and its members also discussed the appointment between themselves informally. The members of the Committee each met and interviewed Mr Crookenden before deciding to recommend his appointment to the Board as a non-executive Director. The Committee did not, on this occasion, use an external search consultancy or open advertising to seek further candidates as Mr Crookenden was considered to be such a strong and well-suited candidate for the role. The Committee is not, however, unwilling to use external assistance where appropriate and value-additive.

Contact with shareholders

The company has regular contact with its shareholders, both institutional and individual, typically involving the Chairman, 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 opportunity for communication with shareholders. All of the company's Directors attended the 2005 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 and to be provided with full information about them. An induction programme for Mr Crookenden was organised to ensure that he is properly acquainted with the operations of the group and met key senior executives.

Non-executive Directors may at any time make visits to group businesses or operational sites. Detailed presentations on the group's businesses and specialist functions are made 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 can be 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 one or more 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 Board retains these powers with a view to ensuring that the Board and/or its Committees maintains 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 Board and Audit and Risk 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 (as updated). 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;
- independent 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.
- monthly reporting of results against budget and forecast, with variances explained;
- an annual presentation on tax matters to the Board;
- annual Board review of the insurance programme;
- annual review of pensions exposures and risks;
- monthly reports on disputes and litigation;
- a formal succession plan;
- monthly reports on health and safety matters.

Identification and evaluation of risks and control objectives

The identification and evaluation of risks and control objectives is addressed in the Business review.

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 areas of focus for internal audit.

The Board of Directors has reviewed the system of internal controls in place and considers them to be effective.

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;
- 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

This report sets out the company's policy on the remuneration of its Directors, which it followed for the year under review and currently intends to follow for the present 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 in July 2006.

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 non-executive Directors of the company. Those Directors who served on the Committee during the year under review, were:

D J Shah (Committee Chairman since 19 July 2005)
J L Rennocks
Sir Nigel Essenhigh
The Rt Hon Lord Hesketh (Chairman and member of the Committee 1 April – 18 July 2005)
M J Turner (1 April – 18 July 2005)
J N A Crookenden (from 1 December 2005)

Biographical details of the members of the Committee are set out on page 24.

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. Lord Hesketh has attended meetings of the Committee since 18 July 2005 as an observer. The Committee has access to market research on remuneration. In addition to receiving recommendations from Mr Campbell and Mr Rogers (other than in respect of their own remuneration), the Committee receives advice on executive Director remuneration (including on share schemes and long-term incentive plans) from Inbucon Limited ("Inbucon"), remuneration consultants. Advice is also taken on share schemes from Pinsent Masons, Solicitors. Pinsent Masons also provides other legal advice to the Company, but Inbucon 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). During the year a full review of Chairman, executive Director and senior executive remuneration was commissioned directly from Inbucon by Mr Shah (the Remuneration Committee Chairman)

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. This involves generally positioning basic pay at or about median with the potential, through incentive schemes, for upper quartile pay for upper quartile performance.

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 (until 2003) grants of options under share option schemes and (from 2003) 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.

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, of share awards under the L-TIP. 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.

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 2006 the annual bonus payable to them was dependent on the profit before tax (pre-exceptionals and acquired intangibles amortisation) achieved by the group as against budget. Maximum bonus potential was 40% of basic salary for 10% out-performance of budget, plus up to a further 10% of basic salary for personal performance. The maximum potential annual bonus for each of them was, therefore, 50% of basic salary.

Given the Company's policy of maintaining competitiveness by setting basic remuneration at or around median, but allowing for top quartile performance to deliver top quartile rewards, the Remuneration Committee directly commissioned Inbucon in late 2005 to prepare a review of executive remuneration to test whether the policy was being borne out in practice. The review confirmed that the basic salary of the executive Directors was in accordance with this policy having regard to pay in FTSE 250 companies and comparable companies, but found that restricting the existing maximum annual bonus potential for Mr Rogers and Mr Tame to 50% represented only lower quartile practice, and that therefore the company's bonus practice did not meet the company's policy. For the financial year commencing on 1 April 2006, the Remuneration Committee has, therefore, decided to increase the maximum annual bonus potential for Mr Rogers and Mr Tame to 100% and 80% respectively. The bonus will also now focus on delivering growth rather than merely performance against budget. Maximum bonus will only be payable if the growth in the group's profit before tax (before amortisation of acquired intangibles, but normally after exceptional items) is at least 20%. The Health and Safety performance of the group in the year will also be considered by the Committee, which has discretion to reduce the level of bonus otherwise payable if it considers it appropriate to do so in the light of that performance.

Annual bonuses are not pensionable.

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 37), which were subject to performance criteria as described later in this report.

Details of executive share options and share awards under the L-TIP already granted to Directors are set out in the tables on page 37.

Relative importance of variable and fixed pay
For the year under review, variable, performance-related remuneration (namely annual bonus and new share awards under the L-TIP) represented approximately 43% of the total remuneration package for Mr Rogers and Mr Tame, if minimum 25% vesting of the share awards is achieved and the share price on vesting is the same as at the date of the award. If there is maximum vesting of the share awards made in the year and the value of the shares increases, the proportion of remuneration represented by variable pay increases. For example, if all the shares vest and the share price on vesting is at the level it was on 31 March 2006 (318.75p), the proportion of pay for the year under review that was performance related increases to approximately 70%. In the case of Mr Campbell the equivalent proportions are 20% and 65% respectively. On the basis of the revised annual bonus schemes for the current year the potential proportion of variable pay for Mr Rogers and Mr Tame will increase given the increase in the maximum potential annual bonus.

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 set by the Committee for options and share awards have regard to market conditions and the need to ensure that they serve the purpose of motivating and retaining key staff. Vesting of share awards or option grants depends on the extent to which the targets are met or exceeded.

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

Performance measures – share awards under the L-TIP
For share awards made in 2003 there could be no vesting unless the company's earnings per share (pre-acquired intangible amortisation and exceptional items) in the year ended 31 March 2006 was at least 9.27% (representing a 3% per annum compound growth rate) greater than the basic earnings per share (pre-acquired intangible amortisation and exceptional items) for the financial year ended 31 March 2003. Once this hurdle is achieved, actual levels of vesting depend on the comparative total shareholder return ("TSR") performance of the company as at 31 March 2006 against the shares of the companies comprising the FTSE All-Share Index (other than Investment Trusts) on 1 April 2003. This was selected as being a broad index at a time when the Company had left the Engineering and Machinery Sector, but its transition to a broader based support services company was not yet complete. The target provided for no vesting for at or below median ranking, 25% vesting for immediately above median ranking and 100% vesting for top quartile ranking (with proportionate straight-line vesting in between).

Having completed its transition to a more broadly based support services company, and as explained in the company's Remuneration report for 2005, the company adopted a new more closely identified comparator group and took a new approach to the structuring of share awards under the L-TIP made in 2005 and adjusted the performance target attached to the share awards made in 2004 to reflect this new approach. Half of each such award will vest according to comparative TSR performance measured against a specified list of companies with similar businesses (see below) and half according to growth in earnings per share. This approach will be taken with any share awards made under the L-TIP in the current financial year.

For the half of the share award for which vesting depends on comparative TSR performance a ranking immediately above the median level in the comparator table would result in 25% of those shares vesting (there would be no vesting for ranking at or below median), 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 and 2005 awards (and (apart from PHS Group) for 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 as being an appropriate range of support services providers against which to compare the company given the nature of its and their businesses.

For the half of the share awards for which vesting depends on earnings per share growth, 25% of those shares will vest if growth (adjusted to exclude exceptional items and acquired intangible amortisation), over the performance period is equivalent to a real (i.e. in excess of the growth in the consumer prices index) compound annual growth rate of 4%, with full vesting if this reaches 8%. Vesting will be on a straight-line basis for growth between those two points. There is no vesting for compound annual earnings per share growth of below 4%. International Financial Reporting Standards are taken into account in both the opening position (which may have to be restated accordingly) and the assessment of performance.

Performance measures – share options
Options granted under the 1999 Schemes were made subject to a comparative TSR performance over the performance period. 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 option grants in 2003, made after the company had left the Engineering and Machinery Sector, the comparator group was all those companies comprising the FTSE All-Share Index (other than investment trusts) at the start of the performance period. 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.

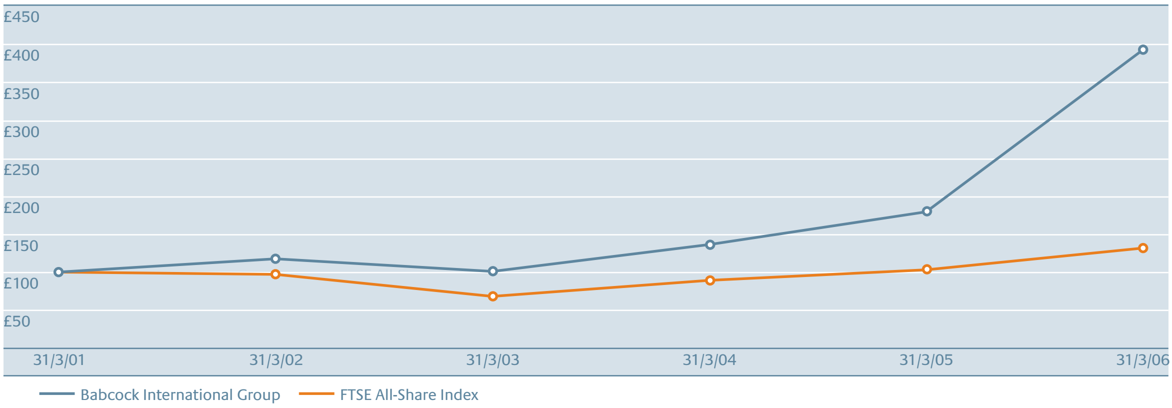
Share options granted in 2004 (not applicable to Directors) have, following an adjustment made in 2005, a performance test consisting solely of the eps test now used for share awards under the L-TIP made in that year. There were no grants of share options in 2005 and it is not currently the intention to make any further option grants under the 1999 Schemes.

Further details of the rules of the L-TIP and the 1999 Schemes are set out below the tables on page 37.

Performance graphs

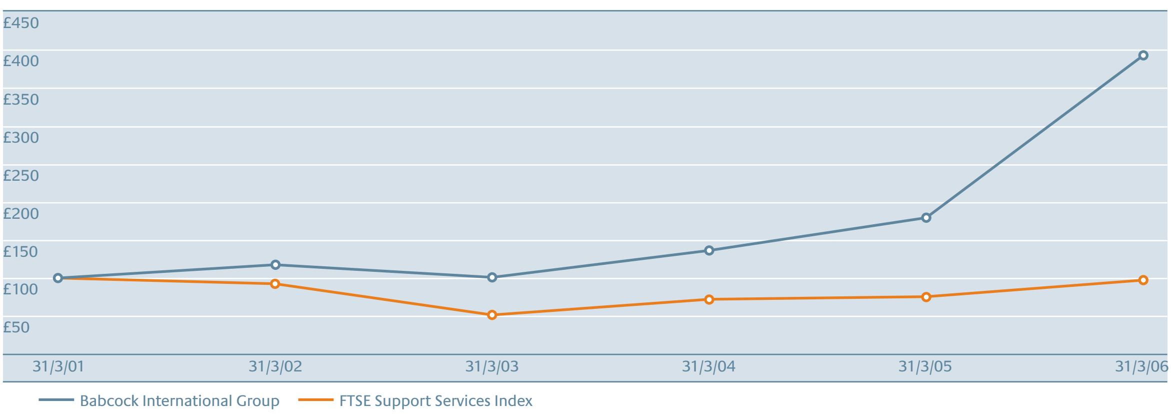
The first graph below, compiled by Inbucon, shows the total shareholder return for a holding in the company's shares for the period from 31 March 2001 to 31 March 2006 relative to a holding of shares representing the FTSE All-Share Index (excluding investment trusts). This is the same index as has been 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)
Cumulative Total Shareholder Return of £100 investment on 31 March 2001



The graph below shows comparative TSR performance against the FTSE Support Services Sector, the sector in which the company's share price is reported:

Total Shareholder Return: Babcock International Group vs FTSE Support Services Index
Cumulative Total Shareholder Return of £100 investment on 31 March 2001



Directors' pensions

Executive Directors of the company are eligible for membership, by invitation, of the company's defined benefit pension plan. Only Mr Tame currently participates in the scheme.

The accrual rate for Mr Tame under the Scheme is one-thirtieth for each year of service, with pension being calculated on his base salary (up to the "earnings cap") in the 12 months prior to attaining age 60. Membership of the Scheme also entitles him to life assurance cover of four times base salary up to the earnings cap. For these purposes the "earnings cap" means the statutory earnings cap that applied up to 5 April 2006 and, thereafter, the earnings cap adopted by the Scheme as part of its rules (which will be the same as the former statutory earnings cap and index-linked in the same way). In respect of his salary in excess of the earnings cap, the company established a Funded Unapproved Retirement Benefit Scheme (FURBS) into which it contributed 20% of the excess (after employer's national insurance contributions), with Mr Tame making contributions into the company's pension scheme on his full uncapped salary. As from April 2006 this has been replaced with a salary supplement of 15% of the excess (less employers' national insurance contributions), with Mr Tame contributing into the company's pension scheme only on capped salary. The cost to the company of each arrangement is the same. The company takes out additional life assurance cover in respect of four times his salary in excess of the earnings cap.

Neither Mr Campbell nor Mr Rogers receives pensions benefits from the company, and their salaries take this into account.

The company's policy is to remain competitive in the market place 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 arising from the changes to the taxation of pensions.

A summary of Directors' pension entitlements is set out at page 36.

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 2006 are set out in the table below:

Director	Salary or fee £'000	Annual bonus £'000	Benefits* in kind £'000	Total year ended 31 March 2006 £'000	Total year ended 31 March 2005 £'000
Executive					
G A Campbell (Chairman)	216	–	1	217	469**
P L Rogers (Chief Executive Officer)	417	195	1	613	577
W Tame (Group Finance Director)	244	113	18	375	351
Non-Executive					
The Rt Hon Lord Hesketh KBE	53	–	–	53	52
J L Rennocks	34	–	–	34	32
D J Shah (Chairman of Remuneration Committee from 19 July 2005)	32	–	–	32	27
M J Turner CBE (retired 31 December 2005)	21	–	–	21	27
Sir Nigel Essenhigh	29	–	1	30	29
J N A Crookenden (from 1 December 2005)	10	–	–	10	–
Total	1,056	308	21	1,385	1,564

*Benefits comprised, for Mr Tame, medical insurance, accommodation expenses and contributions to a FURBS, for Mr Rogers, medical insurance, and for Mr Campbell, home to work expenses.

**The amount shown for Mr Campbell's remuneration for the year ended 31 March 2005 included, as explained in the Remuneration report for that year, £250,000 extra remuneration for the additional services he provided in respect of the acquisition and integration of Peterhouse Group Plc and did not form part of his regular remuneration.

The fees for Lord Hesketh reflect his additional duties as Deputy Chairman. Mr Rennocks' and (for the period from 19 July 2005) Mr Shah's fees reflect their additional duties as Chairmen of, respectively, the Audit and Risk Committee and the Remuneration 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 2006 £ pa	Increase in accrued benefits excluding inflation during the year ended 31 March 2006 £ pa	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2005 £	Transfer value at 31 March 2006 £	Transfer value of increase in accrued benefits less Director's contributions £	Increase in transfer value less Director's contributions £
W Tame	15,093	3,915	3,580	138,863	211,482	35,992	61,369

(1) Inflation has been taken as 3.0% 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 arrangements, including the cost of providing any additional life assurance cover, are set out in the table below:

Director	2006 £'000	2005 £'000
W Tame	12	11

Contributions to a FURBS for Mr Tame were 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 2005	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to options at 31 March 2006*	Exercise price (pence)	Exercisable from	Expiry date
G A Campbell	a	560,975	–	–	–	560,975	123.00	Nov 2003	Nov 2010
	b	22,349	–	22,349	–	–	99.33	Jun 2004	Jun 2011
	c	209,104	–	–	–	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	21,278	–	–	–	21,278	104.33	Jan 2005	Jan 2012
	c	148,951	–	–	–	148,951	104.33	Jan 2005	Jan 2012
	c	198,125	–	–	–	198,125	124.50	Jan 2005	Jan 2012

*All vested.
a = Share Option Agreement (agreed as part of the terms of recruitment). Whilst, in each case, the Agreement originally allowed for full vesting on a change of control, this is no longer relevant as the options have now vested in accordance with the performance targets following the completion of the relevant performance period. In all other respects each Agreement essentially mirrored the terms of the 1999 Unapproved Executive Share Option Scheme, including as to using the same performance tests as applied at the time it was made.
b = Babcock 1999 Approved Executive Share Option Scheme
c = Babcock 1999 Unapproved Executive Share Option Scheme

During the year, Mr Campbell exercised options in respect of 22,349 shares granted under the Babcock Approved Executive Share Option Scheme, 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 239.5p. The shares obtained on the exercise of the options were sold on the same day at a price of 240.75p.

The exercise prices of the options held by the Directors were not set at a discount to the market value of the company's shares at the date of grant. They were set at the average of the mid-market quotations of a share as shown by the London Stock Exchange Daily Official List for the three dealing days immediately preceding the grant dates.

Directors must exercise vested options before the tenth anniversaries of the grant dates, or earlier if there is a change of control, they leave or die, failing which they will lapse.

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 2005	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to award at 31 March 2006	Market value (in pence) 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
	–	117,994	–	–	117,994	169.5	Jul 2008	Jul 2015
P L Rogers	255,506	–	–	–	255,506	113.5	Jul 2006	Jul 2013
	281,746	–	–	–	281,746	126.0	Jul 2007	Jul 2014
	–	230,088	–	–	230,088	169.5	Jul 2008	Jul 2015
W Tame	171,806	–	–	–	171,806	113.5	Jul 2006	Jul 2013
	162,698	–	–	–	162,698	126.0	Jul 2007	Jul 2014
	–	132,743	–	–	132,743	169.5	Jul 2008	Jul 2015

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 basic salary at the date of grant. For Mr Campbell the award in 2003 was equivalent to his annual salary as part-time Chairman from 1 August 2003. The value of his awards in 2004 and 2005 was equivalent to his annual salary at the date of the awards. Subject to satisfaction of the performance criteria (see page 34) 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, though the Committee has discretion to allow a greater proportion to be released.

There were no changes in the current Directors' share options or share awards between 31 March 2006 and 22 May 2006.

The company's mid-market share price at close of business on 31 March 2006 was 318.75p. The highest and lowest mid-market share prices in the year ended 31 March 2006 were 327.25p and 131.0p 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 letters dated 5 May 2004 and 3 April 2006)	12 months	12 months from company, 6 months from Director
P L Rogers	31 July 2003 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months	12 months from company, 6 months from Director
W Tame	20 September 2001 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months	12 months from company, 6 months from Director

The company's policy for executive Directors' service contracts is that they 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. If the company terminates a Director's service contract (other than following a change of control – see below – 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. Although the agreements for Mr Campbell, Mr Rogers and Mr Tame contain provisions relating to a change of control, as described below, the company believes that they do no more than reflect what would in effect be a likely outcome in practice for these executive positions following a change of control. The provisions are as follows. The contracts provide that within 90 days of the occurrence of the change of control the executive Director may terminate his employment forthwith. If he exercises this right, he will, however, 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. If the company terminates the Director's appointment within 12 months of a change of control, 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).

Directors' service contracts now provide for termination on the Director reaching the age of 65 (amended from 60 in anticipation of age discrimination legislation).

Non-executive Directors

Name	Date of appointment as a Director	Expiry of present term of appointment*
Lord Hesketh	6 October 1993	AGM for 2007
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
J N A Crookenden	1 December 2005	AGM for 2008

*Subject in each case to reappointment before the expiry date if 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 normally being for a three-year term, though in all cases appointments are terminable at will by the company. 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 or is known, by experience, to the Directors concerned.

Outside directorships

The company considers that it can benefit if a Director, executive or non-executive, holds directorships in other companies outside the group. Before taking up any new outside appointment, a Director must first seek the approval of the Board. Any fees for outside appointments are retained by the Director. During the year, Mr Tame became a non-executive director of Carclo PLC. Any fees earned by him from that appointment are retained by him. 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

Dipesh Shah Chairman of the Remuneration Committee
22 May 2006

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

We have audited the group financial statements of Babcock International Group PLC for the year ended 31 March 2006, which comprise the Group income statement, the Group balance sheet, the Group cash flow statement, the Group statement of recognised income and expense and the related notes. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Babcock International Group PLC for the year ended 31 March 2006 and on the information in the Directors' Remuneration report that is described as having been audited.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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 group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Directors' report is consistent with the group financial statements. The information given in the Directors' report includes that specific information presented in the Business review that is cross referenced from the Business review section of the Directors' report. We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Director's remuneration and other transactions is not disclosed.

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.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Chairman's statement, Business review, Directors' report, Corporate and Social Responsibility review and Corporate Governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group'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 group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the group financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2006 and of its profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the group financial statements.

PricewaterhouseCoopers LLP
Chartered accountants and registered auditors
London
22 May 2006

Group income statement

For the year ended 31 March 2006

	Note	2006 Before acquired intangible amortisation and exceptional items £m	2006 Acquired intangible amortisation and exceptional items £m	2006 Total £m	2005 Before acquired intangible amortisation and exceptional items £m	2005 Acquired intangible amortisation and exceptional items £m	Total £m
Revenue	2	836.7	–	836.7	729.0	–	729.0
Operating profit	2, 3, 5	49.9	(3.3)	46.6	41.5	(6.2)	35.3
Finance costs	6	(8.9)	–	(8.9)	(8.5)	–	(8.5)
Finance income	6	3.7	–	3.7	2.5	–	2.5
Share of operating profit from joint ventures	2	(0.1)	–	(0.1)	0.2	–	0.2
Profit before tax		44.6	(3.3)	41.3	35.7	(6.2)	29.5
Income tax expense	8	(9.2)	1.0	(8.2)	(8.2)	–	(8.2)
Profit for the year from continuing operations		35.4	(2.3)	33.1	27.5	(6.2)	21.3
Discontinued operations							
Loss for the year from discontinued operations	9	(0.6)	(2.6)	(3.2)	(0.5)	(1.6)	(2.1)
Profit for the year	4	34.8	(4.9)	29.9	27.0	(7.8)	19.2
Attributable to:							
Equity holders of the parent				29.7			19.1
Minority interest				0.2			0.1
				29.9			19.2
Earnings per share from continuing and discontinued operations	11						
– Basic				14.49p			10.08p
– Diluted				14.15p			10.07p
Earnings per share from continuing operations	11						
– Basic				16.06p			11.20p
– Diluted				15.68p			11.18p

Group balance sheet

At 31 March 2006

	Note	2006 £m	2005 £m
Assets			
Non-current assets			
Goodwill	12	164.0	161.3
Other intangible assets	13	13.8	14.8
Property, plant and equipment	14	25.3	36.0
Investment in joint ventures	15	0.6	0.6
Other investments	15	–	0.1
Retirement benefits	27	64.9	41.5
Trade and other receivables	18	0.3	0.4
Deferred tax	16	4.5	11.8
		273.4	266.5
Current assets			
Inventories	17	41.5	40.6
Trade and other receivables	18	168.5	232.2
Income tax recoverable		0.2	0.3
Other financial assets	22	0.1	–
Cash and cash equivalents	19	109.0	33.1
		319.3	306.2
Assets held for sale	31	9.6	–
Total assets		602.3	572.7
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	24	125.5	125.0
Share premium		69.7	69.3
Other reserves		32.3	30.7
Retained earnings		(57.3)	(112.7)
		170.2	112.3
Minority interest		0.4	0.1
Total equity	26	170.6	112.4
Non-current liabilities			
Bank and other borrowings	21	6.5	8.3
Income tax payable		0.1	–
Retirement liabilities	27	35.6	61.8
Provisions for other liabilities	23	12.6	23.4
		54.8	93.5
Current liabilities			
Trade and other payables	20	212.9	263.0
Income tax payable		7.0	6.2
Other financial liabilities	22	0.2	–
Bank and other borrowings	21	140.7	87.7
Provisions for other liabilities	23	12.3	9.9
		373.1	366.8
Liabilities held for sale	31	3.8	–
Total liabilities		431.7	460.3
Total equity and liabilities		602.3	572.7

Group cash flow statement

For the year ended 31 March 2006

	Note	2006 £m	2005 £m
Cash flows from operating activities			
Cash generated from operations	28	54.1	43.5
Income tax paid		(5.8)	(4.8)
Interest paid		(8.9)	(8.4)
Interest received		3.8	2.5
Net cash flows from operating activities		43.2	32.8
Cash flows from investing activities			
Proceeds on disposal of other investments		–	5.0
Disposal of subsidiaries	31	2.5	(3.2)
Proceeds on disposal of property, plant and equipment		0.9	4.9
Purchases of property, plant and equipment		(6.8)	(4.5)
Purchases of intangible assets		(2.7)	(1.4)
Acquisition of subsidiaries net of cash acquired	31	(4.3)	(26.5)
Net cash flows from investing activities		(10.4)	(25.7)
Cash flows from financing activities			
Dividends paid		(9.0)	(7.0)
Finance lease principal payments		(3.6)	(3.3)
Bank loans (repaid)/raised		(22.5)	23.1
Net proceeds on issue of shares		0.9	–
Movement on own shares		–	0.3
Net cash flows from financing activities		(34.2)	13.1
Net (decrease)/increase in cash, cash equivalents and bank overdrafts		(1.4)	20.2
Cash, cash equivalents and bank overdrafts at beginning of year		26.4	6.3
Effects of exchange rate fluctuations		0.3	(0.1)
Cash, cash equivalents and bank overdrafts at end of year	30	25.3	26.4

Group statement of total recognised income and expense

For the year ended 31 March 2006

	Note	2006 £m	2005 £m
Profit for the year (including discontinued operations)		29.9	19.2
Currency translation differences		1.6	0.1
Net actuarial gains/(losses) in respect of pensions	27	42.2	(34.8)
Tax on net actuarial gains/(losses) in respect of pensions		(12.6)	10.4
Total recognised income and expense		61.1	(5.1)
Attributable to:			
Equity holders of the parent		60.8	(5.2)
Minority interest		0.3	0.1
		61.1	(5.1)

Notes to the consolidated financial statements

1. Basis of preparation and significant accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historic cost convention as modified by the revaluation of certain financial instruments. The comparative consolidated financial information previously published under UK GAAP has been restated on an IFRS basis for the opening balance sheet as at 1 April 2004 and for the year ended 31 March 2005. A description of how the group's reported results and financial position are affected by this change, including reconciliations from UK GAAP to IFRS for prior year results is disclosed in note 37 to these accounts.

First time adoption of IFRS

The group's date of transition to IFRS was 1 April 2004. IFRS 1 'First Time Adoption of International Financial Reporting Standards' generally requires companies to apply their accounting policies retrospectively. There are however a number of exemptions from this general rule in order to assist companies with the transition to reporting under IFRS. The most significant of these are set out below:

Business combinations

The group has elected not to restate business combinations prior to the date of transition.

Employee benefits

All cumulative actuarial gains and losses have been recognised on transition to IFRS. The group will continue to apply this treatment, with all actuarial gains and losses being recognised in the statement of recognised income and expense in compliance with IAS19 'Employee Benefits'.

Financial instruments

The group has adopted the exemption not to restate comparatives for IAS32 'Financial Instruments: Disclosure and Presentation' and IAS39 'Financial Instruments: Recognition and Measurement' but to apply these standards from 1 April 2005. As a result the comparative information to the 2006 financial statements is presented on a UK GAAP basis. A reconciliation between the closing 31 March 2005 balance sheet and the opening 1 April 2005 balance sheet is shown in note 38.

Cumulative translation differences

The group has elected to adopt the 'Cumulative translation exchange differences' exemption which resets all cumulative translation gains and losses to zero at the date of transition.

Principal accounting policies

The principal accounting policies adopted by the group are disclosed below:

Basis of consolidation

The group financial statements comprise the company and all of its subsidiary undertakings made up to 31 March.

(a) Subsidiaries

Subsidiaries are all entities over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Acquisitions are included from the date of acquisition and the results of the 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.

(b) Joint ventures

The group's interest in jointly controlled entities are accounted for by the equity method of accounting and are initially recorded at cost. The group's investment in jointly controlled entities includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The group's share of its jointly controlled entities' post-acquisition profits or losses after tax is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Unrealised gains and losses on transactions between the group and its jointly controlled entity are eliminated to the extent of the group's interest in the joint controlled entity.

Exceptional items

Items that are both material and non-recurring, are presented as exceptional items within the consolidated income statement. The separate reporting of exceptional items helps provide a better indication of the group's underlying business performance. Events which may give rise to the classification of items as exceptional include gains or losses on the disposal of properties and businesses along with the restructuring of businesses and asset impairments.

1. Basis of preparation and significant accounting policies (continued)

Goodwill and intangible assets

(a) 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. When the fair value of the consideration for an acquired undertaking is less than the fair value of its separable net assets, the difference is taken directly to the income statement.

Goodwill relating to acquisitions prior to 1 April 2004 is maintained at its net book value on the date of transition to IFRS. From that date goodwill is not amortised but is reviewed at least annually for impairment. Negative goodwill was written off to reserves on the date of transition to IFRS.

(b) Acquired intangibles
Intangible assets, which are capable of being recognised separately and measured reliably on acquisition of a business, are capitalised at fair value on acquisition. These intangibles will include contracts and customer relationships. Where these assets have a finite life, they are amortised over the period which they are expected to generate benefits, but generally not exceeding ten years. Customer contracts and relationships valued on acquisition are expected to generate higher benefits in the early years following such acquisition as the existing contracts unwind.

(c) Research and development
Research expenditure is recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and only if the cost can be measured reliably. Other development expenditure is recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have been capitalised are amortised from the date the product is available for use on a straight-line basis over the period of its expected benefit but not exceeding seven years.

(d) Computer software
Computer software costs are amortised over their expected useful lives of between three and five years.

Property, plant and equipment (PPE)
Property, plant and equipment is shown at cost less subsequent depreciation and impairment, except for land, which is shown at cost less impairment. Cost includes expenditure that is directly attributable to the acquisition of the items. Depreciation is provided on a straight-line basis to write off the cost of PPE over the estimated useful lives to their estimated residual value (reassessed at each balance sheet date) at the following annual rates:

Freehold land	Nil
Freehold property	2% to 8%
Short leasehold property	lease term
Plant, machinery and motor vehicles	6.6% to 33.3%

Fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the fixed asset may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount exceeds the higher of an asset's fair value less cost to sell or value in use.

Leases
Assets under finance leases are capitalised and the outstanding capital element of instalments is included in borrowings. 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.

Operating lease payments are recognised as an expense in the income statement. A provision is made where the operating leases are deemed to be onerous.

Stocks and work in progress
Stocks are valued at the lower of cost and net realisable value. Cost is determined on a first-in first-out method. In the case of finished goods and work in progress, cost comprises direct material and labour and an appropriate proportion of overheads.

Contract accounting
Contract costs are recognised when incurred. When the outcome of a contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recovered. When the outcome of a contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The group uses the 'percentage of completion method' to determine the appropriate amount of revenue to be recognised in a given period.

The group presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings.

The group presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

Pre-contract costs are recognised as expenses as incurred, except that directly attributable costs are recognised as an asset when it can be reliably expected that a contract will be obtained and the contract is expected to result in future net cash inflows.

1. Basis of preparation and significant accounting policies (continued)

Taxation

(a) Current income tax
Current tax, including UK corporation 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.

(b) Deferred income tax
Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted, or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the group, and it is probable that the temporary difference will not reverse in the foreseeable future.

Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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.

(a) Functional and presentation currency
Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Sterling, which is the company's functional and presentation currency.

(b) Transactions and balances.
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement except when deferred in equity as part of the net investment of a foreign operation.

Exchange differences arising from the translation of the balance sheets and income statements of foreign operations into Sterling are recognised as a separate component of equity on consolidation. Results of foreign subsidiary undertakings are translated using the average exchange rate for the month of the applicable results. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at period end exchange rates.

Revenue
(a) Revenue in respect of contracts is recognised by reference to the stage of completion of the contract, using the 'percentage of completion method' to determine the appropriate amount of revenue to recognise in a given period. An appropriate level of profit attributable to the contract activity is recognised if the final outcome of the contract can be reliably assessed. An expected loss on a contract is recognised immediately in the income statement.

(b) Other revenue comprises the fair value of goods and services rendered by the group.

Borrowing costs
Borrowing costs are recognised as an expense in the period in which they are incurred.

Employee benefits

(a) Pension obligations
The group operates a number of pension schemes. The schemes are generally funded through payments to trustee-administered funds, determined by periodic actuarial calculations. The group has both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the group pays fixed contributions into a separate entity.

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

For defined benefit pension schemes, the cost of providing benefits is determined using the projected unit credit actuarial valuation method. The group's current and past service cost and imputed interest on the defined benefit schemes' obligations, net of the expected return on the scheme's assets, are charged to operating profit within the income statement. Actuarial gains and losses are recognised directly in equity through the Statement of recognised income and expense so that the group's balance sheet reflects the fair value of the scheme's surpluses of deficits at the balance sheet date.

(b) Share-based compensation
The group operates equity-settled, share-based compensation plans. The economic cost of awarding shares and share options to employees is recognised as an expense in the income statement equivalent to the fair value of the benefit awarded. The fair value is determined by reference to option pricing models. The charge is recognised in the income statement over the vesting period of the award.

The share's purchased by the group's ESOP trusts are recognised as a deduction to equity.

(c) Holiday pay
Paid holidays are regarded as an employee benefit and as such are charged to the income statement as the benefits are earned.

1. Basis of preparation and significant accounting policies (continued)

Derivative financial instruments

(a) From 1 April 2005
Derivatives are initially recognised at fair value on the date a derivative is entered into and are subsequently re-measured at their fair value. The group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of recognised assets or liabilities or unrecognised firm commitments.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

For foreign exchange contracts that qualify as cash flow hedges, gains and losses are deferred in equity until such time as the firm commitment is recognised, at which point any deferred gain or loss is included in the assets carrying amount. These gains or losses are then realised through the income statement as the asset is sold.

Certain derivatives do not qualify or are not designated as hedging instruments and any movement in their fair values is recognised in the income statement immediately.

(b) From 1 April 2004 to 31 March 2005
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 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 exchange movements on the group's operations. Gains or losses on these contracts are deferred and recognised in the income statement, or as adjustments to the carrying amount of property, plant and equipment, 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.

Financial risk management
Financial instruments, in particular, forward currency contracts and interest swaps, are used to manage the financial risks arising from the business activities of the group and the financing of those activities.

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 exposure to foreign currency fluctuations arise through its activities in South Africa where both translational and transactional exposure 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 functional currency, Sterling. All material transactional exposures arising through trading in currencies other than the operation's functional currency must be eliminated by the use of forward cover contracts as soon as they are known of.

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

Dividends
Dividends are recognised as a liability in the group's financial statements in the period in which they are approved.

Critical accounting estimates and judgements
Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key areas of estimates and judgements for the group are contract accounting (see above), the accounting for defined benefit pension schemes (see note 27), impairment of goodwill (see note12) and income tax recognition.

Standards, amendments and interpretations to published standards that are not yet effective
Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the group's accounting periods beginning on or after 1 April 2006 or later periods but which the group has not early adopted. Management has identified IFRS7 "Financial Instruments: Disclosure" (effective years commencing 1 January 2007), IFRIC4 "Determining whether an arrangement contains a lease" (effective years commencing 1 January 2006) and the amendment to IAS39 and IFRS4 "Financial Guarantee Contracts" (effective years commencing 1 January 2006) as being relevant to its business. The impact on the group's operations is currently being assessed.

2. Segmental information

(a) Primary reporting format – business segments

	2006 Group revenue £m	2006 Operating profit before acquired intangible amortisation, exceptional items £m	2006 Acquired intangible amortisation and exceptional items £m	2006 Group operating profit £m	2005 Group revenue £m	2005 Operating profit before acquired intangible amortisation, exceptional items £m	2005 Acquired intangible amortisation and exceptional items £m	2005 Group operating profit £m
Continuing operations								
Defence Services	271.7	21.8	–	21.8	245.1	16.8	–	16.8
Technical Services	130.5	9.0	(0.2)	8.8	159.0	14.3	–	14.3
Engineering and Plant Services	144.2	9.7	–	9.7	112.7	4.8	–	4.8
Networks	73.0	6.4	(0.7)	5.7	45.2	2.9	(0.6)	2.3
Rail	217.3	8.8	(2.4)	6.4	167.0	8.4	(3.8)	4.6
Unallocated	–	(5.8)	–	(5.8)	–	(5.7)	(1.8)	(7.5)
Total continuing operations	836.7	49.9	(3.3)	46.6	729.0	41.5	(6.2)	35.3
Finance cost		(8.9)	–	(8.9)		(8.5)	–	(8.5)
Finance income		3.7	–	3.7		2.5	–	2.5
Share of post tax profit/loss from joint ventures (net of tax)		(0.1)	–	(0.1)		0.2	–	0.2
Profit before tax		44.6	(3.3)	41.3		35.7	(6.2)	29.5
Income tax		(9.2)	1.0	(8.2)		(8.2)	–	(8.2)
Profit for the year from continuing operations		35.4	(2.3)	33.1		27.5	(6.2)	21.3
Discontinued operations								
HS&E	7.5	(1.3)	(0.4)	(1.7)	13.3	(1.3)	–	(1.3)
Networks	20.5	0.3	(1.6)	(1.3)	16.3	0.6	–	0.6
Unallocated		–	(1.3)	(1.3)		–	(1.6)	(1.6)
Income tax		0.4	0.7	1.1		0.2	–	0.2
Total for the year from discontinued operations	28.0	(0.6)	(2.6)	(3.2)	29.6	(0.5)	(1.6)	(2.1)
Total for the year	864.7	34.8	(4.9)	29.9	758.6	27.0	(7.8)	19.2

Inter divisional sales are immaterial.

The share of joint venture results not separately disclosed above are:

	2006				2005			
	Revenue £m	Operating profit £m	Tax and interest £m	Net JV results £m	Revenue £m	Operating profit £m	Tax and interest £m	Net JV results £m
Continuing operations								
Defence Services	1.3	0.1	–	0.1	1.3	0.3	(0.1)	0.2
Technical Services	–	–	–	–	1.7	0.2	–	0.2
Networks	0.3	(0.1)	–	(0.1)	0.1	(0.2)	–	(0.2)
Rail	–	–	(0.1)	(0.1)	–	–	–	–
Total continuing operations	1.6	–	(0.1)	(0.1)	3.1	0.3	(0.1)	0.2

2. Segmental information (continued)

The segment assets and liabilities at 31 March 2006 and 31 March 2005 and capital expenditure for the years then ended are as follows:

	Assets		Liabilities		Capital expenditure	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Defence Services	153.1	140.8	46.4	52.7	0.3	0.5
Technical Services	40.5	45.0	70.5	94.8	0.1	0.2
Engineering and Plant Services	62.1	61.3	49.2	45.9	1.9	2.4
Networks	88.5	84.2	21.4	12.9	1.8	0.9
Rail	126.8	166.0	62.7	113.6	2.6	1.4
Unallocated	131.3	75.4	181.5	140.4	3.1	1.4
Group total	602.3	572.7	431.7	460.3	9.8	6.8

Capital expenditure represents additions to property, plant and equipment and intangible assets.

All assets and liabilities are allocated to their appropriate segments except for cash, cash equivalents, borrowings, income and deferred tax and discontinued operations which are included in the unallocated segment.

The segmental depreciation, amortisation and impairment of goodwill for the years ended 31 March 2006 and 31 March 2005 are as follows:

	Depreciation		Amortisation and impairment of intangible assets		Impairment of goodwill	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Defence Services	0.4	0.5	–	–	–	–
Technical Services	0.9	1.3	0.2	0.8	–	4.8
Engineering and Plant Services	1.6	1.2	–	–	–	–
Networks	0.9	0.7	0.7	0.6	–	–
Rail	1.2	0.9	2.7	12.8	–	–
Unallocated	0.2	0.3	–	–	–	–
Total continuing operations	5.2	4.9	3.6	14.2	–	4.8
Discontinued operations	1.9	2.5	–	–	–	–
Group total	7.1	7.4	3.6	14.2	–	4.8

(b) Secondary reporting format – geographical segments

	Revenue		Assets		Capital expenditure	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
United Kingdom	692.0	611.4	414.7	445.2	4.8	2.9
Rest of Europe	0.5	0.7	1.0	0.8	–	–
Africa	138.3	108.9	59.6	59.3	1.7	2.5
North America	5.9	3.8	2.6	1.9	0.2	–
Rest of World	–	4.2	0.4	0.6	–	–
Unallocated	–	–	124.0	64.9	3.1	1.4
Group total	836.7	729.0	602.3	572.7	9.8	6.8

	2006 £m	2005 £m
Analysis of revenue by category		
Sales of goods	94.3	83.8
Sales of services	730.5	638.9
Rental income	11.9	6.3
	836.7	729.0

3. Operating expenses

	2006 £m	2005 £m
Continuing operations		
Cost of sales	728.6	630.9
Distribution expenses	0.8	0.8
Administrative expenses	60.7	62.0
	790.1	693.7

4. Profit for the year

The following items have been included in arriving at profit for the year.

	Continuing operations		Discontinued operations		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Employee costs (note 7)	268.6	248.8	10.4	9.7	279.0	258.5
Inventories						
– cost of inventories recognised as an expense	105.3	122.7	0.4	2.9	105.7	125.6
– increase in inventory provisions	1.4	1.2	–	–	1.4	1.2
Depreciation of property, plant and equipment (PPE)						
– owned assets	4.0	3.9	1.3	2.1	5.3	6.0
– under finance leases	1.2	1.0	0.6	0.4	1.8	1.4
	5.2	4.9	1.9	2.5	7.1	7.4
Amortisation of intangible assets						
– acquired intangibles	3.1	13.2	–	–	3.1	13.2
– software and development costs	0.5	0.3	–	–	0.5	0.3
	3.6	13.5	–	–	3.6	13.5
Impairment of goodwill	–	4.8	–	–	–	4.8
Impairment of development costs	–	0.7	–	–	–	0.7
Impairment of PPE	–	–	2.6	–	2.6	–
Loss on disposal of intangible assets	0.1	–	–	–	0.1	–
Loss on disposal of PPE	0.1	0.9	0.1	–	0.2	0.9
Operating lease rentals payable						
– property	7.0	6.4	0.9	0.7	7.9	7.1
– plant and machinery	5.8	5.9	0.2	0.3	6.0	6.2
– other	0.6	0.2	0.5	0.3	1.1	0.5
Research and development	0.2	0.2	–	–	0.2	0.2
Auditors' remuneration						
– audit services	0.8	0.6	–	0.1	0.8	0.7
– non audit services	0.3	0.2	–	–	0.3	0.2
Trade receivables impairment	0.5	0.6	–	–	0.5	0.6
Net foreign exchange losses	0.7	0.5	–	–	0.7	0.5

The fees and expenses paid to the group's auditor for non audit services are £0.1 million for pensions consulting and £0.2 million for tax and accountancy services.

Also included above are fees paid to the group's auditor in respect of non audit services in the UK of £0.3 million (2005: £0.2 million).

5. Operating exceptional items and acquired intangible amortisation

In 2006 within continuing operations there is an exceptional redundancy cost arising within the Technical Services segment of £1.5 million which is partially offset by a pension curtailment gain of £1.3 million also arising in relation to the redundancies.

In 2005 exceptional items for continuing operations were £1.8 million. This related to £0.8 million of restructuring costs and £4.8 million of goodwill write-off offset by a pension curtailment gain of £5.6 million within the Technical Services segment, £8.8 million credit relating to the transfer of rail maintenance back to Network Rail, offset by £8.8 million of exceptional acquired intangible amortisation relating to rail maintenance and a £1.8 million charge relating to the closure costs of the Peterhouse head office in the unallocated segment.

In 2006 acquired intangible amortisation was £3.1 million (2005: £4.4 million), with £0.7 million (2005: £0.6 million) relating to the Networks segment and £2.4 million (2005: £3.8 million) relating to the Rail segment.

6. Net finance costs

	2006 £m	2005 £m
Finance costs		
Bank loans and overdrafts	7.9	7.6
Finance leases	0.5	0.4
Amortisation of issue costs of bank loan	0.2	0.4
Other	0.3	0.1
Total finance costs	8.9	8.5
Finance income		
Bank deposits	3.7	2.5
Total finance income	3.7	2.5
Net finance costs	5.2	6.0

7. Employee costs

	Continuing operations		Discontinued operations		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Wages and salaries	236.0	217.9	8.9	8.8	244.9	226.7
Social security costs	21.3	19.5	1.4	0.8	22.7	20.3
Share-based payments (note 25)	1.1	0.9	–	–	1.1	0.9
Pension costs – defined contribution plans	7.4	7.3	0.1	0.1	7.5	7.4
Pensions costs – defined benefit plans (note 27)	2.8	3.2	–	–	2.8	3.2
	268.6	248.8	10.4	9.7	279.0	258.5

The redundancy costs and curtailment gain referred to in note 5 are not included above.

The average number of people employed by the group during the year were:

	Continuing operations		Discontinued operations		Total	
	2006 Number	2005 Number	2006 Number	2005 Number	2006 Number	2005 Number
Operations	7,279	7,570	293	320	7,572	7,890
Administration and management	1,112	1,017	79	181	1,191	1,198
	8,391	8,587	372	501	8,763	9,088

Emoluments of Directors are included in employee costs above.

Key management compensation
Key management is defined as those employees who are directly responsible for the operational management of the key cash generating units. The employees would typically report to the Chief Executive.

	2006 £m	2005 £m
Salaries and short-term employee benefits	3.9	4.1
Post-employment benefits	0.3	0.2
Share-based payments	0.9	0.5
	5.1	4.8

The key management figures given above include Directors.

8. Income tax expense

	2006 £m	2005 £m
Analysis of tax charge in the year		
Current tax		
– UK current year charge	4.9	2.2
– Overseas current year charge	3.7	2.7
	8.6	4.9
Deferred tax		
– UK charge	0.3	3.8
– Overseas credit	(0.7)	(0.5)
	(0.4)	3.3
Total income tax expense – continuing operations	8.2	8.2

The tax for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2006 £m	2005 £m
Profit before tax – continuing operations	41.3	29.5
Profit on ordinary activities multiplied by rate of corporation tax in the UK of 30% (2005: 30%)	12.4	8.9
Effects of:		
Expenses not deductible for tax purposes	0.6	2.1
Adjustments to tax in respect of prior period	–	(0.2)
Adjustments in respect of foreign tax rates	(4.8)	(3.1)
Utilisation of brought forward tax assets not previously recognised	–	(0.2)
Other	–	0.7
Total income tax expense – continuing operations	8.2	8.2

9. Discontinued operations

Four businesses are treated as discontinued operations within these statements. Pivotal Services Group (previously in the HS&E segment) was disposed of on 22 July 2005, IETG (also previously in the HS&E segment) was disposed of on 16 February 2006.

EPS (previously in Networks) was disposed of on 27 March 2006 and Eve Trakway Limited (also previously in Networks) was disposed of post year end on 4 April 2006 and has been impaired to its fair value less costs to sell and is included as assets and liabilities held for sale. (See note 31.)

In 2005 there was a loss on disposal of CMR Consultants Limited and FBMA reflected in the exceptional items.

	2006 £m	2005 £m
Financial performance of discontinued operations		
Revenue	28.0	29.6
Operating loss	(1.0)	(0.7)
Taxation	0.4	0.2
Net loss after tax	(0.6)	(0.5)
Exceptional items:		
Loss on disposal	(0.2)	(0.4)
Impairment to reflect disposal post year end	(1.8)	–
Costs on previously disposed of businesses	(1.3)	(1.2)
	(3.3)	(1.6)
Taxation	0.7	–
Exceptional loss	(2.6)	(1.6)
Total discontinued operations	(3.2)	(2.1)
Cash flows from discontinued operations		
Net cash flows from operating activities	(0.9)	2.5
Net cash flows from investing activities	0.7	(3.4)
Net cash flows from financing activities	(2.7)	–
	(2.9)	(0.9)

10. Dividends

	2006 £m	2005 £m
Final paid: 2.65p (2005: 2.10p) per 60p share	5.4	4.2
Interim paid 1.75p (2005: 1.35p) per 60p share	3.6	2.8
	9.0	7.0

In addition, the Directors are proposing a final dividend in respect of the financial year ending 31 March 2006 of 4.25p per share which will absorb an estimated £8.7 million of shareholders' funds. It will be paid on 7 August 2006 to shareholders who are on the register of members on 7 July 2006. These financial statements do not reflect this dividend payable.

11. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year excluding those held in the Babcock Employee Share Trust and the Peterhouse Employee Share Trust. The calculation of the basic and diluted EPS is based on the following data:

Number of shares

	2006 Number	2005 Number
Weighted average number of ordinary shares for the purpose of basic EPS	204,638,536	189,193,887
Effect of dilutive potential ordinary shares: share options	4,996,555	258,810
Weighted average number of ordinary shares for the purpose of diluted EPS	209,635,091	189,452,697

Earnings

	2006 Earnings £m	2006 Basic per share pence	2006 Diluted per share pence	2005 Earnings £m	2005 Basic per share pence	2005 Diluted per share pence
Continuing and discontinued operations						
Earnings from continuing and discontinued operations	29.7	14.49	14.15	19.1	10.08	10.07
Add back:						
Amortisation of acquired intangible assets, net of tax	2.2	1.06	1.04	3.0	1.64	1.63
Exceptional items, net of tax	2.7	1.32	1.29	4.8	2.50	2.51
Earnings before amortisation and exceptionals	34.6	16.87	16.48	26.9	14.22	14.21
Continuing operations						
Earnings from continuing operations	32.9	16.06	15.68	21.2	11.20	11.18
Add back:						
Amortisation of acquired intangible assets, net of tax	2.2	1.06	1.04	3.1	1.64	1.64
Exceptional items, net of tax	0.1	0.06	0.06	3.1	1.64	1.64
Earnings before discontinued operations, amortisation and exceptionals	35.2	17.18	16.78	27.4	14.48	14.46

12. Goodwill

	2006 £m	2005 £m
Cost		
At 1 April	166.1	81.5
On acquisition of subsidiaries (note 31)	2.7	85.0
On disposal of subsidiaries	–	(0.4)
At 31 March	168.8	166.1
Accumulated impairment		
At 1 April	4.8	–
Impairment charge	–	4.8
At 31 March	4.8	4.8
Net book value at 31 March	164.0	161.3

During the year, the goodwill was tested for impairment in accordance with IAS36. The recoverable amount for all the cash-generating units has been measured based on a value in use calculation derived from Board approved three year budgeted cash flows and extrapolated cash flows thereafter based on an estimated growth rate of 2%. A post-tax discount rate in the range 7% to 9% was used in the value in use calculation for the cash generating units within each segment. The group's weighted average cost of capital is approximately 8%. No reasonable change in the discount rate would give rise to an impairment.

The goodwill impairment in 2005 arose on the downsizing of the group's marine design business.

12. Goodwill (continued)

Goodwill is allocated to the group's cash generating units (CGU) identified according to the business segment and country of operation. A segment level summary of goodwill allocation is presented below:

	2006 £m	2005 £m
Defence Services	76.9	73.9
Technical Services	1.4	1.4
Engineering and Plant Services	1.2	1.0
Networks	53.9	54.4
Rail	30.6	30.6
	164.0	161.3
United Kingdom	162.8	160.3
Rest of Europe	–	–
Africa	0.2	–
North America	1.0	1.0
Rest of world	–	–
	164.0	161.3

13. Other intangible assets

	Acquired intangibles £m	Software £m	Development costs £m	Total £m
Cost				
At 1 April 2005	25.9	2.7	3.2	31.8
On acquisition of subsidiaries	–	0.1	–	0.1
On disposal of subsidiaries	–	(0.1)	–	(0.1)
Additions	–	2.7	–	2.7
Disposals	–	(0.1)	–	(0.1)
At 31 March 2006	25.9	5.3	3.2	34.4
Accumulated amortisation and impairment				
At 1 April 2005	13.2	0.8	3.0	17.0
Amortisation charge	3.1	0.5	–	3.6
At 31 March 2006	16.3	1.3	3.0	20.6
Net book value at 31 March 2006	9.6	4.0	0.2	13.8
Cost				
At 1 April 2004	–	0.9	3.0	3.9
On acquisition of subsidiaries	25.9	0.6	–	26.5
Additions	–	1.2	0.2	1.4
At 31 March 2005	25.9	2.7	3.2	31.8
Accumulated amortisation and impairment				
At 1 April 2004	–	0.5	2.3	2.8
Amortisation charge – exceptional	8.8	–	–	8.8
Amortisation charge – ordinary	4.4	0.3	–	4.7
Impairment charge	–	–	0.7	0.7
At 31 March 2005	13.2	0.8	3.0	17.0
Net book value at 31 March 2005	12.7	1.9	0.2	14.8

All amortisation charges for the year have been charged through cost of sales.

Acquired intangibles are the fair value of contracts and customer relationships of acquired entities.

14. Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Total £m
Cost				
At 1 April 2005	15.2	2.5	60.0	77.7
Exchange adjustments	–	–	0.7	0.7
On acquisition of subsidiaries	–	–	0.5	0.5
On disposal of subsidiaries	(0.8)	(0.1)	(2.5)	(3.4)
Reclassify as assets held for sale	–	–	(8.6)	(8.6)
Additions	–	0.2	6.9	7.1
Disposals	(0.2)	–	(2.3)	(2.5)
At 31 March 2006	14.2	2.6	54.7	71.5
Accumulated depreciation and impairment				
At 1 April 2005	10.0	0.5	31.2	41.7
Exchange adjustments	–	–	0.4	0.4
On disposal of subsidiaries	–	–	(1.9)	(1.9)
Reclassify as assets held for sale	–	–	(2.3)	(2.3)
Charge for the year	0.3	0.3	6.5	7.1
Disposals	–	–	(1.4)	(1.4)
Impairment charge*	–	–	2.6	2.6
At 31 March 2006	10.3	0.8	35.1	46.2
Net book value at 31 March 2006	3.9	1.8	19.6	25.3
Cost				
At 1 April 2004	12.6	0.9	40.3	53.8
Exchange adjustments	–	–	(0.2)	(0.2)
On acquisition of subsidiaries	4.3	1.3	26.7	32.3
On disposal of subsidiaries	–	–	(0.3)	(0.3)
Additions	0.1	0.1	5.2	5.4
Disposals	(1.8)	–	(11.5)	(13.3)
Reclassification	–	0.2	(0.2)	–
At 31 March 2005	15.2	2.5	60.0	77.7
Accumulated depreciation and impairment				
At 1 April 2004	10.0	0.2	31.8	42.0
Exchange adjustments	–	–	(0.1)	(0.1)
On disposal of subsidiaries	–	–	(0.2)	(0.2)
Charge for the year	0.4	0.3	6.7	7.4
Disposals	(0.4)	–	(7.0)	(7.4)
At 31 March 2005	10.0	0.5	31.2	41.7
Net book value at 31 March 2005	5.2	2.0	28.8	36.0

*Relates to business disposals.

Assets held under finance leases have the following net book value within plant and equipment:

	2006 £m	2005 £m
Cost	9.5	19.5
Aggregate depreciation and impairment	(2.2)	(6.0)
Net book value	7.3	13.5

15. Investment in joint ventures and other investments

	Joint ventures		Other investments		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
At 1 April						
– Net assets excluding goodwill	0.6	0.6	0.1	0.1	0.7	0.7
– Goodwill	–	–	–	–	–	–
	0.6	0.6	0.1	0.1	0.7	0.7
Additions	0.1	0.3	–	0.1	0.1	0.4
Disposals	–	(0.5)	(0.1)	(0.1)	(0.1)	(0.6)
Share of profits	(0.1)	0.2	–	–	(0.1)	0.2
At 31 March						
– Net assets excluding goodwill	0.6	0.6	–	0.1	0.6	0.7
– Goodwill	–	–	–	–	–	–

Included within joint ventures are:

	DynCorp-Hiberna Ltd		Other joint ventures		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Assets	1.2	0.7	1.7	4.1	2.9	4.8
Liabilities	(0.4)	(0.2)	(1.9)	(4.0)	(2.3)	(4.2)
Net assets	0.8	0.5	(0.2)	0.1	0.6	0.6
Revenue	1.3	1.3	0.3	1.8	1.6	3.1
Operating profit	0.1	0.2	(0.2)	0.1	(0.1)	0.3
Retained profit	0.1	0.2	(0.2)	–	(0.1)	0.2
Percentage owned	50.0%	50.0%				

The joint ventures have no significant contingent liabilities to which the group is exposed.

Listed below are the group's joint ventures.

	Country of incorporation	Description of interest and % ownership	Year end
DynCorp-Hiberna Limited	United Kingdom	Shares – 50%	31 March
Debut Services Limited	United Kingdom	Shares – 50%	30 June
One Network Solutions Limited	United Kingdom	Shares – 50%	31 March
FSP (2004) Limited	United Kingdom	Shares – 50%	31 March
First Swietelsky Operation and Maintenance	United Kingdom	Partnership – 50%	31 March
First Swietelsky Joint Venture High Output	United Kingdom	Partnership – 50%	31 March

16. Deferred tax

The movements in deferred tax assets and liabilities (prior to offsetting of balances within the same tax jurisdiction as permitted by IAS12) during the period are shown below:

	Accelerated tax depreciation £m	ACT £m	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
At 1 April 2005	3.3	4.5	5.8	0.1	(1.9)	11.8
Income statement credit*	(0.1)	–	(2.1)	–	2.9	0.7
Tax charge to equity	–	–	(12.6)	–	3.9	(8.7)
Transfer to corporation tax	–	(1.2)	–	–	–	(1.2)
Reclassify as liabilities held for sale	1.6	–	–	–	–	1.6
Exchange differences	0.3	–	–	–	–	0.3
At 31 March 2006	5.1	3.3	(8.9)	0.1	4.9	4.5
At 1 April 2004	2.3	4.5	(1.0)	–	1.7	7.5
On acquisition of subsidiaries	1.5	–	(1.8)	2.8	(5.2)	(2.7)
Income statement charge*	(0.5)	–	(1.8)	(2.7)	1.6	(3.4)
Tax charge to equity	–	–	10.4	–	–	10.4
At 31 March 2005	3.3	4.5	5.8	0.1	(1.9)	11.8

*Includes deferred tax of £0.3 million (2005: £0.1 million) in respect of discontinued operations.

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

At the balance sheet date, the group has unused tax losses (excluding UK capital losses and advanced corporation tax) of £71.0 million (2005: £71.0 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £0.3 million (2005: £0.3 million) of such losses. No deferred tax has been recognised in respect of the remaining £70.7 million (2005: £70.7 million) due to the unpredictability of future profit streams. Other losses may be carried forward indefinitely.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries and joint ventures. As the earnings are continually reinvested by the group, no tax is expected to be paid on them in the foreseeable future. If earnings were remitted, tax of £12 million (2005: £10 million) would be payable.

17. Inventories

	2006 £m	2005 £m
Raw materials	7.2	6.0
Work in progress	8.8	4.6
Finished goods and goods for resale	25.5	30.0
Total	41.5	40.6

18. Trade and other receivables

	2006 £m	2005 £m
Current assets		
Trade receivables	54.0	42.4
Less: provision for impairment of receivables	(2.0)	(2.1)
Trade receivables – net	52.0	40.3
Amounts due from customers for contract work	85.4	165.0
Retentions	4.4	2.4
Amounts owed by related parties (note 35)	11.0	4.4
Other debtors	4.1	6.0
Prepayments and accrued income	11.6	14.1
	168.5	232.2
Non-current assets		
Other debtors	0.3	0.4

Trade and other receivables are classified as loans and receivables and are stated at amortised cost.

19. Cash and cash equivalents

	2006 £m	2005 £m
Cash at bank and in hand	95.7	24.6
Short-term bank deposits (overnight)	13.3	8.5
	109.0	33.1

In 2004/05, the group's cash balances were reported net of bank overdrafts where a cash pool was in operation and the legal right of offset existed. On adoption of IAS32, netting can only occur to the extent that there is both the legal ability and the intention to settle net by entity. Although the group's cash is, where practical, managed on a pooled basis and interest is charged or earned on a net basis, there is a grossing up of cash and borrowings in 2005/06 of £78.1 million.

The carrying amount of the group's cash and cash equivalents are denominated in the following currencies:

	2006	
	Total £m	Floating rate £m
Currency		
Sterling	92.0	92.0
Euro	1.3	1.3
US Dollar	1.9	1.9
South African Rand	12.8	12.8
Swedish Krone	0.6	0.6
Other currencies	0.4	0.4
	109.0	109.0

The above balances are invested at short term, floating rates 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.

20. Trade and other payables

	2006 £m	2005 £m
Current liabilities		
Amounts due to customers for contract work	94.7	148.5
Trade creditors	67.8	68.9
Amounts owed to related parties (note 35)	2.2	0.1
Other creditors	18.5	14.9
Other taxes and social security	10.3	9.7
Accruals and deferred income	19.4	20.9
	212.9	263.0

21. Bank and other borrowings

	2006 £m	2005 £m
Current liabilities		
Bank loans and overdrafts due within one year or on demand		
Secured (a)	–	0.2
Unsecured	140.1	85.2
	140.1	85.4
Finance lease obligations (b)	0.6	2.3
	140.7	87.7
Non current liabilities		
Bank loans		
Secured (a)	–	2.1
Unsecured	1.8	–
	1.8	2.1
Finance lease obligations (b)	4.7	6.2
	6.5	8.3

See note 19 regarding grossing up of cash and overdraft pooling arrangements contained within current liabilities.

(a) Secured against floating charge on the assets of a subsidiary undertaking.

(b) Finance leases are secured against the assets to which they relate.

Bank loans are denominated in a number of currencies and bear interest based on LIBOR or foreign equivalents appropriate to the country in which the borrowing is incurred. The group has entered into an interest rate swap and an interest rate cap, details of which are found in note 22.

The carrying amount of the group's borrowings are denominated in the following currencies:

			2006
	Total £m	Floating rate £m	Fixed rate £m
Currency			
Sterling	143.0	140.2	2.8
South African Rand	1.8	1.8	–
Other	2.4	2.4	–
	147.2	144.4	2.8

The weighted average interest rates of Sterling fixed rate borrowings, which comprise financial lease obligations, are 5.2%. The weighted average period for which these interest rates are fixed is seven years.

The floating rate for borrowings 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 exposure of the group to interest rate changes when borrowings re-price is as follows:

Total borrowings	1 year	1-5 years	5 years	Total
As at 31 March 2006	140.7	5.8	0.7	147.2
As at 31 March 2005	87.7	7.1	1.2	96.0

The effective interest rates at the balance sheet dates were as follows:

	2006 %	2005 %
UK bank overdraft	5.5	5.7
UK bank borrowings	5.0	5.7
Other borrowings	14.6	11.0
Finance leases	5.0–9.0	5.0–9.0

21. Bank and other borrowings (continued)

Repayment details

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

	2006		2005	
	Bank loans and overdrafts £m	Finance lease obligations £m	Bank loans and overdrafts £m	Finance lease obligations £m
Within one year	140.1	0.6	85.4	2.3
Between one and two years	0.4	0.9	0.5	1.9
Between two and five years	1.3	3.2	1.6	3.1
Greater than five years	–	0.7	–	1.2
	141.8	5.4	87.5	8.5

Borrowing facilities

The group has the following undrawn committed borrowing facilities available at 31 March in respect of which all conditions precedent had been met at that date.

	2006 £m	2005 £m
Expiring in less than one year	24.6	16.9
Expiring in more than one year but not more than five years	84.2	62.0
	108.8	78.9

The minimum lease payments under finance leases fall due as follows:

	2006 £m	2005 £m
Not later than one year	0.7	2.4
Later than one year but not more than five	4.7	5.9
More than five years	0.8	1.3
	6.2	9.6
Future finance charges on finance leases	(0.8)	(1.1)
Present value of finance lease liabilities	5.4	8.5

22a. Financial instruments

The group has adopted the exemption not to restate comparatives for IAS32 'Financial Instruments: Disclosure and Presentation' and IAS39 'Financial Instruments: Recognition and Measurement' but to apply these standards from 1 April 2005. As a result the comparative information to the 2006 financial statements will be presented on the existing UK GAAP basis. A reconciliation between the closing 31 March 2005 balance sheet and the opening 1 April 2005 balance sheet is shown in note 38.

Other financial assets and liabilities

	Fair value	
	Assets 2006 £m	Liabilities 2006 £m
Financial derivatives	0.1	0.2

The group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies, as the transaction occurs.

Interest rate swaps

The notional principal amount of the outstanding interest rate swap contracts at 31 March 2006 was £30.0 million (2005: £50.0 million).

The group held the following interest rate swaps:

	Amount	Fixed %	Maturity
Interest rate CAP	20,000,000	5.00	25/6/2006
SWAP	10,000,000	4.89	29/11/2007

22a. Financial instruments (continued)

Fair value of financial assets and financial liabilities

The fair values of financial assets and liabilities at the balance sheet date were:

	2006 Book value £m	2006 Fair value £m
Fair value of non current borrowings		
Long-term borrowings	(6.5)	(5.7)
Fair value of other financial assets and financial liabilities		
Short-term borrowings	(140.7)	(140.7)
Trade and other payables	(212.9)	(212.9)
Trade and other receivables	168.5	168.5
Short-term deposits	13.3	13.3
Cash at bank and in hand	95.7	95.7
Other financial assets and liabilities	(0.1)	(0.1)
	(76.2)	(76.2)

Fair values of long-term borrowings are based on cash flows discounted using a rate of 5.0%.

22b. Previous year's FRS13 disclosure

The UK GAAP 2005 disclosure for derivatives and other financial instruments is shown below:

Interest rate profile

The group's financial assets comprise cash deposits of £33.1 million. Cash deposits are placed on money markets at call, seven-day and monthly rates. The interest rate profile of the group's financial assets and liabilities (excluding short-term debtors and creditors), after taking into account of the interest rate swaps used to manage the interest profile, is as follows:

	2005 Financial assets	2005 Financial liabilities			
	Total and floating rate £m	Total £m	Floating rate £m	Fixed rate £m	No interest paid £m
Currency					
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 Krone	0.5	–	–	–	–
Other currencies	0.7	2.9	2.9	–	–
	33.1	96.0	93.5	2.5	–

The above table does not include onerous lease liabilities of £6.1 million. The interest rate on this liability is 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 financial lease obligations, are 6.2%. 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.

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

22b. Previous year's FRS13 disclosure (continued)

Currency exposures

The accounting policy note 1 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 income statement. 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 £m	Swedish Krone £m	Other £m	Total £m
Sterling	–	0.9	1.7	–	0.4	3.0
Swedish Krone	–	–	0.5	–	-	0.5
Total	–	0.9	2.2	–	0.4	3.5

The amounts shown in the table above 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 foreign currency contract that the group had taken out to hedge expected future foreign currency movements.

Fair values

Set out below is a comparison of the book and fair values of derivative financial instruments held to manage the interest rate and currency profile of the group's operations. In all other cases, there is no material difference between the book value and the fair value of the group's financial assets/(liabilities).

	2005 Book value	2005 Fair value
Interest rate swaps	0.3	0.1
Forward foreign currency contracts	–	(0.5)

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 of hedging instruments.

23. Provisions for other liabilities

	Acquisition/ deferred consideration (a) £m	Insurance provisions (b) £m	Reorganisation or disposal of businesses (c) £m	Property and other (d) £m	Total provisions £m
At 1 April 2005	5.6	10.0	10.9	6.8	33.3
On acquisition of subsidiaries	3.0	–	–	–	3.0
Charged to income statement	–	–	3.5	0.7	4.2
Utilised in year	(5.9)	(2.3)	(5.3)	(0.5)	(14.0)
Released in year	–	(1.4)	(0.1)	(0.1)	(1.6)
At 31 March 2006	2.7	6.3	9.0	6.9	24.9

Provisions have been analysed between current and non-current as follows:

	2006 £m	2005 £m
Current	12.3	9.9
Non-current	12.6	23.4
	24.9	33.3

(a) Acquisition/deferred consideration relates to the contingent consideration for Turners, remaining costs and consideration for SGI, and certain other provisions set up on acquisition of Peterhouse.

(b) The insurance provisions arise in the group's captive insurance companies, Chepstow Insurance Limited and Peterhouse Insurance Limited. They relate to specific claims assessed in accordance with the advice of independent actuaries.

(c) Provisions for costs relating to the reorganisation or disposal of businesses are principally redundancy provisions and claims and litigation.

(d) Property and other in the main relate to provisions for onerous leases and dilapidation costs.

The group's non-current provisions are expected to be utilised within two to five years.

24. Share capital

	Ordinary shares of 60p Number	Unclassified shares of 30p Number	Ordinary shares of 60p £m	Unclassified shares of 30p £m
Authorised:				
At 1 April 2005	306,219,012	1	183.7	–
Authorised during the year	–	–	–	–
At 31 March 2006	306,219,012	1	183.7	–
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	–

	Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2005	208,355,202	125.0
Allotted under share option schemes	811,276	0.5
At 31 March 2006	209,166,478	125.5
At 1 April 2004	150,249,029	90.1
Allotted under share option schemes	1,086,441	0.7
Allotted on acquisition of Peterhouse	57,019,732	34.2
At 31 March 2005	208,355,202	125.0

24. Share capital (continued)

Potential issues of ordinary shares

The table below shows options existing over the company's shares as at 31 March 2006. They represent outstanding options granted under all the company's Executive Share Option Schemes. Of the total number of shares shown, 2,885,707 are in respect of options granted by the trustees of the Babcock Employee Share Trust and 761,111 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 1,734,045 shares is in respect of options granted by the company to subscribe for newly issued shares.

Grant date	Exercise price Pence	Exercise period	2006 Number	2005 Number
03 Jan 1996	151.00	03/01/1999 – 02/01/2006	–	50,000
18 Dec 1996	74.50	19/12/1999 – 18/12/2006	–	20,000
20 Jul 1998	89.00	20/07/2001 – 19/07/2008	30,000	171,404
08 Jul 1999	122.50	08/07/2002 – 07/07/2009	60,625	120,216
09 Sep 1999	118.00	09/09/2002 – 08/09/2009	22,100	76,350
23 Jun 2000	96.33	23/06/2003 – 22/06/2010	46,664	183,664
22 Nov 2000	123.00	22/11/2003 – 21/11/2010	560,975	560,975
25 Jun 2001	99.33	25/06/2004 – 24/06/2011	386,377	544,412
28 Nov 2001	79.50	28/11/2004 – 27/11/2011	–	39,204
31 Jan 2002	104.33	31/01/2005 – 30/01/2012	170,229	170,229
20 Feb 2002	104.00	20/02/2005 – 19/02/2012	134,615	134,615
24 Jun 2002	124.50	24/06/2005 – 23/06/2012	1,593,157	1,852,453
27 Nov 2002	106.33	27/11/2005 – 26/11/2012	120,000	120,000
30 Jun 2003	115.60	30/06/2006 – 29/06/2013	737,511	750,000
06 Jul 2004	126.00	06/07/2007 – 05/07/2014	1,518,610	1,577,925
			5,380,863	6,371,447

Options granted to Directors are summarised in the Remuneration report on pages 33 to 38 and are included in the outstanding options set out above.

A reconciliation of option movements is shown below:

	2006		2005	
	Number ('000)	Weighted average exercise price	Number ('000)	Weighted average exercise price
Outstanding at 1 April	6,371	£1.18	6,560	£1.12
Granted	–	–	1,640	£1.26
Forfeited/lapsed	(92)	£1.19	(522)	£1.10
Exercised	(898)	£1.08	(1,280)	£0.99
Expired	–	–	(27)	£1.33
Outstanding at 31 March	5,381	£1.20	6,371	£1.18
Exercisable at 31 March	3,124	£1.18	2,071	£1.08

Weighted average share price for options exercised during the year was 191.0p per share (2005: 130.6p per share).

Notes to the consolidated financial statements continued

25. Share based payments

The charge to the income statement has been based on the assumptions below and is based on the binomial model as adjusted, allowing for a closed form numerical-integrated solution, which makes it analogous to the Monte Carlo simulations, including performance conditions. The detailed description of the plans below is included within the Remuneration report.

During the year the total charge relating to employee share-based payment plans was £1.1 million (2005: £0.9 million) all of which related to equity settled share-based payment transactions.

After tax, the income statement charge was £0.8 million (2005: £0.7 million).

The fair value per option granted and the assumptions used in the calculation are as follows:

Options

Grant or modification date	2004 post-modification EPS 24/5/2005	2004 pre-modification TSR 24/5/2005	2004 at inception 6/7/2004	2003 30/6/2003
Share price at grant or modification date (pence)	136.0	136.0	126.0	115.7
Exercise price (pence)	126.0	126.0	126.0	115.7
Vesting period (years)	2.12	2.12	3.00	3.00
Expected volatility	27%	27%	28%	28%
Option life (years)	9.12	9.12	10.00	10.00
Expected life (years)	5.40	5.40	6.70	6.80
Risk free rate	4.3%	4.3%	5.2%	4.1%
Expected dividends expressed as dividend yield	2.8%	2.8%	2.8%	2.8%
Possibility of ceasing employment before vesting	–	–	–	–
Expectations of meeting performance criteria	50%	n/a	n/a	n/a
Fair value per option (pence)	33.5	23.5	24.6	21.6
Correlation	n/a	6%	6%	6%

L-TIPS

Grant or modification date	2005 TSR 11/7/2005	2005 EPS 11/7/2005	2004 post-modification TSR 24/5/2005	2004 post-modification EPS 24/5/2005	2004 pre-modification TSR 24/5/2005	2004 at inception 6/7/2004	2003 22/7/2003
Share price at grant or modification date (pence)	169.5	169.5	136.0	136.0	136.0	126.0	113.5
Exercise price (pence)	–	–	–	–	–	–	–
Vesting period (years)	3.0	3.0	2.12	2.12	2.12	3.0	3.0
Expected volatility	25%	25%	27%	27%	27%	28%	28%
Option life (years)	10.0	10.0	9.12	9.12	9.12	10.0	10.0
Expected life (years)	3.0	3.0	2.12	2.12	2.12	3.0	3.0
Risk free rate	4.2%	4.2%	4.3%	4.3%	4.3%	5.1%	3.7%
Expected dividends expressed as dividend yield	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%
Expectations of meeting performance criteria	n/a	50%	n/a	50%	n/a	n/a	n/a
Fair value per option (pence)	108.9	155.7	62.1	128.5	64.9	67.3	60.6
Correlation	9%	n/a	9%	n/a	6%	6%	6%

The number of L-TIP's awarded in 2005 were 993,283, in 2004 were 1,535,119 and in 2003 were 1,157,668.

The expected volatility is based on historical volatility over the last one to three years. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon government bonds of a term consistent with the assumed option life.

26. Statement of changes in equity

	Share capital	Share premium	Capital redemption	Retained earnings	Translation reserve	Total	Minority interests	Year ended 31 March
At 1 April 2004	90.1	38.6	30.6	(100.7)	–	58.6	–	58.6
Shares issued in the period	34.9	30.7	–	–	–	65.6	–	65.6
Total recognised income and expense	–	–	–	(5.3)	0.1	(5.2)	0.1	(5.1)
Dividends	–	–	–	(7.0)	–	(7.0)	–	(7.0)
Share-based payments	–	–	–	0.9	–	0.9	–	0.9
Tax on share based payments	–	–	–	(0.2)	–	(0.2)	–	(0.2)
Movement in ESOP	–	–	–	(0.4)	–	(0.4)	–	(0.4)
Net movement in equity	34.9	30.7	–	(12.0)	0.1	53.7	0.1	53.8
At 31 March 2005	125.0	69.3	30.6	(112.7)	0.1	112.3	0.1	112.4
Adoption of IAS39 at 1 April 2005	–	–	–	–	–	–	–	–
At 1 April 2005	125.0	69.3	30.6	(112.7)	0.1	112.3	0.1	112.4
Shares issued in the period	0.5	0.4	–	–	–	0.9	–	0.9
Total recognised income and expense	–	–	–	59.2	1.6	60.8	0.3	61.1
Dividends	–	–	–	(9.0)	–	(9.0)	–	(9.0)
Share-based payments	–	–	–	1.1	–	1.1	–	1.1
Tax on share-based payments	–	–	–	4.1	–	4.1	–	4.1
Net movement in equity	0.5	0.4	–	55.4	1.6	57.9	0.3	58.2
Equity at 31 March 2006	125.5	69.7	30.6	(57.3)	1.7	170.2	0.4	170.6

During the year the company acquired no ordinary shares through either the Babcock Employee Share Trust or the Peterhouse Employee Share Trust (together "the Trusts") in respect of obligations under the Babcock 1999 Executive Share Option Schemes or the Babcock 2003 L-TIP. During the year ended 31 March 2006 87,161 shares (2005: 193,528 shares) were disposed by the Trusts resulting from options exercised. At 31 March 2006, the Trusts held between them a total of 4,109,918 (2005: 4,197,079) ordinary shares at a total market value of £13,090,089 (2005: £6,253,648) representing 1.96% (2005: 2.01%) 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, though full dividends were paid in respect of shares held by the Peterhouse Employee Share Trust. All the Trusts' shares are under option, the subject of L-TIP share awards to employees or represent a provision for future L-TIP vesting. The company meets the operating expenses of the Trusts.

The Trusts enable shares in the company to be held or purchased and made available to employees through the grant and exercise of rights or awards under the Babcock 1999 Executive Share Option Schemes and the Babcock 2003 L-TIP. The Trusts are discretionary settlements for the benefit of employees within the group. The company is excluded from benefiting under them. They are controlled and managed outside the UK and each has a single corporate trustee which is an independent trustee services organisation. The right to remove and appoint the trustees rests ultimately with the company. The trustee of the Babcock Employee Share Trust 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, but the trustee of the Peterhouse Employee Share Trust does not have the power to waive dividends due on Babcock ordinary shares and therefore receives the full amount of any dividends declared.

27. Retirement benefits and liabilities

The group has established a number of pension schemes around the world covering many of its employees. The principal funds are those in the UK.

Defined contributions schemes

Pension costs for defined contribution schemes are as follows:

	2006 £m	2005 £m
Defined contribution schemes	7.5	7.4

Defined benefit schemes

Balance sheet assets and liabilities recognised are as follows:

	2006 £m	2005 £m
Retirement benefits – funds in surplus	64.9	41.5
Retirement benefits – funds in deficit	(35.6)	(61.8)
	29.3	(20.3)

27. Retirement benefits and liabilities (continued)

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

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m
Date of last formal actuarial valuation	01.04.04	31.03.03	31.12.04
Number of active members at 31 March 2006	528	1,229	843
Actuarial valuation method	Projected unit	Projected unit	Attained age
Results of formal actuarial valuation:			
Value of assets	£404.8m	£355.1m	£121.4m
Level of funding	114%	107%	96%
Principal valuation assumptions:			
Excess of investment returns over earnings increases	1%–2.5%	1.5%	(0.5%)–1.75%
Excess of investment returns over pension increases	2.5%–4%	3%	1.75%–1.95%

As a result of the level of surplus the group's required contribution to the Babcock International Group Pension Scheme is currently suspended until at least the results of the next formal valuation are available. The group does however make voluntary payments to the scheme.

The contribution rates for the Rosyth Royal Dockyard Scheme is 8% of pensionable pay and the First Engineering Scheme is 11.5% to June 2006 and thereafter will increase.

During the year the Eve Group Scheme and the Jackson Group plc Pension and Life Assurance Scheme were merged with the Babcock International Group Scheme.

In addition to the three principal defined benefit schemes referred to above, the group also operates a number of smaller defined 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 as at 31 December 2005. The company made a contribution of £232,000 during the year to 31 March 2006. The plan was frozen as of 31 January 2003 and, therefore, no active members existed as at 31 March 2006.

The HMNB Clyde contract includes a contract specific defined benefit pension scheme where all funding risk is borne by the customer and hence the costs are included within the defined contribution analysis above.

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 contributions to the scheme during the year to 31 March 2006.

As part of the Peterhouse acquisition three smaller defined benefit schemes were acquired: Jackson Group plc Pension and Life Assurance Scheme, Shorco Group Pension Scheme and AMT International Limited Pension Scheme. All three schemes had no active members and all members have either transferred or are in the process of transferring to the Babcock International Group Pension Scheme. £18,000 (2005: £150,000) was contributed to the Jackson Group Scheme during the year to 31 March 2006.

The latest full actuarial valuation of the group's defined benefit pension schemes have been updated to 31 March by qualified independent actuaries for IAS19 purposes using the following assumptions:

	Babcock International Group Scheme %	Rosyth Royal Dockyard Scheme %	First Engineering Scheme %	Eve Group Scheme %	Other Schemes (weighted average) %
2006					
Rate of increase in pensionable salaries	4.0	3.0–3.5	4.0	–	–
Rate of increase in pensions	3.0	3.0	3.0	–	3.0
Discount rate	5.1	5.1	5.1	–	5.2
Inflation rate	3.0	3.0	3.0	–	3.0
Expected return on plan assets	6.0	6.9	7.4	–	6.5
2005					
Rate of increase in pensionable salaries	4.0	3.0–3.5	4.0	4.0	–
Rate of increase in pensions	3.0	3.0	3.0	3.0	3.1
Discount rate	5.43	5.43	5.43	5.43	5.45
Inflation rate	3.0	3.0	3.0	3.0	3.1
Expected return on plan assets	5.7	7.3	7.5	6.9	7.3

27. Retirement benefits and liabilities (continued)

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 were as follows:

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		First Engineering Scheme		Eve Group Scheme		Other Schemes		Total
	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	Expected rate of return %	Fair value £m	Fair value £m
2006											
Equities	–	–	8.0	229.0	8.0	118.7	–	–	8.0	33.2	380.9
Property	–	–	7.5	68.0	7.5	14.4	–	–	7.5	0.2	82.6
Conventional gilts	–	–	4.5	80.1	–	–	–	–	4.5	19.4	99.5
Bonds – corporate	–	–	5.1	59.5	–	–	–	–	5.1	6.7	66.2
Bonds – government	–	–	–	–	4.5	14.9	–	–	4.5	0.7	15.6
Liability matching bonds	6.0	485.5	–	–	–	–	–	–	–	–	485.5
Cash	–	–	4.5	5.1	4.5	7.8	–	–	4.5	0.7	13.6
Fair value assets		485.5		441.7		155.8		–		60.9	1,143.9
Present value of funded obligation		(433.3)		(473.5)		(143.1)		–		(64.7)	(1,114.6)
Net assets/(liabilities) recognised in the balance sheet		52.2		(31.8)		12.7		–		(3.8)	29.3

In June 2005 the Babcock International Group Pension Scheme assets were reorganised to give a composite return of 6% which is reflected in the expected return for 2005/6 year.

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		First Engineering Scheme		Eve Group Scheme		Other Schemes		Total
	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	Expected rate of return %	Fair value £m	Fair value £m
2005											
Equities	8.0	52.5	8.0	224.8	8.0	94.5	8.0	18.5	8.0	34.8	425.1
Property	–	–	7.5	57.5	7.5	11.0	7.5	0.7	7.5	0.3	69.5
Bonds – corporate	5.5	135.8	5.5	42.2	–	–	–	–	5.5	10.2	188.2
Bonds – government	4.7	211.4	4.7	47.4	4.7	12.3	4.7	11.2	4.7	15.3	297.6
Cash	4.75	7.1	4.75	3.7	4.75	6.0	4.75	0.1	4.75	0.6	17.5
Fair value of assets		406.8		375.6		123.8		30.5		61.2	997.9
Present value of funded obligation		(376.7)		(428.2)		(117.9)		(25.1)		(70.3)	(1,018.2)
Net assets/(liabilities) recognised in the balance sheet		30.1		(52.6)		5.9		5.4		(9.1)	(20.3)

27. Retirement benefits and liabilities (continued)

The amounts recognised in the income statement are as follows:

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Group £m
2006						
Current service cost	(3.6)	(5.9)	(2.8)	(0.4)	–	(12.7)
Interest on obligation	(19.9)	(23.0)	(4.3)	(0.9)	(1.6)	(49.7)
Expected return on plan assets	24.0	26.5	6.3	1.4	1.4	59.6
Curtailment gain	–	1.3	–	–	–	1.3
Settlement gains/(losses)*	3.8	–	–	(8.2)	4.4	–
Total included within operating profit	4.3	(1.1)	(0.8)	(8.1)	4.2	(1.5)

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Group £m
2005						
Current service cost	(3.3)	(6.1)	(2.2)	(0.4)	–	(12.0)
Interest on obligation	(19.3)	(21.4)	(4.8)	(1.0)	(1.3)	(47.8)
Expected return on plan assets	22.3	24.8	6.8	1.5	1.2	56.6
Curtailments gain	–	5.6	–	–	–	5.6
Total included within operating profit	(0.3)	2.9	(0.2)	0.1	(0.1)	2.4

*Settlement gains/ (losses) arise on the merging of the Schemes.

Amounts recorded in statement of recognised income and expense

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Group £m
At 1 April 2005						
Actual return less expected return on pension scheme assets	25.5	53.2	26.3	2.3	14.0	121.3
Experience losses arising on scheme liabilities	(0.5)	(13.2)	(8.4)	–	–	(22.1)
Change in assumptions relating to present value of scheme liabilities	(11.1)	(20.8)	(12.4)	0.2	(12.9)	(57.0)
At 31 March 2006	13.9	19.2	5.5	2.5	1.1	42.2
At 1 April 2004						
Actual return less expected return on pension scheme assets	3.7	19.6	7.6	1.3	0.6	32.8
Experience losses arising on scheme liabilities	2.2	(7.4)	(0.9)	–	(5.3)	(11.4)
Change in assumptions relating to present value of scheme liabilities	(21.0)	(24.7)	(7.0)	(1.3)	(2.2)	(56.2)
At 31 March 2005	(15.1)	(12.5)	(0.3)	–	(6.9)	(34.8)
Cumulative recognised income and expense at 31 March 2006	(1.2)	6.7	5.2	2.5	(5.8)	7.4

27. Retirement benefits and liabilities (continued)

Analysis of movement in the balance sheet

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Total £m
Fair value of plan assets						
At 1 April 2005	406.8	375.6	123.8	30.5	61.2	997.9
Assets distributed on settlements	48.3	–	–	(33.2)	(15.1)	–
Expected return	24.0	26.5	6.3	1.4	1.4	59.6
Actuarial gain	25.5	53.2	26.3	2.3	14.0	121.3
Employer contributions	4.1	2.6	2.1	0.1	0.2	9.1
Employee contributions	0.6	0.5	1.0	0.1	–	2.2
Benefits paid	(23.8)	(16.8)	(3.7)	(1.2)	(0.8)	(46.3)
Exchange differences/other	–	0.1	–	–	–	0.1
At 31 March 2006	485.5	441.7	155.8	–	60.9	1,143.9
Present value of benefit obligations						
At 1 April 2005	376.7	428.2	117.9	25.1	70.3	1,018.2
Liabilities extinguished on settlements	44.5	–	–	(25.1)	(19.4)	–
Service cost	3.6	5.9	2.8	0.4	–	12.7
Interest cost	19.9	23.0	4.3	0.9	1.6	49.7
Employee contributions	0.6	0.5	1.0	0.1	–	2.2
Actuarial (gain)/loss	11.6	34.0	20.8	(0.2)	12.9	79.1
Curtailment gain	–	(1.3)	–	–	–	(1.3)
Benefits paid	(23.8)	(16.8)	(3.7)	(1.2)	(0.8)	(46.3)
Exchange differences/other	0.2	–	–	–	0.1	0.3
At 31 March 2006	433.3	473.5	143.1	–	64.7	1,114.6
Net surplus/(deficit) at 31 March 2006	52.2	(31.8)	12.7	–	(3.8)	29.3
Fair value of plan assets						
At 1 April 2004	401.7	344.5	–	–	45.6	791.8
At acquisition date	–	–	114.2	28.7	14.6	157.5
Expected return	22.3	24.8	6.8	1.5	1.2	56.6
Actuarial gain	3.7	19.6	7.6	1.3	0.6	32.8
Employer contributions	–	2.6	1.1	0.2	0.3	4.2
Employee contributions	0.7	0.6	0.8	–	0.1	2.2
Benefits paid	(21.6)	(16.5)	(6.6)	(1.2)	(1.2)	(47.1)
Exchange differences/other	–	–	(0.1)	–	–	(0.1)
At 31 March 2005	406.8	375.6	123.8	30.5	61.2	997.9
Present value of benefit obligations						
At 1 April 2004	356.3	390.2	–	–	43.4	789.9
At date of acquisition	–	–	108.7	23.4	19.4	151.5
Service cost	3.3	6.1	2.2	0.4	–	12.0
Interest cost	19.3	21.4	4.8	1.0	1.3	47.8
Employee contributions	0.7	0.6	0.8	–	0.1	2.2
Actuarial (gain)/loss	18.8	32.1	7.9	1.3	7.5	67.6
Curtailment gain	–	(5.6)	–	–	–	(5.6)
Benefits paid	(21.6)	(16.5)	(6.6)	(1.2)	(1.2)	(47.1)
Exchange differences/other	(0.1)	(0.1)	0.1	0.2	(0.2)	(0.1)
At 31 March 2005	376.7	428.2	117.9	25.1	70.3	1,018.2
Net surplus/(deficit) at 31 March 2005	30.1	(52.6)	5.9	5.4	(9.1)	(20.3)
Actual return on plan assets						
Year ending 31 March 2006	49.5	79.7	32.6	3.7	15.4	180.9
Year ending 31 March 2005	26.0	44.4	14.4	2.8	1.8	89.4

The expected return on plan assets is based on market expectations at the beginning of the year.

27. Retirement benefits and liabilities (continued)

History of experience gains and losses

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Eve Group Scheme £m	Other Schemes £m	Total £m
March 2006						
Difference between the expected and actual return on scheme assets	25.5	53.2	26.3	2.3	14.0	121.3
Percentage of scheme assets at 31 March 2006	5%	12%	17%	0%	23%	11%
Experience losses of scheme liabilities	(0.5)	(13.2)	(8.4)	–	–	(22.1)
Percentage of present value of scheme liabilities at 31 March 2006	0%	3%	6%	–	–	2%
Total amount recognised in statement of total recognised income and expense	13.9	19.2	5.5	2.5	1.1	42.2
Percentage of present value of scheme liabilities at 31 March 2006	3%	4%	4%	0%	2%	4%
March 2005						
Difference between the expected and actual return on scheme assets	3.7	19.6	7.6	1.3	0.6	32.8
Percentage of scheme assets at 31 March 2005	1%	5%	6%	4%	1%	3%
Experience gains/(losses) of scheme liabilities	2.2	(7.4)	(0.9)	–	(5.3)	(11.4)
Percentage of present value of scheme liabilities at 31 March 2005	1%	2%	1%	–	8%	1%
Total amount recognised in statement of total recognised income and expense	(15.1)	(12.5)	(0.3)	–	(6.9)	(34.8)
Percentage of present value of scheme liabilities at 31 March 2005	4%	3%	0%	–	10%	3%

28. Reconciliation of operating profit to cash generated from operations

	2006 £m	2005 £m
Cash flows from operating activities		
Operating profit	46.6	35.3
Loss from discontinued operations	(0.6)	(0.5)
Add back tax on discontinued operations	(0.4)	(0.2)
	45.6	34.6
Depreciation of property, plant and equipment	7.1	7.4
Amortisation and impairment of intangible assets	3.6	19.0
Equity share-based payments	1.1	0.9
Loss on disposal of property, plant and equipment	0.3	0.9
Operating cash flows before movement in working capital	57.7	62.8
(Increase)/decrease in inventories	1.5	(6.0)
Decrease/(increase) in receivables	52.8	(30.9)
Increase/(decrease) in payables	(49.2)	18.2
Decrease in provisions	(8.7)	(0.6)
Cash generated from operations	54.1	43.5

29. Movement in net debt

	2006 £m	2005 £m
Increase/(decrease) in cash in the year	(1.4)	20.2
Cash flow from the decrease in debt and lease financing	26.1	(19.8)
Change in net funds resulting from cash flows	24.7	0.4
Loans and finance leases (acquired)/disposed of with subsidiaries	0.1	(47.2)
New finance leases	(0.4)	(0.9)
Foreign currency translation differences	0.3	0.2
Movement in net debt in the year	24.7	(47.5)
Net debt at the beginning of the year	(62.9)	(15.4)
Net debt at the end of the year	(38.2)	(62.9)

30. Changes in net debt

	At 1 April 2005 £m	Cash flow £m	Acquisitions and Disposals £m	New Finance leases £m	Exchange movement £m	At 31 March 2006 £m
Cash and bank balances	33.1	75.6	–	–	0.3	109.0
Bank overdrafts	(6.7)	(77.0)	–	–	–	(83.7)
Cash, cash equivalents and bank overdrafts at end of year	26.4	(1.4)	–	–	0.3	25.3
Debt	(80.8)	22.5	–	–	0.2	(58.1)
Finance leases	(8.5)	3.6	0.1	(0.4)	(0.2)	(5.4)
	(89.3)	26.1	0.1	(0.4)	–	(63.5)
Total	(62.9)	24.7	0.1	(0.4)	0.3	(38.2)

31. Acquisitions and disposals

(a) Acquisitions

The acquisition in the current period is Central Flying Academy, a South African subsidiary acquired on 1 May 2005. In addition £3.6 million was paid in deferred consideration for previously acquired businesses.

	Acquired in current period £m	Acquired in prior period £m	Total £m
Non current assets			
– Goodwill	0.2	2.5	2.7
– Other intangible assets	0.1	–	0.1
– Property, plant and equipment	0.5	–	0.5
Current liabilities	(0.1)	1.1	1.0
Net assets acquired (at book and fair value)	0.7	3.6	4.3
Contingent consideration	–	–	–
Cash outflow from acquisitions	0.7	3.6	4.3

(b) Disposals and held for sale

	Disposed in current period £m	Disposed in prior period £m	Held for sale £m	Total £m
Non current assets				
– Intangible assets	0.1	–	–	0.1
– Property, plant and equipment	0.9	0.6	6.3	7.8
Current assets	4.5	0.1	2.9	7.5
Current liabilities	(0.7)	(2.6)	(3.8)	(7.1)
Net assets disposed	4.8	(1.9)	5.4	8.3
Profit/(loss) on disposal	(0.2)	0.3	–	0.1
Net assets held for sale (excluding cash)	–	–	(5.4)	(5.4)
Net consideration	4.6	(1.6)	–	3.0
Net cash disposed	–	–	(0.5)	(0.5)
Net cashflow	4.6	(1.6)	(0.5)	2.5

32. Operating lease commitments – minimum lease payments

	2006 Property £m	2006 Vehicles, plant and equipment £m	2005 Property £m	2005 Vehicles, plant and equipment £m
Commitments under non-cancellable operating leases:				
Within one year	6.8	5.6	6.2	5.1
Later than one year and less than five years	22.0	4.8	21.4	4.8
After five years	43.1	–	44.1	–
	71.9	10.4	71.7	9.9

The group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The group also leases plant and machinery under non-cancellable operating leases.

33. Contingent liabilities

a. 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.

b. The group has given certain indemnities and warranties in the course of disposing of businesses and companies. The group believes that any liability in respect of these is unlikely to have a material effect on the group's financial position.

c. 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 in the group's financial position.

34. Capital and other financial commitments

	2006 £m	2005 £m
Contracts placed for future capital expenditure not provided in the financial statements	–	–

35. Related party transactions

The following transactions were carried out with related parties.

(a) Transactions with joint ventures

(i) During the year a group subsidiary sold services to, its joint venture Debut Services Limited for £101,172,000 (2005: £74,977,000). The amounts outstanding at the year end on these sales were £595,000 (2005: £78,000). All transactions with the joint venture arise in the normal course of business.

(ii) During the year a group subsidiary sold services to its joint venture DynCorp-Hiberna Limited for £220,000 (2005: £176,000). The amount outstanding at year end on these sales was £36,000 (2005: £97,000). A group subsidiary also made loans to the joint venture. The amount outstanding at the year end was £nil (2005: £138,000). All transactions with the joint venture arise in the normal course of business.

(iii) During the year a group subsidiary sold services to, and purchased services from its joint venture One Network Solutions Limited for £162,000 and £240,000 respectively (2005: £146,000 and £107,000). The amounts outstanding at year end on these sales and purchases were £69,000 and £nil respectively (2005: £32,000 and £61,000). 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 £168,000 and £64,000 respectively (2005: £54,000 and £116,000). The amounts outstanding at year end on these sales and purchases were £105,000 and £51,000 respectively (2005: £1,000 and £10,000). 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 £6,250,000 (2005: £4,646,000). The amounts outstanding at the year end on these sales were £1,385,000 (2005: £773,000). All transactions with the joint venture arise in the normal course of business.

(vi) During the year a group subsidiary sold goods to, and purchased services from First Swietelsky Joint Venture High Output for £26,656,000 and £10,792,000 respectively (2005: £7,154,000 and £nil). The amounts outstanding at year end on these sales and purchases were £8,531,000 and £2,149,000 respectively (2005: £2,744,000 and £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 £749,926 and £1,422,423 respectively (2005: £1,068,449 and £2,553,853). The amounts outstanding at year end on these purchases and sales were £7,037 and £256,357 respectively (2005: £56,724 and £717,034). Mr M J Turner, Chief Executive Officer of BAE Systems PLC, retired as a non-executive Director of Babcock International Group PLC on 31 Dec 2005. The Rt Hon Lord Hesketh, resigned as a non-executive Director of BAE Systems PLC on 4 May 2005 and is a non-executive Director 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 26 on page 65.

36. Post balance sheet events

On 9 May 2006 the group acquired Alstec Group Ltd for a net consideration before costs of £44.9 million. Alstec reported turnover of £82.6 million and profit before interest and tax of £3.7 million for the year ended 31 March 2006. The acquisition balance sheet is under review.

Details on dividends are given in note 10. There are no further material events subsequent to 31 March 2006 that require disclosure.

37. Reconciliation of operating profit and net assets under UK GAAP to IFRS

Babcock International Group PLC reported under UK GAAP in its previously published financial statements for the year ended 31 March 2005. The analysis below together with the attached notes shows a reconciliation of net assets and profit as reported under UK GAAP as at 31 March 2005 to the revised net assets and profit under IFRS as reported in these financial statements. The detailed transition document is available on the company's website www.babcock.co.uk, some of the numbers have been restated to allow for the changes in presentation of discontinued operations.

Reconciliation of operating profit and profit after tax

	Notes	Year ended 31 March 2005 Operating profit £m	Year ended 31 March 2005 Profit after tax £m
Profit reported under UK GAAP		35.9	20.7
Pensions – ordinary	a	0.1	0.1
– exceptional	a	5.6	4.2
Acquired intangibles – exceptional	b	(8.8)	(8.8)
– ordinary	b	(4.4)	(3.1)
Goodwill – UK GAAP reversed	c	6.5	6.2
Share-based payments	d	(0.5)	(0.4)
Long-term contracts	e	(0.1)	(0.1)
Holiday pay	f	0.6	0.5
Debtor discounting	g	(0.3)	(0.1)
Discontinued operations		0.7	–
Profit reported under IFRS		35.3	19.2

37. Reconciliation of operating profit and net assets under UK GAAP to IFRS (continued)

Reconciliation of equity at 1 April 2004 (date of transition to IFRS)

	Note	Previous GAAP £m	Effect of transition to IFRS £m	IFRS £m
Assets				
Non current assets				
Goodwill	b,c	76.8	4.7	81.5
Other intangible assets	b,h	0.6	0.4	1.0
Property, plant and equipment	h	12.2	(0.4)	11.8
Investments in joint ventures		0.7	–	0.7
Retirement benefits	a	69.0	(20.4)	48.6
Trade and other receivables		0.4	–	0.4
Deferred tax	a,b,c,e,f,g,j,k	(12.3)	19.9	7.6
		147.4	4.2	151.6
Current assets				
Inventories	e	29.7	(1.6)	28.1
Trade and other receivables	e,f,g	69.5	2.4	71.9
Income tax recoverable		0.3	–	0.3
Other financial assets		–	0.1	0.1
Cash and cash equivalents		17.5	–	17.5
		117.0	0.9	117.9
Total assets		264.4	5.1	269.5
Equity and liabilities				
Equity attributable to equity holders of the parent				
Share capital		90.1	–	90.1
Share premium		38.6	–	38.6
Other reserves		30.6	–	30.6
Retained earnings		(62.2)	(38.5)	(100.7)
		97.1	(38.5)	58.6
Minority interest		–	–	–
Total equity		97.1	(38.5)	58.6
Non-current liabilities				
Bank and other borrowings		15.7	–	15.7
Trade and other payables		0.1	–	0.1
Income tax payable		0.1	–	0.1
Retirement liabilities	a	1.3	45.3	46.6
Provisions for other liabilities		7.2	–	7.2
		24.4	45.3	69.7
Current liabilities				
Trade and other payables	e,f,j	111.5	(5.8)	105.7
Income tax payable		6.0	–	6.0
Other financial liabilities		–	4.1	4.1
Bank and other borrowings		17.2	–	17.2
Provisions for other liabilities		8.2	–	8.2
		142.9	(1.7)	141.2
Total liabilities		167.3	43.6	210.9
Total equity and liabilities		264.4	5.1	269.5

37. Reconciliation of operating profit and net assets under UK GAAP to IFRS (continued)

Reconciliation of equity at 31 March 2005

	Note	Previous GAAP £m	Effect of transition to IFRS £m	IFRS £m
Assets				
Non current assets				
Goodwill	b,c	153.2	8.1	161.3
Other intangible assets	b,h	0.2	14.6	14.8
Property, plant and equipment	h	37.9	(1.9)	36.0
Investments in joint ventures		0.7	–	0.7
Retirement benefits	a	99.8	(58.3)	41.5
Trade and other receivables		0.4	–	0.4
Deferred tax	a,b,c,e,f,g,j,k	(19.9)	31.7	11.8
		272.3	(5.8)	266.5
Current assets				
Inventories	e	41.3	(0.7)	40.6
Trade and other receivables	a,e,f,g	178.0	54.2	232.2
Income tax recoverable		0.3	–	0.3
Cash and cash equivalents		33.1	–	33.1
		252.7	53.5	306.2
Total assets		525.0	47.7	572.7
Equity and liabilities				
Equity attributable to equity holders of the parent				
Share capital		125.0	–	125.0
Share premium		69.3	–	69.3
Other reserves		30.7	–	30.7
Retained earnings		(51.1)	(61.6)	(112.7)
		173.9	(61.6)	112.3
Minority interest		0.1	–	0.1
Total equity		174.0	(61.6)	112.4
Non-current liabilities				
Bank and other borrowings		8.3	–	8.3
Retirement liabilities	a	1.8	60.0	61.8
Provisions for other liabilities		23.4	–	23.4
		33.5	60.0	93.5
Current liabilities				
Trade and other payables	a,e,f,j	213.7	49.3	263.0
Income tax payable		6.2	–	6.2
Bank and other borrowings		87.7	–	87.7
Provisions for other liabilities		9.9	–	9.9
		317.5	49.3	366.8
Total liabilities		351.0	109.3	460.3
Total equity and liabilities		525.0	47.7	572.7

37. Reconciliation of operating profit and net assets under UK GAAP to IFRS (continued)

Reconciliation of profit for the year ended 31 March 2005

	Note	Previous GAAP £m	Discontinued operations £m	Effect of transition to IFRS £m	IFRS £m
Revenue	e,g	760.0	(29.6)	(1.4)	729.0
Operating profit	a,b,c,d,e,f,g	35.9	0.7	(1.3)	35.3
Finance costs		(8.5)	–	–	(8.5)
Finance income	g	2.3	–	0.2	2.5
Share of operating profit form joint ventures	j	0.3	–	(0.1)	0.2
Loss on sale of operations		(1.6)	1.6	–	–
Profit before tax		28.4	2.3	(1.2)	29.5
Income tax expense	f,h,k	(7.7)	(0.2)	(0.3)	(8.2)
Profit for the year from continuing operations		20.7	2.1	(1.5)	21.3
Discontinued operations					
Loss for the year from discontinued operations	a,b,c	–	(2.1)	–	(2.1)
Profit for the year		20.7	–	(1.5)	19.2
Minority interest		0.1	–	–	0.1
Profit attributable to shareholders		20.6	–	(1.5)	19.1

Explanation of reconciling items between UK GAAP and IFRS

(a) Under UK GAAP, the group previously accounted for defined benefit pension schemes in accordance with SSAP24 and also reported the transitional disclosure required in accordance with FRS17. The methodology and assumptions used to calculate the value of pension assets and liabilities under FRS17 are substantially consistent with the requirements of IAS19. Although there are some minor technical differences, which result in a different income statement charge. In accordance with IAS19, finance costs/income will be shown within the operating profit and the retirement benefits and retirement liabilities are disclosed separately as is the related deferred tax asset also under IAS19, in the event of a significant reduction in active members, the effect on the surplus/deficit is taken to the income statement immediately. This has been shown as an exceptional gain of £5.6 million

(b) IAS38 requires that intangible assets of an acquired business are separately recognised from goodwill if their fair value can be measured reliably. Intangible assets include contracts and customer relationships. Intangible assets recognised are then amortised over their useful life. Under the transition rules, the group is not required to identify any acquired intangible assets for acquisitions prior to 31 March 2004. As a result of acquisitions made in 2004/5 the group has reclassified intangible assets of £25.9 million out of goodwill arising on acquisition. There is an associated ordinary amortisation charge of £4.4 million for the year ended 31 March 2005 and in addition the amortisation of £8.8 million relating to the rail maintenance transfer which is treated as exceptional.

(c) In accordance with IFRS3, no amortisation of goodwill is charged in the group's consolidated IFRS accounts from 1 April 2004. Instead, annual impairment reviews of the goodwill are performed. In addition, negative goodwill at 1 April 2004 has been taken to reserves in compliance with IFRS3. Under UK GAAP the group's policy was to capitalise goodwill in respect of businesses acquired and amortise it over its estimated useful economic life, which has been assessed as 20 years for recent acquisitions. Accordingly amortisation charged in the year to 31 March 2005 has been reversed.

(d) Under UK GAAP, the cost of share options was based on the intrinsic value in the option at the date of grant, meaning that the options granted to employees at market price did not generate an expense. Under IFRS2, the group measures the costs of all share options granted since November 2002 using fair value models. As a result, additional expense is recognised in the IFRS income statement.

(e) In accordance with IFRS, all contracts are accounted for under either IAS11 or IAS18 resulting in a timing difference in profit recognition. In addition, IAS prohibits netting of payments on account on a more strictly defined basis resulting in a grossing up of the balance sheet under IAS.

(f) As a result of further more prescriptive guidance in IAS19, holiday pay accruals and prepayments are definitively required.

(g) Under IAS18 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 the income statement as interest income as the debt unwinds.

(h) IAS38 requires that software costs are capitalised as intangible assets. UK GAAP included such costs in tangible assets. Accordingly, these assets have now been reclassified as intangible assets.

(i) Under SSAP17, proposed dividends are accrued for as an adjusting post balance sheet event in the accounting period to which they relate. Under IAS10, dividends are recognised in the accounting period in which they are declared and paid.

(j) Under UK GAAP, the group's share of operating profit, interest and tax of equity accounted investments were presented separately. Under IAS, the group's share of results from equity accounted investments is presented as a single line on the income statement. As a result of the reclassification, £0.1 million relating to the group's share of tax of equity accounted investments is reclassified from tax under UK GAAP to within profit before tax under IFRS for the year ended 31 March 2005.

(k) Under IAS12, certain temporary differences, in relation to property revaluations not recognised under UK GAAP require recognition, which at acquisition was £0.3 million.

(l) Certain balance sheet items are disclosed separately within an IFRS balance sheet.

(m) Under UK GAAP the increase in cash in the year was £14.6 million, which when added to the cash placed on short-term deposit of £5.6 million gives a total of net increase in cash, cash equivalents and overdrafts of £20.2 million, which compares to the IFRS equivalent of £20.1 million. Included in the change in cash, cash equivalents and overdrafts there are a number of changes reflected in operating profit described above. These changes, in the main, produce a corresponding adjustment in either working capital or amortisation.

38. First time adoption of IAS39 at 1 April 2005

The group has adopted the exemption not to restate comparatives for IAS32 'Financial Instruments: Disclosure and Presentation' (IAS32) and IAS39 'Financial Instruments: Recognition and Measurement' (IAS39) but to apply these from 1 April 2005. As a result the comparative information is presented on a UK GAAP basis. The following table shows the impact of adopting IAS32 and IAS39 at 1 April 2005.

	Book value at 31 March 2005	IAS39 transition requirements	Book value at 1 April 2005
Assets			
Non-current assets			
Goodwill	161.3	–	161.3
Other intangible assets	14.8		14.8
Property, plant and equipment	36.0	–	36.0
Investments in joint ventures	0.6	–	0.6
Other investments	0.1	–	0.1
Retirement benefits	41.5	–	41.5
Trade and other receivables	0.4	–	0.4
Deferred tax	11.8	(0.1)	11.7
	266.5	(0.1)	266.4
Current assets			
Inventories	40.6	–	40.6
Trade and other receivables	232.2	0.4	232.6
Income tax recoverable	0.3	–	0.3
Cash and cash equivalents	33.1	–	33.1
	306.2	0.4	306.6
Total assets	572.7	0.3	573.0
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	125.0	–	125.0
Share premium	69.3	–	69.3
Other reserves	30.7	–	30.7
Retained earnings	(112.7)	–	(112.7)
	112.3	–	112.3
Minority interest	0.1	–	0.1
Total equity	112.4	–	112.4
Non-current liabilities			
Bank and other borrowings	8.3	–	8.3
Retirement liabilities	61.8	–	61.8
Provisions for other liabilities	23.4	–	23.4
	93.5	–	93.5
Current liabilities			
Trade and other payables	263.0	0.3	263.3
Income tax payable	6.2	–	6.2
Bank and other borrowings	87.7	–	87.7
Provisions for other liabilities	9.9	–	9.9
	366.8	0.3	367.1
Total liabilities	460.3	0.3	460.6
Total equity and liabilities	572.7	0.3	573.0

On adopting IAS39 prospectively from 1 April 2005, net assets have decreased by £5,000 principally resulting from restating financial assets and liabilities to fair value or an amortised cost basis.

Statement of directors’ responsibilities on the company financial statements

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company for that year. In preparing those financial statements the Directors are required to:

1. Select suitable accounting policies and then apply them consistently.
2. Make judgements and estimates that are reasonable and prudent.
3. State that the financial statements comply with UK GAAP.
4. Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The Directors confirm that they have complied with the above requirements in preparing the company financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company 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.

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

We have audited the parent company financial statements of Babcock International Group PLC for the year ended 31 March 2006 which comprise the Balance sheet and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration report that is described as having been audited.

We have reported separately on the group financial statements of Babcock International Group PLC for the year ended 31 March 2006.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual report, the Directors' Remuneration report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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 parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' report is consistent with the parent company financial statements. The information given in the Directors' report includes that specific information presented in the Business review that is cross referred from the Business review section of the Directors' report. We also report to you if, in our opinion, 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 other transactions is not disclosed.

We read other information contained in the Annual report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Chairman's statement, Business review, Directors' report, Corporate and Social Responsibility review, Corporate Governance statement and the unaudited part of the Directors' Remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' Remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent company 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 parent company financial statements and the part of the Directors' Remuneration report to be audited 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 parent company financial statements and the part of the Directors' Remuneration report to be audited.

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006;
- the parent company financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered accountants and registered auditors
London
22 May 2006

Company balance sheet
At 31 March 2006

	Note	2006 £m	2005 £m (as restated)
Fixed assets			
Investment in subsidiary undertakings	3	308.0	308.0
Property, plant and equipment	4	0.4	0.4
		308.4	308.4
Current assets			
Debtors	5	42.5	43.0
Cash and bank balances		3.6	26.3
		46.1	69.3
Creditors – amounts due within one year	6	90.4	113.0
Net current liabilities		(44.3)	(43.7)
Total assets less current liabilities		264.1	264.7
Provisions for liabilities and charges	7	2.4	3.5
Net assets		261.7	261.2
Capital and reserves			
Called up share capital	8	125.5	125.0
Share premium account	9	69.7	69.3
Capital redemption reserve	9	30.6	30.6
Profit and loss account	9	35.9	36.3
Shareholders' funds – equity interests		261.7	261.2

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

The Financial Statements were approved by the Board of Directors on 22 May 2006 and are signed on its behalf by:

G A Campbell Director

W Tame Director

Notes to the company financial statements

1. Significant accounting policies

The principal accounting policies adopted by the company are disclosed below:

Basis of accounting

The company's 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.

Investments

Fixed asset investments are stated at cost less provision for impairment in value.

Leases

Operating lease payments are recognised as an expense in the income statement.

Taxation

Current UK corporation 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.

Borrowing costs

Borrowing costs are recognised as an expense in the period in which they are incurred.

Employee benefits

(a) Share-based compensation

The group operates equity-settled, share-based compensation plans. The economic cost of awarding shares and share options to employees is recognised as an expense in the income statement equivalent to the fair value of the benefit awarded. The fair value is determined by reference to option pricing models. The charge is recognised in the income statement over the vesting period of the award and recharged to subsidiaries. Following the adoption of FRS20: 'Share-based payments', these accounts include a prior year adjustment to comply with the above policy (note 9). Full details of the share-based compensation plans are disclosed in note 25 of the group financial statements.

(b) Treasury shares

The share's purchased by the company's ESOP trusts are recognised as a deduction to equity. Refer to the group financial statements note 26 for further details.

(c) Pension arrangement

The company operates a multi-employer defined benefit pension scheme. The scheme is accounted for on a defined contribution basis as the company is unable to identify its share of the underlying assets and liabilities.

There is no material difference between the FRS17: "Retirement Benefits" and IAS19: "Employee Benefits" valuation. Refer to the group financial statements note 27 for further details.

As a result of the level of surplus the companies compulsory contribution to the Babcock International Group Pension Scheme is currently suspended until at least the results of the next formal valuation are available although voluntary contributions have been made.

Financial risk management

All treasury transactions are carried out only with prime rated counter-parties as are investments of cash and cash equivalents.

Dividends

Dividends are recognised in the company's Financial Statements in the period in which they are approved and in the case of interims, when paid. Following the adoption of FRS21: 'Events after the balance sheet date', these accounts included a prior year adjustment to comply with the above policy (note 9).

2. 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. The company's profit for the financial year is £7.5 million (2005: £29.1 million).

Audit fees and expenses paid to the company's auditors was £0.1 million (2005: £0.1 million).

3. Investment in subsidiary undertakings

	2006 £m	2005 £m
Investment in shares	308.0	308.0

4. Property, plant and equipment

	Leasehold property £m
Cost	
At 1 April 2005 and at 31 March 2006	0.4
Accumulated amortisation	
At 1 April 2005 and at 31 March 2006	–
Net book value at 31 March 2006	0.4
Net book value at 31 March 2005	0.4

5. Debtors

	2006 £m	2005 £m
Due within one year		
Trade debtors	0.3	0.4
Amounts owed by subsidiary undertakings	40.9	41.2
Other debtors	–	0.1
Prepayments and accrued income	1.3	1.3
	42.5	43.0

6. Creditors

	2006 £m	2005 £m
Bank loans	56.0	78.2
Trade creditors	0.1	–
Amounts owed to subsidiary undertakings	34.2	34.6
Other creditors	0.1	0.2
	90.4	113.0

The company has £150 million of Sterling bank facilities of which £56 million was drawn at the year end. The interest rate applying is 5% and is linked to LIBOR.

7. Provisions

	2006 £m	2005 £m
Contingent consideration on acquisitions	2.4	3.5

8. Share capital

	Ordinary shares of 60p Number	Unclassified shares of 30p Number	Ordinary shares of 60p £m	Unclassified shares of 30p £m
Authorised:				
At 1 April 2005 and at 31 March 2006	306,219,012	1	183.7	–

	Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2005	208,355,202	125.0
Allotted under share option schemes	811,276	0.5
At 31 March 2006	209,166,478	125.5

9. Reserves

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2005 (as previously reported)	69.3	30.6	30.9
Prior year adjustment – share-based payment	–	–	–
Prior year adjustment – dividends	–	–	5.4
As restated	69.3	30.6	36.3
Shares issued in the period	0.4	–	–
Share-based payments	–	–	1.1
Retained profit for the year – profit for the year	–	–	7.5
– dividends	–	–	(9.0)
At 31 March 2006	69.7	30.6	35.9

10. Operating lease commitments

The company has an operating lease commitment for land and buildings as at 31 March 2006 with an annual commitment expiring after more than five years of £2.2 million (2005: £2.2 million).

11. Contingent liabilities

a. The company has guaranteed or has joint and several liability for bank facilities of £180.3 million (2005: £179.5 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 2006 these amounted to £27.7 million (2005: £22.9 million), of which the company had counter-indemnified £21.0 million (2005: £15.0 million).

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

12. Post balance sheet events

On 9 May 2006 the company acquired Alstec Group Ltd for a cash consideration before costs of £44.9 million. Alstec reported turnover of £82.6 million and profit before interest and tax of £3.7 million for the year ended 31 March 2006. The acquisition balance sheet is under review.

There are no further material events subsequent to 31 March 2006 that require disclosure.

A dividend of 4.25p per 60p ordinary share (2005: 2.65p per 60p ordinary share) was proposed after the balance sheet date and will be paid on 7 August 2006 to shareholders registered on 7 July 2006.

Principal subsidiary, joint venture and associated undertakings

Defence Services

Babcock Naval Services Limited
Air Power International Limited
Babcock Support Services Limited
Hiberna FM Limited
Acetech Personnel Limited

Technical Services

Babcock Design & Technology Limited
Babcock Support Services 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 Limited

Joint Ventures

DynCorp-Hiberna Limited
Debut Services Limited
One Network Solutions Limited
FSP (2004) Limited
First Swietelsky Operation and Maintenance
First Swietelsky Joint Venture High Output

Networks

Eve Group Limited

Others

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 (Guernsey)

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 the 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 seventeenth Annual General Meeting of the members of Babcock International Group PLC ('the company') will be held at The Royal Society of Medicine, 1 Wimpole Street, London W1G 0AE, on Friday 14 July 2006, 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 2006.

(2) To declare a final dividend for the year ended 31 March 2006 as recommended by the Directors.

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

(4) To reappoint Mr J N A Crookenden as a Director of the company.

(5) To reappoint Lord Hesketh as a Director of the company.

(6) To approve the Remuneration report of the Directors for the year ended 31 March 2006.

(7) To reappoint PricewaterhouseCoopers LLP as Auditors.

(8) 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 special resolution:

Special Resolution

(9) 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 20,900,000;

(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 2007 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
15 June 2006

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 reappointment (Lord Hesketh, Sir Nigel Essenhigh and Mr Crookenden) should be reappointed are set out in the Accompanying Notes on page 86.

(2) An explanation of the special business resolution is given in the Explanatory Notes on page 86.

(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 reappointment (Lord Hesketh, Sir Nigel Essenhigh and Mr Crookenden) should be reappointed. These are as follows:

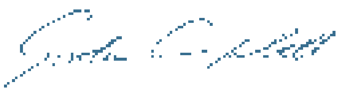
Lord Hesketh: The Board continues to value the contribution that Lord Hesketh brings to its meetings, with his longer-term experience of the group's activities and the markets in which it operates, together with his wide experience in a variety of commercial and political spheres. In view of his length of service, he does not sit on any Committees membership of which, under the Combined Code, should be confined to independent non-executive Directors.

Sir Nigel Essenhigh: Sir Nigel has been a valued member of the Board since 2003, being an active and enthusiastic participant in its meetings (and those of its committees), at which he demonstrates a robust independence of thought and brings a valuable perspective with his particular background in defence services.

Justin Crookenden: Although Mr Crookenden only joined the Board in December 2005 he is already playing an important part in its meetings and those of its committees, fully justifying the Board's decision to appoint him. He brings valuable fresh perspectives and experience to the Board with his background in investment banking and insights into the City.

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, Sir Nigel Essenhigh and Mr Crookenden continues to be effective and to demonstrate commitment to his roles, including commitment of time for Board and, where applicable, Committee Meetings and other duties."



Gordon Campbell

Explanatory note

Resolution 9, 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 2006, 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 2007 or, if earlier, at the conclusion of the Annual General Meeting of the company to be held in 2007. 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 2006 (being the latest practicable date before publication of the notice of meeting) was 1,975,530 representing 0.94% of issued share capital as at 1 June 2006. If the full authority to buy back shares were to be used, and the shares cancelled, these outstanding options would represent 1.05% of issued share capital.

Shareholder information

Financial calendar

Financial year end	31 March 2006
2005/06 preliminary results announced	3 May 2006
Annual General Meeting	14 July 2006
Final dividend payment date (record date 7 July 2006)	7 August 2006*

*See also 'Results and Dividends' on page 25.

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

Registered in England
Company number 2342138

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

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

Auditors
PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

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

Barclays Bank plc
1 Churchill Place
Canary Wharf
London E14 5HP

HBOS plc
Level 7 – Bishopsgate Exchange
155 Bishopsgate
London EC2M 3YB

Investment bankers
Hawkpoint Partners Limited
4 Great St. Helens
London EC3A 6HA

Stockbrokers
JP Morgan Cazenove
20 Moorgate
London EC2R 6DA

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 just 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 convenient 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 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.

To the extent that this statement is a financial promotion for the share dealing service provided by Computershare Investor Services PLC, it has been approved by Computershare Investor Services PLC for the purpose of section 21 (2) (b) of the Financial Services and Markets Act 2000 only. Computershare Investor Services PLC is authorised and regulated by the Financial Services Authority.

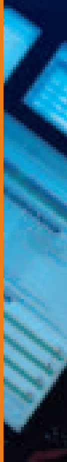
Where this has been received in a country where the provision of such a service would be contrary to local laws or regulations, this should be treated as information only.

Five year financial record

	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m	UK GAAP 2003 £m	UK GAAP 2002 £m
Continuing revenue	836.7	729.0	438.0	377.9	326.8
Operating profit	46.6	35.3	22.2	21.1	4.7
Share of operating profit from joint ventures	(0.1)	0.2	0.1	(0.2)	(0.5)
Profit before interest	46.5	35.5	22.3	20.9	4.2
Net interest and similar charges	(5.2)	(6.0)	(0.5)	(2.6)	(1.0)
Profit before taxation	41.3	29.5	21.8	18.3	3.2
Income tax expense	(8.2)	(8.2)	(3.4)	(5.1)	(3.1)
Profit from continuing operations	33.1	21.3	18.4	13.2	0.1
Discontinued operations	(3.2)	(2.1)	(2.0)	(4.9)	(17.1)
Profit/(loss) for the year	29.9	19.2	16.4	8.3	(17.0)
Minority interest	(0.2)	(0.1)	–	–	(0.1)
Profit/(loss) attributable to shareholders	29.7	19.1	16.4	8.3	(17.1)
Non current assets	273.4	266.5	90.4	99.3	85.1
Net assets held for sale	5.8	–	–	–	–
Net current assets/(liabilities)	(53.8)	(60.6)	51.7	34.5	25.6
Non-current liabilities and provisions	(54.8)	(93.5)	(45.0)	(46.4)	(29.7)
Total net assets	170.6	112.4	97.1	87.4	81.0
Shareholders funds	170.2	112.3	97.1	87.3	81.0
Minority interest	0.4	0.1	–	0.1	–
	170.6	112.4	97.1	87.4	81.0
Earnings/(loss) per share – basic	14.49p	10.08p	11.31p	5.72p	(11.86)p
Dividends per share (proposed)	6.00p	4.00p	3.35p	3.00p	2.85p

Design and production: Radley Yeldar (London)

Babcock International Group PLC
2 Cavendish Square
London W1G 0PX
Telephone +44 (0)20 7291 5000
Fax +44 (0)20 7291 5055
www.babcock.co.uk



Babcock International Group PLC Annual report and accounts 2006