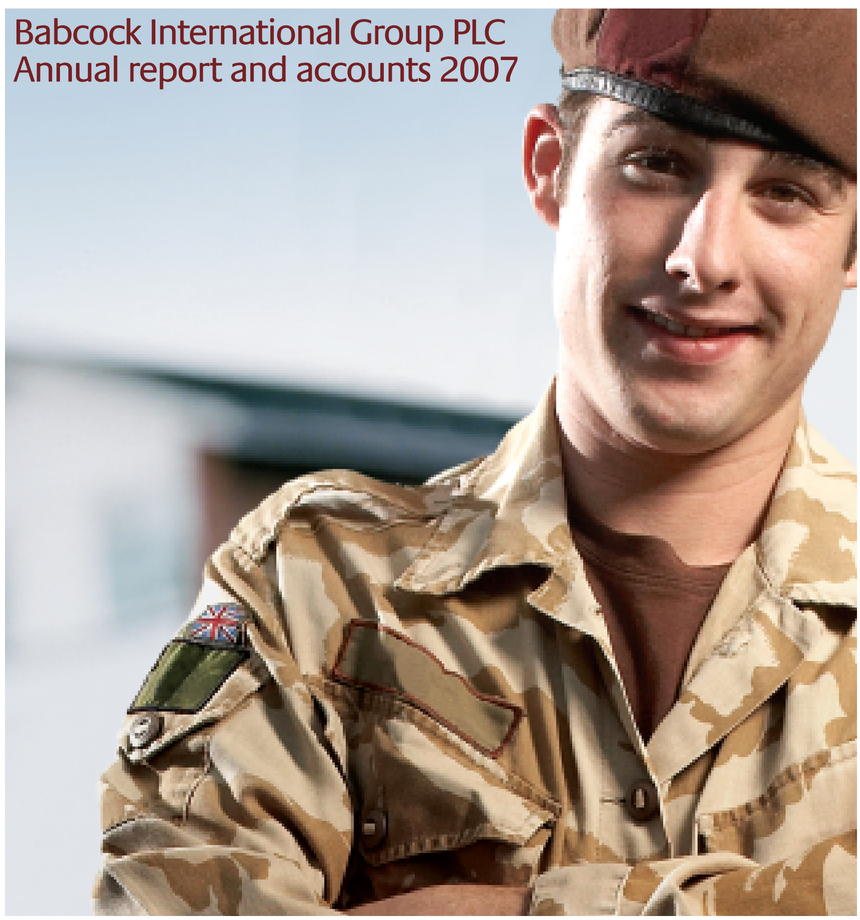
Babcock International Group PLC
Annual report and accounts 2007



Contents

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.

Statistory

Statutory	Revenue	Operating profit	Profit before tax	Continuing earnings per share	Dividend proposal
	£988.3m	£62.8m	£57.0m	21.49p	8.05p
	+18%	+35%	+38%	+34%	+34%
	2006: £836.7m	2006: £46.6m	2006: £41.3m	2006: 16.06p	2006: 6.00p

Underlying

(Before amortisation of acquired intangibles and exceptionals)

Operating profit	Profit before tax	Continuing earnings per share
£68.3m	£62.5m	23.35p
+37%	+40%	+36%
2006: £49.9m	2006: £44.6m	2006: 17.18p

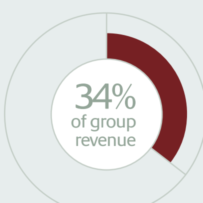
Business highlights

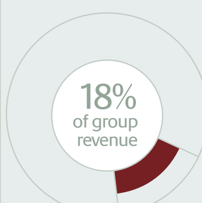
- Record results: fifth successive year of double digit growth. Revenue up 18%, underlying PBT up 40%
- Further operating margin increase to 6.9% (2005/06: 6.0%)
- Operating cash flow above target at 96% conversion of EBIT
- Strong financial position. Net debt at £73.7m after £52.5m of acquisitions in year
- Further major contract wins underpin continuing growth; National Grid – alliance contract, EDF Energy Solutions Networks contract, Network Rail Type C signalling framework contracts
- Current order book at £2.4bn
- Strengthened position in civil nuclear support market – Alstec acquired in 2006 and purchase of stake in International Nuclear Solutions plc
- Agreement on the acquisition of Devonport Management Limited a strategic step in marine announced on 10 May 2007 for £350 million.

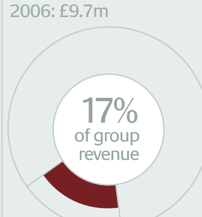
Our five core business segments:

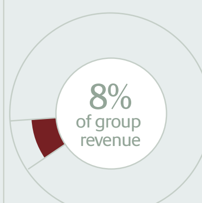
(Before amortisation of acquired intangibles and exceptionals)

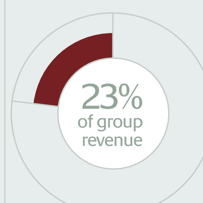
	Defence Services	Technical Services	Engineering and Plant Services	Networks	Rail
Revenue	£340.6m	£178.4m	£165.6m	£74.9m	£228.8m
2006	£271.7m	£130.5m	£144.2m	£73.0m	£217.3m
Operating profit	£29.9m	£16.1m	£13.3m	£6.8m	£9.3m
2006	£21.8m	£9.0m	£9.7m	£6.4m	£8.8m











Chairman's statement

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With a highly visible order book, Babcock is well placed to deliver strong growth in both revenue, earnings and shareholder value.

The year ending March 2007 continued the excellent progress of recent years with profit before tax, before amortisation of acquired intangibles and exceptional items, increased by 40% following the 25% increase in the previous year. The Directors are recommending a final dividend of 5.65p per share giving a total dividend for the year of 8.05p per share, an increase of 34% on the previous year; this increase reflects the increased earnings, our confidence for Babcock's future prospects and our previously declared policy on dividend cover.

The share price continued to improve during the year and reached 400p at the end of March 2007. At close of business on the date our accounts were approved the price stood at 552p per share. 400p per share represents an out-performance over five years of 285% compared to the FTSE all share index (excluding investment trusts). £100 invested in Babcock on the 31 March 2002 would have been worth £427 on the 31 March 2007, compared to £151 had it been invested in that index.

We have reached agreement with the shareholders of Devonport Management Limited ('DML') to acquire the entire share capital of DML for £350 million. The deal, which is subject to Babcock shareholders' approval, is expected to be earnings enhancing in the first full financial year of ownership. Details of the proposals will be contained in the Shareholders' circular for the EGM.

The Board believes that a combination of DML, HMNB Clyde, which we currently manage, and Rosyth Royal Dockyard is in line with the consolidation of the naval industry, as proposed in the Ministry of Defence's Defence Industrial Strategy, and can achieve significant cost savings.

The Board is confident however, that in addition to the opportunities with DML, there is considerable scope for further earnings enhancement as a result of organic growth, and our forward order book before the DML deal was £2.4 billion.

Our strong track record in acquiring and integrating businesses has been maintained, and Alstec, which was acquired in May 2006, contributed handsomely to Babcock's profits.

The Alstec acquisition and our purchase of a stake in International Nuclear Solutions plc increases our presence in the field of nuclear support services and offers the basis for further growth within an expanding nuclear market.

Babcock's financial position is strong with net debt at 31 March 2007 of £73.7 million, after £52.5 million invested in acquisitions, reflecting the high conversion of profit to cash ratios.

The success of a company is dependent on the skills and dedication of its workforce, particularly in a service business which Babcock has become over the last five years, and I would like to thank all our employees for their efforts and support. A special mention should be made, however, for the hard work and skills of the senior management team in securing DML, and it is also testimony to the reputation the company has established with its largest customer.

The Board is confident of Babcock's prospects and is convinced that the Group is well placed to continue to develop and grow. As a consequence, the underlying value of Babcock to its shareholders should continue to increase.

Gordon Campbell
Chairman

Gordon Campbell

Operating and financial review

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 (left to right):
Peter Rogers Group Chief Executive
Bill Tame Group Finance Director

Introduction

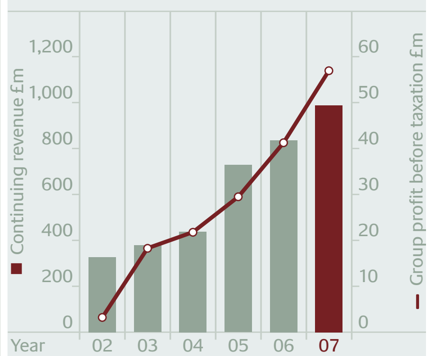
Babcock International Group PLC is a provider of engineering based support services operating extensively in the United Kingdom, Africa and North America.

We operate in complex markets with good long-term prospects. Typically we focus upon markets that ideally have the twin characteristics of longevity coupled with long-term infrastructure investment needs.

Our strengths are in our project management expertise and engineering skill base. We focus on adding value at the operational level working alongside our customers to manage their mission-critical infrastructure and assets.

We are continuing to extend a strong track record of performance since initiating our strategy to transform Babcock into a support services business.

Continuing revenue versus Group profit before taxation £m



Business profile

Babcock International Group PLC is a successful FTSE 250 listed support services business. During the past five years the business has been transformed from an engineering conglomerate with a long heritage to providing support services consistent with our culture, experience and knowledge base.

We meet our customers needs by leveraging our engineering skills base and project management expertise. We focus on adding value at the operational level working alongside our customers to manage their mission-critical infrastructure and assets. The breadth of assets that we support and manage for our customers range from those which are fixed, such as buildings, to the mobile, such as nuclear submarines.

Babcock is focused with regard to the markets we choose to operate in and the customers we seek to work with. We address markets that ideally have the twin characteristics of longevity and long-term infrastructure investment needs. The public sector and elements of the private sector both own and maintain large, complex infrastructure that requires support, maintenance and upgrade. Often these programmes are critical to the delivery of services where the reputation of Babcock as a partner who is trusted to deliver come to the fore.

In terms of customers, within the United Kingdom this strategy translates into working with both major owners of government assets (for example the Ministry of Defence and Network Rail) and private sector companies that have inherited public sector infrastructure, such as National Grid and BAA. We are well versed with working alongside large, complex customer organisations to help them better understand the challenges they face and tailor a solution to meet their specific needs.

In Africa, our business has a network of facilities that supplies and supports the customers of Volvo construction equipment, whilst the engineering division works with the national electricity and transmission company, Eskom, to support and re-commission its power generation and transmission infrastructure to serve the nation's energy needs.

We believe customers choose to work with Babcock because of three key differentiators; our extensive skill base and engineering reputation, our recognition of the primacy of health and safety awareness and our integration into the communities in which we operate.

Our skill base covers a wide breadth of engineering disciplines. On a day-to-day basis our staff are engaged with challenges where knowledge of aerospace, built infrastructure, maritime, nuclear, power transmission, telecommunications and transportation engineering is critical to the successful delivery of our customers operations.

At Babcock we regard the safe delivery of complex programmes and the health of our workforce, often in potentially hazardous environments, as absolute priorities which benefit our staff, customers and our shareholders which is covered in greater detail further in this report.

In the United Kingdom and internationally, Babcock understands the importance of building links with the local communities in which we operate. Due to our experience of operating in relatively remote areas our staff participate in local activities and often contribute to the local community. Our operational activities are sensitive to the local supply chain and seek to engage it wherever practical. Our businesses often sponsor local sports and participate in support of charitable causes. We are forward looking and have a number of apprentice and graduate programmes aimed at offering long-term, higher value employment opportunities that benefit the local economy and meet business needs.

Babcock International Group is organised into five core business segments covering the breadth of our commercial activities in the UK and internationally; Defence, Technical, Engineering and Plant Services, Networks and Rail.

The successful execution of our strategic transformation that we embarked upon some six years ago has focused upon growing our support services business by both organic means and selective acquisitions. Within our existing portfolio of contracts we have thus far been successful in driving greater operational efficiencies and delivering significant cost savings to our customers.

In measuring our performance we adopt a number of Key Performance Indicators (KPI's) across the business. With the exception of Health and Safety and Environment these KPI's are financial in nature; Operating Return on Revenue (ORR), revenue growth, Return On Invested Capital (ROIC), Operating Cash Flow (OCF) conversion rate, net debt/EBITDA, interest cover, gearing and order book. These KPI's are discussed in greater detail in the financial review.

Unless otherwise indicated, the terms 'operating margin', 'margins', 'operating profit' and 'earnings' below refer to the said items before charges for exceptional items and amortisation of acquired intangibles.

Reconciliation to statutory operating profit

	Revenue		Operating profit		Net margin		Growth	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 %	2006 %	Revenue 2007 %	Operating profit 2007 %
Total statutory	988.3	836.7	62.8	46.6	6.4	5.6	18	35
Amortisation of acquired intangibles			6.1	3.1				
Exceptional items			(0.6)	0.2				
Total underlying	988.3	836.7	68.3	49.9	6.9	6.0	18	37

Segmental analysis

	Revenue			*Operating profit/ Return on revenue		
	2007 £m	2006 £m	Growth %	2007 £m	2006 £m	Growth %
Defence Services	340.6	271.7	25	29.9	21.8	37
				8.8%	8.0%	
Technical Services	178.4	130.5	37	16.1	9.0	78
				9.0%	6.9%	
Engineering and Plant Services	165.6	144.2	15	13.3	9.7	37
				8.0%	6.7%	
Networks	74.9	73.0	3	6.8	6.4	6
				9.1%	8.6%	
Rail	228.8	217.3	5	9.3	8.8	6
				4.1%	4.0%	
Unallocated				(7.1)	(5.8)	
Total continuing	988.3	836.7	18	68.3	49.9	37

*Before amortisation of acquired intangibles and exceptional items.

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Key KPI's for business segments

Featured in the reviews of segmental performance over the following pages are the following Key Performance Indicators:

Operating Return on Revenue (ORR)
Operating Return on Revenue is defined as operating profit before amortisation of acquired intangibles and exceptional items expressed as a percentage of revenue.

Revenue growth
Revenue growth is defined as the increase in the company's continuing revenue when compared to that of the previous year.

Defence Services

Market overview

Defence Services provides facilities management, equipment support and training expertise to the British Armed Forces.

Defence Services end-customers are the three armed services – the Royal Navy, British Army and RAF. Within the Ministry of Defence, the main day-to-day business is conducted with Defence Estates, Defence Equipment & Support (formerly the Defence Logistics Organisation and Defence Procurement Agency) and the Air Command (formerly the RAF Personnel & Training Command).

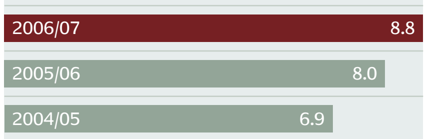
Review of operations

Defence Services has had an excellent year. New contracts were signed for the second tranche of Single Living Accommodation Modernisation (or 'SLAM') – a scheme central to the Ministry of Defence to improve recruitment and retention of service personnel. Additionally, Babcock secured its position in future support of the current fleet of Hawk jet trainer aircraft through the commencement of an Integrated Operational Support ('IOS') contract led by BAE Systems. As a consequence of the IOS arrangements, Babcock is engaged in negotiations with BAE Systems as to the in-service support solution for the successor Hawk 128 aircraft.

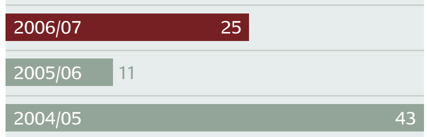
2006/07 saw the first full year in the operation of the Regional Prime East contract for Defence Estates after mobilisation. The contract is one of five in the United Kingdom where industry is responsible for maintaining existing infrastructure. Babcock is the only supplier to be engaged in two of the five regional prime contracts.

Defence Services includes the Airports division of Alstec acquired during the year.

Operating return on revenue %



Revenue growth %



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Maintaining accommodation facilities for the Armed Services

The Group provides through life support for an important enabler for our customer, the Ministry of Defence, that of recruitment and retention. As part of the Department's effort to improve the single living accommodation provided to the soldiers, sailors and airmen of the three armed forces, Babcock has recently commenced the second phase of the programme known as SLAM, supporting an additional 7,000 modern bed spaces beyond the 14,000 put in place since the programme started in 2003.

Key customers:

- Royal Navy
- British Army
- RAF
- Ministry of Defence
- Defence Estates
- BAA plc

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The acquisition of Alstec adds a civil nuclear support and decommissioning capability to our offering

Babcock is growing its capabilities to provide expert engineering support to the challenges of maintaining the nuclear power generation infrastructure of the United Kingdom and assist in meeting the emerging challenge of nuclear decommissioning. Successful decommissioning will act as an enabler to provide additional confidence for the UK Government to proceed with building new reactors which will help maintain diversity and security of supply of power for the next generation.

Key customers:

- Royal Navy
- Defence Equipment & Support organisation
- Aircraft Carrier Alliance
- Various commercial companies in the oil & gas market
- Major nuclear industry organisations
- Nuclear Decommissioning Authority

Operating return on revenue %

Year	%
2006/07	9.0
2005/06	6.9
2004/05	9.0

Revenue growth %

Year	%
2006/07	37
2005/06	-18
2004/05	-12

Note: Negative revenue growth in 2004/05 and 2005/06 for Technical Services was driven as the consequence of a contraction in warship refit activity for the Royal Navy.

Technical Services

Market overview

Technical services supports the activities of customers in the marine, defence, nuclear, oil & gas, and supply chain service markets.

Technical services customers include the Royal Navy, the Defence Equipment & Support organisation (formerly the Defence Logistics Organisation and Defence Procurement Agency), Aircraft Carrier Alliance, various commercial companies in the oil & gas market, the Nuclear Decommissioning Agency and major nuclear industry organisations.

Review of operations

Technical Services had an outstanding 2006/07 with sales increasing by 37% and operating profit by 78%.

In the defence field the surface ship support alliance arrangements have matured, reaching an agreed position on the need to protect core skills at Rosyth in preparation for the future aircraft carrier ('CVF') programme. As a consequence Rosyth, uniquely amongst the UK surface ship refit yards, will be operating a twin stream of activity.

The Design & Technology team have been busy both in the further design of the aircraft carriers as well as, increasingly, a body of commercial projects in oil & gas – accounting for some 60% of revenues.

2006/07 was also the first year of Alstec's operations in the civil nuclear support market. Babcock sees this as an important future market. The Nuclear Decommissioning Authority have identified the entire UK requirement for support to be worth in excess of £2 billion per annum over a timeframe measured in decades.

Engineering and Plant Services

Market overview

The Engineering and Plant Services segment comprises our international operations in Africa and the United States.

In South Africa the Plant Services division supplies Volvo construction equipment to a variety of customers in the construction, resource extraction and energy markets. The Engineering division works with the South African power utility, Eskom, in support of power generation and transmission infrastructure. In North America Babcock provides specialist pipeline assessment services and works with a number of significant oil & gas companies.

Review of operations

Engineering and plant continued its run of strong performance during the past year enjoying another record year of growth. Commodity prices and the award of 2010 soccer world cup to South Africa has stimulated investment in civil infrastructure. This investment is driving demand for high quality construction and resource extraction and movement equipment for which our Volvo franchise remains well placed.

Additionally, the South African government recognise fully the challenge of delivering electricity in sufficient quantities to where its needed. Our recently acquired powerlines business has proven to be a timely decision with its order book already having quadrupled since purchase.

Operating return on revenue %

2006/07	8.0
2005/06	6.7
2004/05	4.3

Revenue growth %

2006/07	15
2005/06	28
2004/05	30

"I have access to energy"

← ↑

Supporting Eskom's investment in African power generation and transmission

Babcock is growing its capabilities to assist Eskom in improving its electricity generation capacity and ensuring the electricity transmission infrastructure can deliver the power to the communities where it is needed. Eskom is planning to add some 5000 Mw by 2009 from return-to-service projects where Babcock is playing its part in supporting both these projects and via its recent acquisition of ABB Powerlines division, improving the high-voltage transmission infrastructure.

Key customers:
Volvo
A variety of customers in the construction, resource extraction and energy markets
Eskom
A number of significant oil & gas companies

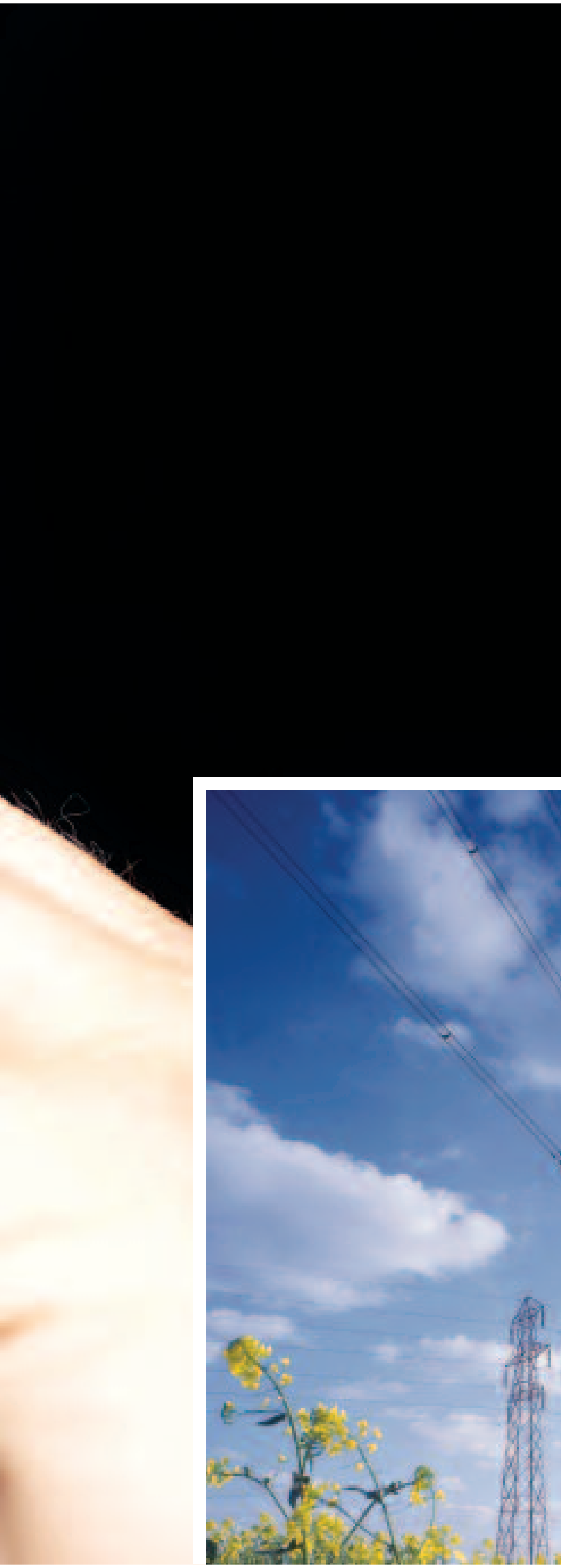
"I can rely on the network"

↑ →

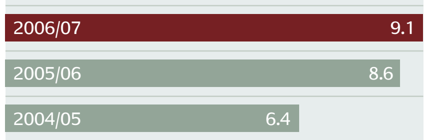
Joint venture with AMEC and Mott MacDonald to renew power lines in the West

Babcock is working with its partners to deliver a major commitment by National Grid to improve the quality of its transmission infrastructure which was originally constructed in the 1960s, providing electricity to homes, businesses and organisations nationally. The project lasting initially some five years will deliver the capital works programme for overhead transmission lines and cable works in the West of England and throughout Wales. In addition Babcock Networks has secured a contract with EDF Energy Networks for the delivery of overhead transmission line works in the East of England, the South East and London.

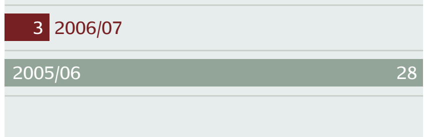
Key customers:
National Grid
Scottish Power
EDF Energy Networks
National Grid Wireless
Arqiva



Operating return on revenue %



Revenue growth %



Note: Networks was acquired in June 2004.

Networks

Market overview

Babcock Networks, is a significant player in the high voltage electricity transmission, mobile telecommunications and digital television infrastructure in the United Kingdom.

Networks carries out its power transmission activities for amongst others, National Grid, Scottish Power and EDF. Networks provides telecommunications services for several of the leading mobile telephony service providers in the United Kingdom. Networks digital switch-over activity is conducted on behalf of National Grid Wireless and Arqiva.

Review of operations

Networks has had a transformational year which is expected to bring considerable benefits in the current financial year. The decision of National Grid to move towards two alliance contracts to manage the UK high voltage distribution infrastructure has seen Networks come together successfully with AMEC and Mott MacDonald Limited to win a five year, £100 million per annum contract to commence the urgent work of improving the UK distribution grid.

Beyond the alliance, Networks has won further business in its own right to support EDF Energy Solutions in the South East of England. This five year contract is worth circa. £50 million.

The Telecommunications business has focused on the opportunities related to the impending switch-over of the TV broadcast signal from analogue to digital as the expansion of the 3G mobile telecoms infrastructure remains slow.

Rail

Market overview

Babcock's rail business, First Engineering, is a United Kingdom focused railway infrastructure support business.

The principal customer of Rail is Network Rail. However Babcock also provides significant engineering support to Transport Scotland.

Review of operations

Rail has had commercial successes over the past year whilst starting a restructuring programme to position itself strongly for the future.

The business won two signalling framework contracts valued at up to £10 million each per annum and lasting five years. In addition the business secured a significant capacity enhancement project in Trent valley worth some £25 million for Network Rail.

Network Rail is currently intending to reduce its supplier base for elements of track renewals this summer from six key suppliers to four. The consolidation will not affect the high output activity performed by Babcock in conjunction with its partner Swietelsky and we remain confident that the Rail business is positioned to pursue higher value activities effectively.

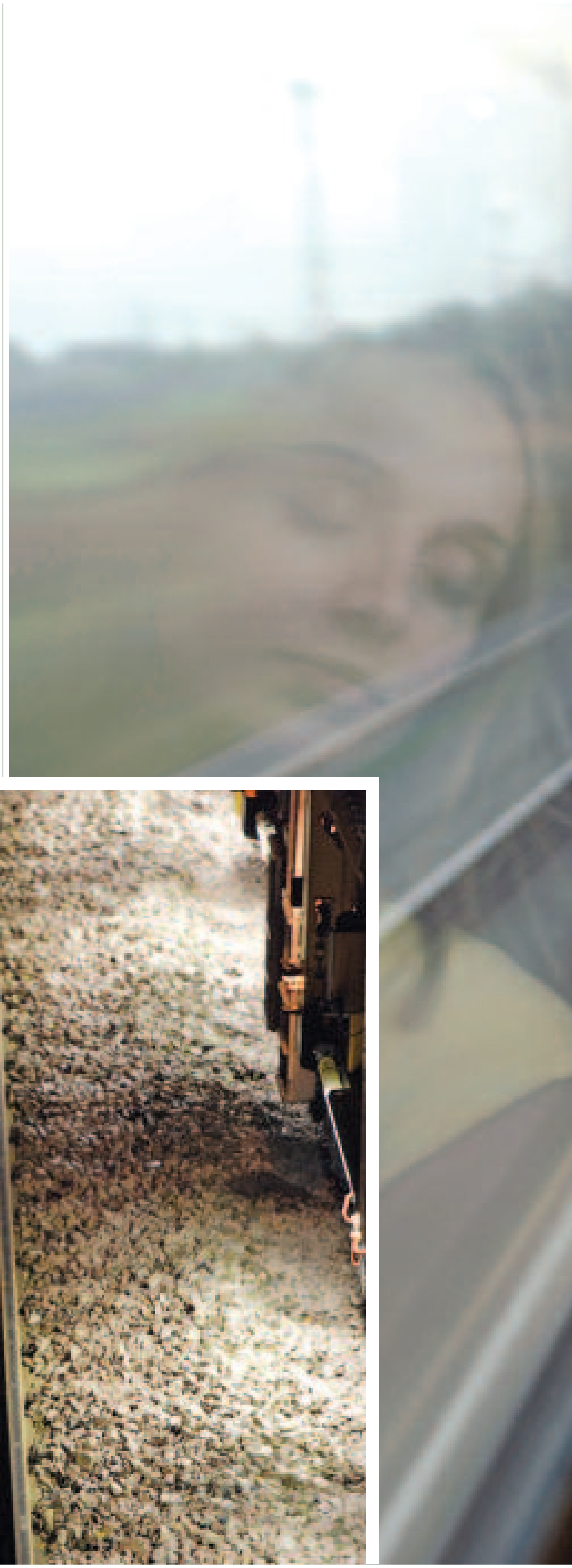
Operating return on revenue %

2006/07	4.1
2005/06	4.0
2004/05	5.0

Revenue growth %

2006/07	5
2005/06	3

Note: Rail was acquired in June 2004.



"I can get there sooner"

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Extending the UK's rail network in the Trent Valley and Stirling-Alloa in Scotland

Babcock is working to upgrade the quality of rail infrastructure in support of Network Rail and Transport Scotland to assist the train operators in moving passengers safely and quickly around the United Kingdom. In the Trent Valley we are working to add additional lines of track and infrastructure whilst in Stirling – Alloa the project involves reopening some 20km of railway track to re-establish passenger services and movement of goods reconnecting communities and commerce.

Key customers:

- Network Rail
- Transport Scotland

Business strategy

Babcock continues to develop, implement and refine a consistent strategy to deliver long term performance for its shareholders.

At the core of the strategy has been the objective to transform Babcock from an engineering conglomerate into a support services business operating in technically demanding, higher value environments, providing strong project management skills and engineering expertise across a range of challenging environments.

The illustration below shows key milestones in the implementation of our strategy.

Key events

2001

Board initiates strategic transformation of Babcock into a support services focused business

Acquisition of Hunting Defence (Babcock Defence Services)

2002

Awarded WSMI contract for HMNB Clyde (Faslane)

Acquisition of SGI (Babcock Infrastructure Services)

BIS awarded SLAM (Single Living Accommodation contract)

Babcock re-categorised as a support service business on the London Stock Exchange

2003

Babcock Defence Services awarded RAF Valley hawk support contract

Completed divestment of the materials handling business

2004

Acquisition of Peterhouse Group – First Engineering and EVE

BIS awarded Southwest Regional Prime contract

2005

BIS awarded East Regional Prime contract (only company to be involved in two of the five regional prime contracts)

BNS contract at HMNB Clyde extended early due to performance

First Engineering win ‘high output’ system 3 track renewal contract

2006

Acquisition of Alstec

Acquisition of ABB Powerlines

Networks win National Grid Alliance opportunity

2007

BIS awarded second phase of SLAM programme

Purchase of stake in International Nuclear Solutions PLC

Our approach to acquisitions has been to identify the markets and customers with whom Babcock would wish to operate which are consistent with our culture and capabilities. Our acquisition activity has been targeted to meet a gap in a clearly defined market. For example, the Peterhouse Group acquisition in 2004 gave Babcock access to the rail and telecommunications /power transmission markets whilst the 2006 acquisition of Alstec enabled Babcock to build a position in the emerging market for civil nuclear decommissioning and support.

Building on this solid foundation the Babcock strategy will continue to focus upon identification and successful participation in markets possessing investment programmes which fit with our understanding of the technical challenges, appreciation of the market dynamics and consistency with our style of operations.

Objectives of the business

The over-arching objective of Babcock is to generate value in a sustainable manner for the benefit of our shareholders and wider stakeholders. In our strategic planning we have identified eight indicators which are essential in achieving this goal;

1 To be one of the top three competitors in the marketplaces which we identify. In the event of identifying a desirable marketplace where we are not amongst the lead players the business has to have a robust plan to achieve a significant position within three years.

2 To achieve sustainable growth in operating profit.

3 To identify our preferred customers (which tend to be with public or regulated private sector and blue chip companies).

4 To be customer focussed and importantly to be able to work collaboratively in partnership with these customers. Across our operations we place a premium on strong collaborative working skills which we deploy to meet customer needs.

5 To focus on projects containing a high technical content and important to supporting the customer's own operations. Our portfolio of skills are engineering based and because of this we seek projects which are consistent with our capabilities. Additionally, we focus on projects which are mission-critical to the customer as we see these as having an intrinsic value and match with our experience and abilities.

6 To seek long-term commercial arrangements which balance risk and reward sensibly.

7 To maintain continual improvement in health and safety across our operations and;

8 To operate with respect for the environment.

Financial review

Group Income Statement

Group Revenue showed substantial growth over 2005/06, increasing by 18% to £988 million driven by a combination of new contract wins and growth from existing contracts (organic growth) and from businesses acquired during the year. Organic growth contributed £50 million whilst Revenue accruing from the acquisition of Alstec and the ABB Powerlines businesses added £102 million.

The Group operating margin, which improved to 6.9% (2006: 6.0%) benefited from enhanced contract profitability in all business segments with the exception of Rail where margins were close to last year's level at 4.1%. Margin gains in Defence Services and Engineering and Plant arising from efficiency gains on existing contract operations were further enhanced by the Alstec and ABB Powerlines acquisitions. Operating Profit improved by 37% to £68.3 million of which £9.5 million was attributable to acquisitions in the year.

There were a number of exceptional items in the year totalling £0.4 million (2006: £2.7 million) which comprised:

	£million
Restructuring costs in Rail	(2.0)
Pension gains	3.2
Bid Defence costs	(0.6)
Operating exceptionals	0.6
Legacy issues	(1.0)
Total exceptionals	(0.4)

Costs incurred in respect of Rail restructuring, fully provided for in the year, were part of a programme of cost reductions commenced during the year and which is expected to be completed during 2007/08. Further discussion of discontinued costs can be found at note 33 on page 77. Pension gains arose from a pension liability management project in respect of both deferred and pensioner member liabilities and which is expected to show further gains in 2007/08. The financial position of the Group's pension schemes is discussed further below.

Finance costs net of finance income increased from £5.2 million to £6.2 million following the increase in bank debt taken on to finance the acquisition of Alstec and ABB Powerlines. Further discussion of the Group's funding status is set out below.

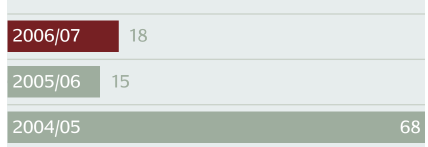
The charge to income tax, before adjusting for tax on exceptional items and amortisation of acquired intangibles, was £12.6 million (2006: £9.2 million) and represented an effective rate of tax on profit before tax of 20% (2006: 21%). However, this included a one-off gain relating to prior years of £1.0 million, absent which the rate would have been 22%. The Group benefits from lower tax rates in overseas jurisdictions allowing the application of an effective rate of tax on its profit before tax which is lower than the standard rate of UK corporation tax. The effective tax rate is calculated as the total charge to income tax as a proportion of the Group's profit before tax before exceptional items and amortisation of acquired intangibles and is expected to be sustainable at its current level for the financial year to 31 March 2008.

Profit for the year from continuing operations was £49.9 million, up from £35.4 million in 2005/06 and representing a year on year increase of 41%. This yielded an increase in basic earnings per share from continuing operations to 23.35 pence (2006: 17.18 pence).

Revenue growth %

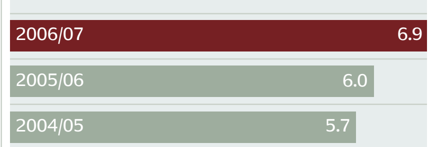
KPI:
Revenue growth is defined as the increase in the company's continuing revenue when compared to that of the previous year.

Note: 2004/05 includes the effect of the acquisition of Peterhouse Group in June 2004.



Operating return on revenue (ORR) %

KPI:
Operating Return on Revenue (ORR) is defined as operating profit before amortisation of acquired intangibles and exceptional items expressed as a percentage of revenue.



Diluted earnings per share were 22.66 pence against 16.78 pence in the previous year, an increase of 35%. Based upon the strong increase in earnings, the Board has recommended a total dividend for the year of 8.05 pence per share, up 34% on 2005/06, and at 2.9 times covered, is in line with the group's stated policy of achieving a ratio of earnings to dividend (dividend cover) of between 2.5 and 3 times.

Liquidity

Bank and other borrowings, net of cash balances (net debt), totalled £73.7 million, up from £38.2 million at the end of 2005/06. During the year the group acquired the shares of Alstec Group Limited and the business and assets of ABB Powerlines for a total consideration of £52.0 million for which existing bank borrowing facilities were used. Gearing (see chart below) increased from 22% to 36% and the key ratio of earnings before interest, depreciation and amortisation as a multiple of net debt was 1.0 (2006: 0.7) comfortably within the group's internal guidelines. At 31 March 2007, the group had access to a five year revolving credit facility of £140.0 million and a similar eighteen month facility of £50.0 million, of which £91.0 million had been drawn on these two facilities. In addition, the group had £17.5 million of overdraft facility.

Treasury policies

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.

Interest rate risk is managed by the use of a mixture of fixed and floating rate debt and interest rate swaps, 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.

Pensions

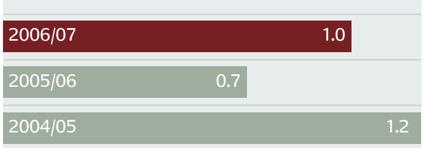
The group has a number of defined benefit pension schemes with long term commitments to pay pensions to past and present employees based on a pre-determined formula of length of service and pensionable pay.

Using cash contributions from both the group and employees, such pension schemes invest in a variety of financial instruments with the objective of providing sufficient financial resources to pay pensions as they fall due, over the long term. These financial instruments are valued at the balance sheet date by reference to their market value, for instance the quoted value of shares on a recognised stock exchange, and compared to the value of pension liabilities as assessed by the pension schemes' and group's actuaries to derive a surplus or deficit of assets over liabilities. At 31 March 2007 the group's combined pension schemes showed a net surplus of £53.1 million of assets over liabilities, on assets valued at £1.2 billion. The assessed value of liabilities is critically dependent on a number of assumptions. These include the estimated longevity of the scheme members, bond yield, the expected return on assets and future salary and pension increases. The 'fair value' approach thus used in accounting for pension schemes is a snapshot of values assessed at a particular point in time for what is essentially a long term structure and can yield volatile results, depending on market conditions, both for the balance sheet and income statement. In 2006/07 the amounts charged or credited to the income statement in respect of pensions were as follows:

	2007 £m	2006 £m
Service cost	15.0	12.7
Expected return on plan assets	(68.5)	(59.6)
Interest on obligations	51.6	49.7
	(16.9)	(9.9)
Net (credit)/charge to operating profit before exceptionals	(1.9)	2.8

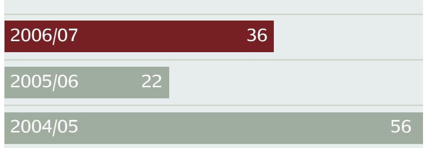
Net debt/EBITDA %

KPI:
Net debt/EBITDA is calculated as net debt divided by Earnings Before Interest, Tax, Depreciation and Amortisation.



Gearing ratio %

KPI:
Gearing ratio measures the extent to which a company is funded by debt. Calculated as net debt divided by shareholders funds.



Group Cash Flow

The group generated £60.2 million of cash from operations (2006: £54.1 million) on statutory operating profit of £62.8 million, representing a conversion rate of operating profit to cash of 96% (2006: 116%). We target a conversion rate over the medium term of 80% allowing for the inevitable 'lumpiness' of cash receipts and payments involved in large scale, long term contracts which can materially distort cash generation at any given point.

We acquired two businesses in the year (Alstec in the UK and ABB Powerlines in South Africa) for a net consideration of £52.0 million as well as paying £0.5 million deferred consideration in respect of acquisitions from prior years. In addition, we acquired 24.5% of the equity in International Nuclear Solutions PLC (INS) for £9.7 million.

After accounting for these investments and inter alia, income tax of £7.7 million, net interest payments of £5.5 million, dividends totalling £14.0 million and capital expenditure of £7.0 million, the group's net cash outflow in the year was £33.5 million.

The improving margin combined with good management of cash flow have yielded an improvement in Return on Invested Capital and interest cover (the three year track record of which is illustrated below).

Health and Safety

Our Commitment

We have always regarded the safety of our employees and those working along side them as a key management obligation, and safety performance is considered when making bonus payments. We have in place the necessary policies and procedures to comply with applicable laws and good practice, and have a safety management structure, described below, that is necessary to achieve our legal obligations. Our health and safety record is, we believe, consistent with industry norms.

In prior years we have achieved year-on-year reductions in the number of, as well as the rate of Health & Safety incidents across the group. During 2006/07 the number of incidents increased and therefore to address this, we embarked upon an ongoing programme designed to bring about a qualitative change in our approach to Health and Safety. We now aim to build on compliance and incremental improvements in safety performance, by making part of our management and employee culture the belief and determination that it is possible for all our employees, and anyone else for whom we are responsible, to go home safe and well at the end of each day.

We are making a significant investment in terms of both time and money towards this objective, complementing it with specific health and safety behavioural programmes targeted at supervisors and operational staff, where appropriate.

Health and Safety Management

Our 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 facilitates cross-business discussion of health and safety management and is responsible for creating the conditions that allow the group Health and Safety Policy 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 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 attend from time to time. Monthly reports on health, safety and environmental performance are reviewed by the group's Executive Committee. The Board formally reviews performance twice a year, but sees monthly divisional management reports that include sections on health, safety and environmental matters.

Each business has Health and Safety procedures appropriate to its operations, the local environment and its customer base. Appropriate training is provided for personnel and non-employees, where relevant.

Divisions have specialist Health and Safety teams or advisers reporting to Divisional Managing Directors.

Operating Cash Flow (OCF) conversion rate %

KPI:
Operating Cash Flow (OCF) conversion rate is defined as cash generated by operations as a percentage of operating profit (post exceptionals).

2006/07	96
2005/06	119
2004/05	126

Return on Invested Capital (ROIC) %

KPI:
Return on Invested Capital (ROIC) is defined as net income divided by total capital.

2006/07	15.4
2005/06	12.3
2004/05	10.9

Interest cover %

KPI:
Interest cover is a measure of the adequacy of the company's profits relative to interest payments on its debt. Profit before interest, tax and amortisation, divided by net interest payable.

2006/07	10.9
2005/06	9.6
2004/05	6.9

The Group's businesses have, between them, won many awards and customer recognition for their Health and Safety management. New awards received during the year are summarised below:

In 2006, our Alstec business won a RoSPA Gold Award, (for the third consecutive year) and a British Safety Council Award (for the eleventh consecutive year). During the year it completed 450,000 man-hours of work at Sizewell, Dungeness and Hinckley Point power stations with no reportable incidents in respect of any employee or agency worker under its control. 500,000 man hours were worked at the Whetstone manufacturing facility since its last reportable incident.

Our Babcock Engineering Services operations at Rosyth were awarded the prestigious 'British Safety Council Sword of Honour' for a third time. They have also been accredited with the British Safety Council Health and Safety Management 5 star rating from 2002–2006 (inclusive).

Having been awarded RoSPA Gold Awards for fifteen consecutive years and an 'Order of Distinction' in 2005, Babcock Infrastructure Services have been selected by the RoSPA Awards Adjudication Panel to receive a Major Award in the Facilities Management sector. They were also accredited ISO14001 for the Regional Prime East contract.

We monitor accidents, incidents and near misses monthly and measure the incident frequency rate on a per 100,000 hours worked basis. The tables below show the group's incident history since April 2002.

Regrettably, there were two fatalities in the year to 31 March 2007 as a result of a single incident in the newly acquired ABB Powerlines business in South Africa.

The environment

We aim to achieve the highest standards in environmental management and seek accreditation to relevant standards where appropriate.

As a support services provider, many of our operations are carried out on customer sites where the customer is responsible for environmental matters. Some customers ask us to take on environmental management, though they set the standards, budgets and timescales for us.

On those sites that we do own and control, such as Rosyth, we have made significant advances in environmental management. For example, there have been significant improvements over time in the efficient use of energy and in water consumption at Rosyth Dockyard. 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. In addition our activity on the Regional Prime East contract for the Defence Estates organisation has achieved similar ISO14001 accreditation.

Having regard to the nature of those operations for which we do have management control and discretion, we do not make significant emissions of greenhouse gases that could otherwise be reduced or avoided. We do, however, keep this under review.

Identification and evaluation of risks and control objectives

Of importance to Babcock is the identification, monitoring, management and minimisation of risks to the business and our staff.

The Board has the primary responsibility for monitoring the major business risks facing the group and for developing appropriate policies to manage those risks. The group has a Group Risk Manager who reports to the Group Finance Director and to the Audit & Risk Committee. The Group Risk Manager oversees a group Risk Management 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.

Internal analysis has identified 10 group wide 'themes' or categories into which individual risks are allocated, processes put into place to manage them and are subsequently monitored through the group risk register.

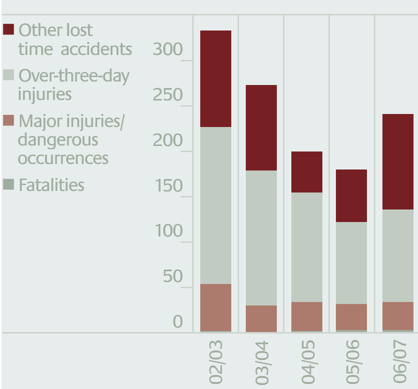
Health, safety and environmental issues

Given the complexity of the working environments the group is active in, the safety of our employees is paramount. Please see the relevant sections of the Operating and Financial review which detail the mechanisms we have put in place to address these risks and details of the metrics we actively monitor and review.

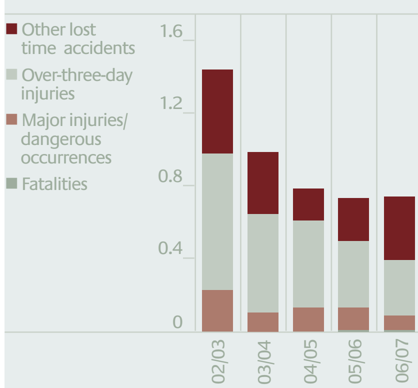
Acquisitions/disposals

Inappropriate acquisitions potentially put the group at risk depending on their size and scope. To mitigate this risk the group makes strenuous efforts early in the process to thoroughly understand the market and culture of the organisation under consideration to smooth the process of acquisition and integration.

Number of incidents



Incident rate per 100,000 hours worked



	2002 /03	2003 /04	2004 /05	2005 /06	**2006 /07**
Number of incidents:					
Fatalities	1	0	1	2	**2**
Major injuries/ dangerous occurrences	52	29	32	29	**31**
Over-three-day injuries	173	149	121	90	**102**
Other lost time accidents	106	94	45	58	**105**
Incident rate per 100,000 hours worked:					
Fatalities	0.00	0.00	0.00	0.01	**0.01**
Major injuries/ dangerous occurrences	0.26	0.12	0.15	0.14	**0.09**
Over-three-day injuries	0.86	0.62	0.55	0.42	**0.35**
Other lost time accidents	0.53	0.39	0.20	0.27	**0.40**

Bid success

Given the nature of the group's businesses, the principal business risk relates 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 the Group Executive Directors on a regular basis. The final submission of significant bids requires formal approval from one or more executive Directors.

Progress on all significant contracts is kept under review within the relevant Division and is reviewed quarterly by group Head Office.

Contractual process and contract performance

An identified risk is that of failing to meet the requirement of a contract and/or not securing the contract when a customer chooses to re-let the opportunity. Each business division has governance procedures in place, backed up by contract review and operational reviews with the Group Chief Executive to consider performance. In addition, Babcock carefully selects commercial partners to ensure the availability of the appropriate mix of capabilities to meet customer needs. An example of this is in the Babcock approach to the Regional Prime Contracts issued by Defence Estates where Babcock partners with Bovis Lend Lease in the South-West and DynCorp in the East to provide the optimum solution to the customer.

Elements of group activity are also reviewed through customer initiatives such as the Supplier Relations Group of the Ministry of Defence on an annual basis and by Network Rail.

Personnel

The principal resource available to Babcock is our possession of a critical mass of skilled engineers and project management staff. Their knowledge base enables the organisation to respond flexibly to meet customer challenges of a multi-disciplinary nature – drawing on engineering and project management expertise from several domains.

In order to nurture our engineering cadre, Babcock has developed and continues to expand apprenticeship and graduate entry schemes with a view to ensuring that the company maintains a range of capabilities capable of meeting current and emerging business opportunities.

Political

The largest customer for Babcock is the UK public sector where decision-making processes can affect the securing and retention of business. To ensure that Babcock remains well positioned in a changing environment the group monitors its customers' environment and regularly considers how best to communicate its position.

Information technology

Given the scale of the business and its geographic spread across the United Kingdom and overseas, ensuring that the information technology architecture is fit for purpose is of importance. The Group maintains an IT Steering Group (ITSG) chaired by both the Group Finance Director and Group Head of IT. The ITSG reviews current development and projects and considers forthcoming business and what, if any, IT issues are raised.

Pensions

Managing the pension schemes of the group properly is of great importance. There is Board level input into strategy as well as the use of external professional advisers as appropriate. In addition, where practical, all pension schemes in the group have a corporate trustee. An annual review of pension funds is conducted by the Board.

Ethical/reputational risks

Breaches of ethics and/or potential damage to the group's reputation is a business risk. Babcock has established a 'whistle-blower' hot line in order to enable employees across the group to express concern anonymously should they feel they are being asked to act inappropriately or that others may be doing so. See page 22 for more information.

At the reputational level, having established a track record for financial performance, forecasting coupled with periodic strategic reviews are conducted to ensure alignment within the group as to current position.

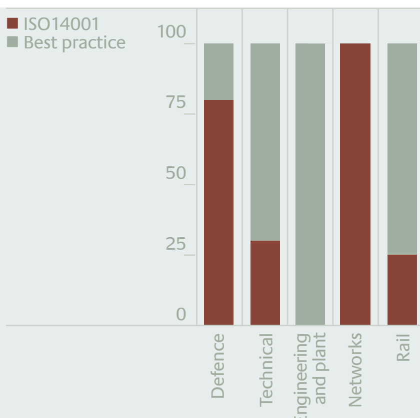
Legacy liabilities

Babcock, by virtue of its operational heritage and through acquisition has potential legacy liabilities. These are monitored and, as required, managed by the group and/or with external professional advisors, as appropriate.

Environment %

KPI:
Although our ability to implement good environmental stewardship practices is on occasion set for us by customer requirements our target is to grow the percentage of revenues in each business segment from contracts which are ISO14001 accredited as a means of encouraging grass-roots application of best environmentally sound practice across our operations. 'Best practice' refers to activities where non-ISO14001 compliant measures are being applied.

Note: 2006/07 is the first year in which we have conducted this analysis.



Corporate and Social Responsibility

Introduction

We will only be successful if our employees want to do their best for us and our customers and partners, and the communities in which we operate, want to do business with us. We recognise that this depends on our reputation and a key element of that is how we manage the impact of our operations on the environment and on the heath and safety of our employees and others, and how we are perceived by those communities and customers.

Overview

We believe that awareness of these factors is embedded in our management and operations, and at Board level. Health, safety and environmental performance is considered when awarding bonuses under bonus schemes for senior management, to emphasise the importance the Board places on these matters.

Through its Audit and Risk Committee, the Board regularly reviews a Group Risk Management Standard. This, directly or indirectly, involves reviewing environmental, social and governance matters that might pose a threat to the company's short and long-term value. The process, which is described further on pages 30 and 31, is well established as part of group management practice. Internal and external auditors are also able to comment on the process and share in its findings. The Board considers that this Risk Review process, with the importance it attaches to health, safety and environmental issues, when taken with the specific risk management and health, safety and environmental management structures in place work together as an effective system for managing and mitigating significant risks from these matters.

The group has in place group-wide and/or divisional policies covering employment issues, health, safety and environmental matters and ethical conduct.

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 on page 19 in more detail.

The environment

The environment is addressed on page 20 in more detail.

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 management in group head office who will ensure, if the issue is one that is making proper use of the service, that the matter is followed up and, if appropriate, reported to the Group Chief Executive and/or 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 and employees is a key objective.

Training: The past year has seen the continuation of the Babcock Academy, which is run in conjunction with the University of Strathclyde Business School. The Academy encourages development of common business tools, ideas and a language across our operations. It covers strategic planning, financial matters, leadership, human resources and project management. Our divisional businesses supplement this training with business-specific training through their own programmes.

We believe that we have an enviable skills base that enhances our contract performance and allows us to deliver flexible and reliable services to our expanding customer base. However, in common with many other technically-based business, we are concerned at the increasing shortage of skilled employees.

At divisional level we have for some time run a variety of graduate development programmes, but given the growing competition for skilled resource we are implementing a group-based graduate recruitment and development programme to broaden the attraction of our businesses as a whole by offering a more broadly based experience and greater opportunity for career progression and specialisation.

Communication: 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.

In the year ended 31 March 2007 the group employed an average of 9,643 staff worldwide, of whom approximately 90% 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. A few examples are mentioned below.

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 Networks business has participated 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.

Outlook

Our financial results were pleasing, with continued double-digit sales growth, underlying profit before tax up by 40% and underlying earnings per share increasing by 36%. This is the fifth successive year of double-digit growth.

This has been another good year for Babcock with continuing growth in core businesses and the successful integration of Alstec and ABB Powerlines, each of which has performed better than our planning assumptions. The potential addition of INS to our nuclear portfolio will further strengthen our position in the nuclear and nuclear decommissioning areas.

The outlook for Babcock remains positive with our markets remaining good and our ability to deliver to customers requirements will continue to ensure that we benefit from the strength of these markets.

Order book £bn

2006/07	2.4
2005/06	2.3

Peter Rogers
Group Chief Executive

Bill Tame
Group Finance Director

Directors and Company Secretary

Gordon Campbell CBE Chairman
Mr Campbell has served on the Board since 10 October 2000 when he was appointed as Group Chief Executive, and from 2001 to August 2003 he was Executive Chairman; 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 Holdings Ltd, Accsys Technologies plc and Jsst Securities Limited. He is a former Vice President of the Royal Academy of Engineering.

He is chairman of the Nominations Committee of the Board.

Mr Campbell was last re-appointed as a Director of the company at its Annual General Meeting in July 2004 and will be retiring and offering himself for reappointment at the company's forthcoming Annual General Meeting in July. (Age 60)

The Rt Hon Lord Alexander Hesketh KBE 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. He was reappointed as a Director of the company at its Annual General Meeting in July 2006. Having served for more than nine years, he will, in accordance with the Combined Code, offer himself for re-election at the forthcoming Annual General Meeting in July. (Age 56)

Peter Rogers 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 Officer. 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. (Age 59)

William Tame 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. (Age 52)

John Rennocks 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, Nestor Health Care Group plc and Intelligent Energy Holdings PLC and is a non-executive Director of Foreign & Colonial Investment Trust PLC, JP Morgan Overseas Investment Trust PLC, Wagon PLC, Inmarsat plc and Gyrus Group PLC. As well as being Chairman of the Audit and Risk Committee, Mr Rennocks is a member of the Remuneration Committee and Nominations Committee. He was last reappointed as a Director of the company at its Annual General Meeting in July 2005. (Age 61)

Dipesh Shah OBE 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 Advisory Chairman of HgCapital Renewable Power Partners Llp and was non executive Chairman of Viridian Group PLC. He is a former Chief Executive of the United Kingdom Atomic Energy Authority. He was also formerly a 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. (Age 54)

Sir Nigel Essenhigh GCB 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 2006. (Age 62)

Justin Crookenden 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. He was reappointed at the company's Annual General Meeting in July 2006. (Age 44)

Albert Dungate Company Secretary
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. (Age 50)

Directors' report

The Directors present their Report and the audited Financial Statements of the group and the company for the year ended 31 March 2007.

Result and dividends

The profit attributable to shareholders for the financial year was £43.4 million (2006: £29.7 million). An interim dividend of 2.40p per 60p ordinary share was declared in the year (2006: 1.75p per 60p ordinary share). The Directors propose to recommend the payment on 6 August 2007 of a final dividend of 5.65p (2006: 4.25p per 60p ordinary share) on each of the ordinary shares of 60p entitled thereto and in issue on 6 July 2006.

Business review and group structure

The Operating and Financial review on pages 3 to 23 (which constitutes the company's Business review) reviews the group's activities and likely future developments and forms part of this report. That review contains a description of the principal risks and uncertainties facing the group and also addresses use of financial instruments and describes important events since 31 March 2007. The principal subsidiary, joint venture and associated undertakings of the company are set out on page 85.

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 76 and these are also referred to in the Operating and financial review.

Post balance sheet events

On 10 May 2007 the group agreed to buy Devonport Management Ltd for £350 million subject to shareholder approval. On the same date the group made an equity placing of 19 million shares at 475p per share raising £90 million of equity before costs.

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 £67,000 (2006: £55,000) 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. The company itself had no trade creditors at either 31 March 2007 or 31 March 2006.

Directors

Details of the Directors serving during the year are shown on page 24.

Gordon Campbell will retire at the company's forthcoming Annual General Meeting in July 2007 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 2004. 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.

Each Director submits himself for reappointment at least every three years in accordance with the Combined Code.

Directors' interests

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

The interests of the 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 2007	At 1 April 2006
G A Campbell	49,685	49,685
P L Rogers	100,000	100,000
The Rt Hon Lord Hesketh	8,249	8,249
W Tame	26,189	26,189
D J Shah	8,333	8,333
Sir Nigel Essenhigh	–	–
J L Rennocks	–	–
J N A Crookenden	–	–

Holdings are all of ordinary shares of 60p each.

There were no changes in the Directors' interests in shares between 31 March 2007 and 22 May 2007.

Details of options and awards over shares in the company granted to Directors up to 22 May 2007 (and any exercise of them during the year) are given on pages 35 and 36.

Significant shareholdings

As at 22 May 2007, the company had been notified in accordance with Chapter 5 of the Disclosure and Transparency Rules of the following major interests in voting rights attached to its ordinary shares (which represent interests in 3% or more of its issued ordinary share capital).

Name	Number of 60p ordinary shares	%
Schroder Investment Management Limited	45,360,094	19.83
Resolution Investment Services Limited	9,082,378	3.97
Lloyds TSB Group Plc	8,646,684	3.78
Legal & General plc	7,354,997	3.22

Employee share schemes

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) The Babcock International Group PLC Approved and Unapproved Executive Share Option Schemes (pre- 1999)

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.

(iii) The Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme ("the 1999 Schemes")

Option grants under these schemes were linked to company performance, and are described in more detail in the Remuneration report on page 35.

(iv) The Babcock 2003 Long-Term Incentive Plan ("the L-TIP")

This plan allows for the making of share awards to Directors and senior employees in the form of options granted at a nominal price. The plan and the performance conditions attaching to awards made under it are described further in the Remuneration report on page 36.

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 section on Corporate and social responsibility appearing on pages 22 and 23.

Authority to purchase own shares

At the Company's Annual General Meeting in July 2006, the shareholders authorised the company to make market purchases of up to 20.9 million of its own ordinary shares of 60p each. That authority will expire at the forthcoming Annual General Meeting in July 2007. Although no ordinary shares have been purchased by the company during the period from 14 July 2006 (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 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 steps that he ought to have taken as a Director in order 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 2007, entitled to be indemnified by respectively 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 0AE on Friday, 13 July 2007, at 11.30 am. The notice of meeting is on page 86 and a note on the resolutions to be proposed at it as special business is set out on page 87.

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 2007

By Order of the Board

A N Dungate Company Secretary
22 May 2007

Statement on Corporate Governance

Statement of compliance with the Combined Code

During the year ended 31 March 2007 the company complied with the provisions of section 1 of The Combined Code on Corporate Governance 2003 (the 'Combined Code').

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.

The Board and Board balance

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, having two full time executive Directors, one non-independent non-executive Director and a Chairman, (who having formerly been Chief Executive Officer of the company is not regarded as independent for Code purposes) balanced by four independent non-executive Directors.

Refreshing of the Board

Three new independent non-executive Directors have been appointed in the past five years, one in 2002, one in 2003 and the other in 2005. In that time two long-standing non-executive Directors left. None of the executive Directors was in post before 2000. With the exception of Mr Campbell, who will offer himself for reappointment at the forthcoming Annual General Meeting in July 2007, all Directors have been reappointed to office within the past three years.

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. The Board explains, in notes accompanying the notice of meeting, why it recommends reappointment of non-executive Directors proposed for re-election 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

Mr Shah, Sir Nigel Essenhigh, Mr Rennocks and Mr Crookenden are considered by the Board to be independent.

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

Board procedures

There were nine scheduled Board meetings in the financial year under review, each was attended by all the Directors. 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, including a Finance Committee.

The Chairman regularly holds meetings 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 using an independent facilitator who carried out individual confidential interviews with each of the Board members, the Company Secretary and certain senior group employees eliciting their views. The results of those interviews is reported to the Chairman who shares them with Board members. No serious concerns were raised in the interviews, although suggestions as to areas needing greater focus by the Board were made and are being acted upon.

The performance of the Chairman was evaluated during the year by the Remuneration Committee.

All Directors have full and timely access to information.

Change in Chairman's significant external commitments

During the year there were no changes to the Chairman's significant external commitments.

Board Committees – the Audit and Risk Committee

Those Directors who served on the Committee did so for the entire year under review, and were:

J Rennocks (Committee Chairman)
D Shah
Sir Nigel Essenhigh
J Crookenden

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

The Committee 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.

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 and Ernst & Young in the absence of executive management.

The Committee met formally five times in the year under review. All Committee members attended the meetings. At its meetings for the year ended 31 March 2007, the Committee:

- reviewed preliminary and interim statements of results and the proposed announcements relating to them;
- reviewed the Financial Statements for the year ended 31 March 2006 and the half-year ended 30 September 2006 and internal and external auditors' comments in connection with them;
- evaluated the effectiveness of internal controls;
- considered reports specifically evaluating the scope for fraud in the group's operations and the misreporting of results by business units;
- 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 the Operating and financial review including consideration of key performance indicators;
- reviewed the arrangements for confidential 'whistle-blowing';
- reviewed the group risk standard and its implementation, together with group risk reports;
- conducted a going concern review.

Whistle-blowing arrangements

These arrangements are dealt with in the Corporate and social responsibility section on page 22.

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 pages 32 to 38. The Committee met formally three times in the year. Each Committee member attended all the meetings.

Board Committees – Nominations Committee

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

G Campbell (Committee Chairman)
D Shah
J Rennocks
Sir Nigel Essenhigh
The Rt. Hon Lord Hesketh
J Crookenden

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. During the year, the Committee did not need to meet formally, with discussions on succession planning being held in the course of Board Meetings.

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 and market perceptions 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 2006 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.

Non-executive Directors may at any time make visits to group businesses or operational sites. Presentations on the group's businesses and specialist functions are made to the Group Board from time to time, and non-executive Directors receive copies of minutes of meetings of the Group Executive Committee and 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 acknowledges its 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, which were reviewed in March 2007. 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. This process is described on pages 20 and 21 and below. The Board and Audit and Risk Committee has regularly reviewed the effectiveness of this process formally at least once per year and informally on an ongoing basis by identifying its various elements, seeking the views of executive management and of internal and external auditors upon it and as to how it compares with processes in other companies, and considering it against operational outcomes. This process is considered to be in accordance with Internal Controls: Guidance for Directors on the Combined Code ('the Turnbull Guidance'). 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.

There are no material joint ventures or associates that are not dealt with as part of the group for the purposes of applying the Turnbull Guidance.

Control environment and procedures

The group has an established system of internal control comprising principally of:

- a risk identification, evaluation and management process;
- 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 also addressed on pages 20 and 21.

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 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), and by group management.

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

Statement of Directors' responsibilities in respect of the annual report, the Directors' Remuneration report and the Financial Statements

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

The Directors are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the group and of the profit or loss of the group and a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of affairs of the company 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; and
- state whether the group financial statements comply with IFRSs as adopted by the European Union, and with regard to the parent company financial statements whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with the above requirements in preparing the 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 the group and to enable them to ensure that the group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the parent company financial statements and the Directors' Remuneration report comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's 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 remuneration policy for its Directors for the 2006/07 financial year and which it currently intends to follow for the present and subsequent financial years;
- 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 2007.

Remuneration Committee

Responsibility for determining and approving the remuneration packages of the Chairman, executive Directors and certain other senior group executives is delegated by the Board to a Remuneration Committee ('the Committee') consisting solely of independent non-executive Directors of the company. Those Directors who served on the Committee did so for the entire year under review, and were:

D Shah (Committee Chairman)
J Rennocks
Sir Nigel Essenhigh
J Crookenden

The Committee met formally three times in the year and each committee member attended all the meetings.

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

Other than the Company Secretary who attends meetings as Secretary to the Committee, no other director or executive attends meetings unless by invitation. Mr Campbell, Group Chairman and Mr Rogers, Chief Executive Officer have attended meetings at such invitation, but neither is present when his own remuneration is under discussion. Lord Hesketh attends some meetings of the Committee as an observer. The Committee receives independent, market-based advice on the Chairman's, executive Directors' and senior management remuneration from The Inbucon Group Limited ('Inbucon'), remuneration consultants. Inbucon was appointed, with the Committee's approval, by the company (acting through the Group Company Secretary). Inbucon does not provide other services to group companies. During the year, Mr Shah (Committee Chairman) directly commissioned Inbucon to update the full review of the Chairman's and senior executive remuneration carried out by Inbucon in the previous financial year.

Remuneration policy

The company's management team has a proven track-record of successfully implementing strategy, (see graph overleaf). There is a highly competitive market for such talent. Reflecting this competition, the company's remuneration policy is based on the following principles:

- retaining and facilitating the recruitment of talent with such proven record; and
- providing a fair sharing of rewards between management, employees and shareholders.

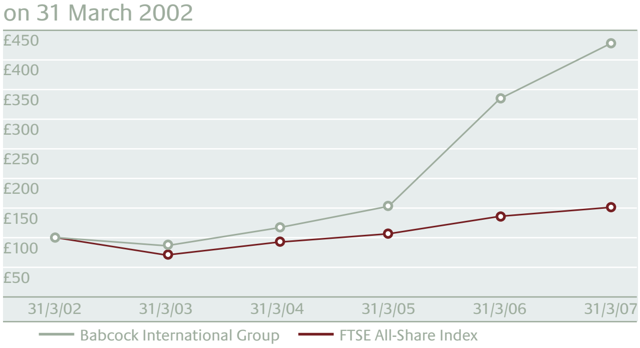
These principles are reflected in the remuneration packages adopted for the executives, which comprise a combination of basic pay, benefits, annual bonus and long-term incentive programmes.

Performance graphs

The first graph below (left), compiled by Inbucon, shows the total shareholder return for a holding in the company's shares for the period from 31 March 2002 to 31 March 2007 relative to a holding of shares representing the FTSE All-Share Index (excluding investment trusts). This is the same index as 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. Over the five year period, the company has substantially out-performed both the All-Share Index (excluding Investment Trusts) and the Support Services index. An investment of £100 in the company on 1 April 2002 would have delivered a return of £327.

The second graph below (right) (also prepared by Inbucon) shows comparative TSR performance over the same period 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 All-Share Index (excluding Investment Trusts)
Cumulative Total Shareholder Return of £100 investment on 31 March 2002



Total Shareholder Return: Babcock International Group vs FTSE Support Services Index
Cumulative Total Shareholder Return of £100 investment on 31 March 2002

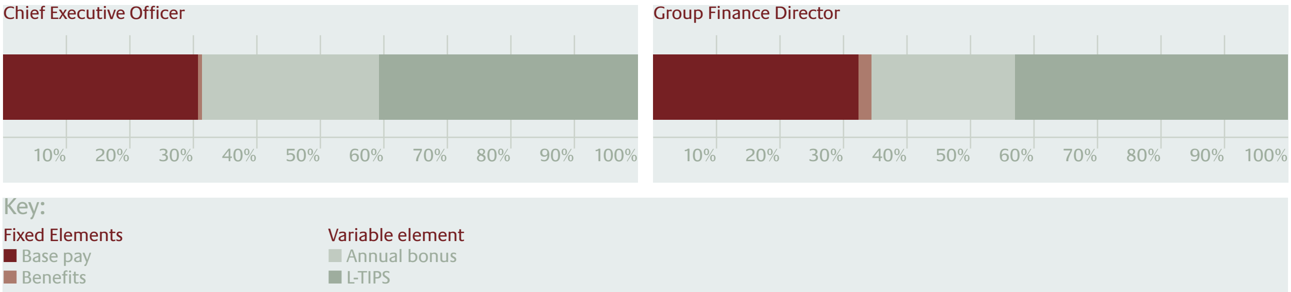
Level and balance of remuneration

Level of remuneration

The potential level of overall remuneration is set so that upper quartile rewards can be earned for upper quartile performance, with basic packages set having in mind the median for comparable companies. In reviewing base pay and remuneration the company considers both companies of a similar size generally as well as pay levels specifically in the support service sector.

Balance of remuneration

The balance of remuneration for executive Directors is set so that the major part of overall remuneration is subject to performance, either short or long term. The balance for the Chief Executive Officer and the Group Finance Director is shown in the graphs below, L-TIP awards are valued on a projected value basis and the graph assumes full achievement of bonus potential.



Mr Campbell as part-time Chairman has a remuneration package where the performance related element is just over 50% of potential remuneration. Other non-executive Directors only receive fixed fees.

Internal relativity

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 in the light of current market practice and in the best interests of shareholders.

Shareholding requirements

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

Basic pay

Basic pay is considered against other companies in terms of size, (comparing revenues, number of employees and market capitalisation), and companies in the support services sector. Against these data sources taken as a whole, the company's basic pay is normally about the median. Basic pay is reviewed annually against the market.

Non-executive Directors

Non-executive Directors' fees are reviewed against market practice at least every three years by the Chairman and the executive Directors, to whom the task has been delegated by the Board.

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. Neither the Chairman nor the non-executive Directors participate in an annual bonus scheme. For the year ended 31 March 2007, the annual bonuses payable to Mr Rogers and Mr Tame were dependent on a combination of the profit before tax and operating cash flow achieved by the group as against budget and growth in profit before tax over the prior financial year, because these are key indicators of group performance. In addition, the Committee has discretion to reduce or extinguish the bonus achieved if they consider health, safety (and now environmental) performance warrants it.

Maximum bonus potential was 100% of qualifying salary for Mr Rogers (which for the year was £400,000) and 80% of basic salary (excluding car allowance and other supplements) for Mr Tame. Maximum bonuses were earned, as profit growth was at least 20%.

The Committee has adopted similar schemes for Mr Rogers and Mr Tame for the current financial year.

Annual bonuses are not pensionable.

Long-term incentives:

During the financial year, L-TIP awards were made to each of Mr Campbell, Mr Rogers and Mr Tame of 100% of their qualifying basic salaries. The vesting of the awards is based on the achievement of performance criteria, half being comparative TSR performance (against a specific comparator list) and half based upon EPS growth. Further details of the performance criteria are set out on pages 36 and 37. Details of options and L-TIP awards held by the Directors are set out on pages 35 and 36.

To aid recruitment and retention, for certain divisional senior managers, but not the company's Directors, there is a cash-based long-term incentive scheme. This scheme has a performance period of four years and the performance targets are set by reference to divisional profit targets and return on capital employed or operating cash flow, as most appropriate to the division's business. A similar scheme is in place for senior group employees (but not the company's Directors) based on eps growth over the period. Target bonuses under this scheme vary between participants but will not normally exceed a year's basic salary.

Directors' pensions

Only Mr Tame currently participates in a group pension scheme. A summary of Mr Tame's pension entitlements is set out at page 34.

Neither Mr Campbell nor Mr Rogers receives pension benefits from the company; 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 Directors for tax changes or changes to the taxation of pensions.

Directors' emoluments and compensation (audited)

The Directors' emoluments for the year ended 31 March 2007 are set out in the table below:

Director	Salary or fee* £'000	Annual bonus £'000	Benefits** in kind £'000	Total year ended 31 March 2007 £'000	Total year ended 31 March 2006 £'000
Chairman and executive Directors					
G A Campbell (Chairman)	241	–	–	241	217
P L Rogers (Chief Executive Officer)	447	400	1	848	613
W Tame (Group Finance Director)	269	188	17	474	375
Non-executive Directors					
The Rt Hon Lord Hesketh	58	–	–	58	53
J Rennocks	39	–	–	39	34
D J Shah (Chairman of Remuneration Committee from 19 July 2005)	38	–	–	38	32
Sir Nigel Essenhigh	33	–	1	34	30
J N A Crookenden (appointed 1 December 2005)	33	–	–	33	10
M J Turner (retired 31 December 2005)	–	–	–	–	21
Total	1,158	588	19	1,765	1,385

*Salary or fee includes car and other cash allowances not forming part of basic salary.

**For Mr Tame, benefits comprised home to work travel expenses, medical insurance and accommodation expenses. For Mr Rogers they comprised medical insurance. For Sir Nigel Essenhigh they comprised home to work travel expenses.

The fees for Lord Hesketh reflect his additional duties as Deputy Chairman. Mr Rennocks' and 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 ('the scheme')

Mr Tame is a member of the upper tier of the Babcock International Group Pension Scheme. No other Directors are members of the scheme or receive pension benefits from the group.

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 scheme's "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 is the same as the former statutory earnings cap, index-linked in the same way). The company takes out additional life assurance cover in respect of four times his salary in excess of the earnings cap.

Mr Tame's pension entitlements under the scheme (defined benefit) are set out in the following table:

Director	Accrued pension at 31 March 2007 £ pa	Increase in accrued benefits excluding inflation during the year ended 31 March 2007 £ pa	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2006 £	Transfer value at 31 March 2007 £	Transfer value of increase in accrued benefits less Director's contributions £	Increase in transfer value less Director's contributions £
W Tame	19,141	4,048	3,505	211,482	312,238	30,170	89,006

(1) Inflation has been taken as 3.6% 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) In calculating the above figures for Mr W Tame no account has been taken of any retained benefits which he may have from previous employments.

(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)

Before 1 April 2006, in respect of his salary in excess of the earnings cap, the company had established a Funded Unapproved Retirement Benefit Scheme (FURBS) for Mr Tame. The company contributed to the FURBS an amount equal to 20% of the excess (including 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 was replaced with a salary supplement of 15% of the excess (including employer's national insurance contributions), with Mr Tame contributing into the company's pension scheme only on capped salary. The cost to the company of the salary supplement arrangement is the same as was the case for the FURBS arrangement. The amount of contributions made to Mr Tame's own pension plans or arrangements, including the cost of providing any additional life assurance cover, are set out in the table below:

Director	2007 £'000*	2006 £'000
W Tame	2	12

*Life insurance benefit only; no pension contributions.

Directors' share options (audited)

Details of Directors' share options (all of which are now vested and exercisable) are set out in the table below and the notes beneath it:

Director	Option scheme	Number of shares subject to options at 1 April 2006	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to options at 31 March 2007	Exercise price (pence)	Exercisable from	Expiry date
G A Campbell	a	560,975	–	–	–	560,975	123.00	Nov 2003	Nov 2010
	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	Jun 2005	Jun 2012

a = Share Option Agreement (agreed as part of the terms of recruitment).
b = Babcock 1999 Approved Executive Share Option Scheme.
c = Babcock 1999 Unapproved Executive Share Option Scheme.

These options vested according to performance targets based on comparative TSR performance over three-year performance periods, which were set on grant and not subject to re-testing. 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. There was 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 vested, with 100% vesting for top quartile ranking and proportionate vesting on a straight-line basis for a ranking between those points.

The exercise prices of the options 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 closing price of the company's shares for the three business days preceding the date of the grant.

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.

There were no changes in the Directors' share options between 31 March 2007 and 22 May 2007.

Directors' share awards under the L-TIP (audited)

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

Director and year of award	Number of shares subject to award at 1 April 2006	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to award at 31 March 2007*	Market value (in pence) of each share at date of award	Exercisable (subject to vesting and plan rules) from**	Expiry date
G A Campbell								
2003	167,400			1,005	*166,395*	113.5	Jun 2006	Jul 2013
2004	158,730				158,730	126.0	May 2007	Jul 2014
2005	117,994				117,994	169.5	May 2008	Jul 2015
2006		66,469			66,469	338.5	May 2009	Jul 2016
P L Rogers								
2003	255,506			1,534	*253,972*	113.5	Jun 2006	Jul 2013
2004	281,746				281,746	126.0	May 2007	Jul 2014
2005	230,088				230,088	169.5	May 2008	Jul 2015
2006		118,168			118,168	338.5	May 2009	Jul 2016
W Tame								
2003	171,806			1,031	*170,775*	113.5	Jun 2006	Jul 2013
2004	162,698				162,698	126.0	May 2007	Jul 2014
2005	132,743				132,743	169.5	May 2008	Jul 2015
2006		69,423			69,423	338.5	May 2009	Jul 2016

*Those awards shown in italics were fully vested and exercisable as at 31 March 2007.

**Vesting date depends on the date of notification of the vesting, which must be after announcement of results for the final year of the applicable performance period. The above table assumes that the announcement is made in May and notification of vesting given in the same month.

The company's mid-market share price at close of business on 30 March 2007 (the last dealing day before the close of the financial year) was 399.75p. The highest and lowest mid-market share prices in the year ended 30 March 2007 were 449.75p and 299.50p respectively.

The L-TIP awards that vested during the year were those granted in July 2003. The market value of those shares on award was 113.5p per share. On the date of vesting, 15 June 2006, they had a market value of 306p per share, being the mid-market closing price on that day. The performance conditions attached to the award are described below.

All the L-TIP awards made to Directors to date have been 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 qualifying annual salary at the date of taking the award and the average of the mid-market closing price of the company's shares for the three business days preceding that date.

Subject to satisfaction of the performance criteria (see below) attached to the awards, the Directors may call for the release to them of the shares subject to the awards 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.

Performance measures attached to L-TIP awards

Performance targets set by the Committee for L-TIP awards have regard to market conditions and the need to ensure that they serve the purpose of motivating and retaining key staff.

Performance is judged over the period of three financial years from the start of the financial year in which the award is made. Performance is measured at the end of the period. There is no retesting of performance.

For L-TIP 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 was achieved, actual levels of vesting depended 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 group was selected 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). In the event they vested as to 99.4%.

For L-TIP awards made after 2003, half of each award vests 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 awards made in the current financial year.

For the half of the share awards for which vesting depends on comparative TSR performance a ranking immediately above the median level in the comparator table results in 25% of those shares vesting (with no vesting for ranking at or below median). A ranking in the top quartile results in 100% vesting. Rankings between these threshold levels result in proportionate vesting calculated on a straight-line basis between 25% and 100%. The comparator group of listed companies for the 2004, 2005 and, (apart from PHS Group in 2006) 2006 were:

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.

The comparator group was chosen after consultation with Inbucon, with a view to giving an appropriate range of support services providers against which to compare the company having regard to the nature of its and their businesses.

The comparator group for use in any awards made in 2007 is under review, but is likely to be substantially the same as the above, with the exception of PHS Group and Laing, but with the possible addition of one or more other companies after further consultation with Inbucon and the company's brokers.

For the half of the post 2003 L-TIP awards where vesting depends on earnings per share growth, 25% of the shares vest if that 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 is 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%.

It is policy that L-TIP awards are made only to 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 qualifying basic annual salary at the date of grant (subject to any adjustment that may be made to reflect the payment of employer's National Insurance).

Service contracts

The following tables set out a summary of the Directors' service contracts or terms of appointment:

Chairman and executive Directors

Name	Date of service contract	Unexpired term	Notice period
G A Campbell (Chairman)	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 (Group Chief Executive Officer)	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 (Group Financial Director)	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 Directors' service contracts is that they be capable of being terminated by the company on not more than 12 months' notice. The company reserves the right to terminate the 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 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 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).

Non-executive Directors

Name	Date of appointment as a Director	Date of current appointment letters	Expiry of present term of appointment*
Lord Hesketh	6 October 1993	28 April 2005 (as amended by letter dated 17 May 2007)	AGM for 2008
D J Shah	15 June 1999	28 April 2005 (as amended by letter dated 3 April 2007)	AGM for 2008
J L Rennocks	13 June 2002	28 April 2005	AGM for 2008
Sir Nigel Essenhigh	4 March 2003	28 April 2005 (as amended by letter dated 3 April 2007)	AGM for 2009
J N A Crookenden	1 December 2005	16 November 2005	AGM for 2008

*(subject in each case to extension by agreement and also to reappointment by the company in general meeting 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 or the Director. The latest 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 set out in their current written terms of appointment.

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 Chairman. Any fees for outside appointments are retained by the Director. Mr Tame, executive Director, is a non-executive Director of Carclo plc. During the period 1 April 2006 to 31 March 2007, his fees for this position were £25,000.

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

Dipesh Shah
Chairman of the Remuneration Committee
22 May 2007

Independent auditors' report to the members of Babcock International PLC

We have audited the group financial statements of Babcock International Group PLC for the year ended 31 March 2007 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 2007 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 also 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 Operating and financial review that is cross referred from the Business review section of the Directors' report.

In addition we 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 directors' 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 Combined Code (2003) 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 Directors' report, the Chairman's statement, the Operating and financial review and the 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 2007 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 2007

Group income statement
For the year ended 31 March 2007

	Note	2007 Before acquired intangible amortisation and exceptional items £m	2007 Acquired intangible amortisation and exceptional items £m	2007 Total £m	2006 Before acquired intangible amortisation and exceptional items £m	2006 Acquired intangible amortisation and exceptional items £m	Total £m
Revenue	2	988.3	–	988.3	836.7	–	836.7
Operating profit	2, 3, 5	68.3	(5.5)	62.8	49.9	(3.3)	46.6
Share of profit/(loss) from joint ventures	2	0.4	–	0.4	(0.1)	–	(0.1)
Operating profit including share of joint ventures		69.0	(5.5)	63.5	49.8	(3.3)	46.5
Joint venture share of interest		(0.2)	–	(0.2)	–	–	–
Joint venture share of tax		(0.1)	–	(0.1)	–	–	–
		68.7	(5.5)	63.2	49.8	(3.3)	46.5
Finance costs	6	(9.8)	–	(9.8)	(8.9)	–	(8.9)
Finance income	6	3.6	–	3.6	3.7	–	3.7
Profit before tax		62.5	(5.5)	57.0	44.6	(3.3)	41.3
Income tax expense	8	(12.6)	1.6	(11.0)	(9.2)	1.0	(8.2)
Profit for the year from continuing operations		49.9	(3.9)	46.0	35.4	(2.3)	33.1
Discontinued operations							
Loss for the year from discontinued operations	9	–	(0.8)	(0.8)	(0.6)	(2.6)	(3.2)
Profit for the year	4	49.9	(4.7)	45.2	34.8	(4.9)	29.9
Attributable to:							
Equity holders of the parent				43.4			29.7
Minority interest				1.8			0.2
				45.2			29.9
Earnings per share from continuing and discontinued operations	11						
– Basic				21.10p			14.49p
– Diluted				20.48p			14.15p
Earnings per share from continuing operations	11						
– Basic				21.49p			16.06p
– Diluted				20.85p			15.68p

The Group financial statements were approved by the Board of Directors on 22 May 2007 and are signed on its behalf by:

G A Campbell Director

W Tame Director

Group balance sheet

At 31 March 2007

	Note	2007 £m	2006 £m
Assets			
Non-current assets			
Goodwill	12	198.2	164.0
Other intangible assets	13	23.0	13.8
Property, plant and equipment	14	28.2	25.3
Investment in joint ventures	15	0.9	0.6
Other investments	15	9.4	–
Retirement benefits	27	62.5	64.9
Trade and other receivables	18	2.5	0.3
Deferred tax	16	2.5	4.5
		327.2	273.4
Current assets			
Inventories	17	57.7	41.5
Trade and other receivables	18	167.2	168.5
Income tax recoverable		1.2	0.2
Other financial assets	22	0.5	0.1
Cash and cash equivalents	19	95.6	109.0
		322.2	319.3
Assets held for sale	31	–	9.6
Total assets		649.4	602.3
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	24	125.8	125.5
Share premium		70.1	69.7
Other reserves		26.8	32.3
Retained earnings		(17.1)	(57.3)
		205.6	170.2
Minority interest		1.6	0.4
Total equity	26	207.2	170.6
Non-current liabilities			
Bank and other borrowings	21	3.6	6.5
Trade and other payables	20	0.9	–
Income tax payable		–	0.1
Deferred tax	16	2.5	–
Retirement liabilities	27	9.4	35.6
Provisions for other liabilities	23	7.6	12.6
		24.0	54.8
Current liabilities			
Trade and other payables	20	232.9	212.9
Income tax payable		5.9	7.0
Other financial liabilities	22	0.1	0.2
Bank and other borrowings	21	165.7	140.7
Provisions for other liabilities	23	13.6	12.3
		418.2	373.1
Liabilities held for sale	31	–	3.8
Total liabilities		442.2	431.7
Total equity and liabilities		649.4	602.3

Group cash flow statement

For the year ended 31 March 2007

	Note	2007 £m	2006 £m
Cash flows from operating activities			
Cash generated from operations	28	60.2	54.1
Income tax paid		(7.7)	(5.8)
Interest paid		(9.1)	(8.9)
Interest received		3.6	3.8
Net cash flows from operating activities		47.0	43.2
Cash flows from investing activities			
Disposal of subsidiaries	31	0.9	2.5
Proceeds on disposal of property, plant and equipment		0.7	0.9
Dividend received from joint ventures		0.1	–
Purchase of other investments		(9.7)	–
Purchases of property, plant and equipment		(5.5)	(6.8)
Purchases of intangible assets		(1.5)	(2.7)
Acquisition of subsidiaries net of cash acquired	31	(52.5)	(4.3)
Net cash flows from investing activities		(67.5)	(10.4)
Cash flows from financing activities			
Dividends paid		(13.6)	(9.0)
Finance lease principal payments		(1.9)	(3.6)
Bank loans raised/(repaid)		35.0	(22.5)
Dividends paid to minority interests		(0.4)	–
Net proceeds on issue of shares		0.7	0.9
Movement on own shares		0.3	–
Net cash flows from financing activities		20.1	(34.2)
Net decrease in cash, cash equivalents and bank overdrafts		(0.4)	(1.4)
Cash, cash equivalents and bank overdrafts at beginning of year		25.3	26.4
Effects of exchange rate fluctuations		(2.8)	0.3
Cash, cash equivalents and bank overdrafts at end of year	30	22.1	25.3

Group statement of recognised income and expense

For the year ended 31 March 2007

	Note	2007 £m	2006 £m
Profit for the year (including discontinued operations)		45.2	29.9
Currency translation differences		(5.9)	1.6
Fair value adjustment of interest rate swap		0.4	–
Net actuarial gains in respect of pensions	27	8.7	42.2
Tax on net actuarial gains in respect of pensions		(2.6)	(12.6)
Total recognised income and expense		45.8	61.1
Attributable to:			
Equity holders of the parent		44.2	60.8
Minority interest		1.6	0.3
		45.8	61.1

Notes to the group 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.

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 exceptional in size or nature, 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.

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.

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

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%

PPE 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.

Inventory and work in progress
Inventory is 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, whereby costs incurred to date as a percentage of total costs of completion represents the 'percentage cost of completion'.

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.

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.

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

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

(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)

Investments

The accounting for investments is decided on a case by case basis depending on whether the investment is held for resale or other strategic reasons.

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative is entered into and are subsequently remeasured 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.

Financial risk management

Financial instruments, in particular, forward currency contracts and interest rate 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 swaps, 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 counterparties as are investments of cash and cash equivalents. The group's revenue is derived mainly from government or government backed institutions or blue chip 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 note 12) and income tax recognition.

Profit recognition on contracts is a key judgement exercised by management on a contract by contract basis. In order to make such a judgement an estimate of contract outturn is made and for all significant contracts both local management and group review and challenge estimates made.

The group has disposed of a number of businesses in recent years. There are a number of disputes arising from these disposals, which results in a provision for settlement, the quantum of which is a judgemental issue.

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

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 2007 or later periods but which the group has not early adopted.

a) Standards, amendments and interpretations effective in 2006 with minimal or no impact on the group:

- IAS39 (Amendment), "The Fair Value Option".
- IAS1 (Amendment), "Net Investment in a Foreign Operation".
- IAS39 (Amendment), "Cash Flow Hedge Accounting of Forecast Intragroup Transactions".
- IAS39 and IFRS4 (Amendment), "Financial Guarantee Contracts".
- IFRS1 (Amendment), "First-time Adoption of International Financial Reporting Standards" and IFRS6 (Amendment), "Exploration for and Evaluation of Mineral Resources".
- IFRIC4, "Determining whether an Arrangement contains a Lease".
- IFRIC5, "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds".

b) New standards and interpretations to existing standards that are not yet effective and have not been early adopted by the group. The impact on the group's operations is currently being assessed:

- IFRIC10, "Interim Financial Reporting and Impairment" (effective for annual periods beginning on or after 1 November 2006). IFRIC10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The group will apply IFRIC10 from 1 April 2007.
- IFRIC11, "Group and Treasury Share Transactions". This IFRIC interpretation is effective for annual periods beginning on or after 1 March 2007.
- IFRIC12, "Service Concession Arrangements". This IFRIC interpretation is effective for annual periods beginning on or after 1 January 2008.
- IFRS7, "Financial Instruments: Disclosures", and the complementary Amendment to IAS1, "Presentation of Financial Statements – Capital Disclosures". The group will apply IFRS7 and the Amendment to IAS1 from 1 February 2007.
- IFRS8, "Operating Segments". This standard is effective for annual periods beginning on or after 1 January 2009. The group is currently evaluating the impact of this standard.
- IFRIC8, Scope of IFRS2 (effective for annual periods beginning on or after 1 May 2006). IFRIC8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS2. The group will apply IFRIC8 from 1 February 2007.

c) Interpretations to existing standards that are not yet effective and are not anticipated to be relevant for the group's operations:

- IFRIC7, "Applying the Restatement Approach under IAS29", Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006).
- IFRIC9, "Reassessment of Embedded Derivatives" (effective for annual periods beginning on or after 1 June 2006).

2. Segmental information

(a) Primary reporting format – business segments

	2007 Group revenue £m	2007 Operating profit before acquired intangible amortisation, exceptional items £m	2007 Acquired intangible amortisation and exceptional items £m	2007 Group operating profit £m	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
Continuing operations								
Defence Services	340.6	29.9	0.6	30.5	271.7	21.8	–	21.8
Technical Services	178.4	16.1	(1.5)	14.6	130.5	9.0	(0.2)	8.8
Engineering and Plant Services	165.6	13.3	–	13.3	144.2	9.7	–	9.7
Networks	74.9	6.8	(0.3)	6.5	73.0	6.4	(0.7)	5.7
Rail	228.8	9.3	(4.1)	5.2	217.3	8.8	(2.4)	6.4
Unallocated	–	(7.1)	(0.2)	(7.3)	–	(5.8)	–	(5.8)
Total continuing operations	988.3	68.3	(5.5)	62.8	836.7	49.9	(3.3)	46.6
Finance cost		(9.8)	–	(9.8)		(8.9)	–	(8.9)
Finance income		3.6	–	3.6		3.7	–	3.7
Share of post tax profit/(loss) from joint ventures (net of tax)		0.4	–	0.4		(0.1)	–	(0.1)
Profit before tax		62.5	(5.5)	57.0		44.6	(3.3)	41.3
Income tax		(12.6)	1.6	(11.0)		(9.2)	1.0	(8.2)
Profit for the year from continuing operations		49.9	(3.9)	46.0		35.4	(2.3)	33.1
Discontinued operations								
HS&E	–	–	–	–	7.5	(1.3)	(0.4)	(1.7)
Networks	–	–	–	–	20.5	0.3	(1.6)	(1.3)
Unallocated	–	–	(1.0)	(1.0)	–	–	(1.3)	(1.3)
Income tax	–	–	0.2	0.2	–	0.4	0.7	1.1
Total for the year from discontinued operations	–	–	(0.8)	(0.8)	28.0	(0.6)	(2.6)	(3.2)
Total for the year	988.3	49.9	(4.7)	45.2	864.7	34.8	(4.9)	29.9

Inter divisional sales are immaterial.

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

	2007				2006			
	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	1.8	0.2	(0.1)	0.1	1.3	0.1	–	0.1
Engineering and Plant Services	1.5	0.2	–	0.2	–	–	–	–
Networks	1.4	0.2	–	0.2	0.3	(0.1)	–	(0.1)
Rail	0.4	0.1	(0.2)	(0.1)	–	–	(0.1)	(0.1)
Total continuing operations	5.1	0.7	(0.3)	0.4	1.6	–	(0.1)	(0.1)

2. Segmental information (continued)

The segment assets and liabilities at 31 March 2007 and 31 March 2006 and capital expenditure for the years then ended are as follows:

	Assets		Liabilities		Capital expenditure	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Defence Services	171.2	153.1	60.4	46.4	0.3	0.3
Technical Services	62.0	40.5	53.8	70.5	0.5	0.1
Engineering and Plant Services	81.1	62.1	69.7	49.2	2.9	1.9
Networks	89.0	88.5	20.5	21.4	1.8	1.8
Rail	106.8	126.8	38.8	62.7	0.7	2.6
Unallocated	139.3	131.3	199.0	181.5	0.8	3.1
Group total	649.4	602.3	442.2	431.7	7.0	9.8

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 2007 and 31 March 2006 are as follows:

	Depreciation		Amortisation and impairment of intangible assets	
	2007 £m	2006 £m	2007 £m	2006 £m
Defence Services	0.4	0.4	1.5	–
Technical Services	0.9	0.9	2.0	0.2
Engineering and Plant Services	1.9	1.6	–	–
Networks	0.9	0.9	0.8	0.7
Rail	1.1	1.2	3.0	2.7
Unallocated	0.4	0.2	–	–
Total continuing operations	5.6	5.2	7.3	3.6
Discontinued operations	–	1.9	–	–
Group total	5.6	7.1	7.3	3.6

(b) Secondary reporting format – geographical segments

	Revenue		Assets		Capital expenditure	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
United Kingdom	821.3	692.0	466.7	414.7	3.3	4.8
Rest of Europe	0.9	0.5	1.3	1.0	–	–
Africa	159.8	138.3	79.1	59.6	2.8	1.7
North America	5.9	5.9	2.1	2.6	0.1	0.2
Rest of world	0.4	–	0.9	0.4	–	–
Unallocated	–	–	99.3	124.0	0.8	3.1
Group total	988.3	836.7	649.4	602.3	7.0	9.8

	2007 £m	2006 £m
Analysis of revenue by category		
Sales of goods	132.1	94.3
Sales of services	853.0	730.5
Rental income	3.2	11.9
	988.3	836.7

3. Operating expenses

	2007 £m	2006 £m
Continuing operations		
Cost of sales	858.3	728.6
Distribution expenses	7.0	0.8
Administrative expenses	60.2	60.7
	925.5	790.1

4. Profit for the year

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

	Continuing operations		Discontinued operations		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Employee costs (note 7)	314.2	268.6	–	10.4	314.2	279.0
Inventories						
– cost of inventories recognised as an expense	112.3	105.3	–	0.4	112.3	105.7
– increase in inventory provisions	1.2	1.4	–	–	1.2	1.4
Depreciation of property, plant and equipment (PPE)						
– owned assets	4.7	4.0	–	1.3	4.7	5.3
– under finance leases	0.9	1.2	–	0.6	0.9	1.8
	5.6	5.2	–	1.9	5.6	7.1
Amortisation of intangible assets						
– acquired intangibles	6.1	3.1	–	–	6.1	3.1
– software and development costs	1.2	0.5	–	–	1.2	0.5
	7.3	3.6	–	–	7.3	3.6
Impairment of other investments (note 15)	0.3	–	–	–	0.3	–
Impairment of PPE (note 14)	–	–	–	2.6	–	2.6
Loss on disposal of intangible assets	–	0.1	–	–	–	0.1
Loss on disposal of PPE	0.2	0.1	–	0.1	0.2	0.2
Operating lease rentals payable						
– property	8.1	7.0	0.3	0.9	8.4	7.9
– plant and machinery	4.8	5.8	–	0.2	4.8	6.0
– other	1.4	0.6	–	0.5	1.4	1.1
Research and development	–	0.2	–	–	–	0.2
Trade receivables impairment	0.3	0.5	–	–	0.3	0.5
Net foreign exchange losses	1.0	0.7	–	–	1.0	0.7

4. Profit for the year (continued)

Services provided by the group's auditor and network firms

During the year the group (including its overseas subsidiaries) obtained the following services from the group's auditor as detailed below:

	Total 2007 £m	Total 2006 £m
Audit fees:		
Fees payable to the group's auditor for the audit of the parent entity and the consolidated financial statements	0.3	0.3
Fees for other services:		
The auditing of accounts of subsidiaries of the company pursuant to legislation (including that of countries and territories outside Great Britain)	0.5	0.5
Tax	0.1	–
All other services	0.8	0.3
Total fees paid to the group's auditor and network firms	1.7	1.1

5. Operating exceptional items and acquired intangible amortisation

In 2007 there was a net gain of £0.6 million in operating exceptional items. There was a net £3.2 million exceptional pension gain, after costs, as a result of a liability limitation exercise of which £2.1 million is within the Defence Services segment, £0.4 million within the Technical Services segment, £0.3 million within the Networks segment and £0.4 million unallocated. Offset against this are operating exceptional costs of £2.6 million of which £2.0 million is reorganisation costs in the Rail segment and £0.6 million being bid defence costs arising out of a possible joint bid from BAE Systems plc and VT Group plc.

In 2007 acquired intangible amortisation was £6.1 million (2006: £3.1 million), with £0.6 million (2006: £0.7 million) relating to the Networks segment, £2.1 million (2006: £2.4 million) relating to the Rail segment, and with the Alstec Group Limited acquisition giving the following: £1.9 million (2006: £nil) within the Technical Services segment and £1.5 million (2006: £nil) within the Defence Services segment.

	2007 Acquired intangible amortisation £m	2007 Exceptional items £m	2007 Total £m	2006 Acquired intangible amortisation £m	2006 Exceptional items £m	2006 Total £m
Defence Services	(1.5)	2.1	0.6	–	–	–
Technical Services	(1.9)	0.4	(1.5)	–	–	–
Networks	(0.6)	0.3	(0.3)	(0.7)	–	(0.7)
Rail	(2.1)	(2.0)	(4.1)	(2.4)	(0.2)	(2.6)
Unallocated	–	(0.2)	(0.2)	–	–	–
	(6.1)	0.6	(5.5)	(3.1)	(0.2)	(3.3)

6. Net finance costs

	2007 £m	2006 £m
Finance costs		
Bank loans and overdrafts	7.9	7.9
Finance leases	0.3	0.5
Amortisation of issue costs of bank loan	0.2	0.2
Other	1.4	0.3
Total finance costs	9.8	8.9
Finance income		
Bank deposits	2.9	3.7
Other	0.7	–
Total finance income	3.6	3.7
Net finance costs	6.2	5.2

7. Employee costs

	Continuing operations		Discontinued operations		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Wages and salaries	279.3	236.0	–	8.9	279.3	244.9
Social security costs	26.0	21.3	–	1.4	26.0	22.7
Share-based payments (note 25)	1.7	1.1	–	–	1.7	1.1
Pension costs – defined contribution plans	9.0	7.4	–	0.1	9.0	7.5
Pensions costs – defined benefit plans (note 27)	(1.8)	2.8	–	–	(1.8)	2.8
	314.2	268.6	–	10.4	314.2	279.0

The redundancy costs and pension liability limitation exercise 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	
	2007 Number	2006 Number	2007 Number	2006 Number	2007 Number	2006 Number
Operations	8,199	7,279	–	293	8,199	7,572
Administration and management	1,444	1,112	–	79	1,444	1,191
	9,643	8,391	–	372	9,643	8,763

Emoluments of executive 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.

	2007 £m	2006 £m
Salaries and short-term employee benefits	4.4	3.9
Post-employment benefits	0.2	0.3
Share-based payments	1.4	0.9
	6.0	5.1

The key management figures given above include Directors.

8. Income tax expense

	2007 £m	2006 £m
Analysis of tax charge in the year		
Current tax		
– UK current year charge	7.5	4.9
– Overseas current year charge	6.7	3.7
– UK prior year credit	(0.5)	–
	13.7	8.6
Deferred tax		
– UK current year (credit)/charge	(0.6)	0.3
– Overseas credit	(1.6)	(0.7)
– UK prior year credit	(0.5)	–
	(2.7)	(0.4)
Total income tax expense – continuing operations	11.0	8.2

8. Income tax expense (continued)

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

	2007 £m	2006 £m
Profit before tax – continuing operations	57.0	41.3
Profit on ordinary activities multiplied by rate of corporation tax in the UK of 30% (2006: 30%)	17.1	12.4
Effects of:		
Expenses not deductible for tax purposes	1.3	0.6
Adjustments to tax in respect of prior period	(1.0)	–
Adjustments in respect of foreign tax rates	(6.2)	(4.8)
Utilisation of brought forward tax assets not previously recognised	(0.3)	–
Other	0.1	–
Total income tax expense – continuing operations	11.0	8.2

9. Discontinued operations

Eve Trakway Limited was sold of on 4 April 2006 at its held for sale value of £5.8 million after allowing for costs (see note 31).

In 2006 four businesses were treated as discontinued operations. 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) which was disposed of on 4 April 2006 and had been impaired to its fair value less costs to sell and was included as assets and liabilities held for sale.

	2007 £m	2006 £m
Financial performance of discontinued operations		
Revenue	–	28.0
Operating loss	–	(1.0)
Taxation	–	0.4
Net loss after tax	–	(0.6)
Exceptional items:		
Loss on disposal	–	(0.2)
Impairment to reflect disposal post year end	–	(1.8)
Costs on previously disposed of businesses	(1.0)	(1.3)
	(1.0)	(3.3)
Taxation	0.2	0.7
Exceptional loss	(0.8)	(2.6)
Total discontinued operations	(0.8)	(3.2)
Cash flows from discontinued operations		
Net cash flows from operating activities	–	(0.9)
Net cash flows from investing activities	–	0.7
Net cash flows from financing activities	–	(2.7)
	–	(2.9)

10. Dividends

	2007 £m	2006 £m
Final dividend for the year ended 31 March 2006 of 4.25p (2005: 2.65p) per 60p share	8.7	5.4
Interim dividend for the year ended 31 March 2007 of 2.40p (2006: 1.75p) per 60p share	4.9	3.6
	13.6	9.0

In addition, the Directors are proposing a final dividend in respect of the financial year ending 31 March 2007 of 5.65p (2006: 4.25p) per share which will absorb an estimated £11.7 million (2006: £8.7 million) of shareholders' equity. It will be paid on 6 August 2007 to shareholders who are on the register of members on 6 July 2007. 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

	2007 Number	2006 Number
Weighted average number of ordinary shares for the purpose of basic EPS	205,715,620	204,638,536
Effect of dilutive potential ordinary shares: share options	6,228,491	4,996,555
Weighted average number of ordinary shares for the purpose of diluted EPS	211,944,111	209,635,091

	2007 Earnings £m	2007 Basic per share Pence	2007 Diluted per share Pence	2006 Earnings £m	2006 Basic per share Pence	2006 Diluted per share Pence
Continuing and discontinued operations						
Earnings from continuing and discontinued operations	43.4	21.10	20.48	29.7	14.49	14.15
Add back:						
Amortisation of acquired intangible assets, net of tax	4.2	2.06	2.00	2.2	1.06	1.04
Exceptional items, net of tax	0.4	0.19	0.18	2.7	1.32	1.29
Earnings before amortisation and exceptionals	48.0	23.35	22.66	34.6	16.87	16.48
Continuing operations						
Earnings from continuing operations	44.2	21.49	20.85	32.9	16.06	15.68
Add back:						
Amortisation of acquired intangible assets, net of tax	4.2	2.06	2.00	2.2	1.06	1.04
Exceptional items, net of tax	(0.4)	(0.20)	(0.19)	0.1	0.06	0.06
Earnings before discontinued operations, amortisation and exceptionals	48.0	23.35	22.66	35.2	17.18	16.78

12. Goodwill

	2007 £m	2006 £m
Cost		
At 1 April	168.8	166.1
On acquisition of subsidiaries (note 31)	34.3	2.7
Exchange adjustments	(0.1)	–
At 31 March	203.0	168.8
Accumulated impairment		
At 1 April	4.8	4.8
Impairment charge	–	–
At 31 March	4.8	4.8
Net book value at 31 March	198.2	164.0

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 8% 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 8.5%. No reasonable change in the discount rate would give rise to an impairment.

12. Goodwill (continued)

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

	2007 £m	2006 £m
Defence Services	95.1	76.9
Technical Services	18.6	1.4
Engineering and Plant Services	1.1	1.2
Networks	52.8	53.9
Rail	30.6	30.6
	198.2	164.0
United Kingdom	197.1	162.8
Africa	0.2	0.2
North America	0.9	1.0
	198.2	164.0

13. Other intangible assets

	Acquired intangibles £m	Software £m	Development costs £m	Total £m
Cost				
At 1 April 2006	25.9	5.3	3.2	34.4
On acquisition of subsidiaries (note 31)	14.6	0.4	–	15.0
Additions	–	1.5	–	1.5
At 31 March 2007	40.5	7.2	3.2	50.9
Accumulated amortisation and impairment				
At 1 April 2006	16.3	1.3	3.0	20.6
Amortisation charge	6.1	1.1	0.1	7.3
At 31 March 2007	22.4	2.4	3.1	27.9
Net book value at 31 March 2007	18.1	4.8	0.1	23.0
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

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 2006	14.2	2.6	54.7	71.5
Exchange adjustments	–	–	(3.6)	(3.6)
On acquisition of subsidiaries (note 31)	0.7	–	4.9	5.6
Additions	–	0.3	5.2	5.5
Disposals	(0.1)	–	(2.9)	(3.0)
At 31 March 2007	14.8	2.9	58.3	76.0
Accumulated depreciation and impairment				
At 1 April 2006	10.3	0.8	35.1	46.2
Exchange adjustments	–	–	(1.5)	(1.5)
Charge for the year	0.3	0.3	5.0	5.6
Disposals	(0.1)	–	(2.4)	(2.5)
At 31 March 2007	10.5	1.1	36.2	47.8
Net book value at 31 March 2007	4.3	1.8	22.1	28.2
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

*Relates to business disposals.

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

	2007 £m	2006 £m
Cost	5.3	9.5
Aggregate depreciation and impairment	(2.3)	(2.2)
Net book value	3.0	7.3

15. Investment in joint ventures and other investments

	Joint ventures		Other investments		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
At 1 April						
– Net assets excluding goodwill	0.4	0.4	–	0.1	0.4	0.5
– Goodwill	0.2	0.2	–	–	0.2	0.2
	0.6	0.6	–	0.1	0.6	0.7
Additions	–	0.1	9.7	–	9.7	0.1
Disposals	(0.1)	–	–	(0.1)	(0.1)	(0.1)
Share of profits	0.4	(0.1)	–	–	0.4	(0.1)
Impairment of investment	–	–	(0.3)	–	(0.3)	–
At 31 March						
– Net assets excluding goodwill	0.7	0.4	9.4	–	10.1	0.4
– Goodwill	0.2	0.2	–	–	0.2	0.2
	0.9	0.6	9.4	–	10.3	0.6

On 25 January 2007 the group acquired a 24.5% holding in International Nuclear Solutions PLC for £9.7 million, including costs. On 4 April 2007 the group made an offer for the balance of the shares at 63p per share. At 31 March 2007 the carrying value of the investment was impaired to the fair market value, calculated using the market price from the London Stock Exchange on 30 March 2007.

Included within joint ventures are:

	Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
2007							
DynCorp-Hiberna Limited	United Kingdom	0.6	0.2	1.8	0.2	0.1	50%
FSP (2004) Limited	United Kingdom	4.2	4.2	0.4	0.1	(0.1)	50%
Babjeh Joint Venture	South Africa	1.4	1.2	1.5	0.2	0.2	50%
Other		2.3	2.2	1.4	0.2	0.2	
		8.5	7.8	5.1	0.7	0.4	

	Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
2006							
DynCorp-Hiberna Limited	United Kingdom	1.2	0.4	1.3	0.1	0.1	50%
FSP (2004) Limited	United Kingdom	1.6	1.7	–	–	(0.1)	50%
Other		0.1	0.2	0.3	(0.1)	(0.1)	
		2.9	2.3	1.6	–	(0.1)	

On 6 November 2006 the group acquired the remaining 50% of the shares in One Network Solutions Limited and therefore it is now accounted for as a wholly owned subsidiary. During the year the group entered into a new joint venture with Babjeh Joint Venture.

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

16. Deferred tax

	2007 £m	2006 £m
Deferred tax asset	2.5	4.5
Deferred tax liability	(2.5)	–
	–	4.5

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 2006	5.1	3.3	(8.9)	0.1	4.9	4.5
Income statement credit*	–	–	(1.7)	–	4.6	2.9
Tax charge to equity	–	–	(2.6)	–	2.1	(0.5)
Transfer to corporation tax	(0.8)	–	(2.8)	–	0.2	(3.4)
Acquisition of subsidiaries	0.6	–	–	–	(3.5)	(2.9)
Exchange differences	–	–	–	–	(0.6)	(0.6)
At 31 March 2007	4.9	3.3	(16.0)	0.1	7.7	–
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

*Includes deferred tax of £nil (2006: £0.3 million) in respect of discontinued operations.

The deferred tax asset in respect of 'other' includes an asset of £2.5 million in respect of the group's non-UK operations. This is disclosed separately in the group's balance sheet, as it cannot be offset against the net overall UK deferred tax liability of £2.5 million.

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

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2007 £m	2006 £m
Deferred tax asset	(13.5)	(13.4)
Deferred tax liability	16.0	8.9
	2.5	(4.5)

At the balance sheet date, the group has unused tax losses (excluding UK capital losses and advance corporation tax) of £52.8 million (2006: £71.0 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £0.3 million (2006: £0.3 million) of such losses. No deferred tax has been recognised in respect of the remaining £52.5 million (2006: £70.7 million) due to the unpredictability of future profit streams. Other losses may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £25 million (2006: £40 million). No liability has been recognised in respect of these differences because the group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

17. Inventories

	2007 £m	2006 £m
Raw materials	10.1	7.2
Work in progress and long-term contracts	9.4	8.8
Finished goods and goods for resale	38.2	25.5
Total	57.7	41.5

18. Trade and other receivables

	2007 £m	2006 £m
Current assets		
Trade receivables	65.1	54.0
Less: provision for impairment of receivables	(2.2)	(2.0)
Trade receivables – net	62.9	52.0
Amounts due from customers for contract work	73.9	85.4
Retentions	6.4	4.4
Amounts owed by related parties (note 35)	11.6	11.0
Other debtors	2.9	4.1
Prepayments and accrued income	9.5	11.6
	167.2	168.5
Non-current assets		
Other debtors	2.5	0.3

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

19. Cash and cash equivalents

	2007 £m	2006 £m
Cash at bank and in hand	95.6	95.7
Short term bank deposits (overnight)	–	13.3
	95.6	109.0

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

	2007	
	Total £m	Floating Rate £m
Currency		
Sterling	78.8	78.8
Euro	0.6	0.6
US Dollar	2.1	2.1
South African Rand	13.5	13.5
Swedish Krona	0.2	0.2
Other currencies	0.4	0.4
	95.6	95.6

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

	2007 £m	2006 £m
Current liabilities		
Amounts due to customers for contract work	99.5	94.7
Trade creditors	70.5	67.8
Amounts owed to related parties (note 35)	6.9	2.2
Other creditors	16.2	18.5
Other taxes and social security	15.8	10.3
Accruals and deferred income	24.0	19.4
	232.9	212.9
Non-current liabilities		
Other creditors	0.9	–

21. Bank and other borrowings

	2007 £m	2006 £m
Current liabilities		
Bank loans and overdrafts due within one year or on demand		
Unsecured	165.2	140.1
	165.2	140.1
Finance lease obligations (a)	0.5	0.6
	165.7	140.7
Non-current liabilities		
Bank loans		
Unsecured	1.1	1.8
	1.1	1.8
Finance lease obligations (a)	2.5	4.7
	3.6	6.5

(a) 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 interest rate swaps, details of which are included in note 22.

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

2007	Total £m	Floating rate £m	Fixed rate £m
Currency			
Sterling	167.0	164.6	2.4
South African Rand	0.3	0.3	–
Other	2.0	2.0	–
	169.3	166.9	2.4

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 finance 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 2007	165.7	3.1	0.5	169.3
As at 31 March 2006	140.7	5.8	0.7	147.2

21. Bank and other borrowings (continued)

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

	2007 %	2006 %
UK bank overdraft	6.3	5.5
UK bank borrowings	5.8	5.0
Other borrowings	14.7	14.6
Finance leases	5.0–6.0	5.0–9.0

Repayment details

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

	2007		2006	
	Bank loans and overdrafts £m	Finance lease obligations £m	Bank loans and overdrafts £m	Finance lease obligations £m
Within one year	165.2	0.5	140.1	0.6
Between one and two years	0.6	0.5	0.4	0.9
Between two and five years	0.5	1.5	1.3	3.2
Greater than five years	–	0.5	–	0.7
	166.3	3.0	141.8	5.4

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.

	2007 £m	2006 £m
Expiring in less than one year	26.4	24.6
Expiring in more than one year but not more than five years	99.0	84.2
	125.4	108.8

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

	2007 £m	2006 £m
Not later than one year	0.6	0.7
Later than one year but not more than five	2.3	4.7
More than five years	0.5	0.8
	3.4	6.2
Future finance charges on finance leases	(0.4)	(0.8)
Present value of finance lease liabilities	3.0	5.4

22. Financial instruments

Other financial assets and liabilities

	Fair value			
	Assets		Liabilities	
	2007 £m	2006 £m	2007 £m	2006 £m
Financial derivatives	0.1	0.1	0.1	0.2
Interest rate swaps	0.4	–	–	–
Total other financial assets and liabilities	0.5	0.1	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.

The group enters into interest rate swaps to hedge interest rate exposure.

Interest rate swaps

The notional principal amount of the outstanding interest rate swap contracts at 31 March 2007 was £50.0 million (2006: £30.0 million).

The group held the following interest rate swaps at 31 March 2007:

	Amount £m	Fixed %	Maturity
Unhedged			
SWAP	10.0	4.89	29/11/2007
Hedged			
SWAP	10.0	5.28	20/10/2009
SWAP	10.0	5.27	20/10/2009
SWAP	10.0	5.27	20/10/2009
SWAP	10.0	5.27	20/10/2009
	40.0		
Total interest rate SWAPS	50.0		

Fair value of financial assets and financial liabilities

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

	2007		2006	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Fair value of non-current borrowings				
Long-term borrowings	(3.6)	(3.2)	(6.5)	(5.7)
Fair value of other financial assets and financial liabilities				
Short-term borrowings	(165.7)	(165.7)	(140.7)	(140.7)
Trade and other payables	(233.8)	(233.8)	(212.9)	(212.9)
Trade and other receivables	169.7	169.7	168.5	168.5
Short-term deposits	–	–	13.3	13.3
Cash at bank and in hand	95.6	95.6	95.7	95.7
Other financial assets and liabilities	0.4	0.4	(0.1)	(0.1)
	(133.8)	(133.8)	(76.2)	(76.2)

Fair values of long-term borrowings are based on cash flows discounted using a rate of 5.5% (2006: 5.0%).

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 2006	2.7	6.3	9.0	6.9	24.9
On acquisition of subsidiaries	–	–	–	4.6	4.6
Charged to income statement	–	–	0.7	0.1	0.8
Utilised in year	(0.5)	(0.1)	(3.1)	(2.0)	(5.7)
Released in year	(1.1)	(0.7)	(0.6)	(0.8)	(3.2)
Exchange differences	–	–	(0.2)	–	(0.2)
At 31 March 2007	1.1	5.5	5.8	8.8	21.2

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

	2007 £m	2006 £m
Current	13.6	12.3
Non-current	7.6	12.6
	21.2	24.9

(a) Acquisition/deferred consideration relates primarily to contingent consideration for Turner & Partners.

(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 2006	306,219,012	1	183.7	–
Authorised during the year	–	–	–	–
At 31 March 2007	306,219,012	1	183.7	–
At 1 April 2005	306,219,012	1	183.7	–
Authorised during the year	–	–	–	–
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 2006	209,166,478	125.5
Allotted under share option schemes	575,341	0.3
At 31 March 2007	209,741,819	125.8
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

24. Share capital (continued)

Potential issues of ordinary shares

The table below shows options existing over the company's shares as at 31 March 2007. They represent outstanding options granted under all the company's Executive Share Option Schemes. Of the total number of shares shown, 2,499,924 are in respect of options granted by the trustees of the Babcock Employee Share Trust and 583,815 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 1,135,894 shares is in respect of options granted by the company to subscribe for newly issued shares. Subsequent to the year end the group made an equity placement of 19 million shares (refer to note 36).

Grant date	Exercise price Pence	Exercise period	2007 Number	2006 Number
20 July 1998	89.00	20/07/2001 – 19/07/2008	30,000	30,000
08 July 1999	122.50	08/07/2002 – 07/07/2009	–	60,625
09 September 1999	118.00	09/09/2002 – 08/09/2009	11,800	22,100
23 June 2000	96.33	23/06/2003 – 22/06/2010	–	46,664
22 November 2000	123.00	22/11/2003 – 21/11/2010	560,975	560,975
25 June 2001	99.33	25/06/2004 – 24/06/2011	311,697	386,377
31 January 2002	104.33	31/01/2005 – 30/01/2012	170,229	170,229
20 February 2002	104.00	20/02/2005 – 19/02/2012	–	134,615
24 June 2002	124.50	24/06/2005 – 23/06/2012	1,320,748	1,593,157
27 November 2002	106.33	27/11/2005 – 26/11/2012	43,152	120,000
30 June 2003	115.60	30/06/2006 – 29/06/2013	429,717	737,511
06 July 2004	126.00	06/07/2007 – 05/07/2014	1,341,315	1,518,610
			4,219,633	5,380,863

Options granted to Directors are summarised in the Remuneration report on pages 32 to 38 and are included in the outstanding options set out above.

A reconciliation of option movements is shown below:

	2007 Number '000	2007 Weighted average exercise price	2006 Number '000	2006 Weighted average exercise price
Outstanding at 1 April	5,381	£1.20	6,371	£1.18
Granted	–	–	–	–
Forfeited/lapsed	(257)	£1.21	(92)	£1.19
Exercised	(904)	£1.14	(898)	£1.08
Expired	–	–	–	–
Outstanding at 31 March	4,220	£1.21	5,381	£1.20
Exercisable at 31 March	2,878	£1.18	3,124	£1.18

Weighted average share price for options exercised during the year was 358.1p per share (2006: 191.0p per share).

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 £1.7 million (2006: £1.1 million) all of which related to equity settled share-based payment transactions.

After tax, the income statement charge was £1.2 million (2006: £0.8 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
Share price at grant or modification date (pence)	136.0	136.0	126.0
Exercise price (pence)	126.0	126.0	126.0
Vesting period (years)	2.12	2.12	3.00
Expected volatility	27%	27%	28%
Option life (years)	9.12	9.12	10.00
Expected life (years)	5.40	5.40	6.70
Risk free rate	4.3%	4.3%	5.2%
Expected dividends expressed as dividend yield	2.8%	2.8%	2.8%
Possibility of ceasing employment before vesting	0%	0%	0%
Expectations of meeting performance criteria	50%	n/a	n/a
Fair value per option (pence)	33.5	23.5	24.6
Correlation	n/a	6%	6%

L-TIPS

Grant or modification date	2006 TSR 24/7/2006	2006 EPS 24/7/2006	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
Share price at grant or modification date (pence)	338.5	338.5	169.5	169.5	136.0	136.0	136.0	126.0
Exercise price (pence)	–	–	–	–	–	–	–	–
Vesting period (years)	3.0	3.0	3.0	3.0	2.12	2.12	2.12	3.0
Expected volatility	25%	25%	25%	25%	27%	27%	27%	28%
Option life (years)	10.0	10.0	10.0	10.0	9.12	9.12	9.12	10.0
Expected life (years)	3.0	3.0	3.0	3.0	2.12	2.12	2.12	3.0
Expected dividends expressed as dividend yield	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%
Expectations of meeting performance criteria	n/a	40%	n/a	100%	n/a	100%	n/a	n/a
Fair value per option (pence)	276.0	311.0	108.9	155.7	62.1	128.5	64.9	67.3
Correlation	15%	n/a	9%	n/a	9%	n/a	6%	6%

The number of L-TIP's awarded in 2006 were 551,405, 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 £m	Share premium £m	Capital redemption £m	Retained earnings £m	Other reserves £m	Total £m	Minority interests £m	Year ended 31 March £m
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
At 31 March 2006	125.5	69.7	30.6	(57.3)	1.7	170.2	0.4	170.6
At 1 April 2006	125.5	69.7	30.6	(57.3)	1.7	170.2	0.4	170.6
Shares issued in the period	0.3	0.4	–	–	–	0.7	–	0.7
Total recognised income and expense	–	–	–	49.7	(5.5)	44.2	1.6	45.8
Dividends	–	–	–	(13.6)	–	(13.6)	(0.4)	(14.0)
Share-based payments	–	–	–	1.7	–	1.7	–	1.7
Tax on shared-based payments	–	–	–	2.1	–	2.1	–	2.1
Movement on ESOP	–	–	–	0.3	–	0.3	–	0.3
Net movement in equity	0.3	0.4	–	40.2	(5.5)	35.4	1.2	36.6
Equity at 31 March 2007	125.8	70.1	30.6	(17.1)	(3.8)	205.6	1.6	207.2

Other reserves include a translation reserve of £4.2 million debit (2006: £1.7 million) and a hedging reserve of £0.4 million (2006: £nil)

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 2007 557,729 shares (2006: 87,161 shares) were disposed by the Trusts resulting from options exercised. At 31 March 2007, the Trusts held between them a total of 3,552,189 (2006: 4,109,918) ordinary shares at a total market value of £14,208,756 (2006: £13,090,089) representing 1.69% (2006: 1.96%) of the issued share capital at that date. The company elected to pay dividends to the Babcock Employee Share 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:

	2007 £m	2006 £m
Defined contribution schemes	9.0	7.5

Defined benefit schemes

Balance sheet assets and liabilities recognised are as follows:

	2007 £m	2006 £m
Retirement benefits – funds in surplus	62.5	64.9
Retirement benefits – funds in deficit	(9.4)	(35.6)
	53.1	29.3

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

	Babcock International Group Scheme	Rosyth Royal Dockyard Scheme	First Engineering Scheme	Alstec Pension Fund
Date of last formal actuarial valuation	01/04/04	31/03/03	31/12/04	01/04/05
Number of active members at 31 March 2007	434	1,110	637	356
Actuarial valuation method	Projected unit	Projected unit	Attained age	Defined accrued benefit
Results of formal actuarial valuation:				
Value of assets	£404.8m	£355.1m	£121.4m	£31.9m
Level of funding	114%	107%	96%	91%
Principal valuation assumptions:				
Excess of investment returns over earnings increases	1%–2.5%	1.5%	(0.5%)–1.75%	4.45%
Excess of investment returns over pension increases	2.5%–4%	3%	1.75%–1.95%	2.9%

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, the First Engineering Scheme is 20.1% and the Alstec Pension Fund is 12%.

The Babcock Holdings (USA) Inc Pension Plan is 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 2007.

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.

During the year the Unicorn Pension Scheme was transferred to the Babcock International Group Scheme.

27. Retirement benefits and liabilities (continued)

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 %	Alstec Pension Fund %	Other Schemes (weighted average) %
2007					
Rate of increase in pensionable salaries	4.0	3.5	4.0	3.0	–
Rate of increase in pensions	2.5	3.0	3.0	2.5	–
Discount rate	5.4	5.4	5.4	5.4	5.9
Inflation rate	3.0	3.0	3.0	3.0	3.0
Expected return on plan assets	6.0	7.0	7.5	6.8	8.0
Total life expectancy – future pensioners (years)	82	83	82	84	–
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
Total life expectancy – future pensioners (years)	82	82	82	–	–

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 Alstec 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		Alstec Pension Fund		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
2007											
Equities	–	–	8.0	237.9	8.0	110.4	8.0	22.9	8.0	30.0	401.2
Property	–	–	7.5	78.4	7.5	16.8	–	–	7.5	7.5	102.7
Conventional gilts	–	–	4.8	82.1	–	–	4.8	4.0	4.8	16.3	102.4
Bonds – corporate	–	–	5.5	59.3	–	–	5.5	16.0	5.5	5.5	80.8
Bonds – government	–	–	–	–	4.8	25.5	–	–	4.8	0.7	26.2
Liability matching bonds	6.4	466.3	–	–	6.4	16.9	–	–	–	–	483.2
Cash	–	–	5.3	3.1	5.3	0.2	5.3	0.2	5.3	0.9	4.4
Fair value of assets		466.3		460.8		169.8		43.1		60.9	1,200.9
Present value of funded obligation		(429.1)		(469.6)		(145.4)		(42.2)		(61.5)	(1,147.8)
Net assets/(liabilities) recognised in the balance sheet		37.2		(8.8)		24.4		0.9		(0.6)	53.1

27. Retirement benefits and liabilities (continued)

	Babcock International Group Scheme		Rosyth Royal Dockyard Scheme		First Engineering Scheme		Alstec Pension Fund		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 of 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

The amounts recognised in the income statement are as follows

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Alstec Pension Fund £m	Other Schemes £m	Total £m
2007						
Current service cost	(3.5)	(5.4)	(2.5)	(3.6)	–	(15.0)
Interest on obligation	(21.6)	(23.7)	(4.1)	(1.9)	(0.3)	(51.6)
Expected return on plan assets	29.0	29.8	6.9	2.3	0.5	68.5
Settlement gains	2.6	–	–	–	–	2.6
Curtailment gain	1.2	–	–	–	–	1.2
Settlement gains/(losses) arising on the merging of schemes	(2.1)	–	–	–	2.1	–
Total included within operating profit	5.6	0.7	0.3	(3.2)	2.3	5.7
2006						
Current service cost	(3.6)	(5.9)	(2.8)	–	(0.4)	(12.7)
Interest on obligation	(19.9)	(23.0)	(4.3)	–	(2.5)	(49.7)
Expected return on plan assets	24.0	26.5	6.3	–	2.8	59.6
Curtailments gain	–	1.3	–	–	–	1.3
Settlement gains/(losses) arising on the merging of schemes	3.8	–	–	–	(3.8)	–
Total included within operating profit	4.3	(1.1)	(0.8)	–	(3.9)	(1.5)

27. Retirement benefits and liabilities (continued)

Amounts recorded in statement of recognised income and expense

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Alstec Pension Fund £m	Other Schemes £m	Total £m
At 1 April 2006						
Actual return less expected return on pension scheme assets	(30.6)	3.8	9.0	–	8.3	(9.5)
Experience losses arising on scheme liabilities	(0.6)	(2.3)	(9.9)	(0.2)	(0.1)	(13.1)
Change in assumptions relating to present value of scheme liabilities	9.7	18.3	9.6	1.3	(7.6)	31.3
At 31 March 2007	(21.5)	19.8	8.7	1.1	0.6	8.7
At 1 April 2005						
Actual return less expected return on pension scheme assets	25.5	53.2	26.3	–	16.3	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)	–	(12.7)	(57.0)
At 31 March 2006	13.9	19.2	5.5	–	3.6	42.2
Cumulative recognised income and expense at 31 March 2007	(22.7)	26.5	13.9	1.1	(2.7)	16.1
Cumulative recognised income and expense at 31 March 2006	(1.2)	6.7	5.2	–	(3.3)	7.4

The effect of the A-day changes taken through the Statement of recognised income and expense in the year ended 31 March 2007 is a net reduction in liabilities of £7.4 million.

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	Alstec Pension Fund £m	Other Schemes £m	Total £m
Fair value of plan assets						
At 1 April 2006	485.5	441.7	155.8	–	60.9	1,143.9
Acquisition of subsidiaries	–	–	–	39.3	–	39.3
Assets distributed on settlements	8.1	–	–	–	(8.1)	–
Expected return	29.0	29.8	6.9	2.3	0.5	68.5
Actuarial gain/(loss)	(30.6)	3.8	9.0	–	8.3	(9.5)
Employer contributions	0.9	2.5	2.7	3.0	0.2	9.3
Employee contributions	0.7	0.4	1.0	–	0.4	2.5
Benefits paid	(27.3)	(17.4)	(5.6)	(1.5)	(1.1)	(52.9)
Exchange differences	–	–	–	–	(0.2)	(0.2)
At 31 March 2007	466.3	460.8	169.8	43.1	60.9	1200.9
Present value of benefit obligations						
At 1 April 2006	433.3	473.5	143.1	–	64.7	1,114.6
Acquisition of subsidiaries	–	–	–	39.3	–	39.3
Liabilities extinguished on settlements	10.2	–	–	–	(10.2)	–
Service cost	3.5	5.4	2.5	3.6	–	15.0
Interest cost	21.6	23.7	4.1	1.9	0.3	51.6
Employee contributions	0.7	0.4	1.0	–	0.4	2.5
Actuarial (gain)/loss	(9.1)	(16.0)	0.3	(1.1)	7.7	(18.2)
Settlement gains	(2.6)	–	–	–	–	(2.6)
Curtailment gain	(1.2)	–	–	–	–	(1.2)
Benefits paid	(27.3)	(17.4)	(5.6)	(1.5)	(1.1)	(52.9)
Exchange differences	–	–	–	–	(0.3)	(0.3)
At 31 March 2007	429.1	469.6	145.4	42.2	61.5	1147.8
Net surplus/(deficit) at 31 March 2007	37.2	(8.8)	24.4	0.9	(0.6)	53.1

27. Retirement benefits and liabilities (continued)

Analysis of movement in the balance sheet (continued)

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Alstec Pension Fund £m	Other Schemes £m	Total £m
Fair value of plan assets						
At 1 April 2005	406.8	375.6	123.8	–	91.7	997.9
Assets distributed on settlements	48.3	–	–	–	(48.3)	–
Expected return	24.0	26.5	6.3	–	2.8	59.6
Actuarial gain	25.5	53.2	26.3	–	16.3	121.3
Employer contributions	4.1	2.6	2.1	–	0.3	9.1
Employee contributions	0.6	0.5	1.0	–	0.1	2.2
Benefits paid	(23.8)	(16.8)	(3.7)	–	(2.0)	(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	–	95.4	1,018.2
Liabilities extinguished on settlements	44.5	–	–	–	(44.5)	–
Service cost	3.6	5.9	2.8	–	0.4	12.7
Interest cost	19.9	23.0	4.3	–	2.5	49.7
Employee contributions	0.6	0.5	1.0	–	0.1	2.2
Actuarial loss	11.6	34.0	20.8	–	12.7	79.1
Curtailment gain	–	(1.3)	–	–	–	(1.3)
Benefits paid	(23.8)	(16.8)	(3.7)	–	(2.0)	(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

27. Retirement benefits and liabilities (continued)

Analysis of movement in the balance sheet (continued)

	Babcock International Group Scheme £m	Rosyth Royal Dockyard Scheme £m	First Engineering Scheme £m	Alstec Pension Fund £m	Other Schemes £m	Total £m
Fair value of plan assets						
At 1 April 2004	401.7	344.5	–	–	45.6	791.8
Acquisition of subsidiary	–	–	114.2	–	43.3	157.5
Expected return	22.3	24.8	6.8	–	2.7	56.6
Actuarial gain	3.7	19.6	7.6	–	1.9	32.8
Employer contributions	–	2.6	1.1	–	0.5	4.2
Employee contributions	0.7	0.6	0.8	–	0.1	2.2
Benefits paid	(21.6)	(16.5)	(6.6)	–	(2.4)	(47.1)
Exchange differences/other	–	–	(0.1)	–	–	(0.1)
At 31 March 2005	406.8	375.6	123.8	–	91.7	997.9
Present value of plan obligations						
At April 2004	356.3	390.2	–	–	43.4	789.9
Acquisition of subsidiary	–	–	108.7	–	42.8	151.5
Service cost	3.3	6.1	2.2	–	0.4	12.0
Interest cost	19.3	21.4	4.8	–	2.3	47.8
Employee contributions	0.7	0.6	0.8	–	0.1	2.2
Actuarial loss	18.8	32.1	7.9	–	8.8	67.6
Curtailment gain	–	(5.6)	–	–	–	(5.6)
Benefits paid	(21.6)	(16.5)	(6.6)	–	(2.4)	(47.1)
Exchange differences/other	(0.1)	(0.1)	0.1	–	–	(0.1)
At 31 March 2005	376.7	428.2	117.9	–	95.4	1,018.2
Net surplus/(deficit) at 31 March 2005	30.1	(52.6)	5.9	–	(3.7)	(20.3)

Actual return on plan assets						
Year ending 31 March 2007	**(1.6)**	**33.6**	**15.9**	**2.3**	**8.8**	**59.0**
Year ending 31 March 2006	49.5	79.7	32.6	–	19.1	180.9
Year ending 31 March 2005	26.0	44.4	14.4	–	4.6	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	Alstec Pension Fund £m	Other Schemes £m	Total £m
March 2007						
Difference between the expected and actual return on scheme assets	(30.6)	3.8	9.0	–	8.3	(9.5)
Percentage of scheme assets at 31 March 2007	(7%)	1%	5%	–	14%	(1%)
Experience losses of scheme liabilities	(0.6)	(2.3)	(9.9)	(0.2)	(0.1)	(13.1)
Percentage of present value of scheme liabilities at 31 March 2007	0%	0%	7%	0%	0%	1%
Total amount recognised in Statement of recognised income and expense	(21.5)	19.8	8.7	1.1	0.6	8.7
Percentage of present value of scheme liabilities at 31 March 2007	(5%)	4%	6%	3%	1%	1%
March 2006						
Difference between the expected and actual return on scheme assets	25.5	53.2	26.3	–	16.3	121.3
Percentage of scheme assets at 31 March 2006	5%	12%	17%	–	27%	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 recognised income and expense	13.9	19.2	5.5	–	3.6	42.2
Percentage of present value of scheme liabilities at 31 March 2006	3%	4%	4%	–	6%	4%
March 2005						
Difference between the expected and actual return on scheme assets	3.7	19.6	7.6	–	1.9	32.8
Percentage of scheme assets at 31 March 2005	1%	5%	6%	–	2%	3%
Experience 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 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

	2007 £m	2006 £m
Cash flows from operating activities		
Operating profit	62.8	46.6
Loss from discontinued operations	–	(0.6)
Add back tax on discontinued operations	–	(0.4)
	62.8	45.6
Depreciation of property, plant and equipment	5.6	7.1
Amortisation and impairment of intangible assets	7.3	3.6
Equity share-based payments	1.7	1.1
Impairment of investments	0.3	–
(Profit)/loss on disposal of property, plant and equipment	(0.2)	0.3
Operating cash flows before movement in working capital	77.5	57.7
(Increase)/decrease in inventories	(16.9)	1.5
(Increase)/decrease in receivables	(5.7)	52.8
Increase/(decrease) in payables	10.0	(49.2)
Decrease in provisions	(4.7)	(8.7)
Cash generated from operations	60.2	54.1

29. Movement in net debt

	2007 £m	2006 £m
Decrease in cash in the year	(0.4)	(1.4)
Cash flow from the (increase)/decrease in debt and lease financing	(33.1)	26.1
Change in net funds resulting from cash flows	(33.5)	24.7
Loans and finance leases disposed of with subsidiaries	–	0.1
New finance leases	–	(0.4)
Foreign currency translation differences	(2.0)	0.3
Movement in net debt in the year	(35.5)	24.7
Net debt at the beginning of the year	(38.2)	(62.9)
Net debt at the end of the year	(73.7)	(38.2)

30. Changes in net debt

	At 1 April 2006 £m	Cash flow £m	Acquisitions and disposals £m	New finance leases £m	Exchange movement £m	At 31 March 2007 £m
Cash and bank balances	109.0	(10.5)	-	–	(2.9)	95.6
Bank overdrafts	(83.7)	10.1	–	–	0.1	(73.5)
Cash, cash equivalents and bank overdrafts at end of year	25.3	(0.4)	–	–	(2.8)	22.1
Debt	(58.1)	(35.0)	–	–	0.4	(92.7)
Finance leases	(5.4)	1.9	–	–	0.4	(3.1)
	(63.5)	(33.1)	–	–	0.8	(95.8)
Total	(38.2)	(33.5)	–	–	(2.0)	(73.7)

31. Acquisitions and disposals

(a) Acquisitions

On 9 May 2006 the group acquired Alstec Group Limited for net cash consideration before costs of £44.9 million. Goodwill amounted to £35.4 million after valuing the acquired intangibles at £14.6 million. The goodwill arises from the experience and knowledge of the workforce and the market position of the entity.

On 1 June 2006 the group acquired certain assets and the high voltage power lines and mobile telecoms business divisions of ABB South Africa (Pty) Ltd for £5.8 million.

On 6 November 2006 the group acquired the remaining 50% interest in its joint venture One Network Solutions Limited for net cash consideration of £0.2 million

	Book value of assets acquired £m	Fair value adjustments £m	Fair value acquired in current period £m	Acquired in prior period £m	Total £m
Non-current assets					
– Goodwill	43.3	(7.9)	35.4	(1.1)	34.3
– Other intangible assets	–	15.0	15.0	–	15.0
– Property, plant and equipment	2.4	3.2	5.6	–	5.6
– Deferred tax	1.5	(4.4)	(2.9)	–	(2.9)
Cash and cash equivalents	6.6	–	6.6	–	6.6
Current assets	20.8	0.3	21.1	–	21.1
Current liabilities	(20.4)	(1.8)	(22.2)	1.6	(20.6)
Net assets acquired (at book and fair value)	54.2	4.4	58.6	0.5	59.1
Cash and cash equivalents in subsidiary acquired			(6.6)	–	(6.6)
Cash outflow from acquisitions			52.0	0.5	52.5

The revenue and operating profit of acquired businesses since the date of acquisition and as if they had been acquired on 1 April 2006 are:

	Since date of acquisition £m	For full year £m
Revenue	101.8	112.5
Operating profit	9.5	10.1

(b) Disposals

	Disposed in current period £m	Disposed in prior period £m	Total £m
Current liabilities	–	(2.7)	(2.7)
Net assets held for sale	5.9	–	5.9
Net assets disposed	5.9	(2.7)	3.2
Profit/(loss) on disposal	–	–	–
Net consideration	5.9	(2.7)	3.2
Deferred consideration	(2.3)	–	(2.3)
Net cash flow	3.6	(2.7)	0.9

32. Operating lease commitments – minimum lease payments

	2007		2006	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Commitments under non-cancellable operating leases payable:				
Within one year	8.0	5.8	6.8	5.6
Later than one year and less than five years	26.6	4.9	22.0	4.8
After five years	32.8	–	43.1	–
	67.4	10.7	71.9	10.4

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.

d. There is a potential liability in respect of the discontinued Jackson Civil Engineering business of the Peterhouse Group arising out of a contract with Tesco Stores for tunnelling works at its Gerrards Cross site. The contract was made and the business disposed of to management before the group acquired Peterhouse in 2004. There was a partial tunnel collapse during construction in 2005. Having considered legal advice the Board does not believe that this matter will result in a liability that would be material to the group.

34. Capital and other financial commitments

	2007 £m	2006 £m
Contracts placed for future capital expenditure not provided in the financial statements	–	–

35. Related party transactions

(a) The following related parties either sell to or receive services from the group. In addition British Nuclear Fuels PLC and United Kingdom Atomic Energy Authority have had a common director, with Babcock International Group PLC during the year.

	2007 Sales to £	2007 Purchases from £	2007 Year end debtor balance £	2007 Year end creditor balance £
Joint venture and alliances				
Debut Services Ltd	87,320,000	–	–	–
DynCorp-Hiberna Ltd	11,000	–	–	–
One Network Solutions Ltd	–	66,000	–	–
Energy alliance	2,744,000	–	2,744,000	–
First Swietelsky Operation and Maintenance	5,806,000	–	1,670,000	–
First Swietelsky Joint Venture High Output	35,344,000	13,836,000	6,946,000	6,946,000
Related by common directorships				
British Nuclear Fuels PLC	1,617,000	137,000	4,000	–
United Kingdom Atomic Energy Authority	5,575,000	2,000	267,000	–
			11,631,000	6,946,000

	2006 Sales to £	2006 Purchases from £	2006 Year end debtor balance £	2006 Year end creditor balance £
Joint venture and alliances				
Debut Services Ltd	101,172,000	–	595,000	–
DynCorp-Hiberna Ltd	220,000	–	36,000	–
One Network Solutions Ltd	162,000	240,000	69,000	–
First Swietelsky Operation and Maintenance	6,250,000	–	1,385,000	–
First Swietelsky Joint Venture High Output	26,656,000	10,792,000	8,531,000	2,149,000
Related by common directorships				
Other	1,590,000	814,000	361,000	58,000
			10,977,000	2,207,000

All transactions noted above arise in the normal course of business.

(b) 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 66.

(c) Defined benefit pension schemes
Please refer to note 27 for transactions with the group defined benefit pension schemes.

36. Post balance sheet events

(a) International Nuclear Solutions plc
On 4 April 2007 the group made an offer for the remaining shares in International Nuclear Solutions plc.

(b) Devonport Management Limited
On 10 May 2007 the group agreed to buy Devonport Management Ltd for £350 million subject to shareholder approval.

(c) Equity placing
On 10 May 2007 the group made an equity placing of 19 million shares at 475p per share raising £90 million of equity before costs.

(d) Dividend
Details on dividends are given in note 10. There are no further material events subsequent to 31 March 2007 that require disclosure.

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 2007 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 2007.

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 also 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 Operating and financial review section of the Directors' report.

In addition we 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 Directors' report, the unaudited part of the Directors' Remuneration report, the Chairman's statement, the Operating and financial review and the Corporate governance statement. 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 2007;
- 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 2007

Company balance sheet

At 31 March 2007

	Note	2007 £m	2006 £m
Fixed assets			
Investment in subsidiary undertakings	3	367.7	308.0
Property, plant and equipment	4	0.3	0.4
		368.0	308.4
Current assets			
Debtors	5	9.3	42.5
Cash and bank balances		–	3.6
		9.3	46.1
Creditors – amounts due within one year	6	128.7	90.4
Net current liabilities		(119.4)	(44.3)
Total assets less current liabilities		248.6	264.1
Provisions for liabilities and charges	7	0.5	2.4
Creditors – amounts due after one year		5.0	–
Net assets		243.1	261.7
Capital and reserves			
Called up share capital	8	125.8	125.5
Share premium account	9	70.1	69.7
Capital redemption reserve	9	30.6	30.6
Profit and loss account	9	16.6	35.9
Shareholders' funds – equity interests		243.1	261.7

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 2007 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. Full details of the share-based compensation plans are disclosed in note 25 of the group financial statements.

(b) Treasury shares
The shares 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 counterparties 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.

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 loss for the financial year is £7.7 million (2006: profit £7.5 million).

Audit fees and expenses paid to the company's auditors was £0.1 million (2006: £0.1 million).

3. Investment in subsidiary undertakings

	2007 £m	2006 £m
Investment in shares	367.7	308.0

4. Property, plant and equipment

	Leasehold Property £m
Cost	
At 1 April 2006 and at 31 March 2007	0.4
Accumulated amortisation	
At 1 April 2006	–
Charge for the year	0.1
At 31 March 2007	0.1
Net book value at 31 March 2007	0.3
Net book value at 31 March 2006	0.4

5. Debtors

	2007 £m	2006 £m
Due within one year		
Trade debtors	0.3	0.3
Amounts owed by subsidiary undertakings	8.0	40.9
Prepayments and accrued income	1.0	1.3
	9.3	42.5

6. Creditors

	2007 £m	2006 £m
Bank loans and overdrafts	91.5	56.0
Trade creditors	–	0.1
Amounts owed to subsidiary undertakings	36.4	34.2
Other creditors	0.1	0.1
Accruals and deferred income	0.7	–
	128.7	90.4

The company has £200 million of Sterling bank facilities of which £91 million (2006: £56 million) was drawn at the year end. The interest rate applying is 5.3% (2006: 5%) and is linked to LIBOR.

7. Provisions

	2007 £m	2006 £m
Contingent consideration on acquisitions	0.5	2.4

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 2006 and at 31 March 2007	306,219,012	1	183.7	–

	Ordinary share of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2006	209,166,478	125.5
Allotted under share option schemes	575,341	0.3
At 31 March 2007	209,741,819	125.8

9. Reserves

	Share premium account	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2006	69.7	30.6	35.9
Shares issue in the period	0.4	–	
Share-based payments	–	–	1.7
Movement on ESOP	–	–	0.3
Retained profit for the year– loss for the year	–	–	(7.7)
– dividends	–	–	(13.6)
At 31 March 2007	70.1	30.6	16.6

10. Operating lease commitments

The company has an operating lease commitment for land and buildings as at 31 March 2007 with an annual commitment expiring after more than five years of £2.2 million (2006: £2.2 million).

11. Contingent liabilities

a. The company has guaranteed or has joint and several liability for bank facilities of £223.5 million (2006: £180.3 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 2007 these amounted to £22.8 million (2006: £27.7 million), of which the company had counter-indemnified £15.7 million (2006: £21.0 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

(a) International Nuclear Solutions plc
On 4 April 2007 the company made an offer for the remaining shares in International Nuclear Solutions plc.

(b) Devonport Management Limited
On 10 May 2007 the company agreed to buy Devonport Management Ltd for £350 million subject to shareholder approval.

(c) Equity placing
On 10 May 2007 the company made an equity placing of 19 million shares at 475p per share raising £90 million of equity before costs.

(d) Disclosure
There are no further material events subsequent to 31 March 2007 that require disclosure.

(e) Dividends
A dividend of 5.65p per 60p ordinary share (2006: 4.25p per 60p ordinary share) was declared after the balance sheet date and will be paid on 6 August 2007 to shareholders registered on 7 July 2007.

Principal subsidiary, joint venture and associated undertakings

Defence Services

Babcock Naval Services Limited
Air Power International Limited
Babcock Support Services Limited
Debut Services (SW) Limited
Acetech Personnel Limited
Alstec Group Limited

Technical Services

Babcock Design & Technology Limited
Babcock Support Services Limited
Marine Engineering & Fabrications Limited
Rosyth Royal Dockyard Limited
Alstec Group Limited

Engineering and Plant Services

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

Networks

Babcock Networks Limited

Rail

First Engineering Limited

Others

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

Joint Ventures

Dyncorp-Hiberna Limited
Babjeh Joint Venture (South Africa)
FSP (2004) Limited
First Swietelsky Operation and Maintenance
First Swietelsky Joint Venture High Output

All undertakings are wholly-owned unless otherwise stated. With the exception of Babcock UK Holdings Limited, which is 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 eighteenth 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, 13 July 2007, 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 group and the company for the year ended 31 March 2007.

(2) To declare a final dividend for the year ended 31 March 2007 as recommended by the Directors.

(3) To reappoint Mr G A Campbell as a Director of the company.

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

(5) To approve the Remuneration Report of the Directors for the year ended 31 March 2007.

(6) To reappoint PricewaterhouseCoopers LLP as Auditors.

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

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

Ordinary Resolution

(8) That the company may send or supply documents or information to members by making them available on a website or by other electronic means and this resolution shall supersede and modify any provision of the company's articles of association to the extent it is inconsistent with this 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 22,800,000;

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

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

(d) the authority hereby conferred shall expire on 31 December 2008 or at the conclusion of the next Annual General Meeting of the company (whichever is the earlier) unless such authority is renewed prior to such time; and

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

By order of the Board.

A N Dungate Secretary
11 June 2007

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 Director standing for reappointment (Lord Hesketh) should be reappointed are set out in the Accompanying Notes on page 87.

(2) An explanation of the special business resolutions is given in the Explanatory Notes on page 87.

(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) Copies of the terms of appointment under which the non-executive 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 Director standing for reappointment (Lord Hesketh) 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-executives directors.

Note from the Chairman:

"I can confirm, as required by the Combined Code, that having fully evaluated his performance, the Board is of the view that Lord Hesketh continues to be effective in and to demonstrate commitment to his role".

Gordon Campbell

Explanatory notes

Resolution 8, In January 2007, certain provisions of the Companies Act 2006 and the Financial Services Authority's Disclosure Rules and Transparency Rules came into force, which contain new provisions facilitating communications between companies and their shareholders in electronic form and by means of a website. The new regime has the aim of moving from a 'paper first' to a 'web first' system of communication. The new regime makes it possible for electronic communication to become the default method of communication, so that shareholders are assumed to have agreed to the company publishing documents and information on its website if certain conditions are met and procedures followed. This goes beyond the previous legislation, under which a shareholder had to opt positively for communication in electronic form. To enable the company to benefit from this opportunity to provide for electronic communication as the default method of communication, the company must obtain the consent of shareholders in general meeting. Accordingly, the company is proposing Resolution 8 which, if passed, will authorise the use of its website and other electronic means as a method of communicating with shareholders who do not request documentation in paper form.

In addition to obtaining the consent of shareholders in general meeting, the new regime also requires the company to ask shareholders individually whether they wish to receive information from the company electronically including through the company's website. A separate letter containing details of the proposed new arrangements, which are conditional upon the passing of Resolution 8 authorising the use of electronic communication, is included with this notice. Shareholders who wish to continue to receive hard copy documents from the company should notify the company's registrars in accordance with the instructions set out in the letter.

Notwithstanding any prior request or deemed consent, a shareholder may at any time tell the company that he or she wishes to receive all or specific information in hard copy.

The overall effect of this resolution, therefore, will be to allow the company to increase the use of electronic communications with shareholders, thereby saving considerable administrative, printing and postage costs as well as paper. However, as already indicated, the rights of those who wish to continue to receive documents in paper form will be fully protected.

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 2007, 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 2008 or, if earlier, at the conclusion of the Annual General Meeting of the company to be held in 2008. 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 2007 (being the latest practicable date before publication of the notice of meeting) was 1,123,751 representing 0.49% of issued share capital as at 1 June 2007. If the full authority to buy back shares were to be used, and the shares cancelled, these outstanding options would represent 0.55% of issued share capital.

Shareholder information

Financial calendar

Financial year end	31 March 2007
2006/07 preliminary results announced	10 May 2007
Annual General Meeting	13 July 2007
Final dividend payment date (record date 6 July 2007)	6 August 2007

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

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Registered in England
Company number 2342138

Registrars
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Stockbrokers
JPMorgan 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 702 0000.

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 2007 £m	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m	UK GAAP 2003 £m
Continuing revenue	988.3	836.7	729.0	438.0	377.9
Operating profit	62.8	46.6	35.3	22.2	21.1
Share of profit from joint ventures	0.4	(0.1)	0.2	0.1	(0.2)
Profit before interest	63.2	46.5	35.5	22.3	20.9
Net interest and similar charges	(6.2)	(5.2)	(6.0)	(0.5)	(2.6)
Profit before taxation	57.0	41.3	29.5	21.8	18.3
Income tax expense	(11.0)	(8.2)	(8.2)	(3.4)	(5.1)
Profit from continuing operations	46.0	33.1	21.3	18.4	13.2
Discontinued operations	(0.8)	(3.2)	(2.1)	(2.0)	(4.9)
Profit for the year	45.2	29.9	19.2	16.4	8.3
Minority interest	(1.8)	(0.2)	(0.1)	–	–
Profit attributable to shareholders	43.4	29.7	19.1	16.4	8.3
Non-current assets	327.2	273.4	266.5	90.4	99.3
Net current assets/(liabilities)	(96.0)	(48.0)	(60.6)	51.7	34.5
Non-current liabilities and provisions	(24.0)	(54.8)	(93.5)	(45.0)	(46.4)
Total net assets	207.2	170.6	112.4	97.1	87.4
Shareholders funds	205.6	170.2	112.3	97.1	87.3
Minority interest	1.6	0.4	0.1	–	0.1
	207.2	170.6	112.4	97.1	87.4
Earnings per share – basic	21.10	14.49p	10.08p	11.31p	5.72p
Dividends per share (proposed)	8.05p	6.00p	4.00p	3.35p	3.00p

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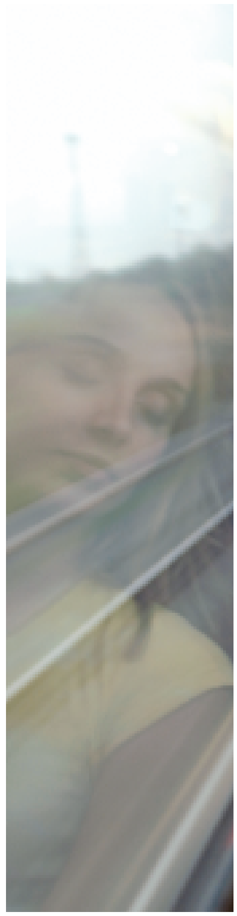

Babcock International Group PLC Annual report and accounts 2007