

trusted  
to deliver



#### Overview:

01	Introduction
02	Group overview
06	Chairman's statement
07	Operating and financial review

#### Governance:

36	Directors and Company Secretary
37	Directors' report
41	Statement on Corporate Governance
44	Audit and Risk Committee
45	Remuneration report

#### Group accounts:

54	Statement of Directors' responsibilities in respect of the Annual Report, the Directors' Remuneration report and the financial statements
55	Independent auditors' report to the members of Babcock International Group PLC
56	Group income statement
57	Group balance sheet
58	Group cash flow statement
58	Group statement of recognised income and expense
59	Notes to the Group financial statements

#### Company accounts:

95	Statement of Directors' responsibilities on the Company financial statements
96	Independent auditors' report to the members of Babcock International Group PLC
97	Company balance sheet
98	Notes to the Company financial statements

#### Other information:

101	Principal subsidiary, joint venture and associated undertakings
102	Notice of meeting
107	Shareholder information
108	Five-year financial record

## Operational highlights

Record results – 57% increase in revenue, 53% increase in underlying PBT

Strong organic growth – 16% increase in revenue, 20% increase in operating profit

DML acquisition positions Babcock as the leading support provider to the Royal Navy

Acquisitions of INS and Strachan & Henshaw further strengthen position as a leading technical support provider for the civil nuclear market

Major contract wins underpin continuing growth

Current order book of £3 billion with strong bidding pipeline

Dividend increase of 43% to 11.50p

## Introduction

Babcock is an engineering support services company. Our heritage of complex engineering expertise combined with excellence in project management has enabled us to achieve leading positions in each of our markets.

## Statutory results

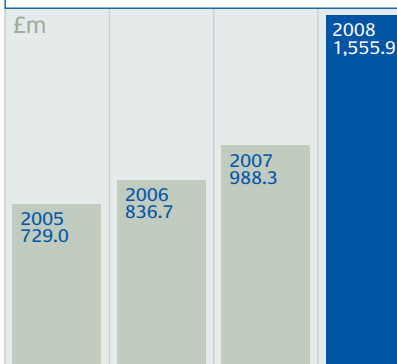
	2008	2007	Change
Revenue	£1,555.9m	988.3m	+57%
Operating profit	£110.2m	£62.8m	+75%
Profit before tax	£84.6m	£57.0m	+48%
Basic earnings per share	29.99p	21.49p	+40%

## Underlying financial highlights

(before amortisation of acquired intangibles and exceptionals)

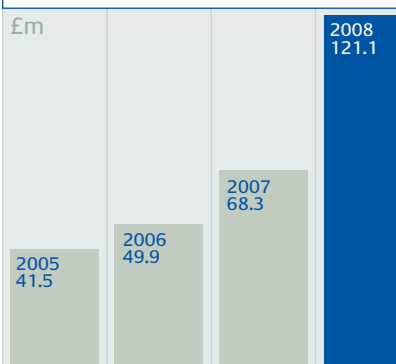
## Revenue

£1.56bn +57%



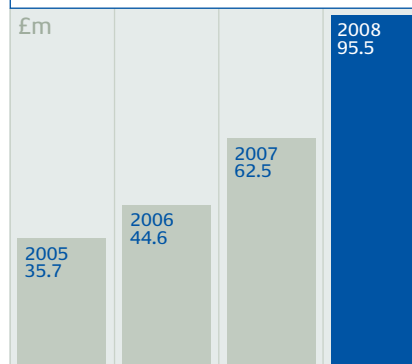
## Operating profit

£121.1m +77%



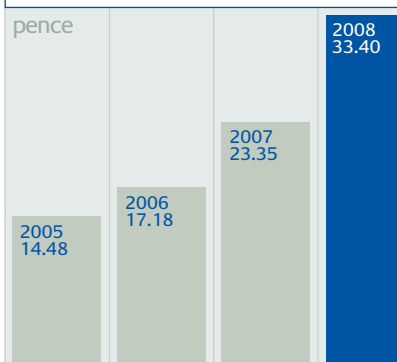
## Profit before tax

£95.5m +53%



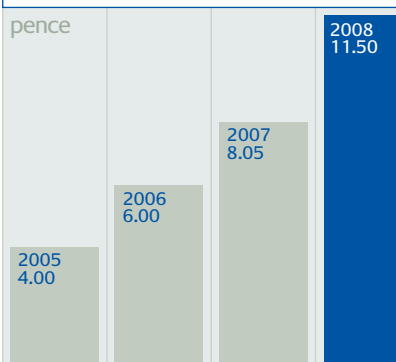
## Basic earnings per share

33.40p +43%



## Dividend proposal



11.50p +43%






## Group overview

We operate across a range of markets drawing on and sharing common skills and expertise to deliver innovative solutions.

We seek to work in partnership with our customers to develop long-term relationships.

Marine	Defence	Rail
We are the UK's leading naval support business and have a unique role supporting the Royal Navy and the Ministry of Defence. In addition we provide support for customers in the civil marine, oil and gas and other commercial markets.	We provide facilities management, equipment support and training expertise. We are the largest provider of facilities management support to the Ministry of Defence.	We are a major player in the UK rail infrastructure market and the largest track renewal contractor for Network Rail.
<b>Revenue</b> <b>£633.2m</b> 41% Group revenues	<b>Revenue</b> <b>£302.1m</b> 19% Group revenues	<b>Revenue</b> <b>£228.1m</b> 15% Group revenues
<b>Operating profit*</b> <b>£68.7m</b> 10.8% operating return on revenue	<b>Operating profit*</b> <b>£27.5m</b> 9.1% operating return on revenue	<b>Operating profit*</b> <b>£0.5m</b> 0.2% operating return on revenue
<b>Key activities</b>	<b>Key activities</b>	<b>Key activities</b>
Submarines – base porting, refit, refuelling and decommissioning	Facilities management for MoD through two Regional Prime Contracts for the South West and East of the UK	High output and traditional track renewal – joint venture with Swietelsky provides the fastest and most efficient track renewal system in the UK
Surface ships – warship refit, member of Aircraft Carrier Alliance, commercial design and engineering work	Technical support for the RAF through multi-activity contracts at RAF Valley and IOS contracts for the RAF Hawk and Hercules fleets	Signalling and control system installation
Naval bases – management of HMNB Devonport and HMNB Clyde	Building Schools for the Future contract with the London Borough of Hackney	Multi-disciplinary projects and provision of rail power solutions
Equipment support – supply chain services for MoD	Baggage handling systems at London Heathrow	
<b>Key customers</b>	<b>Key customers</b>	<b>Key customers</b>
Ministry of Defence – DE&S Equipment Support	MoD – Defence Estates	Network Rail
	RAF	Transport Scotland
	BAA	Nexus
	BAE Systems	Regional Passenger Transport Executives
	Local authorities	
		

\*represents underlying operating profit which is before amortisation of acquired intangibles and exceptionals.

Nuclear	Networks	Engineering and Plant
<p>BNS Nuclear Services has grown through acquisition to become one of the largest civil nuclear engineering support businesses in the UK operating in the areas of power generation, decommissioning and waste management.</p>	<p>We operate in the high voltage power transmission, mobile and fixed telecommunications and digital broadcast infrastructure markets in the UK and Ireland. We are one of three key suppliers to the National Grid.</p>	<p>The division operates mainly in South Africa supporting Eskom, the national power supplier, and Volvo construction equipment. In the US we provide specialist oil pipeline support.</p>
<p>Revenue <b>£76.3m</b> 5% Group revenues</p>	<p>Revenue <b>£98.5m</b> 6% Group revenues</p>	<p>Revenue <b>£217.7m</b> 14% Group revenues</p>
<p>Operating profit* <b>£5.7m</b> 7.5% operating return on revenue</p>	<p>Operating profit* <b>£7.2m</b> 7.3% operating return on revenue</p>	<p>Operating profit* <b>£17.1m</b> 7.9% operating return on revenue</p>
<p><b>Key activities</b></p> <ul style="list-style-type: none"> <li>Mechanical system design and engineering</li> <li>Outage support for operational reactors</li> <li>Waste management and decommissioning</li> <li>Safety and risk analysis and project management</li> </ul>	<p><b>Key activities</b></p> <ul style="list-style-type: none"> <li>Upgrading UK's national electricity grid, working on overhead powerlines, delivering complex support from design and construction through to ongoing maintenance</li> <li>Mobile and fixed telecommunications life cycle support from site acquisition through design and implementation and ongoing mast support</li> </ul>	<p><b>Key activities</b></p> <ul style="list-style-type: none"> <li>Maintenance and engineering work on power station boilers to support the increasing demand for electricity in South Africa</li> <li>Construction, erection and maintenance of high voltage power lines</li> <li>Sole distributor for Volvo equipment to mining and infrastructure construction companies and provider of after sales parts and servicing support</li> </ul>
<p><b>Key customers</b></p> <ul style="list-style-type: none"> <li>British Energy</li> <li>Magnox</li> <li>Sellafield</li> </ul>	<p><b>Key customers</b></p> <ul style="list-style-type: none"> <li>National Grid</li> <li>EDF Energy Networks</li> <li>Scottish and Southern</li> <li>Scottish Power</li> <li>Vodafone</li> <li>Orange</li> <li>Ericsson</li> </ul>	<p><b>Key customers</b></p> <ul style="list-style-type: none"> <li>Eskom</li> <li>Volvo</li> </ul>
		



HMS Victorious leaves Faslane for her long overhaul and refuelling period at Devonport. The refuelling, upgrade and revalidation of her reactor and over 80 other submarine design alterations and additions have been incorporated to return her to 'as new'.

Trusted to deliver:

Faslane  
Scotland



## Chairman's statement

The year ending 31 March 2008 built on the excellent progress of recent years with underlying profit before tax increasing by 53% (year-on-year) to £95.5 million. This followed increases of 40% and 25% in the previous two years. The Directors are recommending a final dividend of 8.20p per share giving a total dividend for the year of 11.50p per share an increase of 43% on the previous year. This increase reflects the growth in earnings per share of 40% on the previous year and confidence in Babcock's future prospects.

The share price continued to improve during the year and reached 571p at the end of March 2008. At the close of business on 12 May 2008 it stood at 598.5p. This gave a market capitalisation of the Company of £1.4 billion – a substantial and consistent improvement from the low point of £87 million following 11 September 2001. This represents a massive return for investors. £100 invested in Babcock on 31 March 2003 would have been worth £721 on 31 March 2008 (assuming dividends were reinvested in further shares), a return of 621%. £100 invested on 31 March 2003 in the FTSE All-Share Index (excluding investment trusts and assuming reinvestment of dividends in the Index) would have had a notional worth on 31 March 2008 of £198, a return of 98%. This out-performance has been achieved by virtue of a consistent strategy yielding organic growth and including judicious acquisitions.

The acquisitions of Devonport Management Limited (DML) and International Nuclear Solutions (INS) were completed in the year and added £408 million to the Group's revenue and £38.8 million of operating profit (before amortisation of acquired intangibles).

Both acquisitions added to our competence in the core areas of defence and the civil nuclear market. In April 2008, we further increased our presence in these core areas by the acquisition of Strachan & Henshaw at a cost of £65 million.

All other areas showed organic growth with the exception of Rail which was static, but, after a challenging first half, the operating profit in Rail recovered during the second half as a result of focused management attention.

Our strategy remains to expand our position in the technically based support services market, where we continue to see above average growth potential.

Despite the bulk of the acquisitions being financed by borrowings (19 million new shares were issued to help fund the DML acquisition), our overall position remains comfortable, with closing debt at £322 million and our coverage ratios well within our internal and external benchmarks. Our consistently high rate of conversion of operating profit to cash leaves the Board confident that this debt will be further reduced over the coming year.

We have matched the rate of growth in recent years by the development of our management expertise. We have invested heavily in both developing existing management and integrating the management of new acquisitions. We are aware of the need to continue this focus and I have confidence that the management team is fully up to the challenges of the future.

I have been with Babcock now for eight years, initially as Chairman and Chief Executive and latterly as Chairman. A successful company can be judged not only by its financial performance and return to shareholders, but also by its ability to provide orderly and timely succession. With this in mind, I have decided to stand down as Chairman later this year, and we have been fortunate to persuade Mike Turner to succeed me as Non-Executive Chairman. Mike was formerly a Non-Executive Director of Babcock, but spent much of his career with BAE Systems, and for the last six years as its Chief Executive. His wealth of experience at BAE Systems and his knowledge of Babcock make him ideal for this role and I wish him well.

Clearly, it is with some regret that I stand down after an exciting and, I believe, successful eight years, in which we have transformed Babcock from an unfocused engineering company into a dynamic support services provider. I look forward to watching it build on today's foundations.

The Board is confident of Babcock's prospects and is convinced the Group is well placed to continue to develop and grow.

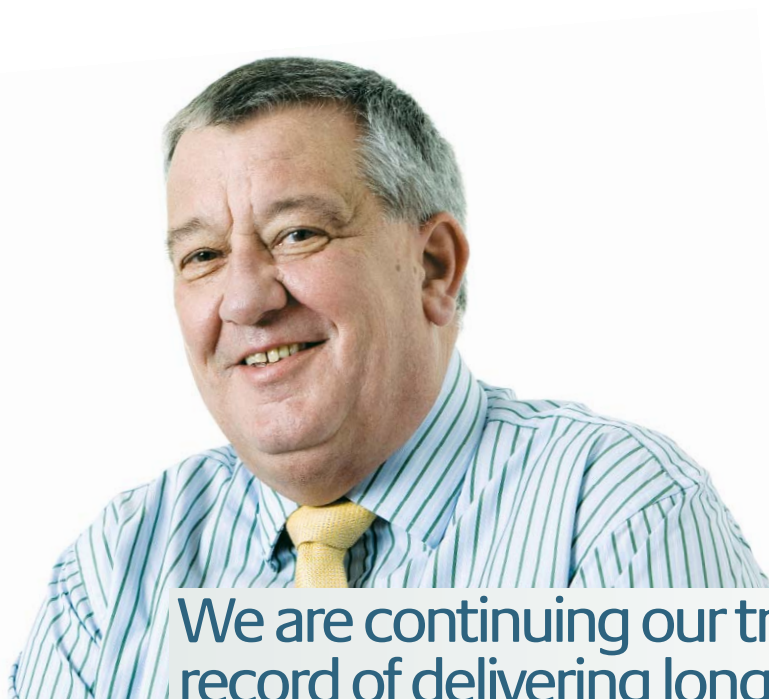
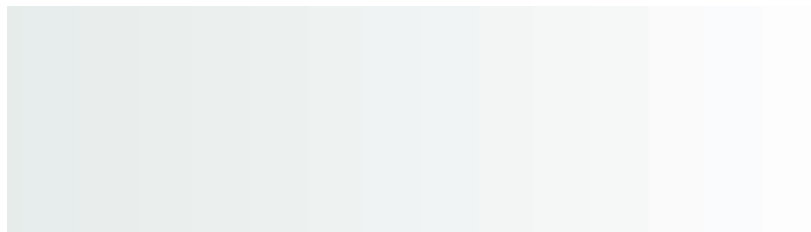
Gordon Campbell  
Chairman



**Our strategy remains to expand our position in the technically based support services market, where we continue to see above average growth potential.**



## Operating and financial review



**We are continuing our track record of delivering long-term growth for our shareholders.**

### Introduction

The 2007/08 financial year has been another year of strong growth for Babcock. Group revenue has increased by 57% to £1,555.9 million (2007: £988.3 million) and underlying operating profit by 77% to £121.1 million (2007: £68.3 million). This continues our track record of delivering long-term sustainable growth for our shareholders.

The successful acquisition of DML ensured that we reinforced our position as the leading provider of support for the Royal Navy and the sole supplier of support and upkeep to the nuclear submarine fleet. We also remain the major provider of refit for the surface fleet and hold two of the three management contracts for naval bases.

The acquisition of INS, which we have combined with the nuclear capabilities of both Alstec and our Marine division, creates a business with a strong position in the nuclear generation and nuclear decommissioning markets. We expect significant growth in each of these markets in the next decade.

The recent acquisition of Strachan & Henshaw will further strengthen our position in the nuclear market and will also provide opportunities to extend our reach in submarine support to overseas markets.

In addition to the growth through acquisition we have achieved strong organic growth of 16% in revenue and 20% in operating profit through extending the scope of existing contracts and the winning of new contracts. Each of our divisions is well regarded in its respective market and each continues to see further growth opportunities.

The order book has remained broadly stable at £3 billion since September, despite delays in contract awards stemming from the late agreement of Ministry of Defence budgets. We expect this situation to improve over the next six months. In particular we anticipate the new aircraft carrier orders and financial close on the Royal School of Military Engineering, together worth some £2 billion. Our bidding pipeline remains healthy with the number of opportunities available to the Group increasing. We will continue our drive to ensure that in each of our market sectors Babcock occupies a leading position.

Much operational effort this year has been directed at further improving our already good record in health and safety. We now figure amongst the industry leadership but further progress will be sought in the next year.

## Business profile

Since 2001 Babcock has transformed from an engineering conglomerate into a support services company, establishing itself as a leading provider in each of its chosen markets and building a reputation as a supplier that can be trusted to deliver.

The Group is divided into six reporting divisions all of which have similarities in their business profiles. Across our divisions we have retained and built on our heritage of engineering expertise to provide complex engineering and programme management support for our customers.

All of our businesses operate in markets with good long-term prospects. We focus on markets with major infrastructure or assets which need significant long-term investment programmes for their support, maintenance and upgrade.

Our customers are government departments or owners of government assets and private companies that have inherited or acquired public sector infrastructure.

We pride ourselves on our ability to work in partnership with our customers and on our reputation as a partner who is trusted to deliver.

## Our strategy

Our overarching business objective is to deliver sustainable value for our shareholders, customers and wider stakeholders and achieve sustainable growth in operating profit.

Since 2001 our strategy has been to transform Babcock into a support services business operating across a range of challenging and technically demanding, higher value environments where we can maximise our strong project management skills and engineering expertise.

At the centre of this transition have been a series of targeted acquisitions which have given the Group scale when entering new markets or have strengthened our existing market positions.

### 2001

Acquisition of Hunting Defence (Babcock Defence Services)

### 2002

Awarded WSMI contract for HMNB Clyde (Faslane)

Acquisition of SGI (Babcock Infrastructure Services)

Awarded SLAM (Single Living Accommodation contract)

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

### 2003

Awarded RAF Valley Hawk support contract

Completed divestment of the materials handling business

### 2004

Acquisition of Peterhouse Group

Awarded Southwest Regional Prime contract

### 2005

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

Contract at HMNB Clyde extended early due to performance

Win 'high output' system 3 track renewal contract

### 2006

Acquisition of Alstec

Acquisition of ABB Powerlines

Win National Grid Alliance opportunity

### 2007

Awarded second phase of SLAM programme

Acquisition of Devonport Management Ltd

Appointed alliance partner to EDF Energy Networks in the East, South East and London

Selected as one of four main contractors to Network Rail for track renewal

Preferred bidder for London Borough of Hackney Building Schools for the future

### 2008

Awarded long-term support contract for British Energy's AGR power stations

Completed acquisition of International Nuclear Solutions operating business

Acquisition of Strachan & Henshaw

We will continue to build on this solid foundation. We will focus on the identification and successful participation in markets with strategic infrastructures that require major investment programmes. We will add value from our expertise and understanding of the technical challenges, appreciation of market dynamics and our ability to work in partnership with our customers.

## Our objectives

In order to achieve our strategic objectives we have identified the following areas that are essential to achieving this goal.

### Top three market position

We expect our businesses to be one of the top three in their sector. If they are not they will have clear plans of how they will achieve this objective within three years.

### Preferred customers

We seek to work with customers who own large operationally critical assets. These customers tend to be large public, regulated private sector and blue-chip companies.

### Customer focused

We seek to work collaboratively in partnership with our customers to underpin the long-term nature of our customer relationships.

### Highly technical projects

Our skills are engineering based and we focus on projects containing a high technical content consistent with our capabilities.

### Long-term contracts

We hold and enter into long-term commercial arrangements which sensibly balance risk and reward.

### Safety conscious

We expect all our divisions to demonstrate a sector-leading safety performance. We believe all our employees and others working on or visiting our operations should be able to return home safe and well at the end of the working day.

### Respect for the environment

All our divisions operate with respect for the environment.

## Measuring our performance

Since 2001 we have consistently achieved growth in revenue and profits and our objective is to continue to deliver sustainable growth for our shareholders.

Last year we published a number of Group and divisional level financial and non-financial Key Performance Indicators (KPIs) to ensure continuous improvement across our business and to enable investors and other stakeholders to measure our progress.

Group KPIs are clearly set out and defined throughout the Operating and financial review and are discussed in detail in the Financial review on pages 31 to 33.

The key KPIs for our divisions featured over the following pages are:

### 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.

### Segmental analysis

Division	Revenue			Operating profit*			Return on revenue	
	2008 £m	2007 £m	Growth %	2008 £m	2007 £m	Growth %	2008 %	2007 %
Marine	633.2	217.3	191%	68.7	22.3	208%	10.8%	10.3%
Defence	302.1	247.3	22%	27.5	20.4	35%	9.1%	8.2%
Rail	228.1	228.8	–	0.5	9.3	–	0.2%	4.1%
Nuclear	76.3	54.4	40%	5.7	3.3	73%	7.5%	6.1%
Networks	98.5	74.9	32%	7.2	6.8	6%	7.3%	9.1%
Engineering and Plant	217.7	165.6	31%	17.1	13.3	29%	7.9%	8.0%
				(5.6)	(7.1)			
Total	1,555.9	988.3	57%	121.1	68.3	77%	7.8%	6.9%

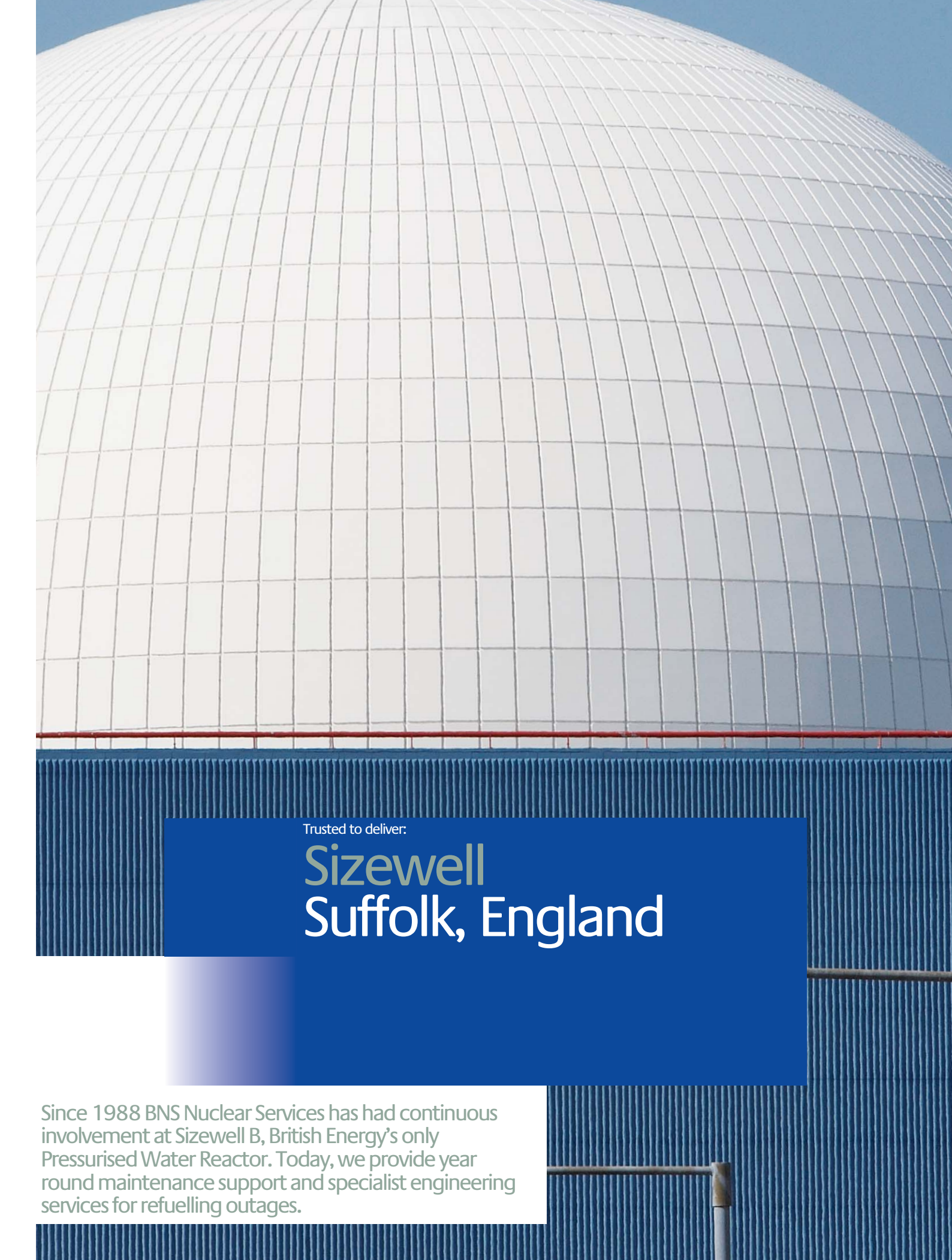
\*Represents underlying operating profit which is before amortisation of acquired intangibles and exceptional items.

### Revenue growth

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

### Reconciliation to statutory operating profit

	Revenue		Operating profit		Operating return on revenue		Growth	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 %	2007 %	Revenue 2008 %	Operating profit 2008 %
Total statutory	1,555.9	988.3	110.2	62.8	7.1	6.4	57	75
Amortisation of acquired intangibles			10.9	6.1				
Exceptional items			–	(0.6)				
Total underlying	1,555.9	988.3	121.1	68.3	7.8	6.9	57	77



Trusted to deliver:

# Sizewell Suffolk, England

Since 1988 BNS Nuclear Services has had continuous involvement at Sizewell B, British Energy's only Pressurised Water Reactor. Today, we provide year round maintenance support and specialist engineering services for refuelling outages.



## Marine

**Archie Bethel**  
Chief Executive Babcock Marine



### Market overview

Babcock Marine is the UK's leading naval support business and in our first year of operation we achieved or improved on all of our key financial and operational targets.

Our ownership of Rosyth and Devonport dockyards and our contracts to manage the Devonport and Clyde Naval Bases provide us with the ideal opportunity to bring together three of the four UK waterfront naval support facilities under a single operating structure. This will allow us to optimise the use of facilities and infrastructure and reduce the overall through-life support costs of maintaining and operating both the submarine and surface ship fleets.

Increasingly, Babcock Marine's naval support activities are based on partnering and alliance contracts in which we share the benefits of efficiency improvements and cost savings that are delivered to the Ministry of Defence.

In support of the broad Maritime Change Programme that flowed from the Defence Industrial Strategy we are supporting a number of important strategic initiatives geared at embedding partnership models at the heart of the relationship between the MoD and its key industrial suppliers in the maritime sector.

### Operational review

The division has had a very successful year financially, although a number of one-off factors have contributed to the strong increase in operating return on revenue. These include margin pick-up at the end of the first term of the HM Naval Base Clyde contract and a satisfactory conclusion to contract negotiations within the yacht business.

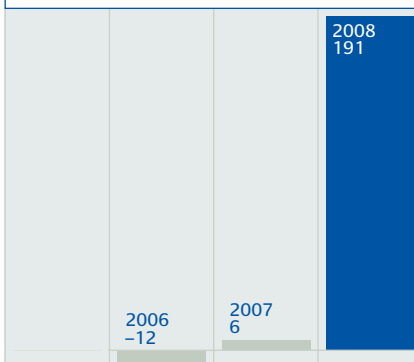
We have made good progress since the acquisition of Devonport Management Limited (DML), realising the £4 million targeted synergies. Negotiations on the Terms of Business Agreement for future naval support continue to progress constructively although we do not expect these to be concluded until the second half of the calendar year.

The business and its management team have been structured around the four key areas of Submarines, Surface Ships, Naval Bases and Equipment Support where Babcock Marine plays a unique role in supporting the Royal Navy and the MoD.

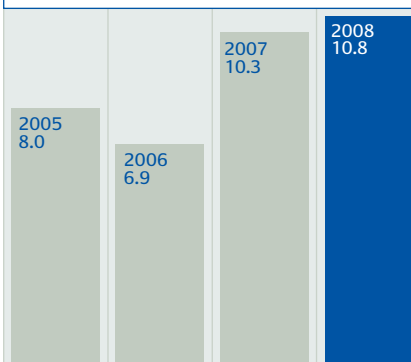
### Submarines

Babcock Marine teams have continued to provide support to operational submarines as they carry out their missions across the world. This year has been dominated by two major projects, HMS Victorious and HMS Triumph. Both projects are progressing well towards completion in 2008 and return to active service. At Devonport, major work was completed on HMS Trafalgar and HMS Turbulent, whilst at Faslane we completed a major maintenance period on HMS Torbay.

**Marine –  
Revenue growth %**



**Marine –  
Operating return on revenue %**



We are developing and extending the support infrastructure required for the Royal Navy's submarine fleet. During the year a £150 million design and build contract was placed by the MoD to provide a defuelling capability at Devonport. When completed in 2012, the new facilities will allow us to complete end of life defuelling operations for current and future in-service submarines leading to eventual disposal solutions. At Faslane, we supported the development of facilities, including a new jetty, in preparation for the first of the Astute Class submarines coming into service over the next year or so.

#### *Surface ships*

This has been a successful year with contract wins secured for the major maintenance packages on the Type 23 Frigate HMS Sutherland and for HMS Ocean, the Royal Navy's largest ship. Work has also been secured on a range of other Royal Navy vessels for our facilities at Rosyth and Devonport further underlining our position as the leading support provider to the Royal Navy surface warship fleet.

We remain confident that the MoD will proceed to contract with the CVF (Future Aircraft Carriers) project. The two new aircraft carriers are being built through an Alliance involving the MoD, Babcock, Thales and the BAE Systems and VT Group joint venture. These vessels, the largest ever built for the Royal Navy, will be assembled at Rosyth where we are already undertaking a significant element of the vessels' detailed design. Although we await the final contract for the manufacturing and assembly phase of this project, the civil engineering contract for the modifications to the dock area at Rosyth was signed in February and witnessed by the Secretary of State for Defence. The cost of these works, which are essential for the assembly of the new carriers, is being paid by the MoD.

During the year we continued to grow our commercial business in a number of areas. In our Design & Technology business we saw strong growth in our commercial marine design activities. We secured a number of important orders for the detailed design of specialist vessels. This included work on what will be the world's largest vessel, the Pieter Schelte, and for the concept and basic design to convert two of the largest vessels currently in-service to floating storage and offload vessels. The strength of our relationship with key customers and the volume of repeat business testifies to the technical expertise we can provide and the approach adopted by our people.

#### *Equipment support*

In addition to our waterfront and upkeep support activities we successfully provided a wide range of technical, operational and logistical support to all three of the Armed Services. Our Land Systems business was awarded a contract to build 179 specialist utility vehicles for use by the Army in Afghanistan and in January 2008 we were awarded preferred bidder status to deliver Ground Support Equipment spares to the Royal Air Force. Our successful Supply Chain Services business achieved significant growth in the year and is the largest provider of piece-part spares to the MoD.

#### *Outlook*

We believe the strength of our relationships with the MoD and the Royal Navy places us in a strong position going forward. We have a steady stream of warship and submarine refit projects as well as in-service maintenance work. We remain confident that the contract for the two new aircraft carriers will be placed and we look forward to playing a major role in their assembly and delivery.

## Defence

**Mike Fellowes** (left)  
Managing Director Babcock Infrastructure Services  
**Nigel Russel** (right)  
Managing Director Babcock Defence Services



### Market overview

The implementation of the Defence Industrial Strategy has significantly changed the marketplace for the Defence Services business as Integrated Operational Support (IOS) contracts replace fragmented work packages. For these contracts, the OEMs act as Integrator with the Ministry of Defence to provide long-term operational support paving the way for multi-platform opportunities rather than single platform multi-activity contracts. For the Infrastructure business, pressures on MoD budgets have increased the division's focus on demonstrating value for money and seeking innovative, efficient and sustainable solutions. In Education, the Government remains committed to the Building Schools for the Future programme.

### Operational review

The division has performed well during the year continuing to deliver strong organic growth. Return on revenue has improved, benefiting from end of contract outcomes. We have been awarded three long-term IOS contracts for the support of Hawk Mk1 with BAE Systems, the Adour engine with Rolls-Royce and Hercules with Marshalls Aerospace.

These contracts have proved to be very successful and are being held up as market best practice in terms of service delivery. We have also been selected by BAE as preferred support provider for the new Hawk Advanced Jet Trainer which will provide excellent skill development opportunities for our workforce at RAF Valley. The multi-activity contracts continue to deliver good returns and achieve high levels of customer satisfaction.

We are working towards the financial close of the Royal School of Military Engineering PPP which is expected in the summer of 2008.

The delivery of training and support services is expected to be worth £1.3 billion over the 30 year project.

The Regional Prime contracts continue to perform well and our reputation for delivery has secured a number of additional projects and contracts. The Bristol and Bath Total Facilities Management contract became operational in December 2007 and we are now providing services to over 11,000 MoD employees across seven locations including Abbeywood.

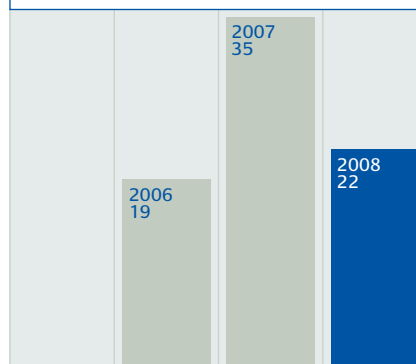
The Hackney Building Schools for the Future (BSF) project is expected to achieve financial close in May/June 2008 with construction work starting immediately. The joint venture 'mouchelbabcock education' has targeted future bid opportunities from BSF Wave 4 funding where its project management and integrator business model fits with the aspirations of the awarding authority.

Babcock's airport operations are dominated by support contracts for Heathrow although successful upgrade projects have been completed on the Gatwick North transfer facility, Stansted hold baggage screening and Heathrow T4 improvements. Our design teams have also had an early involvement in the design approach to the new Heathrow East Terminal.

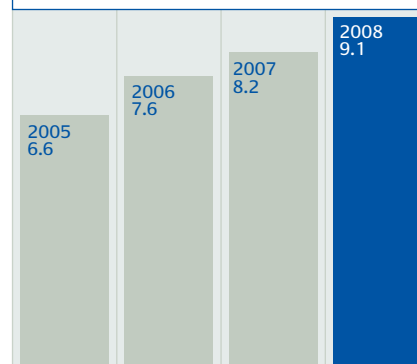
### Outlook

Our successful entry into IOS contracting places us in a strong position in this market and complements our capabilities in the more traditional multi-activity contracts. We are currently in the mid-term of our two Regional Prime Contracts and we expect to see further extensions to these contracts over the coming year. For our baggage handling business there are a number of opportunities resulting from forthcoming airport improvement programmes and we hope to be able to build on our strong relationship with BAA to work more closely with them in future.

Defence –  
Revenue growth %



Defence –  
Operating return on revenue %



## Rail

**Andy Pearson**  
Chief Executive Babcock Rail



### Market overview

The £2 billion per annum market is dominated by Network Rail who, as the main infrastructure owner, is our major customer.

A significant change in the structure of the Network Rail supply chain was implemented in the second half of the year with the number of track renewal framework suppliers reduced from six to four. Otherwise, the market performed generally in line with expectations with an industry-wide focus on improving efficiency and productivity.

### Operational review

After a disappointing performance in the first half a significant restructuring of the business was implemented and actions were taken to address management weaknesses. The business is now structured around three key national business units – Track Renewals, Projects and Signalling and Control Systems. As a result of this, the business returned to profit in the second half and delivered a small profit for the full year with a more robust and stable platform from which to move forward.

### Track Renewals

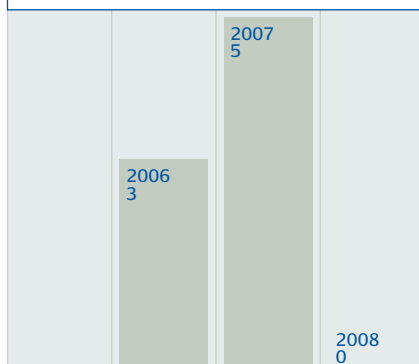
Babcock Rail was selected as one of the four main contractors to deliver track renewals for Network Rail in the UK making us the largest track renewals contractor in the country.

This announcement was made in September after a six month process. Additional work worth around £30 million per annum has been won in Scotland and the North West of England. Around 300 employees transferred to Babcock under TUPE regulations as a result of this process.

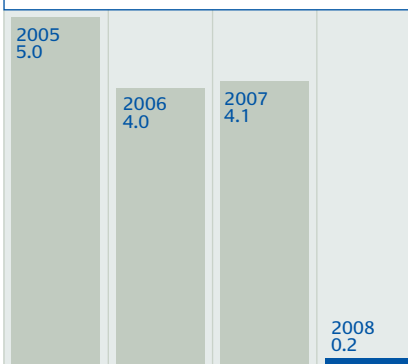
The high output track renewals operations delivered in partnership with Swietelsky of Austria continue to make good progress.

A further extension to the National Plant contract valued at £2.5 million has been awarded to the business for the Automated Finishing Machines which are the most productive advanced track finishing systems available on the market and have been working well on track renewals and maintenance works across the country.

**Rail –  
Revenue growth %**



**Rail –  
Operating return on revenue %**



Operating and financial review continued

### Projects

The business successfully commissioned the Stirling Alloa Kincardine rail reinstatement which is due to open in May 2008. Worth around £30 million in revenue to Babcock Rail this is the largest transport investment project in Scotland's rail infrastructure in recent years.

Recent significant project wins include capacity improvement works on the Settle to Carlisle line (£15 million), a multi-disciplinary contract to reinstate Olive Mount Chord to provide a freight link between the Port of Liverpool and the West Coast Main Line (£3 million) and a contract to design, install and commission the replacement of 33kV switchgear in substations from South West London to Ramsgate (£4 million).

### Signalling and Control Systems

The two signalling framework contracts are progressing well after a slow start, with a steady schedule of work now coming through and a robust forward order book. A significant project was successfully completed at Ellesmere Port in the last week of the year.

The installation of Customer Information Systems at stations throughout Scotland and other national telecoms projects for Network Rail are being successfully delivered through telecoms framework contracts. Growth is anticipated in both these areas and a further opportunity to become framework provider for level crossings is being pursued in partnership with GE Transportation Systems.

### Outlook

Network Rail has announced Investment plans for an additional £2.5 billion over the next two years along with an anticipated project spend in the region of £8.7 billion over the five year period from April 2009. This represents a near doubling of project-related spend by Network Rail. Transport Scotland has announced an ambitious investment programme for the next ten years, including Glasgow Airport Rail Link, which is currently being evaluated under the Strategic Transport Project Review process with results due in summer 2008.

Against this buoyant backdrop, we are confident that our health and safety record and our reputation for delivery on budget and on time, places us in a good position for the future.

## Nuclear

**Martin Austick**

Managing Director BNS Nuclear Services



## Market overview

In the Power Generation sector, British Energy continued a steady programme of spending on plant improvements, addressing key technical issues on their Advanced Gas Reactor (AGR) fleet. There have been uncertainties in the nuclear decommissioning marketplace where funding difficulties have resulted in the cancellation or delay of a number of projects for operational Magnox stations and have delayed projects at Dounreay.

At AWE, we are experiencing a growing market and strong demand for our capability dealing with legacy wastes and decommissioning tasks along with developing and improving existing facilities.

During the year there has been further consolidation of the supply chain and some customers are seeking longer term framework agreements to secure resources going forward.

The creation of BNS Nuclear Services, bringing together the Alstec and INS businesses along with the expertise from the Babcock Marine division gives us a significant market presence and a strong capability. The acquisition of Strachan & Henshaw in April 2008 will further strengthen the division as the demand for high quality nuclear engineering support continues to grow.

## Operational review

We have successfully maintained our role as a strategic supplier to British Energy, leading key projects associated with the inspection and monitoring of the reactor cores and the development of equipment for recovering neutron scatter plugs. We have provided continuing support for the refurbishment and upgrade of fuel routes and reactor projection equipment.

During the year we signed a £70 million contract with British Energy to secure ongoing nuclear services support for their seven AGR power stations through to 2012. This agreement has the option to extend for the lifetime of the stations.

In the decommissioning area we successfully concluded a major upgrade of the Chapel Cross and Calder Hall fuel routes to support the defuelling of the reactors. At Dounreay, the completion of the new facilities for removing the remaining fuel from the fast reactor was a significant step in the site decommissioning programme. Support to the prototype fast reactor decommissioning activities continued.

At AWE Aldermaston we built on our strong track record and increased our involvement with the award of the XTF framework and the A25 decommissioning contract.

The demand for high quality nuclear engineering support continues to grow and has underpinned the opening of new offices at Aldermaston and Warrington.

## Outlook

Budgetary constraints at the Nuclear Decommissioning Agency (NDA) will continue to drive a focus on expenditure at Sellafield and Dounreay in the near-term. We expect activity at Aldermaston to continue at a high level as the pace of decommissioning, refurbishment and building of new facilities continues to increase. Ongoing support for the existing generation of UK reactors will also continue to provide strong demand for key available skills whilst preparations for a new reactor build programme will challenge the availability of resource.

We are now in a position to meet the requirements of all the major UK civil nuclear customers and will be well positioned to respond to the increasing market prospects in the decommissioning, power generation and new build market areas.

## Networks

**Bob Whiley**  
Managing Director Babcock Networks



### Market overview

We are currently experiencing a global surge in demand for power infrastructure construction. This has resulted in a sector skills shortage and has stretched the industry supply chain.

The mobile networks sector has stabilised and seen some recovery. Growth is anticipated in the 3G networks through 2008 and a number of mobile network operators are now looking to combine their networks. In the broadcast sector, significant work is underway as part of the UK Digital Switchover Programme which will continue through to the planned switchover deadline in 2012.

### Operational review

The two major Transmission alliance contracts have both had a successful first year. Whilst the switch from contract tendering to alliancing has reduced the division's operating return on revenue, the change has contributed to the increase in revenue and provides greater long-term visibility. Electricity Alliance West (EAW), our Alliance with National Grid, Amec and Mott MacDonald has delivered a year-on-year increase in volume with a significant improvement in safety performance and has now started year two of the five year programme of works covering Wales and the Western side of England.

Our Alliance with EDF Energy Networks covering East Anglia, London and South East England has also had a very successful first year delivering multiple refurbishment projects on the 132kV transmission network. Year two works are now under way with a further increase in volume anticipated.

Specialist Transmission design activities were at an all time high through the year. A sustained recruitment campaign which successfully doubled design capacity during the year continues. In addition, to alleviate the skilled resource problems being experienced across our sector, we have opened a design office in Bulgaria which functions as an integrated extension to the design office in the UK.

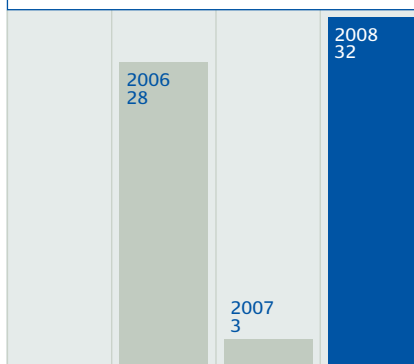
Within the Broadcast sector, significant work is now underway as part of the Digital Switchover Programme. The division is playing a major role in the upgrade of broadcast structures and antenna systems throughout the UK.

During the year we secured our first contract in the Fixed Line Communications Networks Sector to install and commission Huawei equipment in BT Exchanges. BT's 21CN next generation advanced communication network project has been delayed, but this is due to commence during 2008/09 and will provide significant opportunities.

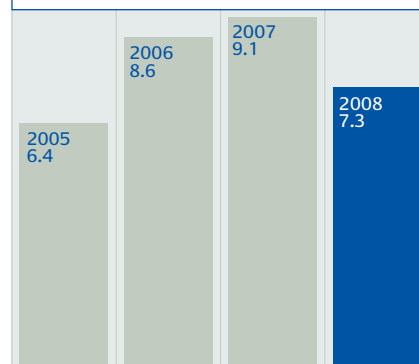
### Outlook

The markets in which we operate remain attractive and we believe there will be a number of significant opportunities coming up during the next year as a result of continuing infrastructure upgrades. The strong positions we hold and the long-term relationships we have developed with our key customers have underpinned our performance this year just ended and make us confident of further progress in the coming year.

**Networks –  
Revenue growth %**



**Networks –  
Operating return on revenue %**



## Engineering and Plant

Roger O'Callaghan  
Chief Executive Babcock Africa



### Market overview

The South African economy has remained relatively strong throughout the year. Infrastructure spending and global commodity prices continued to drive increased demand across our business and we have been well positioned to take advantage of these conditions to generate record results. For our equipment business, trade into other African countries, including Zambia and the Democratic Republic of Congo, has been strong, buoyed by healthy primary markets in minerals and metals.

### Operational review

#### Equipment

The Equipment business supplying Volvo construction equipment delivered a record year with sales of over 1,000 machines, 25% higher than last year. Our parts and service business grew by over 35% and we expect this part of the business to grow considerably as the machine park increases in size and age. Our apprentice training scheme continues to deliver skilled mechanics into our workforce and by the end of this financial year we expect to have 80 apprentices in training.

#### Generation

The need for increased and stable infrastructure in southern Africa, particularly for electricity, has led to increased revenues for our power generation business. The business provides support, maintenance, engineering and construction activities mainly for Eskom, the South African utility company. This year has seen strong growth benefiting from the return to service contract for the Grootvlei Power Station as well as support to Eskom for the general outage and maintenance requirements on in-service stations.

The planned construction of new power stations will offer further new opportunities for the Engineering business which will provide support during the design and build process.

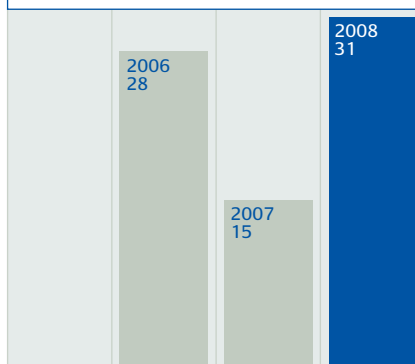
### Powerlines

On the back of increased demand for electricity transmission, Powerlines has had a good year, winning and completing projects in South Africa, Namibia and Botswana keeping the tower and fittings factories near capacity. The business is now in its second year of ownership and as well as achieving significant organic growth has achieved notable improvements in health and safety and production efficiencies. The increasing demand for electricity led to our decision during the year to extend our business into portable generators and our factory now produces a wide range of products.

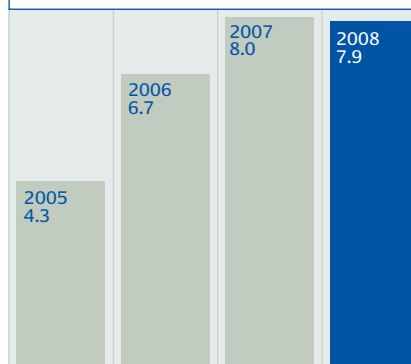
### Outlook

The South African business has had an exceptionally strong year and we expect this to continue. The current demand for electricity and the ten year electricity grid expansion plan along with the continuing demand for infrastructure improvement and the strong mining and mineral industry across southern Africa create a very secure marketplace for us in the coming year.

Engineering and Plant –  
Revenue growth %



Engineering and Plant –  
Operating return on revenue %







Babcock Rail is using pioneering technologies and equipment to provide increased capacity on the 72 mile Settle to Carlisle railway line – a showcase of engineering and transport history.

Trusted to deliver:

# Ribblehead Cumbria, England

## Corporate and Social Responsibility (CSR)

We take our duty to behave as a responsible company seriously. We believe that responsible behaviour makes good business sense and that we will only achieve long-term financial growth if we look beyond short-term financial returns.

We seek to operate in a safe, ethical and responsible manner taking into consideration the needs and ambitions of all our stakeholders – our shareholders, our employees and those who work with us, our customers and the communities in which we operate – whilst making our long-term business a success.

In this section we look at certain areas that are key to achieving our aims but we refer you to other sections in this report which we believe also demonstrate our approach to doing business – page 8 Business profile, Our strategy and Our objectives, pages 26 and 27 Principal risks.

### Corporate Governance

The Board of Babcock International Group PLC is committed to achieving the highest standards of corporate governance. The Corporate Governance Report is set out on pages 41 to 44 of this report.

### Ethical conduct and whistle blowing

The Board insists that Babcock's business is carried out to the highest standards of honesty and integrity. We have a strict ethical policy with guidance on business dealings which we believe complies with international standards. Employees are expected to avoid conflicts of interests, to act lawfully and ethically and report any non-compliance issues of which they become aware.

To facilitate this, we have an independently managed and operated mechanism to enable employees to report non-compliances with our codes of practice in a manner where the issue can remain isolated from the employee's direct reporting lines. Every employee has been provided with details of how to contact the Company Compliance Reporting Line and any reported issues are relayed to Group Executives within 24 hours.

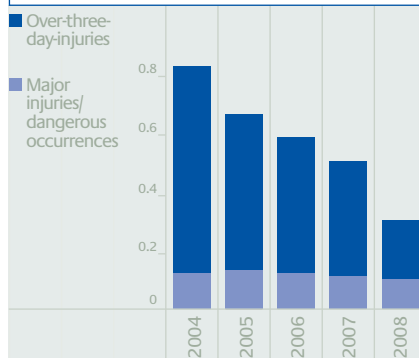
### Health and safety

We have always regarded the health and safety of our employees and those working alongside them as paramount; this is a key priority at all levels of the business. The Board reviews health and safety performance formally twice a year and sees monthly divisional reports on health, safety and environmental matters. Health and safety performance is reviewed at every Executive Committee meeting and is considered when making any bonus payments.

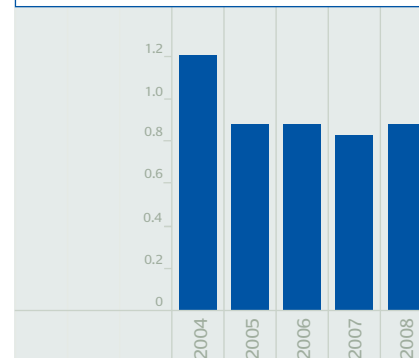
**Number of incidents**  
(prior years restated for acquisitions)

	2003/ 2004	2004/ 2005	2005/ 2006	2006/ 2007	2007/ 2008
Fatalities	0	1	2	2	0
Major injuries/ dangerous occurrences	41	44	40	43	46
Over-three-day-injuries	248	178	155	152	89
Other lost time accidents	136	75	98	124	256

**Incident rate  
per 100,000 hours worked**  
(prior years restated for acquisitions)



**Total reported lost time accidents  
per 100,000 hours worked**  
(prior years restated for acquisitions)



Our Corporate Safety Steering Group (CSSG) has been given responsibility by the Board for the strategic overview of health and safety matters. In addition, the CSSG considers environmental matters. The CSSG meets four times a year and is chaired by the Group Chief Executive. Other members of the Group are the Chairman of the Safety Leadership Team, the Group Risk and Insurance Manager and the manager or director responsible for health and safety from each division.

We strive to do more than merely comply with the letter of health and safety legislation. Despite our already impressive track record, the Group Chief Executive and the Executive Committee have formed a Safety Leadership Team to champion and promote the vision of an accident-free Babcock, supporting and encouraging behavioural and cultural initiatives and ideas, dedicated to achieving this. We had a target of reducing major and over-three-day-injuries in the workplace by 50% and to improve reporting of other minor injuries by March 2008. In the final analysis a reduction of 45% was achieved within the 12 month period.

#### Case study:

#### **Sword of Honour**

Babcock Marine wins Sword of Honour. Babcock Marine's operation in Rosyth was awarded the British Safety Council's Sword of Honour for 2007, the fourth time that Rosyth has been awarded the Sword of Honour in five years.

## Employees

We believe we have one of the best workforces in our sector which allows us to deliver the best service for our customers. We want our employees to enjoy long, successful and rewarding careers with us.

We firmly believe that having a diverse workforce and an inclusive culture is good for our business and should be encouraged. We are committed to not discriminating against employees on grounds of their race, religious belief, gender, marital status, sexual orientation or other considerations that do not affect their ability to carry out their duties.

It is our policy that people with disabilities should have fair consideration for all vacancies and should be supported and encouraged in their application and to achieve progress once employed. We will make reasonable adjustments wherever practicable to accommodate their needs.

Our divisions are committed to local employment and we seek to recruit from the communities in which we operate wherever possible.

Along with many other companies in our sector, we are concerned about the increasing shortage of skilled employees at all levels. Development of our people, present and future, is a critical part of our business activity.

**Apprentices** – We have 234 apprentices in training within our UK operations. We offer accredited apprenticeships in eleven different trades and are recruiting around another 100 apprentices to start in 2008. In South Africa we currently have 45 apprentices in training and hope to increase this to 80 by the year end.

**Graduates** – Over the past two years we have taken on 120 graduate trainees and are expanding our programmes to take on 93 graduates in 2008. We provide formal training and development programmes so all graduates achieve accredited status with appropriate professional bodies.

**Management development** – Babcock Academy is run in conjunction with the University of Strathclyde Business School to enhance the leadership, strategic planning and commercial skills of our managers and senior executives. Since 2005, 80 directors and 250 senior managers have been through the programme.

#### **Setting high standards**

Babcock Rail has reduced reportable workplace injuries by 63% during the year. By March 2008, the division had the best safety performance for a multi-disciplinary contractor working for Network Rail.



#### **The Road to Zero Harm**

Training instructors from Babcock Networks took a specially adapted 'Working at Heights' five day training course out to the Powerlines operation in South Africa. Practical training and sharing experiences helped to improve local practices and standards and demonstrated a commitment to an incident and accident free future.



#### **The best training**

Babcock Marine's Tom Rowse was selected as one of the two best apprentices in the marine industry for 2007 and was presented with a Queen's Bronze Medal by the Worshipful Company of Shipwrights. Tom is now an engineering designer and is being sponsored by the Company to work towards an HNC. He hopes to follow this with a degree course.



Operating and financial review continued

### Communication

We communicate with our employees in a variety of ways. We produce 'The Big Picture' several times a year which is aimed at keeping employees informed of developments in other divisions as well as Group strategy and financial performance.

In the UK we have a Group-wide Employee Forum with the twin aims of consulting and informing on all major developments and issues within the Group. Elected representatives also bring issues forward to be discussed.

#### Case study:

##### Roadshows are a hit!

Nearly 600 employees responded to Babcock Infrastructure Services' 2007 employee staff satisfaction survey. This provided valuable feedback and a number of issues have been addressed. One was a request for more face-to-face meetings with the Directors and so a series of business briefings took place at nine locations. The briefings with an open forum for questions and discussion proved very popular and it is hoped they will become an annual event.

### Customers and customer relations

We seek long-term relationships with our customers, many of whom deliver vital public services. We are committed to working with our customers to provide a more effective and efficient service to the mutual long-term benefit of both those customers and our investors.

We commission regular reviews of our customer relationships to assess where they are working well and to look for where they might be improved. Our aim is to build an enduring reputation as an organisation which delivers what it promises on time and on budget and is easy and pleasurable to do business with. We aim to foster and maintain a culture within our businesses that seeks not merely to meet their basic contractual obligations, but always to exceed our customers' expectations.

### Procurement

We work with a large number of public sector clients and we endeavour to ensure public money is spent wisely and efficiently.

Our customers are rightly taking a greater interest in the supply chains of their contractors. It is a key issue in the maintenance of our reputation that good and reputable supply chain management is achieved by our divisions.

All our businesses have developed supply chain management arrangements to ensure we deal fairly and openly with suppliers and that they meet specific requirements including: requisite insurance levels, fair employment policies, a demonstrably improving health and safety record and a good track record of sustainability and environmental management.

We undertake a range of developmental activities with our key supply chain partners to help them raise their standards and the skills and health and safety of their employees.

### Communities

We operate throughout the UK and South Africa. In many places we are a major employer and contributor to the local economy. We take our social responsibility seriously and we seek to be a good neighbour. We encourage our businesses and employees to take a proactive role in their local communities.

Some examples of the range of our involvement are given below and in the case studies throughout this section.



#### Developing leaders

As well as providing our graduates and apprentices with the specific training required for the chosen careers we seek to develop their broader leadership skills. We have encouraged a number of our young people to attend RYLA (Rotary Youth Leadership Awards) courses which are designed to encourage positive leadership and teamwork, improve communication skills and build self-confidence.



#### Engineering the future

As part of National Science and Engineering Week, BNS Nuclear Services provided talks on engineering to local schools. Subjects are diverse as 'A day in the life of an engineer' and 'Jets and tanks and an explosive career in engineering' provides a huge success and gave the younger generation a realistic idea of modern engineering.



#### Working together

Babcock Infrastructure Services joined Business in the Community to develop their Community Involvement Policy which gives employees time off work to volunteer for company led projects. With our customer, Defence Estates, we will create and maintain a safe play area and garden for local children with special needs, from this derelict site in Plymouth.



**Case study:****Getting back to work**

For the past three years Babcock Networks has participated in a young offenders programme with National Grid and other contractors in the sector. Through professional vocational training and exposure to the working environment the programme seeks to help young offenders return to the workplace.

**Case study:****Student Sponsorship**

In South Africa we continue to support the Student Sponsorship Programme and during the year have sponsored a further four students through their high school education. In addition to financial sponsorship the business will mentor the students through their education.

Across Babcock Marine we have a number of community involvement groups. At HMNB Clyde the Community Investment Group supports the local community in a number of ways. During the year, 25 financial awards were made to support different projects; through the Business Awareness programme employees visited local schools and colleges to help young people gain a better understanding of how businesses operate and our apprentices are encouraged to get involved at an organisational level with a number of community events, for example, providing marshalling support to local fun runs.

At Devonport the Community Relations Group promotes involvement with a range of community projects. Employees are particularly encouraged to become involved with educational projects and around 50 employees are currently active as Governors at local schools.

The Employee Lottery and other social activities generate funds which are used to sponsor local community projects and provide sports equipment for schools. Babcock organises and sponsors the Plymouth Half Marathon, last year 4,500 runners took part raising £150,000 for good causes. The event will take place again on 24 May 2008 when they hope to exceed last year's results.

We support a number of other charitable causes and during the year we donated £105,000. In addition we are a corporate sponsor of the Soldiers, Sailors, Airmen and Families Association (SSAFA).

**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 our customers' sites where they are directly responsible for environmental matters. Some customers ask us to take on environmental management, though they set the standards, budgets and timescales for us. At HM Naval Base Clyde, for example, we have secured the prestigious ISO14001 accreditation for the Ministry of Defence – the first MoD organisation to be so accredited. Our delivery organisation for the Defence Estates' East Prime contract has also received this accreditation. We are actively seeking similar accreditations for other areas of delivery to our customers. Where accreditation has not yet been achieved we seek to operate at best practice levels.

We are working closely with our largest customer, the Ministry of Defence, on a new 'sustainable procurement' initiative, aimed at making a significant contribution to the Ministry's targets to reduce CO<sub>2</sub> emissions, lower water consumption, increase the levels of recycling and improve biodiversity across their estate.

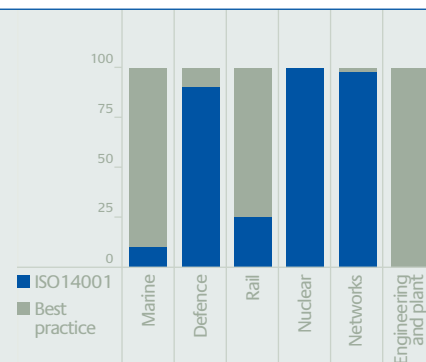
For those operations where we do have management control and discretion, we do not believe we make any significant emissions of greenhouse gases that could otherwise be reduced or avoided. We do, however, keep this under review.

**Preserving and protecting at Marchwood**

At Marchwood, upgrading overhead power lines has involved work with Natural England, environmental agencies and an ecologist to protect sites of special scientific interest between the towers. Woodland flora and fauna was preserved and water courses protected so the local salmon population was not harmed.

**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. 'Best practice' refers to activities where non-ISO14001 compliant measures are being applied.

**Back to nature**

Babcock Marine donated the materials and some of the labour required to build a footbridge at Luss near Loch Lomond. The project was a local initiative to create a network of paths in an area of natural meadow and woodland cut off for 13 years after the original bridge, built in 1875, was washed away.

## Principal risks

In the course of our day-to-day operations we face a number of risks and uncertainties. The Board considers the matters described in this section to be those that could adversely affect the business, results of operations, revenue, profits, cash flow, assets and the delivery of our growth strategy. Given the size, complexity and spread of our businesses and the continually changing environment in which the Group operates, this cannot be an exhaustive list of such risks. Systems and procedures are in place across the Group to identify, assess and mitigate major business risks. The management of risk is an integral part of our operational review process and is supplemented at Group level by independent challenge and review by the Group Risk Manager and the Audit and Risk Committee. Further details on our internal control processes are set out on pages 43 and 44.

### Health, safety and environmental issues

The working environments in which the Group operates are often complex and in some instances are inherently dangerous. Our record in these areas can have a significant impact on our reputation as a business and affect our ability to win and retain contracts and to attract and retain staff. The health and safety of our employees and the impact of our operations is of primary importance to us in their own right and we describe our committed approach to these matters on page 22. We want everyone who works at or visits our sites to go home at the end of the day safe and well.

### Reliance on a small number of large customers and contracts

It is the nature of our businesses that they are reliant on large contracts placed by a limited number of major customers such as The Ministry of Defence, Network Rail, National Grid, BAA, British Energy and Eskom. The extent to which such customers are affected by budgetary, regulatory or political constraints can have a significant effect on the size, scope, timing and duration of the contracts that they can place, which in turn can have a significant effect on the Group's businesses. Such customers have substantial bargaining power and contracts with them can often be terminated on short notice at any time. The loss of a contract or the wider business relationship with such a customer for any reason would be significant.

We endeavour to mitigate this risk by establishing long-term partnering arrangements with all of our customers in which risk and reward are fairly balanced and the financial effects of success and failure are shared. In this way both parties stand to maximise the benefits of co-operation over the long term.

### Bid process and bid success

As a support services company, the Group's ability to deliver growth and create value for shareholders relies to a major extent on its success in winning bids – either alone or in consortium or joint venture with others – for new contracts or retaining existing contracts on terms that are commercially acceptable in the face of strong competition from other suppliers.

Bid processes can be very long and are frequently subject to delays beyond our control. They demand a significant investment in terms of costs and manpower. Tender processes can be abandoned by customers or their scope significantly reduced during the process. Costs on bids that are unsuccessful or that are withdrawn or significantly reduced in scope by the customer are abortive and are not necessarily recoverable.

All proposed bids are subject to continuous monitoring and review by the Group Executive management and Group Business Development to ensure that resources are appropriately focused and the chances of winning bids on profitable terms enhanced. The final submission of any significant bid or re-bid requires formal approval from one or more Executive Directors.

### Contractual performance

The continuing financial success of the Group depends on our ability to meet or exceed the requirements of our customers. Failure to do so could result in the loss of existing contracts and damage the chances of securing further business. We carefully select our commercial partners and sub-contractors to ensure they have the necessary reputation and are capable of meeting or exceeding our customers' requirements and standards. Each division has procedures in place to monitor the ongoing performance of each contract and these are discussed at operational reviews with the Group Executive management. The financial performance of all significant contracts is reviewed quarterly by Group Finance.

### Political and regulatory environment

Our largest customer is the Ministry of Defence. We also have other significant customers at local government level and in the private sector who are strongly influenced by political and/or regulatory considerations beyond our control that affect their budgets, processes, priorities and scope for placing work. These considerations can therefore directly affect the Group's businesses. We seek to maintain regular dialogue with our customers and others to ensure that we understand and monitor the potential effect of these influences on both our customers' and our own business.

## People

Our principal resource is our workforce: it is key to the current and future performance of our business. We operate in many highly technical and complex environments and are particularly dependent on the availability of qualified and experienced engineers and project management staff. The marketplace for such staff is highly competitive and their non-availability in sufficient numbers can place constraints on the Group's business activity. We seek to recruit and retain such employees by making the Group an attractive place to work, offering competitive remuneration and appropriate training and development opportunities. The Group also has an active graduate recruitment and development programme.

## Acquisitions and disposals

The Group has developed and will continue to develop to a significant extent as the result of strategic business acquisitions and disposals. Acquisitions always entail risk, for example, that the post-acquisition performance does not justify the price paid, synergies are less than expected or integration into existing businesses more difficult than planned or that unknown or unforeseen liabilities are acquired. Our acquisition process seeks to reduce these risks by carrying out appropriate due diligence so far as we are able within the context of the bid process and by seeking, where commercially available, contractual protections against such risks. However no due diligence process or contract can offer complete or permanent assurance against such risks. In evaluating bids a detailed valuation process is carried out based on information available and our knowledge of the marketplace. That process also entails consideration of the integration issues that will follow acquisition. All acquisition processes are overseen by the Board and no acquisition may be completed without the formal approval of the Board.

## Information technology

Our business involves high intensity use of complex software for the management of engineering, commercial and financial data. The Group and its customers are dependent on the resilience of the applications software, the data processing facilities and the network infrastructure linking the sites where we operate. A serious failure in these areas would have a significant adverse affect on our business.

To mitigate risks in these areas, the Group has detailed disaster recovery plans in place across all of its sites. We have also established a Group data centre which has high resilience levels built into it as well as a physically separate disaster recovery location and which will increasingly form the hub of all shared IT services.

## Pensions

As a Group we have a significant exposure to the risks associated with defined benefit schemes. At the moment, those schemes are overall in surplus. If any were to go into significant deficit (for example by reason of poor investment performance or changes to mortality or other valuation assumptions) this could lead to an additional funding demand on the Group. With a view to reducing such risks, we seek to maintain constructive and open relationships with the scheme trustees and to encourage them to follow appropriate investment policies given the profile of their members. We also maintain a suitable ongoing funding rate and have conducted various initiatives with a view to reducing future funding risk.

An annual review of the pension schemes is conducted by the Board and the schemes form part of Board discussions at other times during the year with input from professional advisors as appropriate. Further discussion of the position and effect of the defined benefit pension schemes on the Group's financial statements is included in the Financial Review on page 32.

## Ethical and reputational risk

We pride ourselves on our 'trusted to deliver' reputation and insist on the highest standards of honesty, integrity and performance in all aspects of our business. We are acutely aware that any damage to this reputation could severely impact on our ability to win bids and complete contracts and this underlying reputational risk is a feature of many of the other risks described in this section. We have an ethical policy in place that defines the level of behaviour we expect. We have established a 'whistle blower' hot line so all employees across the Group can anonymously express any concerns they have about the way the business is being operated. We maintain regular dialogue with customers, and from time to time carry out formal customer surveys, to ensure that we can identify any potential threats to our customer relationships and act on them.

## Contingent liabilities

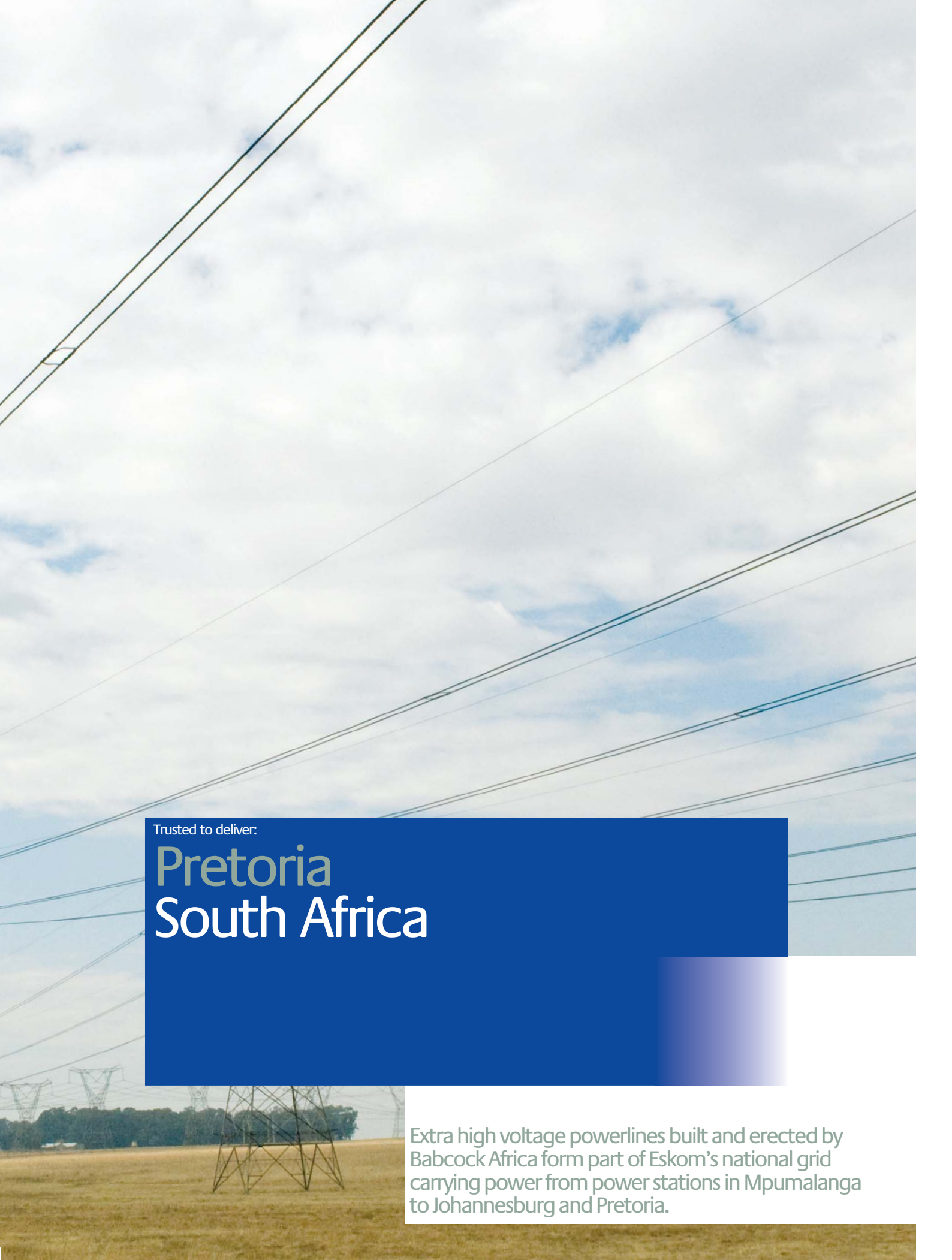
Babcock has a long and diverse operational history and has also developed through a number of acquisitions and disposals. This inevitably exposes us to the risk of legacy liabilities. These are monitored and managed by the Group with external professional advice as appropriate. The Board makes its assessment of the risk of contingent liabilities on the basis of the best information (including appropriate professional advice) available at the time. Should that information change or prove to be incorrect, it is possible that the Group could have an unexpected material liability.

## Financial reporting, accounting controls and treasury

Material mis-statement of financial results through fraud or error could arise if the financial and operational control structures were inadequate. The Group has established robust structures to mitigate this risk through a comprehensive financial policy and accounting standards manual including authority and approval mandates. All commercial and contractual activities are governed by the Group commercial Policy and Procedures manual which sets out the Group's acceptable contractual terms and conditions. These policies and procedures are backed up by a system of regular contract reviews conducted by Group Finance and a regime of internal audit, conducted by Ernst and Young which reports to the Audit and Risk Committee. The statement on Corporate Governance, pages 41 to 43, contains further explanation on internal controls.

A discussion of the Group's approach to the management of treasury risk is set out at page 32.





Trusted to deliver:

# Pretoria South Africa

Extra high voltage powerlines built and erected by Babcock Africa form part of Eskom's national grid carrying power from power stations in Mpumalanga to Johannesburg and Pretoria.



Another year of record results with strong organic growth and the benefits of strategic acquisitions.

## Financial review

### Financial summary

2007/08 was another successful financial year with operating return on revenue at 7.8% showing a considerable increase year-on-year (2007: 6.9%). The Group's return on invested capital at 11.3% (2007: 17.8%) remains substantially in excess of the Group's weighted average cost of capital despite only a part year contribution from Devonport Management Limited (DML). Taking into account the equity cash placing of 19 million shares for the purchase of DML, basic earnings per share increased by 43%. Net debt increased to £322.2 million but gearing and debt and interest multiples remained at comfortable levels.

### Group income statement

The Group's results for the financial year were significantly enhanced by the acquisition of DML, which was completed in June 2007. During the course of the year the Group also completed the acquisition of INS. Including these acquisitions, Group revenue increased by 57% to £1,556 million (2007: £988 million) with significant growth recorded in all divisions except Rail. Underlying operating profit increased by 77% to £121.1 million (2007: £68.3 million). The Group experienced strong growth in operating profit across all of its businesses with the exception of Rail, driven by strong markets and a number of notable contract wins.

Of the two major acquisitions, DML contributed £387.3 million to Group revenue and £38.1 million to operating profit, whilst INS generated £17.5 million in revenue with associated operating profit of £0.9 million. Excluding all acquisitions, Group revenue increased by 16% to £1,148 million and underlying operating profit increased by 20% to £82.3 million.

The Group's operating return on revenue increased to 7.8% (2007: 6.9%) benefiting from an exceptionally strong margin performance in Marine and further progress in Defence. A number of one-off factors contributed to the performance of the Marine division including margin pick-up in the HM Naval Base Clyde (Faslane) contract as it reached the end of its first five year term and a satisfactory conclusion to contract negotiations within the DML yacht business. Similarly in Defence, underlying margins improved and were augmented by end-of-contract outturns. The poor performance in Rail, which ended the year at a breakeven position following first half operating losses of £2.7 million, had an adverse impact on the Group operating return on revenue. In the second half of the financial year, Rail showed clear signs of recovery as a result of decisive management action.

Following the significant increase in bank debt used to fund the acquisitions of DML and INS, net finance costs increased to £25.6 million, including amortisation of bank facility costs, from £6.2 million last year. Upward movements in bank interest rates also adversely affected the unhedged portion of the Group's borrowings. Nonetheless net finance costs remained comfortably covered by earnings before interest, tax, depreciation and amortisation (EBITDA) at 5.5 times (2007: 12.1 times). After net finance costs, profit before tax increased 53% to £95.5 million (2007: £62.5 million).

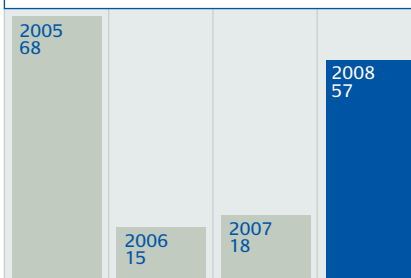
The Group benefits from tax rates in overseas jurisdictions that are lower than the standard rate of UK corporation tax. The Group's effective tax rate on underlying profit before tax was 19% (2007: 20% or 22% excluding a prior year gain of £1.0 million). The effective rate is calculated as the total charge to income tax as a percentage of the Group's profit before tax, before exceptional items and amortisation. Based on the profile of earnings within the Group, we expect this rate to be sustainable at least for the 2008/09 financial year. As a result of the uncertainty created by draft government legislation on the taxation of corporate profits, it is possible that the rate could rise to 23% thereafter.

Profit for the year from continuing operations at £77.3 million was up 55% on last year (£49.9 million) with a corresponding uplift in basic earnings per share to 33.40p (2007: 23.35p). Fully diluted earnings per share were 32.77p, up 45% from 22.66p on last year. Following a further year of strong growth in earnings, the Board has recommended a total dividend for the year of 11.50p per share, an increase of 43% on 2006/07, which is covered 2.9 times by underlying earnings.

### Revenue growth %

#### KPI:

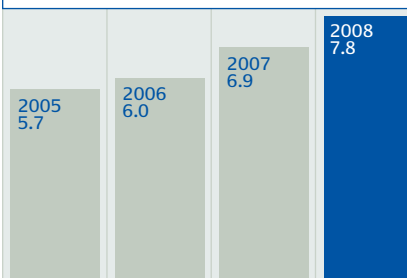
Revenue growth is defined as the increase in the company's continuing revenue when compared to that of the previous year. Note: 2005 includes the effect of the acquisition of Peterhouse Group in June 2004.



### Operating return on revenue (ORR) %

#### KPI:

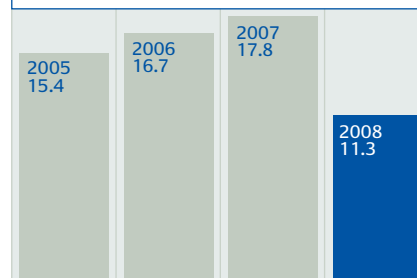
Operating return on revenue (ORR) is defined as operating profit before amortisation of acquired intangibles and exceptional items expressed as a percentage of revenue.



### Return on invested capital (ROIC) %

#### KPI:

Return on invested capital (ROIC) is defined as net income divided by total capital (equity plus net debt).



## Operating and financial review continued

## Liquidity

During the year the Group made acquisitions for net cash consideration of £372.3 million. This comprised DML, which was acquired in June 2007 for a net cash consideration plus costs of £356.7 million, and INS where the balance of the business not acquired in 2006/07 was purchased for net cash consideration of £15.1 million and a payment to minority shareholders of £12.5 million. In conjunction with the purchase of DML, the Group made an equity cash placing of £89.1 million net of costs and raised a new committed five year revolving bank borrowing facility of £600 million. At 31 March 2008, the Group's net debt position was £322.2 million (31 March 2007: £73.7 million).

The Group gearing ratio was 89% and net debt to EBITDA was 2.3 times (2007: 1.0 times), comfortably within both internal and external benchmarks.

## 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. 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 and collars, 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 counterparties including any investment of cash or cash equivalents.

The Group's income is derived 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. As such customer credit risk is considered to be low.

Additional information on the Group's management of financial risk is provided in note 2 of the Notes to the Group financial statements.

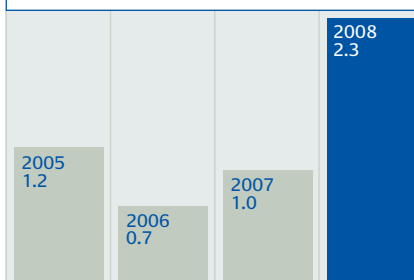
## Pensions

The acquisition of DML included the assets and liabilities of its defined benefit pension scheme, with an overall accounting surplus at the date of acquisition of £16.6 million. As at 31 March 2008, the total of assets and liabilities within Group defined benefit pension schemes including those of DML, were £2.0 billion and £1.8 billion respectively (2007: £1.2 billion and £1.15 billion). The overall accounting surplus at 31 March 2008 was £142.2 million (2007: £53.1 million).

The assumptions used in valuing the schemes are set out in the accounts. Valuations are sensitive to all of these assumptions but the judgements necessary in arriving at the discount rate to be applied in calculating fund liabilities make it particularly sensitive. The Group has historically based the rate on a recognised corporate bond index. We have applied the same principle at 31 March 2008 and in common with other defined benefit pension schemes in the corporate sector, the effect of higher yields resulting from current credit markets has reduced the net present value of pension liabilities relative to last year. Similarly, difficult credit markets have also had the effect of reducing asset values in the schemes. These variations from period-to-period are a consequence of the application of mark-to-market valuation on long-term assets and liabilities and can affect both the balance sheet and profit and loss account significantly in any given period.

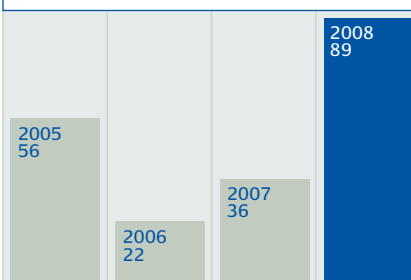
## Net debt/EBITDA x

**KPI:**  
Net debt/EBITDA is calculated as net debt divided by earnings before interest, tax, depreciation and amortisation.



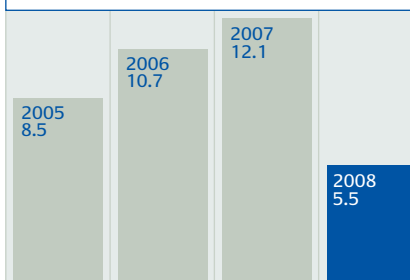
## Gearing ratio %

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



## EBITDA interest cover x

**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, depreciation and amortisation, divided by net interest payable.



Pension schemes valuations are also sensitive to assumptions made as to the likely longevity profile of the schemes' members. We have carried out a full and detailed review of each scheme's specific longevity experience and have adopted assumptions which we believe to be appropriate based on this review. However, pressure from regulatory bodies is leading to calls for increased caution when making assumptions and a resultant increase in the valuation of liabilities. As a consequence the Group will be exploring a number of options to offset this trend.

In 2007/08 the amounts charged or credited to the income statement in respect of pensions were as follows:

	2008 £m	2007 £m
Service cost	26.8	15.0
Expected return on plan assets	(115.1)	(68.5)
Interest on obligations	92.1	51.6
	(23.0)	(16.9)
Net charge/(credit) (before exceptionals)	3.8	(1.9)

### Group cash flow

In the year to 31 March 2008 the Group generated cash from operations of £119.2 million (2007: £60.2 million) representing 108% of operating profit (2007: 96%). We believe consistent cash generation over time is a true indicator of the underlying health of a business and tight control over fixed and working capital is a key feature of the Group. Our medium-term cash conversion rate (cash from operations as a percentage of operating profit) target is 80%; we have consistently exceeded this target over the past five years.

Excluding the effects of fixed and working capital, the principal factors affecting cash flow in the year related in the main to the acquisition of DML and INS. In total, spend on acquisitions was £372.3 million and the purchase of minority interests in INS was £12.5 million. Net finance cash costs were appreciably higher during 2007/08 at £20.3 million (2007: £5.5 million) as a result of the acquisition activity during the period.

Tax and dividend payments in the year totalled £29.8 million (2007: £21.3 million).

## Outlook

The markets in which we operate remain attractive with good long-term growth prospects. We have established leading positions in all our markets and developed strong relationships with our customers. Our long-term financial performance is underpinned by the strength of our current order book, major contracts to be awarded in the near future, opportunities being created by recent acquisitions and a healthy bid pipeline.

The outlook for the Group remains positive and the Board is confident that further progress will be made this year.

**Peter Rogers**  
Group Chief Executive

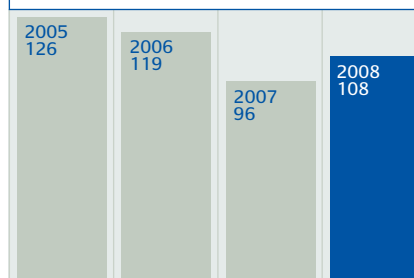


**Bill Tame**  
Group Finance Director

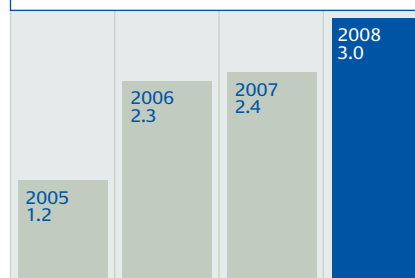


### Operating cash flow (OCF) conversion rate %

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



### Order book £bn



Trusted to deliver:

# Winter Hill Bolton, Lancashire

The Winter Hill transmitter mast is one of the most important in the UK, transmitting to around seven million people. Babcock Networks are designing and installing high powered digital antennae for commercial and public service broadcast.



## Directors and Company Secretary

### Gordon Campbell CBE (61)

*Chairman of the Board  
Chairman of the Nominations Committee*

Gordon Campbell joined the Board in October 2000. Until August 2003 he was Group Chief Executive and Executive Chairman. Since then he has been part-time Chairman.

He is currently Chairman of British Nuclear Fuels plc and Chairman of Jupiter Second Split Trust plc. He is also a Non-Executive Director of Accsys Technologies plc and Jst Securities Limited. He is a former Vice President of the Royal Academy of Engineering.

### The Rt Hon Lord Alexander Hesketh KBE (57)

*Non-Executive Deputy Chairman  
Member of the Nominations Committee*

Alexander Hesketh joined the Board in 1993 and has been Non-Executive Deputy Chairman since 1996.

He is Chairman of British Mediterranean Airways Limited and is a Director of a number of other private companies. He is a former Government Chief Whip in the House of Lords and Industry Minister at the Department of Trade and Industry.

### Peter Rogers (60)

*Group Chief Executive*

Peter Rogers joined the Board in June 2002 as Chief Operating Officer. He became Group Chief Executive in August 2003.

He is a former Director of Courtaulds plc and Acordis BV.

### William Tame (53)

*Group Finance Director*

Bill Tame joined the Board as Group Finance Director in January 2002.

He is a former Finance Director of Scapa Group PLC and is a Non-Executive Director of Carclo PLC.

### John Rennocks (62)

*Senior Independent Non-Executive Director  
Chairman of the Audit and Risk Committee  
Member of the Remuneration Committee  
Member of the Nominations Committee*

John Rennocks has been a Non-Executive Director since June 2002.

He is a former Finance Director of Corus Group PLC and is Chairman of Diploma Plc, Nestor plc and Intelligent Energy Holdings PLC. He is a Non-Executive Director of Foreign & Colonial Investment Trust PLC, JP Morgan Overseas Investment Trust PLC, Wagon PLC and Inmarsat plc.

### Dipesh J Shah OBE (55)

*Independent Non-Executive Director  
Chairman of the Remuneration Committee  
Member of the Audit and Risk Committee  
Member of the Nominations Committee*

Dipesh Shah has been a Non-Executive Director since June 1999.

He is Chairman of HgCapital Renewable Power Partners LLP and Chairman of Jetion Holdings. He was formerly Chairman of Viridian Group PLC and Chief Executive Officer of the United Kingdom Atomic Energy Authority. He was also a Chief Executive Officer of various businesses within BP and a member of the DTI's Renewable Energy Advisory Committee.

He is a director of several companies, including Thames Water and Kemble Water Group of companies, and Lloyd's of London Franchise Board.

### Sir Nigel Essenhigh GCB (63)

*Independent Non-Executive Director  
Member of the Remuneration Committee  
Member of the Audit and Risk Committee  
Member of the Nominations Committee*

Nigel Essenhigh has been a Non-Executive Director since March 2003.

He is a former 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.

### Justin Crookenden (45)

*Independent Non-Executive Director  
Member of the Remuneration Committee  
Member of the Audit and Risk Committee  
Member of the Nominations Committee*

Justin Crookenden has been a Non-Executive Director since December 2005.

A 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.

### Albert Dungate (51)

*Company Secretary*

Albert Dungate has been Group Company Secretary and General Counsel since February 2002. A solicitor, he was formerly General Counsel and Company Secretary of Arjo Wiggins Appleton PLC. He is Secretary to the Company's Audit and Risk, Remuneration and Nominations Committees.

## Directors' report

The Directors present their report and the audited financial statements of the Group and the Company for the year ended 31 March 2008.

### Results and dividends

The profit attributable to shareholders for the financial year was £67.3 million (2007: £43.4 million). An interim dividend of 3.30p per 60p ordinary share was declared in the year (2007: 2.40p). The Directors propose to recommend the payment on 8 August 2008 of a final dividend of 8.20p (2007: 5.65p) on each of the ordinary shares of 60p entitled thereto and in issue on 11 July 2008.

### Directors

Biographies of the Directors who served during the year are shown on page 36. Each Director served throughout the year.

Directors submit themselves for reappointment at least every three years in accordance with the Combined Code.

Lord Hesketh, who has been a Director since 1993, submits himself for reappointment on an annual basis as required by the Combined Code. Dipesh Shah, who on 9 June 2008 will have served nine years as a Director, is submitting himself for re-election at the 2008 AGM in July. If re-elected, he will also subsequently submit himself for annual re-election.

Other Directors retiring and submitting themselves for re-election this year are Mr Rogers, Mr Tame, and Mr Rennocks.

Their fellow Board members unanimously recommend members to vote in favour of the Non-Executive Directors standing for re-election, having rigorously evaluated their performance and the contribution they make to the work and effectiveness of the Board.

### Matters more fully dealt with in other sections of the Report and Accounts

Some of the matters that have to be covered in this Directors' report are dealt with in other sections of the Report and Accounts (and are to be treated as incorporated into this Report), namely:

*Directors' share interests:* These are to be found in the table on page 50.

*Business review and post balance sheet events:* Pages 7 to 33 contain a review of the Group's activities and likely future developments, a description of the principal risks and uncertainties facing the Group, key performance indicators and details of any important events since 31 March 2008.

*Employees:* The Company's approach to employee matters (including employee communication, public interest disclosure, ethical standards and its policy on disabled employees and employee involvement) are dealt with in the Corporate and Social Responsibility section on pages 22 to 25. In the year ended 31 March 2008, the Group employed an average of 15,002 staff worldwide, of whom approximately 92% were located in the UK.

*Principal subsidiary, joint venture and associated undertakings:* These are shown on page 101.

*Treasury management, financial risk management and the use of financial instruments:* This is covered on page 32.

*Changes in asset values:* These are dealt with in the financial statements.

*Corporate Governance and internal controls:* This is addressed in detail on pages 41 to 43.

*Acquisitions and disposals:* Information regarding the Group's acquisitions and disposals during the course of the year are set out in note 32 on pages 91 and 92 and they are also referred to in the Operating and financial review.

### Directors' interests in contracts

At the date of this Report, there is no contract or arrangement with the Company or any of its subsidiaries that is significant in relation to the business of the Group as a whole in which a Director of the Company is materially interested.

### Significant shareholdings

As at 27 May 2008, 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	%
Standard Life Investments Limited	23,311,893	10.17
Schroders plc	20,123,434	8.77
Ameriprise Financial, Inc.	11,483,477	5.01
JP Morgan Chase & Co	11,376,214	4.96
Legal and General Group Plc	9,263,860	4.04
Lloyds TSB Group plc	8,930,111	3.89
Resolution Investment Services Limited	8,605,622	3.75

The Company is not aware of any other person who has a significant direct or indirect holding of securities in the Company and there are no securities in issue which carry special rights with regard to control of the Company.

Directors' report continued

## Employee share schemes

### *The All Employee Share Ownership Plan*

The Company has an All Employee Share Ownership Plan, which is open to all UK employees (including Executive Directors) who meet the necessary service criteria. Under the Plan, employees can buy Company shares in the market out of pre-tax income. The Plan allows the Company to award free and/or matching shares to participants, though the Company has not yet done so. Shares are bought via a tax-approved employee trust which holds them on behalf of the individual 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.

Further details of the following executive share schemes are to be found in the Remuneration report on pages 50 to 52:

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

This is the Plan that has been used since 2003 to make performance-linked share awards to a limited number of Directors and senior employees in the form of options granted at a nominal or nil price.

### *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 performance-linked. No grants under these Schemes have been made to Directors since 2003 or to other employees since 2004.

In respect of the L-TIP and the 1999 Schemes mentioned above, shares are held by the trustees of the Babcock Employee Share Trust and the Peterhouse Employee Share Trust. The trustees of these Schemes do not intend to exercise the voting rights attached to the shares held by them. As at 27 May 2008, the total number of ordinary shares in such trusts was 1,715,748, which represented 0.75% of the Company's issued share capital. Shares are also held by the trustees of the All Employee Share Ownership Plan mentioned above. The trustees only exercise any voting rights attached to such shares in accordance with directions from the employee on whose behalf they are held.

The trustees of the Babcock Employee Share Trust waive dividends on shares held by them – see note 27 on page 86.

## Authority to purchase own shares

At the AGM in July 2007, members authorised the Company to make market purchases of up to 22.8 million of its own ordinary shares of 60p each. That authority expires at the forthcoming AGM in July 2008 when a resolution will be put to renew it to allow purchases of up to a maximum of 22.9 million shares (just under 10% of the Company's issued share capital). No shares in the Company have been purchased by the Company in the period from 14 July 2007 (the date of the last AGM) to the date of this Report. The Company currently does not hold any treasury shares.

Details of purchases of the Company's shares made by the Babcock Employee Share Trust and the Peterhouse Employee Share Trust are to be found in note 27 on page 86.

## Research and development

The Group commits resources to research and development to the extent management considers necessary for the evolution and growth of its business.

## Charitable and political donations

During the year the Group donated £105,000 (2007: £67,000) to charitable organisations. No donations were made during the year for political purposes.

## Supplier payments

The Group's policy is to pay suppliers in accordance with practices or arrangements agreed with them. The Company itself had £33,000 trade creditors at 31 March 2008 (representing 38 days) and nil creditors at 31 March 2007.

## 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. 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 2008, 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. The Directors also disclose qualifying third party indemnity provisions entered into between the Company and two of the Directors (Mr A Bethel and Mr K Thomas) of International Nuclear Solutions PLC (a subsidiary of the Company) on 6 and 8 November 2007, which were in force at the date of approval of this Report. The Company also entered into deeds with the two independent Directors of International Nuclear Solutions PLC on 22 January 2008, under which the Company agreed to pre-pay any reasonable costs or expenses incurred by those Directors that are not pre-paid by the Company's directors and officers insurance policy in respect of any claim made against them and which is connected with their positions as Directors of International Nuclear Solutions PLC. If the Director does not successfully defend any such claim, the Director must repay the Company the amount so pre-paid.

*The Companies Acts now require the Company to disclose the information set out below. References are to the Company's existing Articles of Association (Articles). The changes to the Articles that will be proposed at this year's AGM will affect this information to reflect the provisions of the Companies Act 2006. The information is a summary of the relevant Articles; the full Articles are available for inspection at the Company's registered office.*

#### **Share capital and rights attaching to the Company's shares**

Under the Company's Articles of Association, any share in the Company may be issued with such rights or restrictions, whether in regard to dividend, voting, return of capital or otherwise as the Company may from time to time by ordinary resolution determine (or, in the absence of any such determination, as the Directors may determine).

At a general meeting of the Company, every member has one vote on a show of hands and on a poll one vote for each share held. The notice of general meeting specifies deadlines for exercising voting rights either by proxy or present in person in relation to resolutions to be passed at a general meeting.

No member is, unless the Board decides otherwise, entitled to attend or vote either personally or by proxy at a general meeting or to exercise any other right conferred by being a shareholder if they or any person with an interest in their shares has been sent a notice under section 793 of the Companies Act 2006 (which confers upon public companies the power to require the provision of information with respect to interests in their voting shares) and they or any interested person have failed to supply the Company with the information requested within 14 days after delivery of that notice. The Board may also decide that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered. These restrictions end seven days after receipt by the Company of a notice of an approved transfer of the shares or all the information required by the relevant section 793 notice, whichever is the earlier.

The Directors may refuse to register any transfer of any share which is not a fully-paid share, although such discretion may not be exercised in a way which the Financial Services Authority regards as preventing dealings in the shares of the relevant class or classes from taking place on an open or proper basis. The Directors may likewise refuse to register any transfer of a share in favour of more than four persons jointly.

The Company is not aware of any other restrictions on the transfer of shares in the Company other than certain restrictions that may from time to time be imposed by laws and regulations (for example, insider trading laws).

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities or voting rights.

#### **Appointment and powers of Directors**

Directors are appointed by ordinary resolution at a general meeting of ordinary shareholders. The Directors have the power to appoint a Director during the year, but any person so appointed must be put up for reappointment at the next Annual General Meeting.

Subject to its Articles of Association and relevant statutory law and to such direction as may be given by the Company in general meeting by special resolution, the business of the Company shall be managed by the Directors, who may exercise all powers of the Company which are not required to be exercised by the Company in general meeting.

#### **Articles of Association**

The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders. At the Company's AGM to be held on 10 July 2008, a resolution will be put to shareholders to amend the existing Articles of Association, to incorporate changes introduced by the Companies Act 2006.

#### **Significant agreements that take effect, alter or terminate upon a change of control**

The following agreements are those agreements which the Company considers to be significant to the Group as a whole that contain provisions giving the other party a specific right to terminate them if the Company is subject to a change of control following a takeover bid.

##### ***Babcock Marine***

*Partnering Agreement dated 29 August 2002 between (1) The Secretary of State for Defence (2) Babcock Marine (Clyde) Limited (formerly Babcock Naval Services Limited) and (3) Babcock International Group PLC*

Under the Partnering Agreement (as subsequently amended), Babcock Marine (Clyde) Limited provides services to the MoD in relation to the operation of HM Naval Base Clyde. In 2005, the period of the Agreement was extended and it will now expire in 2013.

In the event of a change of majority control of Babcock International Group PLC, the MoD may request information regarding the new controlling entity and in certain circumstances, including if it is not satisfied as regards the financial affairs and standing of the new entity, serve a 'Change in Circumstance' notice, and thereafter can elect to terminate the Agreement.

In addition, the articles of association of Rosyth Royal Dockyard Limited (RRDL) and Devonport Royal Dockyard Limited (DRDL), both subsidiaries of the Company, grant the Ministry of Defence certain rights as a special shareholder in circumstances which are deemed to constitute unacceptable ownership, influence or control over either company and which are contrary to the essential security interest of the UK, including circumstances where any non-UK domicile acquires direct or indirect control of more than 30% of RRDL or DRDL. Such rights include the right to require the sale of shares in RRDL or DRDL and the right to remove directors of DRDL or RRDL.

Directors' report continued

#### **Babcock Networks**

*Joint Venture Agreement dated 24 November 2006 between (1) Babcock Networks Limited, (2) AMEC Group Limited and (3) Mott MacDonald Limited to form the unincorporated joint venture known as the Energy Alliance*

On 16 March 2007, Babcock Networks Limited, AMEC Group Limited and Mott MacDonald Limited, acting jointly and severally as the Energy Alliance, entered into the Area Alliance Agreement with National Grid Electricity Transmission PLC for the provision of services to upgrade National Grid's transmission network as part of its Capital Investment Programme.

Under the terms of the Energy Alliance joint venture agreement, if any party undergoes a change of control, then the other parties may suspend or exclude that party from further participation in the joint venture and by extension the Area Alliance Agreement.

#### **Babcock Infrastructure Services**

*Joint Venture Agreement dated 16 November 2005 between (1) Babcock Support Services Limited and (2) DynCorp International LLC to form Babcock DynCorp Limited*

On 16 November 2005, Babcock DynCorp Limited entered into the Regional Prime Contract (East) with The Secretary of State for Defence acting through the agency of Defence Estates to provide property maintenance and capital works across the MoD Estate in the East of England.

Under the terms of the Babcock DynCorp joint venture agreement, if either party undergoes a change of control, the other party may require that party to sell its shares in the joint venture at a fair value.

#### **Facility Agreement**

The Group entered into a £600 million credit facility on 9 May 2007 which provides that, in the event of a change of control of the Company, the lenders may within a certain period call for the prepayment of any outstanding loans and cancel the credit facility.

#### **Share Plans**

The Company's share plans contain provisions as a result of which options and awards may vest and become exercisable on a change of control of the Company in accordance with the rules of the plans.

#### **Contracts with employees or Directors**

A description of those agreements with Directors that contain provisions relating to payments in the event of a termination of employment following a change of control of the Company is set out on page 53. One senior employee, who is not a Director of the Company, has an agreement with provisions as to termination of employment following a change of control that are equivalent to the provisions for Mr Rogers and Mr Tame described on page 53, except that the provision for mitigation in the event of voluntary resignation within 90 days of the change of control does not apply. Two other senior employees, who also are not Directors of the Company, have agreements providing for payment as described on that page in the event of a dismissal (including constructive dismissal) by the Company within 12 months following a change of control, but do not have the right to voluntarily resign and claim any payment.

#### **Annual General Meeting**

This year's Annual General Meeting will be held at Savoy Place, 2 Savoy Place, London WC2R 0BL on Thursday 10 July 2008, at 9.30 am. The notice of meeting is on pages 102 and 103 and explanatory notes on the resolutions to be proposed at it as special business are set out on pages 105 and 106.

#### **Auditors**

PricewaterhouseCoopers LLP is willing to continue in office as independent auditor, and a resolution to reappoint it will be proposed at the forthcoming Annual General Meeting.

#### **Approval of report**

Approved by the Directors on 27 May 2008

By order of the Board

#### **A N Dungate**

Company Secretary

27 May 2008

## Statement on Corporate Governance

During the year to 31 March 2008 the Company complied with the provisions of section 1 of The Combined Code on Corporate Governance 2006 (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*

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. A copy of this is available on the Company's website ([www.babcock.co.uk](http://www.babcock.co.uk)).

#### *Senior Independent Director*

During the year, Mr Rennocks was recognised by the Board as the Senior Independent Director to whom concerns could be conveyed by shareholders if they had concerns which had not been resolved through the normal channels of Chairman, Group Chief Executive or Group Finance Director.

#### *The Board and Board balance*

We have two full-time Executive Directors, one non-independent Non-Executive Director and a Chairman. In addition, throughout the year there were four Non-Executive Directors who were considered by the Board to be independent. This met the Combined Code requirement for Board balance. Those independent Directors were: Mr Shah, Sir Nigel Essenhigh, Mr Rennocks and Mr Crookenden.

On 9 June 2008, Mr Shah will have served as a Non-Executive Director for nine years and will consequently cease to be regarded by some shareholders as independent. The Board is aware of the need to take steps to address the consequences of this in order to continue to meet the requirements of the Combined Code for at least half the Board (excluding the Chairman) to be independent.

#### *Refreshing of the Board*

At the time of the AGM in July 2008, our Directors will have served on the Board as follows (approximately):

Gordon Campbell:	8 years
Peter Rogers:	6 years
Bill Tame:	6.5 years
Lord Hesketh	15 years
John Rennocks	6 years
Dipesh Shah	9 years
Sir Nigel Essenhigh	4 years
Justin Crookenden	2.5 years

Directors are normally reappointed at the first AGM following their appointment and then have to offer themselves for reappointment at least every three years. It is the Company's policy to review rigorously the reappointment of Non-Executive Directors who have served more than six years.

As required by the Combined Code, the Board explains, in notes accompanying the notice of meeting on page 104, why it recommends the reappointment of the Non-Executive Directors proposed for re-election at the AGM for 2008. The Chairman confirms in those notes, also 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.

#### *Board procedures*

During the year to 31 March 2008, there were nine scheduled Board meetings. Each Director attended all those meetings, with the exception of Lord Hesketh who was unable to attend one of the meetings due to his absence abroad. Three special additional short-notice Board meetings were held during the process leading up to the acquisition of Devonport Management Limited that were attended by the Directors then available. The Board has also generally authorised the holding of ad hoc meetings of two or more Directors to deal with matters generally in accordance with delegated authorities approved by the Board, including a Finance Committee. It also from time to time establishes special committees for specific purposes, for example in connection with specific acquisitions.

The Chairman regularly meets Non-Executive Directors without Executive Directors or other managers present.

During the year, a review of the performance of the Board as a whole, its committees and individual Directors was carried out by an independent facilitator who conducted individual confidential interviews with each of the Board members, the Company Secretary and certain senior Group employees. The results of those interviews were reported to the Chairman who shared them with Board members. The review concluded that the Board and its committees, and individual Directors, were working very well. It was agreed that succession planning should be an area of focus.

The Chairman's performance was evaluated by the Remuneration Committee and was also discussed in confidence with the independent facilitator during the process mentioned above.

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*

(Details of the membership and operation of the Audit and Risk Committee and its work can be found on page 44 and of the Remuneration Committee on pages 45 to 53.)

### *Nominations Committee*

In the year to 31 March 2008, the Nominations Committee consisted of:

G Campbell (Committee Chairman)

D J 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. Its terms of reference are available on the Company's website. During the year, the Committee did not need to meet formally, as discussions on succession planning were held in the course of Board meetings or in meetings between the Group Chairman and the Non-Executive Directors in the absence of executive management.

### *Whistle-blowing arrangements*

These arrangements are dealt with in the Corporate and Social Responsibility section on page 22.

### *Non-audit fees*

The Audit and Risk Committee Chairman must authorise any engagement of auditors on non-audit work that would entail their being paid fees in excess of 20% of the audit fee in any year. Before giving that authority, he considers potential conflicts and the possibility of actual or perceived threats to the independence of the external auditors. Authority is given only when he considers it is in the Company's interest to do so.

### *Contact with shareholders*

The Group has a full-time Head of Investment Relations whose role it is to ensure that there is regular dialogue between the Company, its principal shareholders and the wider market so that there is a clear understanding of their respective views and that investors have a good understanding of the Company and its management. The Group Chief Executive and the Group Finance Director regularly meet institutional shareholders and analysts. Reports of these meetings are sent to the Board, which also receives at each of its meetings an Investor Relations Report from the Head of Investment Relations.

The Annual General Meeting is used as an opportunity for communication with shareholders. All of the Company's Directors attended the 2007 Annual General Meeting.

The Company's website keeps shareholders abreast 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*

The Company makes arrangements 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 and Board visits are also made to sites. Presentations on the Group's businesses and specialist functions are made to the Group Board from time to time. Non-Executive Directors receive copies of all minutes of meetings of the Group Executive Committee and regularly receive the operating reports sent to the Group head office by the business operations. General Director training that might be of potential interest or relevance to Directors can be arranged on request, for which the Company is willing to pay.

### *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, control environment, procedures and monitoring*

The Board acknowledges its overall responsibility for the Group's system of internal controls, and for monitoring its effectiveness.

There is a written delegation of matters from the Board to committees of one or more Directors. The Board retains responsibility for setting overall strategy, approving annual budgets, authorising equity investments and business acquisitions and disposals, approving significant contracts outside the ordinary course of business and setting treasury and borrowing policy.

There has been a process for identifying, evaluating and managing significant risks throughout the year to 31 March 2008 and up to the date of the approval of the financial statements for that year.

The internal control system is monitored through review visits from Group management and the internal audit service provided by Ernst & Young LLP, which acts under the overall control and direction of the Audit and Risk Committee. The system covers any material joint ventures or associates.

The Board and its Audit and Risk Committee review the effectiveness of the process formally at least once a year. They also review it informally on an ongoing basis by identifying its various elements and by seeking the views of executive management and internal and external auditors upon it as to its operation and how it compares with processes in other companies. It is also assessed by considering it against operational outcomes.

The Board considers the system to be effective and in accordance with Internal Controls: Guidance for Directors on the Combined Code ('the Turnbull Guidance').

The system comprises principally:

- 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 and Risk 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;
- an annual Board review of the insurance programme;
- reviews, at least annually, of pensions exposures and risks;
- monthly reports on disputes and litigation;
- a formal succession plan;
- monthly reports on health and safety matters.

The Group's systems can, however, only seek to manage, rather than eliminate, the risk of failure to achieve business objectives, as any system can only provide reasonable, not absolute, assurance against material misstatement or loss.

#### **Identification and evaluation of risks and control objectives**

The identification and evaluation of risks and control objectives is also addressed on pages 25 to 27.

#### **Budgets**

Comprehensive systems are in place to develop annual budgets and medium-term financial plans. The budgets are reviewed by central management before being submitted to the Board for approval. Updated forecasts for the year are prepared at least quarterly. The Board is provided with details of actual performance each month compared with budgets, forecasts and the prior year, and is given a written commentary on significant variances from approved plans.

## Audit and Risk Committee

### The Audit and Risk Committee

#### *Who is on it?*

The Committee members during the year (each served throughout the year) were all independent Non-Executive Directors:

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

Biographical details of the members are set out on page 36.

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 his role as Committee Chairman.

#### *How does it operate?*

The Committee's formal terms of reference are available on the Company's website at [www.babcock.co.uk](http://www.babcock.co.uk).

The Company Secretary is secretary to the Committee. The Committee invites the Group's Chairman, Chief Executive, Finance Director and Financial Controller to attend its meetings. Non-Executive Directors not sitting on the Committee are also welcome to attend. The Group Risk Manager attends for discussion of Group risk reports and related items.

Ernst & Young LLP provides internal audit services to the Company. PricewaterhouseCoopers LLP is the Group's external auditor. Both auditors usually attend all or part of the Committee's meetings.

The Committee Chairman meets PricewaterhouseCoopers and Ernst & Young in the absence of executive management, and other Committee members have the opportunity to do so.

#### *What did it do?*

The Committee met formally five times in the year to 31 March 2008. Each Committee member attended all meetings.

In the year to 31 March 2008, the Committee:

- reviewed the preliminary and interim statements of results and the proposed announcements relating to them;
- reviewed the financial statements for the year ended 31 March 2007 and the half year ended 30 September 2007 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 misreporting of results by business units;
- reviewed internal audit reports from Ernst & Young LLP and external audit 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 arrangements for confidential 'whistle-blowing';
- reviewed the Group risk standard and its implementation, together with Group risk reports;
- conducted a going concern review.

## Remuneration report

This Report will be submitted for approval at the AGM on 10 July 2008.

### Remuneration Committee

#### *Who is on it?*

The members of the Committee throughout the year (each served throughout the year) were all independent Non-Executive Directors:

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

Their biographical details are on page 36. Each member attended the three formal meetings of the Committee during the year and took part in informal meetings as necessary.

#### *What does it do?*

The Committee determines the remuneration packages of the Chairman, Executive Directors and certain other senior Group executives.

#### *How does the Committee operate?*

The Committee meets formally at least twice a year. The Committee also meets on an ad hoc basis as may be necessary. The Company Secretary attends meetings as secretary to the Committee. The Group Chairman and the Group Chief Executive attend formal meetings by invitation of the Committee, except when their own remuneration is being discussed. The Deputy Chairman attends some meetings as an observer.

The Inbucon Group Limited ('Inbucon') provides the Committee with independent, market-based advice on director and senior management remuneration. Inbucon is formally retained, with the Committee's approval, by the Company (acting through the Company Secretary). Inbucon does not provide other services to Group companies.

#### *What is the Company's remuneration policy?*

The remuneration policy for executives has two objectives:

- to ensure that the remuneration structure for senior executives is competitive, so that when taking account of job complexity, responsibility, skills and experience, the remuneration package is at least at a similar level for comparable post holders in the market in which the Company has to compete in recruiting and retaining such executives; and
- where the Company achieves or exceeds predetermined performance criteria, to share with those executives a fair proportion of the value of that performance.

The link between remuneration policy and strategy is made through the performance criteria used in both the annual bonus and long-term incentive schemes with the intention that executives have remuneration packages overall that are fair and allow enhanced rewards for the delivery of superior performance.

### Level and balance of remuneration

#### *Market comparison*

In reviewing remuneration, the Company considers data relating to both companies generally of a similar size as well as to remuneration specifically in the support services sector.

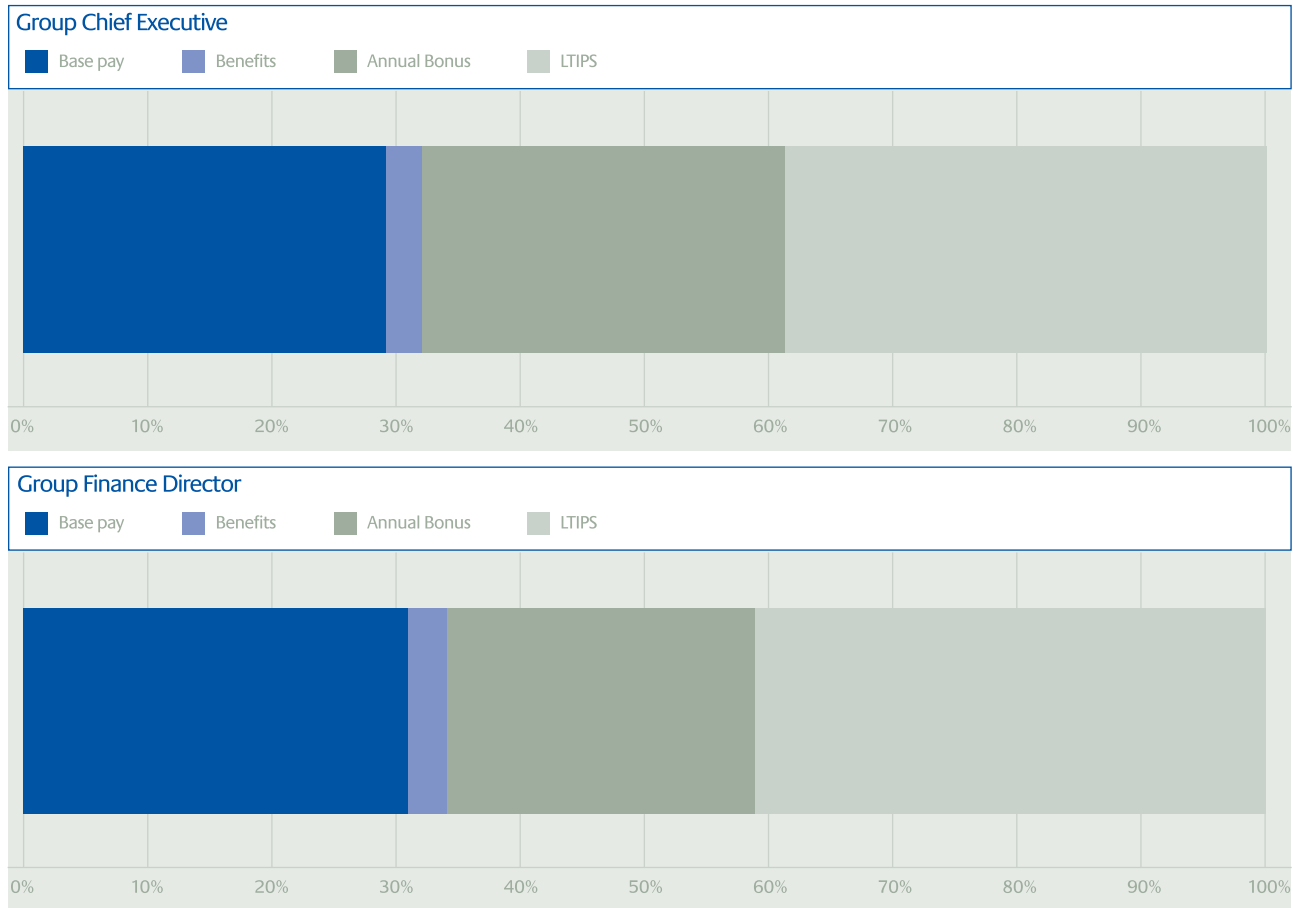
#### *Level of remuneration*

The Committee sets the level of overall remuneration so that upper quartile rewards can be earned for upper quartile performance, having set basic packages bearing in mind the median for comparable companies.

## Remuneration report continued

*Balance of remuneration*

The balance of remuneration for Executive Directors is set so that the major part of overall remuneration is subject to performance, both short- and long-term. The balance for the Group Chief Executive and the Group Finance Director is shown in the graphs below, (with L-TIP awards being valued on a projected value basis and assuming full achievement of bonus potential).



Mr Campbell, as part-time Chairman, has a remuneration package in which the performance related element is over 50% of potential remuneration.

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

*Basic pay*

Basic pay is considered against comparable 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 at or about the median. Basic pay is reviewed annually.

In June 2007, the Company made a major strategic move when it acquired Devonport Management Limited ("DML") and its subsidiaries. This acquisition transformed the size of the Group. The Committee therefore asked Inbucon to carry out a review to ensure that in the changed circumstances remuneration packages remained in line with remuneration policy when tested against relevant comparative data. The salary for Mr Tame had already fallen behind market before this step-change in the size of the Group and the increase in his remuneration also reflects this.

## Performance-related rewards

### *Annual bonus schemes*

Of the Directors, only Mr Rogers, Group Chief Executive, and Mr Tame, Group Finance Director, receive annual bonuses. These are performance-related and the scheme is set by the Committee each year.

The Committee's policy is currently to focus the schemes on profit and/or earnings growth.

For the year ended 31 March 2008, the annual bonuses payable to Mr Rogers (maximum 100% of eligible salary) and Mr Tame (80%) were originally structured as follows: a bonus of 20% was dependent on hitting budgets for profit before tax and cash flow. The balance (80% for Mr Rogers and 60% for Mr Tame) depended on growth in profit before tax over the prior financial year, with maximum pay-out for this element being achieved at 20% growth in profits.

However, the acquisition of Devonport Management Limited (DML) part-way through the year made a meaningful and appropriate year-on-year profits growth comparison difficult. The DML acquisition was financed in part by a placing of newly-issued shares and in part by borrowings.

Against this background, the scheme was amended to provide for maximum bonus to be paid if the revised Group budget, inclusive of DML, was achieved with no diminution in actual earnings per share (before exceptionals and amortisation of acquired intangibles) as against the original pre-acquisition budget for earnings per share.

Mr Rogers and Mr Tame earned maximum annual bonus for financial year 2007/08.

For the financial year 2008/09 the Committee is again setting annual bonuses for Mr Rogers and Mr Tame principally by reference to growth, using growth in earnings per share (before amortisation of acquired intangibles, but, unless the Committee otherwise decides, after exceptionals) (EPS), with the balance by reference to hitting profit before tax and cash flow budgets. The relative proportions as between reward for growth and reward for achieving budget will be as described above. Maximum bonus will be paid for achieving budget and 20% growth in EPS.

Annual bonus schemes for divisional managing directors also include performance measures dependent on growth in divisional profits and/or achievement of budgeted divisional profits and cash flow according to the objectives for the division concerned. Bonus schemes for senior Group managers other than Directors reflect the schemes for Mr Rogers and Mr Tame, but with lower maximum bonus potential.

The Committee has discretion to reduce or extinguish bonuses in light of health, safety or environmental performance.

Annual bonuses are not pensionable.

### *Long-term incentives*

Each year since 2003, qualifying Directors and certain senior Group employees have been granted performance-related long-term incentives in the form of awards of nil-price options under the Babcock 2003 Long-Term Incentive Plan ('L-TIP'). Before 2003 they were granted performance-related market-priced share options under the Babcock 1999 Approved and Unapproved Executive Share Option Schemes.

It is the intention of the Company that shares needed to satisfy options for Directors and awards under the L-TIP will be purchased in the market to the extent not already held in the employee share trusts at the date the options or awards were granted or are exercised.

During the financial year, L-TIP awards were made to each of Mr Campbell, Mr Rogers and Mr Tame over shares having a market value on award of 100% of their qualifying basic salaries. Awards were also made to a small number of other senior managers.

The vesting of the L-TIP awards depends on company performance. Half of each award vests according to comparative Total Shareholder Return performance (against a specific comparator list) and half on earnings per share growth. The performance criteria are set out on page 52.

Details of options and L-TIP awards held by the Directors are set out on pages 50 and 51.

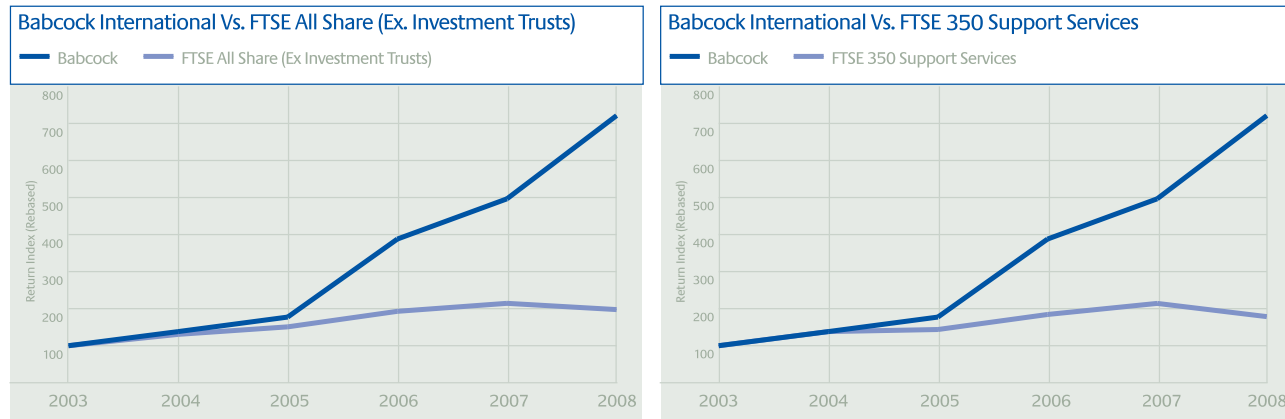
For certain divisional senior managers, but not the Company's Directors, there is a cash-based long-term incentive scheme focused on divisional performance and with particular features to aid retention. The performance targets are set by reference to divisional profit targets and return on capital employed 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 performance period. Target bonuses under these schemes vary between participants but will not normally exceed a year's basic salary for on-target performance, with maximum payout for out-performance capped at 150% of target bonus.

## Remuneration report continued

*Performance graph*

The graphs below were prepared by Inbucon. They show the total shareholder return for a holding in the Company's shares for the period from 1 April 2003 to 31 March 2008 relative to a holding of shares representing respectively the FTSE All-Share Index (excluding investment trusts) and the FTSE 350 Support Services Sector. The calculation of the return assumes dividends are reinvested to purchase additional equity. This FTSE All-Share Index (excluding investment trusts) is the same index as has been used for this purpose in earlier Remuneration reports, as it is a broad index that allows comparison of the Company's performance against the performance of the stock market as a whole. Support Services is the sector in which the Company's share price is reported.

Over the five-year period, the Company has substantially out-performed both indexes. An investment of £100 in the Company on 1 April 2003 would have been worth (assuming the dividends were reinvested in further Company shares) £721 at 31 March 2008.

**Directors' emoluments and compensation (audited)**

Director	Salary or fee <sup>1</sup> £'000	Pay in lieu of pension <sup>2</sup> £'000	Annual bonus <sup>3</sup> £'000	Benefits in kind <sup>4</sup> £'000	Total year ended 31 March 2008 £'000	Total year ended 31 March 2007 £'000
<b>Chairman and Executive Directors</b>						
G A Campbell (Chairman)	250	–	–	–	250	241
P L Rogers (Group Chief Executive)	440	47	451	1	939	848
W Tame (Group Finance Director)	302	22	236	18	578	474
<b>Non-Executive Directors</b>						
The Rt Hon Lord Hesketh	60	–	–	–	60	58
J L Rennocks	42	–	–	–	42	39
D J Shah	40	–	–	–	40	38
Sir Nigel Essenhigh	35	–	–	1	36	34
J N A Crookenden	35	–	–	–	35	33
<b>Total</b>	<b>1,204</b>	<b>69</b>	<b>687</b>	<b>20</b>	<b>1,980</b>	<b>1,765</b>

(This table should be read together with the sections on basic pay and performance-related rewards on pages 46 and 47.

The emoluments disclosed above do not include any amounts for the value of options or other share-based rewards. Details of share-based awards held by the Directors are to be found on pages 50 and 51.)

- Salary or fee includes cash allowances (other than any in lieu of pension benefits) not forming part of basic salary and also car allowances where applicable.
- For Mr Rogers the payment is in lieu of all pension benefits. For Mr Tame, the payment is in lieu of pension benefits on that part of his basic salary as exceeds the earnings cap for the pension scheme (see detailed explanation under Directors' Pensions below).
- Annual bonuses were paid by reference to revised annual salaries following the acquisition of DML.
- 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)

Only Mr Tame currently participates in a Group pension scheme. He receives a salary supplement for his earnings in excess of the scheme earnings cap (see the table on page 48).

Mr Rogers receives a supplement in lieu of pension, which is not taken into account for the purpose of bonus or L-TIP awards. It is separately identified in the table on page 48.

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.

#### Babcock International Group Pension Scheme ('the Scheme')

Mr Tame is a member of the senior executive 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. The earnings cap adopted by the Scheme 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 2008 £ pa	Increase in accrued benefits excluding inflation during the year ended 31 March 2008 £ pa	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2007 £	Transfer value at 31 March 2008 £	Transfer value of increase in accrued benefits less Director's contributions £	Increase in transfer value less Director's contribution £
W Tame	23,652	4,511	3,764	312,238	405,486	43,676	87,608

1. Inflation has been taken as 3.9% 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 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, the Company provided a Funded Unapproved Retirement Benefit Scheme (FURBS) for Mr Tame in respect of his salary in excess of the earnings cap. 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 of providing additional life assurance cover was:

Director	2008 £'000	2007 £'000
W Tame	—	2

#### Non-Executive Directors

The Non-Executive Directors receive only fixed fees. These fees are reviewed against market practice from time to time by the Chairman and the Executive Directors, to whom the task has been delegated by the Board.

## Remuneration report continued

**Directors' interests in shares**

The table below shows the holdings of fully paid ordinary shares of 60p each of the Directors (including family interests) in the issued share capital of the Company. The interests were beneficial interests.

The Board encourages Executive Directors to build and maintain, over time, a personal holding of shares equivalent in value to around a year's basic pay.

Director	At 31 March 2008	At 1 April 2007	Market Value of shareholding as percentage of basic salary as at 31/03/2008*
G A Campbell*	250,000	49,685	600%
P L Rogers*	100,000	100,000	130%
W Tame*	26,189	26,189	56%
Lord Hesketh	1,667	8,249	—
D J Shah	8,333	8,333	—
Sir Nigel Essenhigh	—	—	—
J L Rennocks	—	—	—
J N A Crookenden	—	—	—

\*These Directors also hold significant options and/or L-TIP awards that are vested and exercisable (see tables below), but which they have chosen not yet to exercise.

There were no changes in the Directors' interests in shares between 31 March 2008 and 27 May 2008.

**Directors' share-based rewards and options (audited)****Options**

Details of the Directors' share options are set out in the table below and the notes beneath it. All of the outstanding options are vested and exercisable.

Director	Option scheme	Number of shares subject to options at 1 April 2007	Granted during the year	Exercised during the year*	Lapsed during the year	Number of shares subject to options at 31 March 2008	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

\*Details of the options exercised during the year are as follows:

Director	Option scheme	Exercise date	Number of options exercised	Number of shares sold on exercise*	Market value per share on exercise (pence)	Exercise price per share (pence)	Total gain on date of exercise £
G A Campbell	a	27/06/07	560,975		546.73	123.00	2,377,002
	c	"	209,104		546.73	99.33	935,525
	c	"	317,590		546.73	124.50	1,340,950
	<b>Total</b>		<b>1,087,669</b>	<b>587,669</b>			<b>4,653,477</b>
W Tame	b	27/06/07	—		546.73	104.33	—
	c	"	148,951		546.73	104.33	658,954
	c	"	198,125		546.73	124.50	836,537
	<b>Total</b>		<b>347,076</b>	<b>347,076</b>			<b>1,495,491</b>

\*Mr Campbell sold 587,669 of the shares obtained on the date of exercise. He subsequently sold 250,000 shares on 16 July 2007 at a price per share of 536.73p.

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

Options vested according to comparative TSR performance over three-year performance periods. They were not subject to re-testing. The comparator group was the companies in the FTSE Engineering and Machinery Sector when the options were granted (which was the sector in which the Company's shares were then listed). There was no vesting unless the Company ranked above median performance, in which case 25% of the options vested. Full vesting was for top quartile ranking with proportionate vesting on a straight-line basis for a ranking between those points.

The exercise price was 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. This price was not discounted.

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 2008 and 27 May 2008.

#### *Share awards under the L-TIP*

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 2007	Granted during the year	Exercised during the year <sup>1</sup>	Lapsed during the year	Number of shares subject to award at 31 March 2008 <sup>2</sup>	Market value (in pence) of each share at date of award	Exercisable (subject to vesting and plan rules) from <sup>3</sup>	Expiry date
<b>G A Campbell</b>								
2003	166,395				<i>166,395</i>	113.50	Jun 2006	Jul 2013
2004	158,730				<i>158,730</i>	126.00	May 2007	Jul 2014
2005	117,994				<i>117,994</i>	169.50	May 2008	Jul 2015
2006	66,469				<i>66,469</i>	338.50	May 2009	Jul 2016
2007		42,202			<i>42,202</i>	556.80	May 2010	Jul 2017
<b>P L Rogers</b>								
2003	253,972		253,972		–	113.50	Jun 2006	Jul 2013
2004	281,746				<i>281,746</i>	126.00	May 2007	Jul 2014
2005	230,088				<i>230,088</i>	169.50	May 2008	Jul 2015
2006	118,168				<i>118,168</i>	338.50	May 2009	Jul 2016
2007		74,528			<i>74,528</i>	556.80	May 2010	Jul 2017
<b>W Tame</b>								
2003	170,775				<i>170,775</i>	113.50	Jun 2006	Jul 2013
2004	162,698				<i>162,698</i>	126.00	May 2007	Jul 2014
2005	132,743				<i>132,743</i>	169.50	May 2008	Jul 2015
2006	69,423				<i>69,423</i>	338.50	May 2009	Jul 2016
2007		51,182			<i>51,182</i>	556.80	May 2010	Jul 2017

1. Details of exercises:

Director	Year of award	Date of exercise (and sale)	Exercise price	Number of award shares exercised (all of which were sold on exercise)	Market price on exercise (pence per share)	Total value realised £
P L Rogers	2003	2/07/07	–	253,972	546.72	1,388,535

2. The L-TIP awards shown in italics were fully vested and exercisable as at 31 March 2008.

3. Vesting date depends on the date of notification of the vesting, but will 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 31 March 2008 was 571.50p. The highest and lowest mid-market share prices in the year ended 31 March 2008 were 617.50p and 400.00p respectively.

The L-TIP awards that vested during the year to 31 March 2008 were those granted in July 2004. The market value of those shares on award was 126.00p per share. On the date of vesting, 16 May 2007, they had a market value of 549.00p per share, being the mid-market closing price on that day. The performance conditions attached to the awards 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). The number of shares awarded had a value equal to the qualifying annual salary at the date of the award using the average of the mid-market closing price of the Company's shares for the three business days preceding that date.

## Remuneration report continued

Subject to satisfaction of the performance criteria (see below) attached to the awards, the Directors may call for the release of the award shares during the above 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 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 and is not re-tested.

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 financial year 2008/09.

For the half of the share awards where vesting depends on comparative TSR performance, a ranking immediately above the median level in the comparator table results in 25% of those shares vesting. There is 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) 2006 comprised 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 for the awards made in 2007 was:

- |                           |                             |
|---------------------------|-----------------------------|
| 1. AEA Technology         | 11. Mouchel Parkman         |
| 2. Atkins                 | 12. Rentokil Initial        |
| 3. Aggreko                | 13. SERCO Group             |
| 4. AMEC                   | 14. VT Group                |
| 5. Bodycote International | 15. WSP Group               |
| 6. Capita Group           | 16. The Weir Group PLC      |
| 7. Carillion              | 17. Ashtead Group plc       |
| 8. Cobham                 | 18. Alfred McAlpine plc     |
| 9. Interserve             | 19. Davis Service Group plc |
| 10. MITIE Group           |                             |

The comparator group is chosen by the Remuneration Committee 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 Group will be reviewed before the grant of awards in 2008.

The TSR calculation uses a 12-month average. The Company feels that this is the most appropriate period because a 12-month average ensures both that the short-term market volatility is excluded and that for each company a 12-month period will capture the impact of the announcement of results and payment of dividends. A shorter period would not capture all these events and would not necessarily put all companies on an equal footing.

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%.

For the L-TIP awards made in 2003 vesting depended on the Company's earnings per share (pre-acquired intangible amortisation and exceptional items) in the year to 31 March 2006 being 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 to 31 March 2003. Once this hurdle was achieved, actual levels of vesting depended on the comparative 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. The target provided for no vesting 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).

### Service contracts

The following table summarises the key terms (apart from as to remuneration) of the Chairman's and Executive Directors' service contracts or terms of appointment:

#### Chairman and Executive Directors

Name	Date of service contract	Notice period	Contractual retirement age
G A Campbell (Chairman)	31 July 2003 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months from Company, 6 months from Director	65
P L Rogers (Group Chief Executive)	31 July 2003 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months from Company, 6 months from Director	65
W Tame (Group Finance Director)	20 September 2001 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months from Company, 6 months from Director	65

The Company's policy is that Directors' service contracts should be capable of being terminated by the Company on not more than 12 months' notice.

If the Company terminates a Director's service contract (other than following a change of control or by the exercise of the Company's option to pay salary in lieu of notice – see below) 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. The agreements for Mr Campbell, Mr Rogers and Mr Tame contain provisions relating to termination following a change of control, as described below. These provisions do no more than reflect what would, in effect, be a likely outcome in practice for these positions following a change of control and may contain the liability in such case, as the payment is limited to base salary and for Mr Rogers and Mr Tame, 40% in lieu of bonus, which is significantly less than their actual bonus potential.

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 is only entitled to be paid his basic salary (plus, in the case of Mr Rogers and Mr Tame, 40% in lieu of bonus and all other contractual entitlements) on a monthly basis, but any amount that he receives by way of income from other sources within that 12-month period, if it exceeds 10% of salary, that he would not have been able to earn had he 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 (subject to re-election as required either under the Articles or the Combined Code)*
Lord Hesketh	6 October 1993	21 May 2008	AGM for 2009
D J Shah	15 June 1999	15 May 2008	AGM for 2009
J L Rennocks	13 June 2002	15 May 2008	AGM for 2012
Sir Nigel Essenhugh	4 March 2003	15 May 2008	AGM for 2012
J N A Crookenden	1 December 2005	15 May 2008	AGM for 2011

\*The Company's policy is for Non-Executive Directors to have written terms of appointment normally for no more than three-year terms at a time; however, *in all cases appointments are terminable at will at any time 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

Before taking up any new outside appointment, an Executive 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 2007 to 31 March 2008 his fees for that role were £25,000.

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

#### D J Shah

Chairman of the Remuneration Committee

27 May 2008

## 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 Acts and Article 4 of the IAS Regulation and that the parent Company financial statements and the Directors' Remuneration report comply with the Companies Acts. 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.

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

We have audited the Group financial statements of Babcock International Group PLC for the year ended 31 March 2008 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 2008 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 (2006) 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 unaudited part of the Directors' Remuneration report, the Chairman's statement, the Operating and financial review and the Statement on Corporate Governance. 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 2008 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

27 May 2008

## Group income statement

For the year ended 31 March 2008

	Note	2008 Before acquired intangible amortisation and exceptional items £m	2008 Acquired intangible amortisation and exceptional items £m	2008 Total £m	2007 Before acquired intangible amortisation and exceptional items £m	2007 Acquired intangible amortisation and exceptional items £m	2007 Total £m
Revenue	3	1,555.9	–	1,555.9	988.3	–	988.3
Operating profit	3, 4, 6	121.1	(10.9)	110.2	68.3	(5.5)	62.8
Share of profit from joint ventures	3	–	–	–	0.4	–	0.4
Finance costs	7	(32.0)	–	(32.0)	(9.8)	–	(9.8)
Finance income	7	6.4	–	6.4	3.6	–	3.6
Profit before tax		95.5	(10.9)	84.6	62.5	(5.5)	57.0
Income tax expense	9	(18.2)	3.3	(14.9)	(12.6)	1.6	(11.0)
Profit for the year from continuing operations		77.3	(7.6)	69.7	49.9	(3.9)	46.0
Discontinued operations							
Loss for the year from discontinued operations	10	–	–	–	–	(0.8)	(0.8)
Profit for the year	5	77.3	(7.6)	69.7	49.9	(4.7)	45.2
Attributable to:							
Equity holders of the parent				67.3			43.4
Minority interest				2.4			1.8
				69.7			45.2
Earnings per share from continuing and discontinued operations	12						
– Basic				29.99p			21.10p
– Diluted				29.43p			20.48p
Earnings per share from continuing operations	12						
– Basic				29.99p			21.49p
– Diluted				29.43p			20.85p

The Group financial statements were approved by the Board of Directors on 27 May 2008 and are signed on its behalf by:

**P L Rogers** Director

**W Tame** Director

## Group balance sheet

As at 31 March 2008

	Note	2008 £m	2007 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Goodwill	13	479.6	198.2
Other intangible assets	14	62.9	23.0
Property, plant and equipment	15	145.9	28.2
Investment in joint ventures	16	0.4	0.9
Other investments	16	–	9.4
Retirement benefits	28	142.6	62.5
Trade and other receivables	19	1.7	2.5
Deferred tax	17	3.0	2.5
		836.1	327.2
<b>Current assets</b>			
Inventories	18	76.7	57.7
Trade and other receivables	19	340.9	167.2
Income tax recoverable		2.3	1.2
Other financial assets	23	1.7	0.5
Cash and cash equivalents	20	199.6	95.6
		621.2	322.2
<b>Total assets</b>		<b>1,457.3</b>	<b>649.4</b>
<b>Equity and liabilities</b>			
<b>Equity attributable to equity holders of the parent</b>			
Share capital	25	137.6	125.8
Share premium		148.1	70.1
Other reserves		20.9	26.8
Retained earnings		50.6	(17.1)
		357.2	205.6
Minority interest		3.6	1.6
<b>Total equity</b>	27	<b>360.8</b>	<b>207.2</b>
<b>Non-current liabilities</b>			
Bank and other borrowings	22	377.5	3.6
Trade and other payables	21	15.3	0.9
Deferred tax	17	31.2	2.5
Retirement liabilities	28	0.4	9.4
Provisions for other liabilities	24	32.3	7.6
		456.7	24.0
<b>Current liabilities</b>			
Bank and other borrowings	22	144.3	165.7
Trade and other payables	21	466.7	232.9
Income tax payable		11.6	5.9
Other financial liabilities	23	4.2	0.1
Provisions for other liabilities	24	13.0	13.6
		639.8	418.2
<b>Total liabilities</b>		<b>1,096.5</b>	<b>442.2</b>
<b>Total equity and liabilities</b>		<b>1,457.3</b>	<b>649.4</b>

## Group cash flow statement

For the year ended 31 March 2008

	Note	2008 £m	2007 £m
<b>Cash flows from operating activities</b>			
Cash generated from operations	29	119.2	60.2
Income tax paid		(9.5)	(7.7)
Interest paid		(26.7)	(9.1)
Interest received		6.4	3.6
<b>Net cash flows from operating activities</b>		<b>89.4</b>	<b>47.0</b>
<b>Cash flows from investing activities</b>			
Disposal of subsidiaries and joint ventures		0.3	0.9
Proceeds on disposal of property, plant and equipment		5.4	0.7
Proceeds on disposal of intangible assets		0.2	–
Dividend received from joint ventures		0.2	0.1
Purchase of other investments		–	(9.7)
Purchases of property, plant and equipment		(13.1)	(5.5)
Purchases of intangible assets		(1.1)	(1.5)
Acquisition of minority interests		(12.5)	–
Acquisition of subsidiaries net of cash acquired	32	(372.3)	(52.5)
<b>Net cash flows from investing activities</b>		<b>(392.9)</b>	<b>(67.5)</b>
<b>Cash flows from financing activities</b>			
Dividends paid		(20.3)	(13.6)
Finance lease principal payments		(0.5)	(1.9)
Bank loans raised		276.5	35.0
Dividends paid to minority interests		(1.1)	(0.4)
Net proceeds on issue of shares		89.8	0.7
Movement on own shares		(5.0)	0.3
<b>Net cash flows from financing activities</b>		<b>339.4</b>	<b>20.1</b>
<b>Net increase/(decrease) in cash, cash equivalents and bank overdrafts</b>		<b>35.9</b>	<b>(0.4)</b>
<b>Cash, cash equivalents and bank overdrafts at beginning of year</b>		<b>22.1</b>	<b>25.3</b>
<b>Effects of exchange rate fluctuations</b>		<b>(1.5)</b>	<b>(2.8)</b>
<b>Cash, cash equivalents and bank overdrafts at end of year</b>	31	<b>56.5</b>	<b>22.1</b>

## Group statement of recognised income and expense

For the year ended 31 March 2008

	Note	2008 £m	2007 £m
Profit for the year (including discontinued operations)		69.7	45.2
Currency translation differences		(3.2)	(5.9)
Fair value adjustment of interest rate hedges		(2.7)	0.4
Net actuarial gains in respect of pensions	28	43.0	8.7
Tax on net actuarial gains in respect of pensions and interest rate hedges		(9.7)	(2.6)
<b>Total recognised income and expense</b>		<b>97.1</b>	<b>45.8</b>
<b>Attributable to:</b>			
Equity holders of the parent		94.9	44.2
Minority interest		2.2	1.6
		<b>97.1</b>	<b>45.8</b>

## 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.

#### *Transactions with minorities*

The Group policy is to treat transactions with minorities as transactions with equity holders and therefore result in movements in reserves.

#### *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.

##### *(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*

#### *(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. Monetary assets and liabilities denominated in foreign currencies are translated into the local currency at the year end exchange rates.

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 is recognised when the fair value of goods and services are rendered by the Group.

### *Finance costs*

Finance 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 or 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.

### *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.

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

### *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.

### *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 28), impairment of goodwill (see note 13) 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.

Fair value adjustments on acquisitions are by nature subject to critical judgements. The size of recent acquisitions make them significant in Group terms.

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.

### *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 2008 or later periods but which the Group has not early adopted.

a) Standards, amendments and interpretations effective in 2007 with minimal or no impact on the Group:

- 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.
- 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.
- IFRS4, 'Insurance contracts'.
- IFRIC7, 'Applying the restatement approach under IAS 29, Financial reporting in hyper-inflationary economies'.
- IFRIC9, 'Re-assessment of embedded derivatives'.

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

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:

- IFRIC11, 'Group and Treasury Share Transactions'. This IFRIC interpretation is effective for annual periods beginning on or after 1 March 2007.
- IAS23 (Amendment), 'Borrowing costs'. This IFRIC interpretation is effective for annual periods beginning on or after 1 January 2009.
- 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.
- IFRIC14, 'IAS19 – The limit on a defined benefit asset, minimum funding requirements and their interaction'. This IFRIC interpretation is effective for annual periods beginning on or after 1 January 2008.

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

- IFRIC12, 'Service concession arrangements' (effective from 1 January 2008).
- IFRIC13, 'Customer loyalty programmes' (effective for annual periods beginning on or after 1 July 2008).

**2. Financial risk management***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.

Gearing and liquidity are managed to external and internal benchmarks.

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 customers are mainly from government, government backed institutions or blue chip corporations and as such credit risk is considered small.

*Foreign exchange risk*

The foreign exchange exposure of Group entities on the net monetary position against their respective functional currencies expressed in the Group's presentation currency is insignificant with the largest exposure being Sterling to Euro of £1.6 million (2007: £0.9 million).

Consequently, the effect on profit and equity, increase or (decrease), if the rates moved up or down by an appropriate percentage volatility, assuming all other variables remained constant would in total be less than £0.2 million (2007: £0.1 million). The reasonable shifts in exchange rates are based on historic volatility and range from 15% for Sterling to Euro to 30% for South African Rand to Euro.

*Interest rate risk*

The fair values of debt, and related hedging instruments are affected by movements in interest rates. The following table illustrates the sensitivity in cash flow of interest rate-sensitive instruments to a hypothetical parallel shift of the forward interest rate curves of  $\pm 50$ bp (2006:  $\pm 50$ bp), with effect from the beginning of the year. All other variables are held constant.

	2008		2007	
	£m +50bp	£m -50bp	£m [+50bp	£m -50bp
Net results for the year	(0.6)	1.2	(0.6)	0.6
Equity	2.3	(3.2)	0.5	(0.5)

**2. Financial risk management (continued)***Liquidity risk*

Liquidity risk management includes maintaining sufficient cash and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Group treasury maintains flexibility in funding by maintaining availability under committed credit lines.

The table below analyses the Group's liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contract maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	Less than 1 year £m	Between 1 and 2 years £m	Between 2 and 5 years £m	Over 5 years £m
<b>At 31 March 2008</b>				
Bank and other borrowings	144.3	1.1	376.4	–
Derivative financial instruments	(0.5)	1.4	1.6	–
Trade and other payables	466.7	11.1	2.3	2.8
<b>At 31 March 2007</b>				
Bank and other borrowings	165.7	1.1	2.0	0.5
Derivative financial instruments	0.1	0.1	0.2	–
Trade and other payables	232.9	0.9	–	–

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than 1 year £m	Between 1 and 2 years £m	Between 2 and 5 years £m	Over 5 years £m
<b>At 31 March 2008</b>				
Forward foreign exchange contracts – cash flow hedges:				
– outflow	8.3	–	–	–
– inflow	7.4	–	–	–
Forward foreign exchange contracts – held for trading:				
– outflow	2.9	–	–	–
– inflow	3.1	–	–	–
<b>At 31 March 2007</b>				
Forward foreign exchange contracts – cash flow hedges:				
– outflow	5.8	–	–	–
– inflow	5.8	–	–	–
Forward foreign exchange contracts – held for trading:				
– outflow	1.6	–	–	–
– inflow	1.7	–	–	–

### 3. Segmental information

#### (a) Primary reporting format – business segments

Following the acquisition of Devonport Management Limited and the acquisition of a majority shareholding in International Nuclear Solutions plc (INS) we have realigned our marine and nuclear activities into new divisions. The Marine division encompasses the activities formerly reported under Technical Services along with Babcock Naval Services, previously reported under Defence. The Nuclear division encompasses Alstec nuclear, previously reported under Technical Services and INS.

	2008 Group revenue £m	2008 Operating profit before acquired intangible amortisation, exceptional items £m	2008 Acquired intangible amortisation and exceptional items £m	2008 Group operating profit £m	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
<b>Continuing operations</b>								
Marine	633.2	68.7	(5.4)	63.3	217.3	22.3	(0.1)	22.2
Defence	302.1	27.5	(1.4)	26.1	247.3	20.4	0.6	21.0
Rail	228.1	0.5	(1.8)	(1.3)	228.8	9.3	(4.1)	5.2
Nuclear	76.3	5.7	(1.8)	3.9	54.4	3.3	(1.4)	1.9
Networks	98.5	7.2	(0.5)	6.7	74.9	6.8	(0.3)	6.5
Engineering and Plant	217.7	17.1	–	17.1	165.6	13.3	–	13.3
Unallocated	–	(5.6)	–	(5.6)	–	(7.1)	(0.2)	(7.3)
<b>Total continuing operations</b>	<b>1,555.9</b>	<b>121.1</b>	<b>(10.9)</b>	<b>110.2</b>	<b>988.3</b>	<b>68.3</b>	<b>(5.5)</b>	<b>62.8</b>
Finance cost		(32.0)	–	(32.0)		(9.8)	–	(9.8)
Finance income		6.4	–	6.4		3.6	–	3.6
Share of post tax profit from joint ventures (net of tax)		–	–	–		0.4	–	0.4
<b>Profit before tax</b>		<b>95.5</b>	<b>(10.9)</b>	<b>84.6</b>		<b>62.5</b>	<b>(5.5)</b>	<b>57.0</b>
Income tax		(18.2)	3.3	(14.9)		(12.6)	1.6	(11.0)
<b>Profit for the year from continuing operations</b>		<b>77.3</b>	<b>(7.6)</b>	<b>69.7</b>		<b>49.9</b>	<b>(3.9)</b>	<b>46.0</b>
<b>Discontinued operations</b>								
Unallocated		–	–	–		–	(1.0)	(1.0)
Income tax		–	–	–		–	0.2	0.2
<b>Total for the year from discontinued operations</b>		<b>–</b>	<b>–</b>	<b>–</b>		<b>–</b>	<b>(0.8)</b>	<b>(0.8)</b>
<b>Total for the year</b>	<b>1,555.9</b>	<b>77.3</b>	<b>(7.6)</b>	<b>69.7</b>	<b>988.3</b>	<b>49.9</b>	<b>(4.7)</b>	<b>45.2</b>

Inter divisional sales are immaterial.

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

	2008				2007			
	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
<b>Continuing operations</b>								
Defence	0.6	0.1	–	0.1	1.8	0.2	(0.1)	0.1
Rail	0.7	0.3	(0.3)	–	0.4	0.1	(0.2)	(0.1)
Networks	–	–	–	–	1.4	0.2	–	0.2
Engineering and Plant	3.6	(0.1)	–	(0.1)	1.5	0.2	–	0.2
<b>Total continuing operations</b>	<b>4.9</b>	<b>0.3</b>	<b>(0.3)</b>	<b>–</b>	<b>5.1</b>	<b>0.7</b>	<b>(0.3)</b>	<b>0.4</b>

Notes to the Group financial statements continued

**3. Segmental information (continued)**

The segment assets and liabilities at 31 March 2008 and 31 March 2007 and capital expenditure for the years then ended are as follows:

	Assets		Liabilities		Capital expenditure	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Marine	667.2	51.9	263.4	57.2	5.8	0.2
Defence	175.9	161.5	70.3	46.9	0.7	0.3
Rail	144.0	106.8	47.9	38.8	0.6	0.7
Nuclear	89.2	19.8	21.8	10.1	0.3	0.3
Networks	88.1	89.0	22.1	20.5	3.0	1.8
Engineering and Plant	93.7	81.1	79.1	69.7	3.5	2.9
Unallocated	199.2	139.3	591.9	199.0	0.3	0.8
<b>Group total</b>	<b>1,457.3</b>	<b>649.4</b>	<b>1,096.5</b>	<b>442.2</b>	<b>14.2</b>	<b>7.0</b>

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 and income and deferred tax which are included in the unallocated segment.

The segmental depreciation, amortisation and impairment of goodwill for the years ended 31 March 2008 and 31 March 2007 are as follows:

	Depreciation		Amortisation and impairment of intangible assets	
	2008 £m	2007 £m	2008 £m	2007 £m
Marine	12.1	0.8	6.4	0.5
Defence	0.4	0.3	1.4	1.5
Rail	0.9	1.1	2.7	3.0
Nuclear	0.3	0.2	2.0	1.5
Networks	1.0	0.9	1.0	0.8
Engineering and Plant	2.2	1.9	–	–
Unallocated	0.5	0.4	–	–
<b>Group total</b>	<b>17.4</b>	<b>5.6</b>	<b>13.5</b>	<b>7.3</b>

*(b) Secondary reporting format – geographical segments*

	Revenue		Assets		Capital expenditure	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
United Kingdom	1,335.4	821.3	1,361.3	566.0	10.8	4.1
Africa	210.4	159.8	91.3	79.1	3.2	2.8
North America	7.2	5.9	2.6	2.1	0.2	0.1
Rest of World	2.9	1.3	2.1	2.2	–	–
<b>Group total</b>	<b>1,555.9</b>	<b>988.3</b>	<b>1,457.3</b>	<b>649.4</b>	<b>14.2</b>	<b>7.0</b>

	2008 £m	2007 £m
<b>Analysis of revenue by category</b>		
Sales of goods	252.9	132.1
Sales of services	1,301.7	855.2
Rental income	1.3	1.0
	<b>1,555.9</b>	<b>988.3</b>

#### 4. Operating expenses

	2008 £m	2007 £m
<b>Continuing operations</b>		
Cost of sales	1,375.5	858.3
Distribution expenses	5.9	7.0
Administrative expenses	64.3	60.2
	<b>1,445.7</b>	<b>925.5</b>

#### 5. Profit for the year

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

	Continuing operations		Discontinued operations		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Employee costs (note 8)	487.9	314.1	–	–	487.9	314.1
Inventories						
– cost of inventories recognised as an expense	214.7	112.3	–	–	214.7	112.3
– increase in inventory provisions	1.0	1.2	–	–	1.0	1.2
Depreciation of property, plant and equipment (PPE)						
– owned assets	16.8	4.7	–	–	16.8	4.7
– under finance leases	0.6	0.9	–	–	0.6	0.9
	17.4	5.6	–	–	17.4	5.6
Amortisation of intangible assets						
– acquired intangibles	10.9	6.1	–	–	10.9	6.1
– software and development costs	2.6	1.2	–	–	2.6	1.2
	13.5	7.3	–	–	13.5	7.3
Impairment of other investments (note 16)	(0.3)	0.3	–	–	(0.3)	0.3
Profit on disposal of PPE	2.5	0.2	–	–	2.5	0.2
Operating lease rentals payable						
– property	10.6	8.1	–	0.3	10.6	8.4
– plant and machinery	7.5	4.8	–	–	7.5	4.8
– other	1.9	1.4	–	–	1.9	1.4
Research and development	0.3	–	–	–	0.3	–
Trade receivables impairment	1.7	0.8	–	–	1.7	0.8
Net foreign exchange losses	(0.2)	1.0	–	–	(0.2)	1.0

#### 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:

	2008 £m	2007 £m
<b>Audit fees:</b>		
Fees payable to the Group's auditor for the audit of the parent entity and the consolidated financial statements	0.5	0.3
<b>Fees for other services:</b>		
The auditing of accounts of subsidiaries of the company pursuant to legislation (including that of countries and territories outside Great Britain)	0.6	0.5
Tax	0.2	0.1
All other services	0.6	0.8
<b>Total fees paid to the Group's auditor and network firms</b>	<b>1.9</b>	<b>1.7</b>

Other services, in the current year, are in the main related to statutory requirements in relation to the DML acquisition.

**6. Operating exceptional items and acquired intangible amortisation**

In 2008 there were no operating exceptional items (2007: £0.6 million).

In 2007 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 segment, £0.4 million within the Marine segment, £0.3 million within the Networks segment and £0.4 million unallocated. Offset against this were operating exceptional costs of £2.6 million of which £2.0 million is reorganisation costs in the Rail segment and £0.6 million were bid defence costs arising out of a possible joint bid from BAE Systems plc and VT Group plc.

In 2008 acquired intangible amortisation was £10.9 million (2007: £6.1 million). The acquisition of Devonport Management Limited (DML) resulted in acquired intangible amortisation of £5.0 million and the acquisition of International Nuclear Solutions PLC (INS) resulted in £0.9 million of acquired intangible amortisation. DML is included in the Marine segment whilst INS is included in Nuclear.

	2008 Acquired intangible amortisation £m	2008 Exceptional items £m	2008 Total £m	2007 Acquired intangible amortisation £m	2007 Exceptional items £m	2007 Total £m
Marine	(5.4)	–	(5.4)	(0.5)	0.4	(0.1)
Defence	(1.4)	–	(1.4)	(1.5)	2.1	0.6
Rail	(1.8)	–	(1.8)	(2.1)	(2.0)	(4.1)
Nuclear	(1.8)	–	(1.8)	(1.4)	–	(1.4)
Networks	(0.5)	–	(0.5)	(0.6)	0.3	(0.3)
Unallocated	–	–	–	–	(0.2)	(0.2)
	(10.9)	–	(10.9)	(6.1)	0.6	(5.5)

**7. Net finance costs**

	2008 £m	2007 £m
<b>Finance costs</b>		
Bank loans and overdrafts	25.0	7.9
Finance leases	0.2	0.3
Interest rate hedge	2.8	–
Amortisation of issue costs of bank loan	1.4	0.2
Other	2.6	1.4
<b>Total finance costs</b>	<b>32.0</b>	<b>9.8</b>
<b>Finance income</b>		
Bank deposits	6.4	2.9
Other	–	0.7
<b>Total finance income</b>	<b>6.4</b>	<b>3.6</b>
<b>Net finance costs</b>	<b>25.6</b>	<b>6.2</b>

## 8. Employee costs

	2008 £m	2007 £m
Wages and salaries	432.6	279.3
Social security costs	38.9	26.0
Share-based payments (note 26)	1.4	1.7
Pension costs – defined contribution plans (note 28)	11.2	9.0
Pensions charge/(credit) – defined benefit plans (note 28)	3.8	(1.9)
	487.9	314.1

Pension costs on defined benefit schemes in 2008 are before curtailment and settlement gains which were largely offset by the costs of the liability reduction exercise which created the gains.

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

	2008 Number	2007 Number
Operations	13,231	8,199
Administration and management	1,771	1,444
	15,002	9,643

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.

	2008 £m	2007 £m
Salaries	7.2	4.8
Post-employment benefits	0.2	0.2
Share-based payments	1.4	1.4
	8.8	6.4

The key management figures given above include Directors.

**9. Income tax expense**

	2008 £m	2007 £m
<b>Analysis of tax charge in the year</b>		
Current tax		
– UK current year charge	12.6	7.5
– Overseas current year charge	7.8	6.7
– UK prior year credit	(0.3)	(0.5)
– Overseas prior year credit	(1.3)	–
	<b>18.8</b>	<b>13.7</b>
Deferred tax		
– UK current year credit	(4.2)	(0.6)
– Overseas current year credit	(1.3)	(1.6)
– UK prior year credit	–	(0.5)
– Overseas prior year charge	0.9	–
– Impact of change in UK tax rate	0.7	–
	<b>(3.9)</b>	<b>(2.7)</b>
<b>Total income tax expense – continuing operations</b>	<b>14.9</b>	<b>11.0</b>

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

	2008 £m	2007 £m
<b>Profit before tax – continuing operations</b>	<b>84.6</b>	<b>57.0</b>
Profit on ordinary activities multiplied by rate of corporation tax in the UK of 30% (2006: 30%)	25.4	17.1
Effects of:		
Expenses not deductible for tax purposes	1.0	1.3
Adjustments to tax in respect of prior period	–	(1.0)
Adjustments in respect of foreign tax rates	(6.5)	(6.2)
Utilisation of brought forward tax assets not previously recognised	(0.5)	(0.3)
Other	(5.2)	0.1
Remeasurement of deferred tax change in UK tax rate	0.7	–
<b>Total income tax expense – continuing operations</b>	<b>14.9</b>	<b>11.0</b>

During the year, as a result of the change in UK Corporation Tax rates which will be effective from 1 April 2008, deferred tax balances have been remeasured. Deferred tax relating to temporary differences which reversed prior to 1 April 2008 were reversed at 30% and deferred tax relating to temporary differences expected to reverse after 1 April 2008 is measured at the tax rate of 28% as these are the tax rates that will apply on reversal.

**10. Discontinued operations**

In 2007 costs were incurred on previously disposed of businesses.

	2008 £m	2007 £m
<b>Financial performance of discontinued operations</b>		
Costs on previously disposed of businesses	–	(1.0)
	–	(1.0)
Taxation	–	0.2
<b>Total discontinued operations</b>	<b>–</b>	<b>(0.8)</b>

## 11. Dividends

	2008 £m	2007 £m
Final dividend for the year ended 31 March 2007 of 5.65p (2007: 4.25p) per 60p share	12.8	8.7
Interim dividend for the year ended 31 March 2008 of 3.30p (2007: 2.40p) per 60p share	7.5	4.9
	20.3	13.6

In addition, the Directors are proposing a final dividend in respect of the financial year ending 31 March 2008 of 8.20p (2007: 5.65p) per share which will absorb an estimated £18.7 million (2007: £11.7 million) of shareholders' equity. It will be paid on 8 August 2008 to shareholders who are on the register of members on 11 July 2008. These financial statements do not reflect this dividend payable.

## 12. 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

	2008 Number	2007 Number
Weighted average number of ordinary shares for the purpose of basic EPS	224,459,855	205,715,620
Effect of dilutive potential ordinary shares: share options	4,264,409	6,228,491
Weighted average number of ordinary shares for the purpose of diluted EPS	228,724,264	211,944,111

### Earnings

	2008 Earnings £m	2008 Basic per share Pence	2008 Diluted per share Pence	2007 Earnings £m	2007 Basic per share Pence	2007 Diluted per share Pence
<b>Continuing and discontinued operations</b>						
Earnings from continuing and discontinued operations	67.3	29.99	29.43	43.4	21.10	20.48
Add back:						
Amortisation of acquired intangible assets, net of tax	7.6	3.41	3.34	4.2	2.06	2.00
Exceptional items, net of tax	–	–	–	0.4	0.19	0.18
<b>Earnings before amortisation and exceptionals</b>	<b>74.9</b>	<b>33.40</b>	<b>32.77</b>	<b>48.0</b>	<b>23.35</b>	<b>22.66</b>
<b>Continuing operations</b>						
Earnings from continuing operations	67.3	29.99	29.43	44.2	21.49	20.85
Add back:						
Amortisation of acquired intangible assets, net of tax	7.6	3.41	3.34	4.2	2.06	2.00
Exceptional items, net of tax	–	–	–	(0.4)	(0.20)	(0.19)
<b>Earnings before discontinued operations, amortisation and exceptionals</b>	<b>74.9</b>	<b>33.40</b>	<b>32.77</b>	<b>48.0</b>	<b>23.35</b>	<b>22.66</b>

## 13. Goodwill

	2008 £m	2007 £m
<b>Cost</b>		
At 1 April	203.0	168.8
On acquisition of subsidiaries (note 32)	281.4	34.3
Exchange adjustments	–	(0.1)
<b>At 31 March</b>	<b>484.4</b>	<b>203.0</b>
<b>Accumulated impairment</b>		
At 1 April	4.8	4.8
Impairment charge	–	–
<b>At 31 March</b>	<b>4.8</b>	<b>4.8</b>
<b>Net book value at 31 March</b>	<b>479.6</b>	<b>198.2</b>

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.

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:

	2008 £m	2007 £m
Marine	264.1	6.8
Defence	95.1	95.1
Rail	30.6	30.6
Nuclear	36.1	11.8
Networks	52.6	52.8
Engineering and Plant	1.1	1.1
	<b>479.6</b>	<b>198.2</b>
United Kingdom	478.5	197.1
Africa	0.2	0.2
North America	0.9	0.9
	<b>479.6</b>	<b>198.2</b>

## 14. Other intangible assets

	Acquired intangibles £m	Software £m	Development costs £m	Total £m
<b>Cost</b>				
At 1 April 2007	40.5	7.2	3.2	50.9
On acquisition of subsidiaries (note 32)	46.7	5.8	–	52.5
Additions	–	1.1	–	1.1
Disposals	–	(0.6)	–	(0.6)
<b>At 31 March 2008</b>	<b>87.2</b>	<b>13.5</b>	<b>3.2</b>	<b>103.9</b>
<b>Accumulated amortisation and impairment</b>				
At 1 April 2007	22.4	2.4	3.1	27.9
Amortisation charge	10.9	2.6	–	13.5
Amortisation on disposals	–	(0.4)	–	(0.4)
<b>At 31 March 2008</b>	<b>33.3</b>	<b>4.6</b>	<b>3.1</b>	<b>41.0</b>
<b>Net book value at 31 March 2008</b>	<b>53.9</b>	<b>8.9</b>	<b>0.1</b>	<b>62.9</b>
<b>Cost</b>				
At 1 April 2006	25.9	5.3	3.2	34.4
On acquisition of subsidiaries	14.6	0.4	–	15.0
Additions	–	1.5	–	1.5
<b>At 31 March 2007</b>	<b>40.5</b>	<b>7.2</b>	<b>3.2</b>	<b>50.9</b>
<b>Accumulated amortisation and impairment</b>				
At 1 April 2006	16.3	1.3	3.0	20.6
Amortisation charge	6.1	1.1	0.1	7.3
<b>At 31 March 2007</b>	<b>22.4</b>	<b>2.4</b>	<b>3.1</b>	<b>27.9</b>
<b>Net book value at 31 March 2007</b>	<b>18.1</b>	<b>4.8</b>	<b>0.1</b>	<b>23.0</b>

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.

Notes to the Group financial statements continued

## 15. Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Total £m
<b>Cost</b>				
At 1 April 2007	14.8	2.9	58.3	76.0
Exchange adjustments	–	–	(2.0)	(2.0)
On acquisition of subsidiaries (note 32)	40.8	0.6	84.6	126.0
Additions	1.6	0.3	11.2	13.1
Disposals	(2.2)	(0.5)	(1.6)	(4.3)
Reclassification	0.2	(0.2)	–	–
<b>At 31 March 2008</b>	<b>55.2</b>	<b>3.1</b>	<b>150.5</b>	<b>208.8</b>
<b>Accumulated depreciation and impairment</b>				
At 1 April 2007	10.5	1.1	36.2	47.8
Exchange adjustments	–	–	(0.9)	(0.9)
Charge for the year	3.0	0.2	14.2	17.4
Disposals	(0.2)	(0.2)	(1.0)	(1.4)
<b>At 31 March 2008</b>	<b>13.3</b>	<b>1.1</b>	<b>48.5</b>	<b>62.9</b>
<b>Net book value at 31 March 2008</b>	<b>41.9</b>	<b>2.0</b>	<b>102.0</b>	<b>145.9</b>
<b>Cost</b>				
At 1 April 2006	14.2	2.6	54.7	71.5
Exchange adjustments	–	–	(3.6)	(3.6)
On acquisition of subsidiaries	0.7	–	4.9	5.6
Additions	–	0.3	5.2	5.5
Disposals	(0.1)	–	(2.9)	(3.0)
<b>At 31 March 2007</b>	<b>14.8</b>	<b>2.9</b>	<b>58.3</b>	<b>76.0</b>
<b>Accumulated depreciation and impairment</b>				
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)
<b>At 31 March 2007</b>	<b>10.5</b>	<b>1.1</b>	<b>36.2</b>	<b>47.8</b>
<b>Net book value at 31 March 2007</b>	<b>4.3</b>	<b>1.8</b>	<b>22.1</b>	<b>28.2</b>

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

	2008 £m	2007 £m
Cost	5.3	5.3
Aggregate depreciation and impairment	(2.7)	(2.3)
<b>Net book value</b>	<b>2.6</b>	<b>3.0</b>

## 16. Investment in joint ventures and other investments

	Joint ventures		Other investments		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
<b>At 1 April</b>						
– 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
Additional investment and dividends received	(0.2)	–	–	9.7	(0.2)	9.7
Reclassified as investment in subsidiary	–	–	(9.7)	–	(9.7)	–
Disposals	(0.3)	(0.1)	–	–	(0.3)	(0.1)
Share of profits	–	0.4	–	–	–	0.4
Impairment of investment	–	–	0.3	(0.3)	0.3	(0.3)
<b>At 31 March</b>						
– Net assets excluding goodwill	0.2	0.7	–	9.4	0.2	10.1
– Goodwill	0.2	0.2	–	–	0.2	0.2
	0.4	0.9	–	9.4	0.4	10.3

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 and on 9 July 2007 the Group had acquired 50.9% of the share capital and therefore reclassified the investment as an investment in subsidiary.

Included within joint ventures are:

Country of incorporation		Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
<b>2008</b>							
DynCorp-Hiberna Limited	United Kingdom	–	–	0.6	0.1	0.1	50%
FSP (2004) Limited	United Kingdom	4.0	(4.0)	0.7	0.3	–	50%
Babjeh Joint Venture	South Africa	0.3	(0.2)	3.6	(0.1)	(0.1)	50%
Other		0.4	(0.1)	–	–	–	
		4.7	(4.3)	4.9	0.3	–	

Country of incorporation		Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
<b>2007</b>							
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	

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

## 17. Deferred tax

	2008 £m	2007 £m
Deferred tax asset	3.0	2.5
Deferred tax liability	(31.2)	(2.5)
	(28.2)	–

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 2007	4.9	3.3	(16.0)	0.1	7.7	–
Income statement credit	0.4	–	0.4	–	3.8	4.6
Tax charge to equity	–	–	(12.9)	–	3.5	(9.4)
Transfer to corporation tax	–	–	(9.1)	3.2	(0.3)	(6.2)
Acquisition of subsidiaries (note 32)	(13.8)	–	(4.6)	–	–	(18.4)
Effect of change in tax rate						
– income statement	(0.4)	(0.2)	–	–	(0.1)	(0.7)
– equity	–	–	2.4	–	(0.4)	2.0
Exchange differences	–	–	–	–	(0.1)	(0.1)
At 31 March 2008	(8.9)	3.1	(39.8)	3.3	14.1	(28.2)
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	–

The deferred tax asset in respect of 'other' includes an asset of £3.0 million (2007: £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 £31.2 million (2007: £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:

	2008 £m	2007 £m
Deferred tax asset	(17.5)	(13.5)
Deferred tax liability	48.7	16.0
	31.2	2.5

At the balance sheet date, the Group has unused tax losses (excluding UK capital losses and advance corporation tax) of £61.3 million (2007: £52.8 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £11.0 million (2007: £0.3 million) of such losses, which may be carried forward indefinitely. No deferred tax has been recognised in respect of the remaining £50.3 million (2007: £52.5 million) due to the unpredictability of future profit streams.

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 £50 million (2007: £25 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.

**18. Inventories**

	2008 £m	2007 £m
Raw materials	24.1	10.1
Work in progress and long-term contracts	10.3	9.4
Finished goods and goods for resale	42.3	38.2
<b>Total</b>	<b>76.7</b>	<b>57.7</b>

**19. Trade and other receivables**

	2008 £m	2007 £m
<b>Current assets</b>		
Trade receivables	108.2	65.1
Less: provision for impairment of receivables	(4.4)	(2.2)
Trade receivables – net	103.8	62.9
Amounts due from customers for contract work	204.7	73.9
Retentions	6.9	6.4
Amounts owed by related parties (note 36)	7.2	11.6
Other debtors	3.9	2.9
Prepayments and accrued income	14.4	9.5
	<b>340.9</b>	<b>167.2</b>
<b>Non-current assets</b>		
Other debtors	1.7	2.5

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

As of 31 March 2008, trade receivables of £5.0 million (2007: £2.4 million) were impaired. Impairment arises in the main, through contract disputes rather than credit disputes. The amount of the provision was £4.4 million (2007: £2.2 million). The individually impaired receivables mainly relate to debtors in Marine and Engineering and Plant. It was assessed that a portion of these receivables is expected to be recovered.

The ageing of the impaired receivables is as follows:

	2008 £m	2007 £m
Less than three months	–	0.1
Three to six months	–	0.1
Over six months	0.6	–
	<b>0.6</b>	<b>0.2</b>

As of 31 March 2008, trade receivables of £26.7 million (2007: £11.0 million) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

	2008 £m	2007 £m
Less than three months	21.0	8.2
Three to six months	4.2	2.4
Over six months	1.5	0.4
	<b>26.7</b>	<b>11.0</b>

The carrying amounts of the Group's trade and other receivables are, in the main, denominated in Sterling.

**19. Trade and other receivables (continued)**

Movements on the provision for impairment of trade receivables are as follows:

	2008 £m	2007 £m
Balance at 1 April	(2.2)	(2.0)
Acquisition of subsidiaries	(0.8)	–
Provision for receivables impairment	(2.3)	(1.0)
Receivables written off during the year as uncollectable	0.1	0.2
Unused amounts reversed	0.6	0.2
Exchange differences	0.2	0.4
<b>Balance at 31 March</b>	<b>(4.4)</b>	<b>(2.2)</b>

The creation and release of provisions for impairment of receivables have been included in cost of sales in the income statement (note 5). Amounts charged to the impairment provision are generally written off when there is no expectation of recovering additional cash.

The other classes within trade and other receivables do not contain impaired assets.

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables mentioned above. The Group does not hold any collateral as security other than retention of title clauses issued as part of the ordinary course of business.

**20. Cash and cash equivalents**

	2008 £m	2007 £m
Cash at bank and in hand	193.7	95.6
Short-term bank deposits (overnight)	5.9	–
	<b>199.6</b>	<b>95.6</b>

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

	2008		2007	
	Total £m	Floating rate £m	Total £m	Floating rate £m
<b>Currency</b>				
Sterling	178.7	178.7	78.8	78.8
Euro	2.2	2.2	0.6	0.6
US Dollar	2.0	2.0	2.1	2.1
South African Rand	15.1	15.1	13.5	13.5
Swedish Krona	0.2	0.2	0.2	0.2
Other currencies	1.4	1.4	0.4	0.4
	<b>199.6</b>	<b>199.6</b>	<b>95.6</b>	<b>95.6</b>

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.

**21. Trade and other payables**

	2008 £m	2007 £m
<b>Current liabilities</b>		
Amounts due to customers for contract work	192.5	99.5
Trade creditors	146.1	77.4
Amounts owed to related parties (note 36)	2.6	–
Other creditors	20.6	16.2
Other taxes and social security	27.7	15.8
Accruals and deferred income	77.2	24.0
	<b>466.7</b>	<b>232.9</b>
<b>Non-current liabilities</b>		
Other creditors	15.3	0.9

**22. Bank and other borrowings**

	2008 £m	2007 £m
<b>Current liabilities</b>		
<b>Bank loans and overdrafts due within one year or on demand</b>		
Unsecured	143.7	165.2
	<b>143.7</b>	<b>165.2</b>
Finance lease obligations (a)	0.6	0.5
	<b>144.3</b>	<b>165.7</b>
<b>Non-current liabilities</b>		
<b>Bank loans</b>		
Unsecured	375.5	1.1
	<b>375.5</b>	<b>1.1</b>
Finance lease obligations (a)	2.0	2.5
	<b>377.5</b>	<b>3.6</b>

(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 and collars, details of which are included in note 23.

**22. Bank and other borrowings (continued)**

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

	2008		
	Total £m	Floating rate £m	Fixed rate £m
<b>Currency</b>			
Sterling	520.7	518.6	2.1
South African Rand	–	–	–
Other	1.1	1.1	–
	<b>521.8</b>	<b>519.7</b>	<b>2.1</b>

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

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 £m	1–5 years £m	5 years £m	Total £m
<b>As at 31 March 2008</b>	<b>144.3</b>	<b>377.5</b>	<b>–</b>	<b>521.8</b>
As at 31 March 2007	165.7	3.1	0.5	169.3

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

	2008 %	2007 %
UK bank overdraft	6.8	6.3
UK bank borrowings	6.2	5.8
Other borrowings	14.2	14.7
Finance leases	5.0–6.0	5.0–6.0

**22. Bank and other borrowings (continued)***Repayment details*

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

	2008		2007	
	Bank loans and overdrafts £m	Finance lease obligations £m	Bank loans and overdrafts £m	Finance lease obligations £m
Within one year	143.7	0.6	165.2	0.5
Between one and two years	0.5	0.6	0.6	0.5
Between two and five years	375.0	1.4	0.5	1.5
Greater than five years	–	–	–	0.5
	<b>519.2</b>	<b>2.6</b>	<b>166.3</b>	<b>3.0</b>

*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.

	2008 £m	2007 £m
Expiring in less than one year	45.0	26.4
Expiring in more than one year but not more than five years	225.0	99.0
	<b>270.0</b>	<b>125.4</b>

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

	2008 £m	2007 £m
Not later than one year	0.6	0.6
Later than one year but not more than five years	2.2	2.3
More than five years	–	0.5
	<b>2.8</b>	<b>3.4</b>
Future finance charges on finance leases	(0.2)	(0.4)
Present value of finance lease liabilities	<b>2.6</b>	<b>3.0</b>

Notes to the Group financial statements continued

**23. Financial instruments***Other financial assets and liabilities*

	Fair value			
	Assets		Liabilities	
	2008 £m	2007 £m	2008 £m	2007 £m
Financial derivatives	1.7	0.1	0.5	0.1
Interest rate hedges	–	0.4	3.7	–
Total other financial assets and liabilities	1.7	0.5	4.2	0.1

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 hedges to hedge interest rate exposure.

*Interest rate hedges*

The notional principal amount of the outstanding interest rate swap and collar contracts at 31 March 2008 was £200 million (2007: £50 million).

The Group held the following interest rate hedges at 31 March 2008:

	Amount £m	Fixed %	Maturity
<b>Hedged</b>			
SWAPS	40.0	5.27	20/10/2009
Collar	10.0	Cap 6.25 and floor 5.25	20/07/2011
Collars	150.0	Cap 6.25 and floor 5.25	20/07/2012
Total interest rate hedges	200.0		

*Fair value of financial assets and financial liabilities*

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

	2008		2007	
	Book value £m	Fair value £m	Book value £m	Fair value £m
<b>Fair value of non-current borrowings</b>				
Long-term borrowings	(377.5)	(377.2)	(3.6)	(3.2)
<b>Fair value of other financial assets and financial liabilities</b>				
Short-term borrowings	(144.3)	(144.3)	(165.7)	(165.7)
Trade and other payables	(493.6)	(493.6)	(239.7)	(239.7)
Trade and other receivables	344.9	344.9	170.9	170.9
Short-term deposits	5.9	5.9	–	–
Cash at bank and in hand	193.7	193.7	95.6	95.6
Other financial assets and liabilities	(2.5)	(2.5)	0.4	0.4
	(95.9)	(95.9)	(138.5)	(138.5)

Fair values of long-term borrowings are based on cash flows discounted using a rate of 5.5% (2007: 5.5%).

## 24. 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 2007	1.1	5.5	5.8	8.8	21.2
On acquisition of subsidiaries	(0.4)	–	–	30.3	29.9
Charged/(released) to income statement	–	(1.0)	2.7	(1.6)	0.1
Utilised in year	–	(0.9)	(4.5)	(0.5)	(5.9)
Exchange differences	–	–	(0.1)	0.1	–
At 31 March 2008	0.7	3.6	3.9	37.1	45.3

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

	2008 £m	2007 £m
Current	13.0	13.6
Non-current	32.3	7.6
	45.3	21.2

(a) Acquisition/deferred consideration relates primarily to contingent consideration for Swedia Networks Ireland.

(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, claims and litigation relating to the reorganisation or disposal of businesses.

(d) Property and other in the main relate to provisions for onerous leases, dilapidation costs and contractual obligations in respect of infrastructure.

Included within property and other provisions is £21.8 million expected to be utilised in approximately ten years. Other than this provision the Group's non-current provisions are expected to be utilised within two to five years.

## 25. 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 2007	306,219,012	1	183.7	–
Authorised during the year	–	–	–	–
At 31 March 2008	306,219,012	1	183.7	–
At 1 April 2006	306,219,012	1	183.7	–
Authorised during the year	–	–	–	–
At 31 March 2007	306,219,012	1	183.7	–

	Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2007	209,741,819	125.8
Shares issued*	19,614,550	11.8
At 31 March 2008	229,356,369	137.6
At 1 April 2006	209,166,478	125.5
Shares issued	575,341	0.3
At 31 March 2007	209,741,819	125.8

\*During the year the Group made an equity placement of 19 million shares.

**25. Share capital (continued)***Potential issues of ordinary shares*

The table below shows options existing over the Company's shares as at 31 March 2008. They represent outstanding options granted under all the Company's Executive Share Option Schemes. Of the total number of shares shown, 662,778 are in respect of options granted by the trustee of the Babcock Employee Share Trust and 108,813 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 711,477 shares is in respect of options granted by the Company to subscribe for newly issued shares.

Grant date	Exercise price Pence	Exercise period	2008 Number	2007 Number
20 July 1998	89.00	20/07/2001 – 19/07/2008	–	30,000
09 September 1999	118.00	09/09/2002 – 08/09/2009	11,800	11,800
22 November 2000	123.00	22/11/2003 – 21/11/2010	–	560,975
25 June 2001	99.33	25/06/2004 – 24/06/2011	64,600	311,697
31 January 2002	104.33	31/01/2005 – 30/01/2012	21,278	170,229
24 June 2002	124.50	24/06/2005 – 23/06/2012	625,897	1,320,748
27 November 2002	106.33	27/11/2005 – 26/11/2012	35,082	43,152
30 June 2003	115.60	30/06/2006 – 29/06/2013	222,449	429,717
06 July 2004	126.00	06/07/2007 – 05/07/2014	501,962	1,341,315
			<b>1,483,068</b>	<b>4,219,633</b>

Options granted to Directors are summarised in the Remuneration report on pages 45 to 53 and are included in the outstanding options set out above.

A reconciliation of option movements is shown below:

	2008		2007	
	Number '000	Weighted average exercise price	Number '000	Weighted average exercise price
Outstanding at 1 April	4,220	£1.21	5,381	£1.20
Forfeited/lapsed	(35)	£1.26	(257)	£1.21
Exercised	(2,702)	£1.20	(904)	£1.14
Outstanding at 31 March	1,483	£1.22	4,220	£1.21
Exercisable at 31 March	1,483	£1.22	2,878	£1.18

Weighted average share price for options exercised during the year was 547.1p per share (2007: 358.1p per share).

## 26. 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 £1.4 million (2007: £1.7 million) all of which related to equity settled share-based payment transactions.

After tax, the income statement charge was £1.0 million (2007: £1.2 million).

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

### L-TIPS

Grant or modification date	2007 TSR 26/6/07	2007 EPS 26/6/2007	2006 TSR 24/7/2006	2006 EPS 24/7/2006	2005 TSR 11/7/2005	2005 EPS 11/7/2005
Share price at grant or modification date (pence)	556.8	556.8	338.5	338.5	169.5	169.5
Exercise price (pence)	–	–	–	–	–	–
Vesting period (years)	3.0	3.0	3.0	3.0	3.0	3.0
Expected volatility	25%	25%	25%	25%	25%	25%
Option life (years)	10.0	10.0	10.0	10.0	10.0	10.0
Expected life (years)	3.0	3.0	3.0	3.0	3.0	3.0
Expected dividends expressed as dividend yield	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%
Fair value per option (pence)	370.0	512.0	276.0	311.0	108.9	155.7
Correlation	18%	n/a	15%	n/a	9%	n/a

The number of L-TIP's awarded in 2007 were 396,227, 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.

## 27. 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
<b>At 1 April 2006</b>	125.5	69.7	30.6	(57.3)	1.7	170.2	0.4	<b>170.6</b>
Shares issued in the period	0.3	0.4	–	–	–	0.7	–	<b>0.7</b>
Recognised income and expense	–	–	–	49.7	(5.5)	44.2	1.6	<b>45.8</b>
Dividends	–	–	–	(13.6)	–	(13.6)	(0.4)	<b>(14.0)</b>
Share-based payments	–	–	–	1.7	–	1.7	–	<b>1.7</b>
Tax on share-based payments	–	–	–	2.1	–	2.1	–	<b>2.1</b>
Own shares and other	–	–	–	0.3	–	0.3	–	<b>0.3</b>
Net movement in equity	0.3	0.4	–	40.2	(5.5)	35.4	1.2	<b>36.6</b>
<b>At 31 March 2007</b>	<b>125.8</b>	<b>70.1</b>	<b>30.6</b>	<b>(17.1)</b>	<b>(3.8)</b>	<b>205.6</b>	<b>1.6</b>	<b>207.2</b>
<b>At 1 April 2007</b>	<b>125.8</b>	<b>70.1</b>	<b>30.6</b>	<b>(17.1)</b>	<b>(3.8)</b>	<b>205.6</b>	<b>1.6</b>	<b>207.2</b>
Shares issued in the period	11.8	78.0	–	–	–	89.8	–	<b>89.8</b>
Recognised income and expense	–	–	–	100.8	(5.9)	94.9	2.2	<b>97.1</b>
Dividends	–	–	–	(20.3)	–	(20.3)	(1.1)	<b>(21.4)</b>
Share-based payments	–	–	–	1.4	–	1.4	–	<b>1.4</b>
Tax on share-based payments	–	–	–	2.3	–	2.3	–	<b>2.3</b>
INS acquisition	–	–	–	–	–	–	1.9	<b>1.9</b>
Transactions with minority interests	–	–	–	(11.5)	–	(11.5)	(1.0)	<b>(12.5)</b>
Own shares and other	–	–	–	(5.0)	–	(5.0)	–	<b>(5.0)</b>
Net movement in equity	11.8	78.0	–	67.7	(5.9)	151.6	2.0	<b>153.6</b>
<b>Equity at 31 March 2008</b>	<b>137.6</b>	<b>148.1</b>	<b>30.6</b>	<b>50.6</b>	<b>(9.7)</b>	<b>357.2</b>	<b>3.6</b>	<b>360.8</b>

Other reserves include a translation reserve of £7.4 million debit (2007: £4.2 million debit) and a hedging reserve of £2.3 million debit (2006: £0.4 million credit).

During the year the Company acquired 1,342,845 ordinary shares (2007: nil) 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 2008 3,179,286 shares (2007: 557,729 shares) were disposed by the Trusts resulting from options exercised. At 31 March 2008, the Trusts held between them a total of 1,715,748 (2007: 3,552,189) ordinary shares at a total market value of £9,805,500 (2007: £14,208,756) representing 0.75% (2007: 1.69%) 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.

## 28. 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:

	2008 £m	2007 £m
Defined contribution schemes	11.2	9.0

### Defined benefit schemes

Balance sheet assets and liabilities recognised are as follows:

	2008 £m	2007 £m
Retirement benefits – funds in surplus	142.6	62.5
Retirement benefits – funds in deficit	(0.4)	(9.4)
	142.2	53.1

The Group operates five principal defined benefit schemes for employees in the United Kingdom, the Devonport Royal Dockyard Scheme, 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 Scheme. All five 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 five schemes are as follows:

	Devonport Royal Dockyard Scheme	Babcock International Group Scheme	Rosyth Royal Dockland Scheme	First Engineering Scheme	Alstec Pension Scheme
Date of last formal actuarial valuation	31/03/05	01/04/07	31/03/06	31/12/04	01/04/05
Number of active members at 31 March 2008	4,078	357	1,068	691	323
Actuarial valuation method	Projected unit	Projected unit	Projected unit	Attained age	Defined accrued benefit

### Results of formal actuarial valuation:

Value of assets	£660.0m	£468.9m	£448.3m	£121.4m	£31.9m
Level of funding	88%	103%	98%	96%	91%

### Principal valuation assumptions:

Excess of investment returns over earnings increases	1.5%	1.65%–2.4%	1.75%	(0.5%)–1.75%	4.45%
Excess of investment returns over pension increases	3.5%	1.6%–3.25%	2.75%	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 rate for the Devonport Royal Dockyard Scheme is 24.5% of pensionable pay, the Rosyth Royal Dockyard Scheme is 16.4%, the First Engineering Scheme is 20.1% and the Alstec Pension Scheme 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 £0.2 million during the year to 31 March 2008. The plan was frozen as of 31 January 2003 and therefore, no active members existed as at 31 March 2008.

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.

Notes to the Group financial statements continued

**28. 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:

	2008 (weighted average) %	2007 (weighted average) %
Rate of increase in pensionable salaries	4.36	3.75
Rate of increase in pensions	3.26	2.79
Discount rate	6.90	5.43
Inflation rate	3.50	3.00
Expected return on plan assets	6.97	6.80
Total life expectancy – future pensioners (years)	83.37	81.26

The fair value of the assets, the present value of the liabilities and the expected rates of return of the Group pensions schemes at 31 March were as follows:

	2008		2007	
	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m
Equities	8.0	831.1	8.0	401.2
Property	7.5	149.3	7.5	102.7
Conventional gilts	4.6	–	4.8	102.4
Bonds – corporate	6.9	297.3	5.5	80.8
Bonds – government	4.6	147.7	4.8	26.2
Liability matching bonds	6.0	541.2	6.4	483.2
Cash	5.3	17.2	5.3	4.4
Fair value of assets		1,983.8		1,200.9
Present value of funded obligation		(1,841.6)		(1,147.8)
Net assets recognised in the balance sheet		142.2		53.1

*The amounts recognised in the income statement are as follows*

	2008 £m	2007 £m
Current service cost	(26.8)	(15.0)
Interest on obligation	(92.1)	(51.6)
Expected return on plan assets	115.1	68.5
(Charge)/credit before settlements and curtailments	(3.8)	1.9
Settlement gains	2.4	2.6
Curtailment gain	0.1	1.2
Total included within operating profit	(1.3)	5.7

*Amounts recorded in statement of recognised income and expense*

	2008 £m	2007 £m
Actual return less expected return on pension scheme assets	(158.0)	(9.5)
Experience losses arising on scheme liabilities	(15.7)	(13.1)
Change in assumptions relating to present value of scheme liabilities	216.7	31.3
<b>At 31 March</b>	<b>43.0</b>	<b>8.7</b>
<b>Cumulative recognised income and expense at 31 March</b>	<b>59.1</b>	<b>16.1</b>

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

**28. Retirement benefits and liabilities (continued)***Analysis of movement in the balance sheet*

	2008 £m	2007 £m
<b>Fair value of plan assets</b>		
At 1 April	1,200.9	1,143.9
Acquisition of subsidiaries	883.6	39.3
Expected return	115.1	68.5
Actuarial loss	(158.0)	(9.5)
Assets acquired on settlements	(14.7)	–
Employer contributions	30.8	9.3
Employee contributions	5.3	2.5
Benefits paid	(79.2)	(52.9)
Exchange differences	–	(0.2)
<b>At 31 March</b>	<b>1,983.8</b>	<b>1,200.9</b>
<b>Present value of benefit obligations</b>		
At 1 April	1,147.8	1,114.6
Acquisition of subsidiaries	867.0	39.3
Service cost	26.8	15.0
Interest cost	92.1	51.6
Employee contributions	5.3	2.5
Actuarial gain	(201.0)	(18.2)
Settlement gains	(17.1)	(2.6)
Curtailment gain	(0.1)	(1.2)
Benefits paid	(79.2)	(52.9)
Exchange differences	–	(0.3)
<b>At 31 March</b>	<b>1,841.6</b>	<b>1,147.8</b>
<b>Net surplus at 31 March</b>	<b>142.2</b>	<b>53.1</b>
<b>Actual return on plan assets</b>		
Year ending 31 March	(42.9)	59.0

The expected return on plan assets is based on long term market expectations at the beginning of the year. In the case of equities there is a premium over the risk free rate.

*History of experience gains and losses*

	2008 £m	2007 £m	2006 £m	2005 £m
Difference between the expected and actual return on scheme assets	(158.0)	(9.5)	121.3	32.8
Percentage of scheme assets at 31 March	(8%)	(1%)	11%	3%
Experience losses of scheme liabilities	(15.7)	(13.1)	(22.1)	(11.4)
Percentage of present value of scheme liabilities at 31 March	1%	1%	2%	1%
Total amount recognised in Statement of recognised income and expense	43.0	8.7	42.2	(34.8)
Percentage of present value of scheme liabilities at 31 March	2%	1%	4%	3%

**28. Retirement benefits and liabilities (continued)**

The changes to the balance sheet at March 2008 and the charges to the income statement for the year to March 2009, if the assumptions were sensitised by the amounts below, would be:

	Balance sheet 2008 £m	Income statement 2009 £m
Initial assumptions	142.2	15.3
Discount rate moves up or down by 0.2%	±62.3	±2.7
Inflation rate moves up or down by 0.1%	±29.7	±2.9
Equity return moves up or down by 0.1%	–	±0.6
Total life expectancy changes by half a year up or down	±42.8	±2.4
Real salaries move up or down by 0.25%	±26.4	±3.5

**29. Reconciliation of operating profit to cash generated from operations**

	2008 £m	2007 £m
<b>Cash flows from operating activities</b>		
Operating profit	110.2	62.8
Depreciation of property, plant and equipment	17.4	5.6
Amortisation and impairment of intangible assets	13.5	7.3
Equity share-based payments	1.4	1.7
Impairment of investments	(0.3)	0.3
Profit on disposal of property, plant and equipment	(2.5)	(0.2)
<b>Operating cash flows before movement in working capital</b>	<b>139.7</b>	<b>77.5</b>
Increase in inventories	(16.3)	(16.9)
Increase in receivables	(95.4)	(5.7)
Increase in payables	97.2	10.0
Decrease in provisions	(6.0)	(4.7)
<b>Cash generated from operations</b>	<b>119.2</b>	<b>60.2</b>

**30. Movement in net debt**

	2008 £m	2007 £m
Increase/(decrease) in cash in the year	35.9	(0.4)
Cash flow from the increase in debt and lease financing	(276.0)	(33.1)
Change in net funds resulting from cash flows	(240.1)	(33.5)
Loans acquired with subsidiaries	(7.0)	–
Foreign currency translation differences	(1.4)	(2.0)
Movement in net debt in the year	(248.5)	(35.5)
Net debt at the beginning of the year	(73.7)	(38.2)
Net debt at the end of the year	(322.2)	(73.7)

### 31. Changes in net debt

	At 1 April 2007 £m	Cash flow £m	Acquisitions and disposals £m	New finance leases £m	Exchange movement £m	At 31 March 2008 £m
Cash and bank balances	95.6	101.2	4.4	–	(1.6)	199.6
Bank overdrafts	(73.5)	(67.5)	(2.2)	–	0.1	(143.1)
<b>Cash, cash equivalents and bank overdrafts at end of year</b>	<b>22.1</b>	<b>33.7</b>	<b>2.2</b>	<b>–</b>	<b>(1.5)</b>	<b>56.5</b>
Debt	(92.7)	(276.5)	(7.0)	–	0.1	(376.1)
Finance leases	(3.1)	0.5	–	–	–	(2.6)
	(95.8)	(276.0)	(7.0)	–	0.1	(378.7)
<b>Total</b>	<b>(73.7)</b>	<b>(242.3)</b>	<b>(4.8)</b>	<b>–</b>	<b>(1.4)</b>	<b>(322.2)</b>

### 32. Acquisitions

On 28 June 2007 the Group acquired 100% of the share capital of Devonport Management Limited ('DML') for a consideration of £355.5 million, inclusive of costs. DML provides support for the Royal Navy submarines and warships and manages the facilities at the Devonport Naval Base.

On 9 July 2007 the Group had acquired 50.9% of the share capital of International Nuclear Solutions plc ('INS'). By 30 September 2007 the Group had acquired 67.8% of the share capital for a consideration (before cash acquired) of £28.2 million, inclusive of costs. INS provides nuclear engineering support.

On 15 August 2007 the Group acquired 100% of the share capital of Swedia Networks Ireland for a net cash consideration of €1.

Included in the total consideration paid is deferred consideration of £0.5 million, paid on an acquisition made in a prior period which resulted in a reduction in goodwill.

The goodwill arises from the experience, knowledge and location of the workforce along with the market position of the entities acquired.

Details of the assets acquired and the goodwill are as follows:

	DML £m	INS £m	Other £m	Total £m
<b>Cost of acquisition</b>				
Purchase consideration	350.0	27.0	0.5	377.5
Direct costs	5.5	1.2	–	6.7
<b>Total purchase consideration and costs</b>	<b>355.5</b>	<b>28.2</b>	<b>0.5</b>	<b>384.2</b>
Fair value of assets acquired (see below)	98.2	3.9	0.7	102.8
<b>Goodwill</b>	<b>257.3</b>	<b>24.3</b>	<b>(0.2)</b>	<b>281.4</b>

Notes to the Group financial statements continued

**32. Acquisitions (continued)**

Net assets and liabilities arising from the acquisition are as follows:

	DML		INS		Other		Total	
	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m
Goodwill	18.6	–	–	–	–	–	18.6	–
Software	4.6	5.6	0.2	0.2	–	–	4.8	5.8
Acquired intangibles*	–	41.2	–	5.3	–	0.2	–	46.7
Property plant and equipment	147.0	125.0	1.0	1.0	–	–	148.0	126.0
Deferred tax	(9.3)	(17.1)	–	(1.4)	0.1	0.1	(9.2)	(18.4)
Retirement benefits	(28.4)	16.6	–	–	–	–	(28.4)	16.6
Cash, cash equivalents and bank overdraft	(1.2)	(1.2)	3.4	3.4	–	–	2.2	2.2
Inventory	8.2	8.2	–	–	–	–	8.2	8.2
Current assets	98.1	97.1	5.8	5.8	1.7	1.7	105.6	104.6
Current and non-current liabilities	(132.6)	(140.0)	(8.4)	(8.4)	(1.7)	(1.7)	(142.7)	(150.1)
Provisions	–	(30.2)	–	(0.1)	0.4	0.4	0.4	(29.9)
Bank and other borrowings	(7.0)	(7.0)	–	–	–	–	(7.0)	(7.0)
Minority interests	–	–	(0.7)	(1.9)	–	–	(0.7)	(1.9)
<b>Net assets acquired</b>	<b>98.0</b>	<b>98.2</b>	<b>1.3</b>	<b>3.9</b>	<b>0.5</b>	<b>0.7</b>	<b>99.8</b>	<b>102.8</b>

\*Acquired intangibles are: customer relationships and order book.

Cash outflow to acquire businesses net of cash acquired:

	DML £m	INS £m	Other £m	Total £m
Total purchase consideration plus costs	355.5	28.2	0.5	384.2
Cash, cash equivalents and bank overdrafts	1.2	(3.4)	–	(2.2)
Cash paid in prior period	–	(9.7)	–	(9.7)
<b>Cash outflow this period</b>	<b>356.7</b>	<b>15.1</b>	<b>0.5</b>	<b>372.3</b>

The revenue and operating profit of acquired businesses since the date of acquisition and as if they had been acquired on 1 April 2007 are:

	Since date of acquisition £m	For full year £m
<b>Revenue</b>		
DML	387.3	497.1
INS	17.5	24.3
Other	2.9	5.1
	407.7	526.5
<b>Operating profit</b>		
DML	38.1	44.6
INS	0.9	1.4
Other	(0.2)	–
	38.8	46.0

**33. Operating lease commitments – minimum lease payments**

	2008		2007	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
<b>Commitments under non-cancellable operating leases payable:</b>				
Within one year	12.0	6.5	8.0	5.8
Later than one year and less than five years	36.7	8.2	26.6	4.9
After five years	43.7	–	32.8	–
	<b>92.4</b>	<b>14.7</b>	<b>67.4</b>	<b>10.7</b>

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.

**34. Contingent liabilities**

- 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 RRD 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.
- 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.
- 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.
- 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.

**35. Capital and other financial commitments**

	2008 £m	2007 £m
Contracts placed for future capital expenditure not provided in the financial statements	0.7	–

**36. 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.

	2008 Sales to £	2008 Purchases from £	2008 Year end debtors balance £	2008 Year end creditor balance £
<b>Joint venture and alliances</b>				
Debut Services (South West) Ltd	100,622,000	–	–	–
First Swietelsky Operation and Maintenance	6,638,000	–	1,521,000	–
First Swietelsky Joint Venture High Output	36,046,000	–	3,878,000	2,625,000
<b>Related by common directorships</b>				
British Nuclear Fuels PLC	7,036,000	–	193,000	–
United Kingdom Atomic Energy Authority	15,422,000	526,000	1,598,000	–
			7,190,000	2,625,000

	2007 Sales to £	2007 Purchases from £	2007 Year end debtors balance £	2007 Year end creditor balance £
<b>Joint venture and alliances</b>				
Debut Services (South West) 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	–	6,946,000	–
<b>Related by common directorships</b>				
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	–

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

**(b) Babcock Employee Share Trust and Peterhouse Employee Share Trust**

During the year the Company sold ordinary shares through the Babcock Employee Share Trust and the Peterhouse Employee Share Trust. Further information is given in note 27 on page 86.

**(c) Defined benefit pension schemes**

Please refer to note 28 for transactions with the Group defined benefit pension schemes.

**37. Post balance sheet events****(a) Weir Strachan & Henshaw**

On 21 April 2008 the Group acquired Weir Strachan & Henshaw for a net cash consideration of £65 million.

**(b) Dividend**

Details on dividends are given in note 11. There are no further material events subsequent to 31 March 2008 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 2008 which comprise the Company 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 2008.

### 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 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, 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 Statement on Corporate Governance. 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 2008;
- 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

27 May 2008

## Company balance sheet

At 31 March 2008

	Note	2008 £m	2007 £m
<b>Fixed assets</b>			
Investment in subsidiary undertakings	3	359.3	367.7
Property, plant and equipment	4	0.3	0.3
		359.6	368.0
<b>Current assets</b>			
Debtors	5	440.9	9.3
Cash and bank balances		53.8	–
		494.7	9.3
<b>Creditors – amounts due within one year</b>	6	437.6	128.7
<b>Net current assets/(liabilities)</b>		57.1	(119.4)
<b>Total assets less current liabilities</b>		416.7	248.6
<b>Provisions for liabilities</b>	7	–	0.5
<b>Creditors – amounts due after one year to subsidiary undertaking</b>		5.0	5.0
<b>Net assets</b>		411.7	243.1
<b>Capital and reserves</b>			
Called up share capital	8	137.6	125.8
Share premium account	9	148.1	70.1
Capital redemption reserve	9	30.6	30.6
Profit and loss account	9	95.4	16.6
<b>Shareholders' funds – equity interests</b>		411.7	243.1

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

The financial statements were approved by the Board of Directors on 27 May 2008 and are signed on its behalf by:

**P L Rogers** 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.

#### *Finance costs*

Finance 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 26 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 27 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 FRS 17: 'Retirement Benefits' and IAS 19: 'Employee Benefits' valuation. Refer to the Group financial statements note 28 for further details.

As a result of the level of surplus the Company's 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.

#### *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.

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*

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 profit for the financial year is £104.3 million (2007: loss £7.7 million).

Audit fees and expenses paid to the Company's auditors was £0.1 million (2007: £0.1 million).

## 3. Investment in subsidiary undertakings

	2008 £m	2007 £m
Investment in shares	359.3	367.7

## 4. Property, plant and equipment

	Leasehold Property £m
Cost	
At 1 April 2007	0.4
Additions	0.1
At 31 March 2008	0.5
Accumulated amortisation	
At 1 April 2007	0.1
Charge for the year	0.1
At 31 March 2008	0.2
Net book value at 31 March 2008	0.3
Net book value at 31 March 2007	0.3

## 5. Debtors

	2008 £m	2007 £m
Trade debtors	0.3	0.3
Amounts owed by subsidiary undertakings	439.5	8.0
Deferred tax	0.8	–
Prepayments and accrued income	0.3	1.0
	440.9	9.3

## 6. Creditors – Amounts due within one year

	2008 £m	2007 £m
Bank loans and overdrafts	375.0	91.5
Trade creditors	–	–
Amounts owed to subsidiary undertakings	55.2	36.4
Other creditors	3.6	0.1
Accruals and deferred income	3.8	0.7
	437.6	128.7

The Company has £645 million (2007: £220 million) of Sterling bank facilities of which £375 million (2007: £91.5 million) was drawn at the year end. The interest rate applying is 6.2% (2007: 5.8%) and is linked to LIBOR.

## 7. Provisions for liabilities

	2008 £m	2007 £m
Contingent consideration on acquisitions	–	0.5

Notes to the Company financial statements continued

**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 2007 and at 31 March 2008	306,219,012	1	183.7	–
			Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid				
At 1 April 2007			209,741,819	125.8
Shares issued*			19,614,550	11.8
At 31 March 2008			229,356,369	137.6

\*During the year the Company made an equity placement of 19 million shares.

**9. Reserves**

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2007	70.1	30.6	16.6
Shares issue in the period	78.0	–	–
Share-based payments	–	–	1.4
Movement on ESOP	–	–	(5.0)
Fair value adjustments to interest rate hedges (net of tax)	–	–	(1.6)
Retained profit for the year – profit for the year	–	–	104.3
– dividends	–	–	(20.3)
At 31 March 2008	148.1	30.6	95.4

**10. Operating lease commitments**

The Company has an operating lease commitment for land and buildings as at 31 March 2008 with an annual commitment expiring after more than five years of £2.2 million (2007: £2.2 million).

**11. Contingent liabilities**

- The Company has guaranteed or has joint and several liability for bank facilities of £645 million (2007: £223.5 million) provided to certain Group companies.
- 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 2008 these amounted to £32.3 million (2007: £22.8 million), of which the Company had counter-indemnified £22.0 million (2007: £15.7 million).
- 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) Weir Strachan & Henshaw*

On 21 April 2008 the Company acquired Weir Strachan & Henshaw for a cash consideration of £65 million.

*(b) Disclosure*

There are no further material events subsequent to 31 March 2008 that require disclosure.

*(c) Dividends*

A dividend of 8.20p per 60p ordinary share (2007: 5.65p per 60p ordinary share) was declared after the balance sheet date and will be paid on 8 August 2008 to shareholders registered on 11 July 2008.

## Principal subsidiary, joint venture and associated undertakings

### Marine

Babcock Design & Technology Limited  
Babcock Marine Holdings Limited  
Babcock Marine (Rosyth) Limited  
Rosyth Royal Dockyard Limited  
Devonport Royal Dockyard Limited  
Babcock Marine (Clyde) Limited  
LSC Group Limited  
Frazer-Nash Consultancy Limited  
Appledore (2004) Limited  
BNS Nuclear Services Limited

### Defence Services

Air Power International Limited  
Babcock Support Services Limited  
Acetech Personnel Limited  
Babcock Airports Limited

### Nuclear

BNS Nuclear Services Limited  
INS Innovation Limited

### Engineering and Plant Services

Babcock Africa (Pty) Limited (South Africa)  
Babcock Africa Services (Pty) Limited (South Africa)  
Babcock Ntuthuko Engineering (Pty) Limited (75% owned) (South Africa)  
Babcock Eagleton Inc. (USA)

### Rail

First Engineering Limited

### Networks

Babcock Networks Limited

### Others

Babcock UK Holdings Limited  
Babcock Holdings Limited  
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

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.

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

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to what action to take, you should consult your stockbroker, solicitor, accountant or other appropriate independent professional adviser authorised under the Financial Services and Markets Act 2000. If you have sold or otherwise transferred all your shares in Babcock International Group PLC, please forward this document and the accompanying Form of Proxy to the person through whom the sale or transfer was effected, for transmission to the purchaser or transferee.**

A Form of Proxy for the Annual General Meeting is enclosed and should be completed and returned so as to reach the Company's registrar no later than 9.30 am on 8 July 2008. Completion and return of the Form of Proxy will not prevent you from attending and voting at the Meeting in person, should you so wish.

### **BABCOCK INTERNATIONAL GROUP PLC NOTICE OF ANNUAL GENERAL MEETING**

Notice is hereby given that the nineteenth Annual General Meeting of the members of Babcock International Group PLC ('the Company') will be held at Savoy Place, 2 Savoy Place, London WC2R 0BL on 10 July 2008, at 9.30 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 2008.
2. To declare a final dividend for the year ended 31 March 2008.
3. To reappoint Mr P L Rogers as a Director of the Company.
4. To reappoint Mr W Tame as a Director of the Company.
5. To reappoint Mr D J Shah as a Director of the Company.
6. To reappoint Mr J L Rennocks as a Director of the Company.
7. To reappoint Lord Hesketh as a Director of the Company.
8. To reappoint Mr M J Turner as a Director of the Company.
9. To approve the Remuneration report of the Directors for the year ended 31 March 2008.
10. To reappoint PricewaterhouseCoopers LLP as independent auditors.
11. To authorise the Directors to set the remuneration of the independent 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**

12. That in accordance with sections 366 and 367 of the Companies Act 2006 (the '2006 Act'), the Company and all companies that are its subsidiaries at any time during the period for which this resolution is effective are authorised to:
  - (a) make political donations to a political party or to an independent election candidate;
  - (b) make political donations to political organisations other than political parties; and
  - (c) incur any political expenditure,
 up to an aggregate amount of £100,000, and the amount authorised under each of paragraphs (a) to (c) shall also be limited to such amount, during the period beginning with the date of the passing of this resolution and ending on 30 September 2009 or, if sooner, the conclusion of the Annual General Meeting of the Company in 2009. For the purpose of this resolution 'political donation', 'political party', 'political organisation', 'independent election candidate' and 'political expenditure' are to be construed in accordance with sections 363, 364 and 365 of the 2006 Act.
13. That in lieu of any previous authority for such purposes which has yet to expire, the Directors be and are hereby generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 (the 'Act'), to exercise all the powers of the Company to allot relevant securities (within the meaning of section 80(2) of the Act) up to an aggregate nominal amount of £45,886,243, this authority to expire on 31 December 2009 or at the conclusion of the Annual General Meeting of the Company in 2009, whichever shall be the earlier, (save that the Company may before such expiry make any offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of any such offer or agreement as if the authority conferred hereby had not expired).

##### **Special Resolutions**

14. That subject to the passing of resolution 13 above, and in lieu of any previous authority for such purposes which has yet to expire, the Directors be and are hereby empowered pursuant to section 95(1) of the Act to:
  - (a) allot equity securities (within the meaning of section 94 of the Act) of the Company for cash pursuant to the authority conferred by resolution 13; and
  - (b) sell relevant shares (as defined in section 94(5) of the Act) held by the Company as treasury shares (as provided for in section 94(3) of the Act) ('treasury shares') for cash (as defined in section 162D(2) of the Act),
 as if section 89(1) of the Act did not apply to any such allotment or sale, provided that this power shall be limited to the allotment of equity securities for cash and the sale of treasury shares:

- (i) in connection with or pursuant to a rights issue or open offer or any other pre-emptive offer in favour of holders of ordinary shares in proportion (as nearly as practicable) to the respective number of equity securities held by them on the record date for such allotment but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with fractional entitlements, treasury shares, record dates or legal or practical problems arising under the laws of any overseas territory or the requirements of any regulatory body or stock exchange in any territory or any other matter whatsoever; or
- (ii) otherwise than pursuant to paragraph (i) of this resolution, up to an aggregate nominal amount of £6,882,936, and shall expire on 31 December 2009 or at the conclusion of the Annual General Meeting of the Company in 2009, whichever is the earlier, save that the Company may before such expiry make any offer or enter into any agreement which would or might require equity securities to be allotted, or treasury shares to be sold, after such expiry and the Directors may allot equity securities, or sell treasury shares in pursuance of any such offer or agreement as if the power conferred hereby had not expired.
15. That the Company is hereby authorised for the purposes of section 166 of the Act to make market purchases (within the meaning of section 163 of the Act) of ordinary shares of 60p each ('ordinary shares') in the capital of the Company on such terms and in such manner as the Directors may from time to time determine provided that:
- (a) the maximum number of ordinary shares hereby authorised to be purchased shall be 22,900,000 shares;
- (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 the date falling twelve months from the date of this resolution or at the conclusion of the Annual General Meeting of the Company to be held in 2009, whichever shall be 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.
16. That the Articles of Association produced to the Meeting and initialled by the Chairman for the purpose of identification as New Articles 'A' be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association.
17. That with effect from 00.01 am on 1 October 2008, the new Articles of Association adopted pursuant to resolution 15 be amended by the insertion of new article 101A, such amendment being produced to the Meeting and initialled by the Chairman for the purpose of identification as New Articles 'B'.

By order of the Board.

**A N Dungate**

Company Secretary  
10 June 2008

Registered Office: 2 Cavendish Square, London W1G 0PX.

**Notes:**

1. As required by the Combined Code, the reasons why the Board of the Company believes that the Non-Executive Directors standing for reappointment should be reappointed are set out in the Accompanying Notes on page 104.
2. An explanation of the special business resolutions is given in the Explanatory Notes on pages 105 and 106.
3. Only holders of shares are entitled to attend and vote at this meeting. A member is entitled to appoint another person as their proxy to exercise all or any of their rights to attend, to speak and to vote at the meeting. A member may appoint more than one proxy in relation to the meeting, provided that each proxy is appointed to exercise the rights attached to a different share or shares held by the member. A 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 available 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, Executive Directors' service agreements and a copy of the proposed new Articles of Association of the Company 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.

Notice of meeting continued

7. Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that in order to have the right to attend and vote at the meeting (and also for the purpose of determining how many votes a person entitled to attend and vote may cast), a person must be entered on the register of members of the Company by close of business on 8 July 2008 or, in the event of any adjournment, by close of business on the date which is two days before the day of the adjourned meeting. Changes to entries on the register of members after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.
8. In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that (i) if a corporate shareholder has appointed the Chairman of the meeting as its corporate representative with instructions to vote on a poll in accordance with the directions of all of the other corporate representatives for that shareholder at the meeting then on a poll those corporate representatives will give voting directions to the Chairman and the Chairman will vote (or withhold a vote) as corporate representative in accordance with those directions; and (ii) if more than one corporate representative for the same corporate shareholder attends the meeting but the corporate shareholder has not appointed the Chairman of the meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll and the other corporate representatives will give voting directions to that designated corporate representative. Corporate shareholders are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives – <http://www.icsa.org.uk> – for further details of this procedure. The guidance includes a sample form of representation letter if the Chairman is being appointed as described in (i) above.
9. Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a “Nominated Person”) may have a right, under an agreement between them and the member by whom they were nominated, to be appointed (or to have someone else appointed) as a proxy for the meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, they may have a right, under such an agreement, to give instructions to the member as to the exercise of voting rights. The statement of the above rights of the members in relation to the appointment of proxies does not apply to Nominated Persons. Those rights can only be exercised by shareholders of the Company.
10. Shareholders should note that it is possible that, pursuant to requests made by members of the Company under section 527 of the Companies Act 2006, the Company may be required to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the Annual General Meeting; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which Annual Report and Accounts were laid (in each case) that the members propose to raise at the Annual General Meeting. The Company may not require the members requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the 2006 Act. Where the Company is required to place a statement on a website under section 527 of the 2006 Act, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the Companies Act 2006 to publish on a website.
11. As at 27 May 2008 (being the last practicable day prior to the publication of this notice) the Company's issued share capital consisted of 229,431,215 ordinary shares, carrying one vote each. Therefore, the total voting rights in the Company as at that date were 229,431,215.
12. You may not use any electronic address (within the meaning of section 333(4) of the 2006 Act) provided in this Notice of Meeting (or in any related documents including the proxy form) to communicate with the Company for any purposes other than those expressly stated.

### Accompanying Notes

The Combined Code requires the Board to set out the reasons why it believes that the Non-Executive Directors standing for reappointment 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.

#### Dipesh Shah

Mr Shah is an active participant in the Board's deliberations. His wide experience of various industries, in particular the civil nuclear industry, and as a director of a number of other industrial companies is especially valued.

#### John Rennocks

Mr Rennocks has been a Non-Executive Director since 2002 and the Board especially values his commitment and involvement as Chairman of the Audit and Risk Committee. His financial background and his wide knowledge and experience gained from his other listed company directorships contribute significantly to the balance of skills on the Board.

#### Mike Turner

Mr Turner is a Director of one of Britain's largest companies in the defence industry, which is Babcock's largest market. His extensive knowledge and experience will be a major contribution to the Board's deliberations.

### Note from the Chairman:

“I can confirm, as required by the Combined Code, that having fully evaluated their performances, the Board is of the view that each of Lord Hesketh, Dipesh Shah, John Rennocks and Mike Turner continues to be effective and to demonstrate commitment to his role”.

### Explanatory notes

*Resolutions 3 to 6:* Each of Mr Rogers, Mr Tame, Mr Shah and Mr Rennocks was last re-elected as a Director in 2005 and is therefore offering himself for re-election as required by the Company's Articles of Association and in accordance with the Combined Code.

*Resolution 7:* Lord Hesketh offers himself for re-election annually as required by the Combined Code, having served more than nine years as a Director.

*Resolution 8:* Mr Turner having been appointed as a Director with effect from 1 June 2008 by the Board is submitting himself for reappointment as required by the Company's Articles of Association, this being the first Annual General Meeting following his appointment.

*Resolution 9:* This is to approve the Directors' Remuneration report for the financial year ended on 31 March 2008. You can find the Report on pages 45 to 53 of the Annual Report and Accounts for the year ended 31 March 2008.

*Resolution 12:* It is the Company's policy not to make political donations or incur political expenditure as those expressions are normally understood. However, certain activities undertaken in the usual course of business may fall within the legal definition of support for a political party or political expenditure. The authority is sought to ensure that all the activities of the Company fully comply with the law.

*Resolution 13:* The Directors may only allot shares or grant rights over shares if authorised to do so by shareholders. Resolution No. 13 will be proposed as an ordinary resolution to grant a new authority to allot unissued share capital up to an aggregate nominal value of £45,886,243, representing approximately 33.3% of the total issued ordinary share capital of the Company as at 27 May 2008. As at the date of the notice of this meeting the Company held no treasury shares. If given, this authority will expire on 31 December 2009 or at the Annual General Meeting in 2009, whichever is earlier.

*Resolution 14:* The Directors also require additional authority from shareholders to allot shares or grant rights over shares or sell treasury shares where they propose to do so for cash and otherwise than to existing shareholders pro rata to their holdings. Resolution No. 14 will be proposed as a special resolution to grant such authority. Apart from rights issues, open offers or any other pre-emptive offer as mentioned, the authority will be limited to the issue of shares and sales of treasury shares for cash up to an aggregate nominal value of £6,882,936 (being 5% of the Company's issued ordinary share capital at 27 May 2008). If given, this authority will expire on 31 December 2009 or at the Annual General Meeting in 2009, whichever is earlier. The Directors will have due regard to institutional guidelines in relation to any exercise of this authority, in particular the requirement for advance consultation and explanation before making any such issue which exceeds 7.5% of the Company's issued share capital in any rolling three-year period. With the exception of issues, if necessary, of further shares under the Company's executive or employee share schemes, the Directors do not have any present intention of exercising this authority, but consider it desirable to have the flexibility to use it should opportunities arise.

*Resolution 15:* This will be proposed as a Special Resolution and 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 27 May 2008, 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 at the conclusion of the Annual General Meeting of the Company to be held in 2009 or, if earlier, 12 months from the date of the resolution. 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 27 May 2008 (being the latest practicable date before publication of the notice of meeting) was 636,631 representing 0.28% of issued share capital as at 27 May 2008. If the full authority to buy back shares were to be used, and the shares cancelled, these outstanding options would represent 0.31% of issued share capital.

*Resolutions 15 and 16:* It is proposed in resolutions 15 and 16 to adopt new Articles of Association (the 'New Articles') in order to update the Company's current Articles of Association (the "Current Articles") primarily to take account of changes in English company law brought about by the Companies Act 2006.

The principal changes introduced in the New Articles are summarised below. Other changes, which are of a minor, technical or clarifying nature and also some more changes which merely reflect changes made by the Companies Act 2006 have not been noted below. The New Articles, showing all of the changes to the Current Articles are available for inspection at the Company's registered office (2 Cavendish Square, London W1G 0PX) during normal working hours.

#### 1. Articles which duplicate statutory provisions

Provisions in the Current Articles which replicate provisions contained in the 1985 Act are in the main amended to bring them into line with the 2006 Act. Certain examples of such provisions include provisions as to the variation of class rights and provisions regarding the period of notice required to convene general meetings. The main changes made to reflect this approach are detailed below.

#### 2. Form of resolution

The Current Articles contain a provision that, where for any purpose an ordinary resolution is required, a special or extraordinary resolution is also effective and that, where an extraordinary resolution is required, a special resolution is also effective. This provision is being amended, as the concept of extraordinary resolutions has not been retained under the 2006 Act.

The Current Articles enable members to act by written resolution. Under the Companies Act 2006 public companies can no longer pass written resolutions. These provisions have therefore been removed in the New Articles.

Notice of meeting continued

### 3. Variation of class rights

The Current Articles contain provisions regarding the variation of class rights. The proceedings and specific quorum requirements for a meeting convened to vary class rights are contained in the 2006 Act. The relevant provisions have therefore been amended in the New Articles.

### 4. Convening extraordinary and Annual General Meetings

The provisions in the Current Articles dealing with the convening of general meetings and the length of notice required to convene general meetings are being amended to conform to new provisions in the 2006 Act. In particular, an extraordinary general meeting to consider a special resolution can be convened on 14 days' notice whereas previously 21 days' notice was required.

### 5. Votes of members

Under the 2006 Act, proxies are entitled to vote on a show of hands whereas under the Current Articles proxies are only entitled to vote on a poll. The 2006 Act also entitles proxies to speak. Multiple proxies may be appointed provided that each proxy is appointed to exercise the rights attached to a different share held by the shareholder. Multiple corporate representatives may be appointed. The New Articles reflect these new provisions.

### 6. Age of Directors on appointment

The Current Articles contain a provision limiting the age at which a Director can be appointed. Such a provision could now fall foul of the Employment Equality (Age) Regulations 2006 and so has been removed from the New Articles.

### 7. Directors' indemnities and loans to fund expenditure

The 2006 Act has in some areas widened the scope of the powers of a company to indemnify directors and to fund expenditure incurred in connection with certain actions against directors. In particular, the existing exemption allowing a company to provide money for the purpose of funding a director's defence in court proceedings now expressly covers regulatory proceedings and applies to associated companies. Also, a company that is, and a company that has an associated company that is, a trustee of an occupational pension scheme can now indemnify a director of the company that is a trustee of an occupational pension scheme against liability incurred in connection with the activities of the company that is the trustee, where such activities relate to the scheme. The amendments proposed to the Current Articles reflect the new provisions of the Companies Act 2006.

### 8. Joint holders

In order to make the flow of information more efficient between the Company and any joint shareholders, the Current Articles are being amended so that where there are joint shareholders, anything agreed with or specified to the Company by any one joint shareholder will have been deemed to have been agreed with or specified to the Company by all the joint shareholders.

### 9. Borrowing powers

The provisions regulating the power of the Company to borrow money are being amended so that any provision in the Group's accounts which is required by International Accounting Standard 39 is disregarded for the purpose of calculating the Company's borrowing powers.

### 10. Director fees

The limit on the basic fees payable to Non-Executive Directors will be increased from £40,000 per director (a figure set in 2002) to an aggregate amount of £750,000 (this will allow headroom for the payment of Non-Executive Directors' fees to keep pace with market rates and as the Company grows in size).

The following provisions are coming into effect on 1 October 2008 and hence are the subject of a separate resolution.

### 11. Conflicts of interest

The 2006 Act sets out directors' general duties which largely codify the existing law but with some changes. The provisions relating to conflicts of interest come into effect on 1 October 2008 and it is not possible to reflect them in the Company's Articles of Association until the new legislation is in force. Under the 2006 Act, from 1 October 2008 a Director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the Company's interests. The requirement is very broad and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The 2006 Act allows directors of public companies to authorise conflicts and potential conflicts, where appropriate, where the articles of association contain a provision to this effect. The 2006 Act also allows the articles of association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. The New Articles, as proposed to be altered with effect from 1 October 2008, give the Directors authority to approve such situations and to include other provisions to allow conflicts of interest to be dealt with in a similar way to the current position.

There are safeguards which will apply when directors decide whether to authorise a conflict or potential conflict. First, only directors who have no interest in the matter being considered will be able to take the relevant decision and, secondly, in taking the decision the directors must act in a way they consider, in good faith, will be most likely to promote the company's success. The directors will be able to impose limits or conditions when giving authorisation if they think this is appropriate.

It is also proposed that the New Articles should contain provisions relating to confidential information, attendance at Board meetings and availability of Board papers to protect a Director being in breach of duty if a conflict of interest or potential conflict of interest arises. These provisions will only apply where the position giving rise to the potential conflict has previously been authorised by the Directors.

It is the Board's intention to report annually on the Company's procedures for ensuring that the Board's powers to authorise conflicts are operated effectively and that the procedures have been followed.

## Shareholder information

### Financial calendar

Financial year end	31 March 2008
2007/08 preliminary results announced	13 May 2008
Annual General Meeting	10 July 2008
Final dividend payment date (record date 11 July 2008)*	8 August 2008

\*See also 'Results and dividends' on page 37.

### Registered office and company number

2 Cavendish Square  
London W1G 0PX

Registered in England  
Company number 2342138

### Registrars

Computershare Investor Services PLC  
The Pavilions  
Bridgwater Road  
Bristol BS99 6ZZ

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

### Independent Auditors

PricewaterhouseCoopers LLP  
1 Embankment Place  
London WC2N 6RH

### Principal UK bankers

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

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

### Investment bankers

JPMorgan Cazenove  
20 Moorgate  
London EC2R 6DA

### 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](http://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 2008 £m	IFRS 2007 £m	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m
Continuing revenue	1,555.9	988.3	836.7	729.0	438.0
Operating profit	110.2	62.8	46.6	35.3	22.2
Share of profit from joint ventures	–	0.4	(0.1)	0.2	0.1
Profit before interest	110.2	63.2	46.5	35.5	22.3
Net interest and similar charges	(25.6)	(6.2)	(5.2)	(6.0)	(0.5)
Profit before taxation	84.6	57.0	41.3	29.5	21.8
Income tax expense	(14.9)	(11.0)	(8.2)	(8.2)	(3.4)
Profit from continuing operations	69.7	46.0	33.1	21.3	18.4
Discontinued operations	–	(0.8)	(3.2)	(2.1)	(2.0)
Profit for the year	69.7	45.2	29.9	19.2	16.4
Minority interest	(2.4)	(1.8)	(0.2)	(0.1)	–
Profit attributable to shareholders	67.3	43.4	29.7	19.1	16.4
Non-current assets	836.1	327.2	273.4	266.5	90.4
Net current assets/(liabilities)	(18.6)	(96.0)	(48.0)	(60.6)	51.7
Non-current liabilities and provisions	(456.7)	(24.0)	(54.8)	(93.5)	(45.0)
Total net assets	360.8	207.2	170.6	112.4	97.1
Shareholders funds	357.2	205.6	170.2	112.3	97.1
Minority interest	3.6	1.6	0.4	0.1	–
	360.8	207.2	170.6	112.4	97.1
Earnings per share – basic	29.99p	21.10p	14.49p	10.08p	11.31p
Dividends per share (proposed)	11.50p	8.05p	6.00p	4.00p	3.35p



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

