Babcock International Group PLC

Annual report and accounts 2001

Realigning the business

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Gordon Campbell Chairman
18 June 2001

I was absolutely delighted to become chairman of your company. For people of my generation and educational background, Babcock conjures up an immediate image of process engineering and boilermaking. Over three decades, Babcock has changed enormously, but still commands respect around the world, and the Babcock brand is a great asset to us. However, the change we are currently going through is at least as large as anything that has gone before and many times more exciting. Shortly before I arrived, the Board announced a clear strategy which had three main elements. First, we would return some of the cash in the Babcock balance sheet to you, the shareholders, by way of a return of capital. £30.6 million of capital will be returned to our shareholders of which £27.9 million was returned in the year. This is the equivalent of 18p per old share. The second element was to sell our materials handling business and the Railcare business and thirdly to focus on the support services sector. This was a brave strategy and, like all brave moves, requires complete commitment to deliver. However, the successful delivery of this strategy should enhance shareholder value considerably. It will take your company into higher growth markets, reduce exposure to cyclical businesses, and remove our dependence on risky construction contracts.

I fully support this strategy and, along with my Board colleagues, am determined to drive through the execution.

So far we have succeeded in selling the loss-making Railcare business and are embarked upon the disposal of the BMH businesses. The disposal of BMH as a single

Chairman's introduction

Babcock International is a multinational syste in the UK. This year's acquisition of Hunting provided us with a strong platform from which a dedicated services company.

entity was always going to be difficult, but in the current climate of falling order books, has proved to be impossible. We shall create more value by selling the component parts of BMH and this process is underway. Inevitably, it will take longer than a single sale, but we are committed to seeing it through. The purchase of Hunting plc's Defence Services business (Hunting Defence Services) is a seminal event in the transformation of Babcock. It is an interesting and successful business in its own right, but the acquisition provides a vital first rung on the ladder to becoming a true support services business. It builds on our excellent reputation with the Ministry of Defence (MoD) but also provides a bridge into the civil side of the support services industry.

Unfortunately, during the last year, business conditions deteriorated very markedly, particularly in the engineering sector. We incurred heavy losses in the Railcare business, which were exacerbated by the need for further redundancies. Railcare cost the business £10.7 million in the year to March 2001 and its ultimate sale was a great relief. However, Railcare was not the only problem business, and conditions in many of the BMH activities have also deteriorated markedly. Operating profits (before exceptional items) fell by nearly 70% as demand collapsed and a £9.6 million provision against a major contract was made. On a more positive note, the BES profits held up well and the order book in the immediate future is on plan.

The results in Railcare and BMH meant a fall in profit before tax from £26.0 million to a loss of £7.3 million after exceptional charges of £22.0 million. Earnings per share before non-operating exceptional charges and goodwill were 0.55p. However, the Board believes that with the actions taken and the strategy sufficiently robust a final dividend of 1.55p per share can be recommended.

Despite the return of capital and the acquisition of Hunting Defence Services the group remains virtually debt free at the year end.

The results show what a difficult year some of the businesses have had, and my thanks go to all our employees for their dedication and contribution in such trying circumstances. Special thanks are also due to the retiring chairman, Sir John Parker. When John arrived at Babcock in the early '90s, it was close to bankruptcy and he, with the help of all our employees, turned the business round into the robust position it has today. The group now had a strong enough balance sheet to support its strategy, even through poor trading conditions, and that is the legacy with which John should be associated.

We are embarked upon a strategy clearly designed to enhance shareholder value. If our strategy is implemented successfully, we will have transformed the perception of Babcock from an old engineering business to one of a high growth support services unit. The consequence should be a re-rating of the shares from the depressingly low multiples attributed to engineering businesses to the attractive ones earned in support services. This will not be an easy transformation, but we have made a successful start, with some key disposals and important acquisitions. It is now up to all of us who work in Babcock to deliver the results. I relish the challenge.

ms and services group, headquartered

plc's Defence Services business has

we can realign the business to become

Why is Babcock realigning its business?
Quite unashamedly, Babcock is realigning its business to enhance shareholder value. We are aiming to turn Babcock into a profitable but high-growth group. High-growth companies invariably have to operate in markets which are growing, since to grow in a static or declining market usually means the sacrifice of margins. Since we do not wish to do this, we must reposition the group in sectors which are inherently growing. The support services and facilities management sector is one such area of activity and one where we can apply our managerial skills successfully. This transition, however, will not be achieved without total commitment and, as a consequence, we have to divest ourselves of those business areas which do not fit with this commitment. It is our intent, therefore, to exit the sectors which have a heavy fixed assets base, which are overly dependent on macro-economics, and which have little natural growth. Going forward, we intend to focus on the support services and facilities management businesses whose assets are people, market awareness, and a service culture. This inevitably leads to selling our positions in the materials handling sector and Railcare. It means expanding into those areas where service, rather than manufacturing, becomes all important.

How does the Hunting Defence Services acquisition fit the strategy?
The recent acquisition of Hunting Defence Services is a clear example of this change of emphasis. It is very evidently a support services and facilities management business as one can see from the Operations review. However, it also operates in the defence sector, offering such services to the Royal Air Force and the Army. In this respect, it fits perfectly with our operations at Rosyth, which supply services to the Royal Navy. Whilst Hunting Defence Services is clearly in the support services area, it also can benefit from Babcock's strong reputation with the MoD. We aim to expand this provision of services to the MoD by winning the Faslane facility management contract and other contracts which the MoD wish to put out to private companies. Our immediate target, therefore, is to become a major supplier of support services and facilities management to the MoD.

What comes after Hunting Defence Services?
Our ambitions do not end there. Whilst wishing to continue to expand our position in the UK, there are

Strategic questions and answers

Going forward, we intend to focus on the support services and facilities management businesses whose assets are people, market awareness, and a service culture.

BES
Engineering and support services for customers in the defence, rail, marine and 'secure facilities' sectors.

BES will continue to adapt its current offering to become more focused on support services.

194.2m
Turnover £ (2000: £185.9m)

Hunting Defence Services
Support services and facilities management for customers in the defence sector.

Hunting Defence Services already supplies its existing customers with a comprehensive range of support services.

62.0m
Turnover £ (annualised)

opportunities for transferring these skills overseas. In the fullness of time, one could see an international dimension adding to our UK base of support services in the military field.

Of more immediate opportunity, however, is the expansion of our operations into the civil market. In this respect, Hunting Defence Services is a perfect bridge to expand from our Rosyth operation into the civil market. The primary focus of any company should be to build organically, and this is our underlying ambition. However, this organic growth can often be accelerated by judicious acquisitions. Babcock still has a sufficiently strong balance sheet to allow it to make such acquisitions, were these thought to be capable of accelerating our transformation into the civil support services sector.

What about the businesses that don't fit?
We have clear strategic intent to be a pure support services and facilities management business. This will necessitate the sale of our materials handling business, and this process is already underway. The sale of Railcare was the first move in this direction but, in the course of the next 12 months, there will be additional disposals. There should be no doubt that this is our intent, although we intend to maximise shareholder value in the process.

Can you manage such a change?
To effect such a change of direction, we require a great deal of determination, and it is necessary to sustain a momentum which ensures that one cannot be diverted from this course. It is the small, as well as the large changes which reinforce this. The acquisition of Hunting Defence Services was, of course, a very large move but, during the year, we have also changed our financial advisers. We are relocating our headquarters from Amersham into a small London base, and even the Annual Report has a different appearance. This is not unintentional. It is designed to send the signals to customers, employees, and shareholders that Babcock is changing the nature of its business.

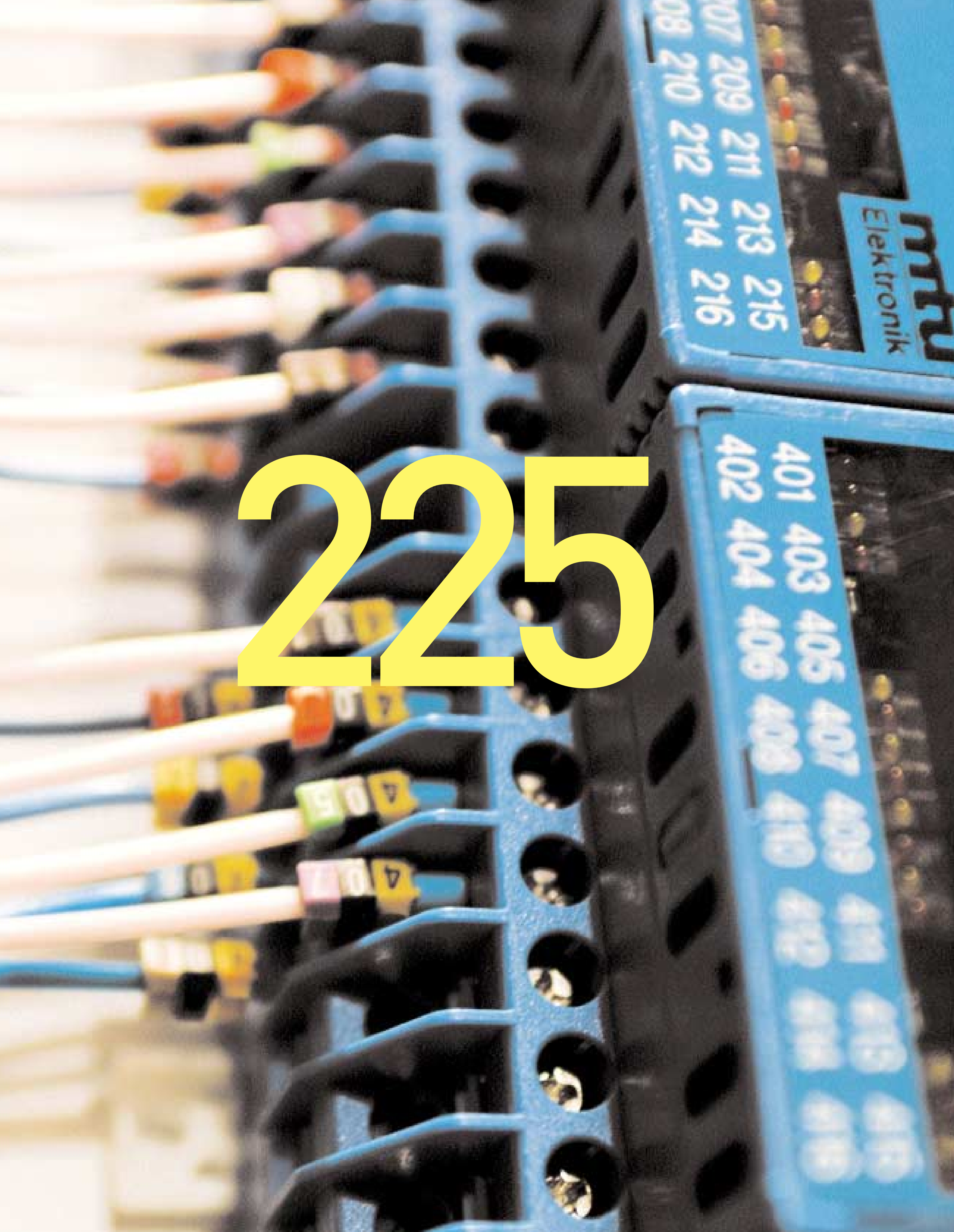
What about the impact on other stakeholders?
This, of course, puts a lot of strain on our employees, and the process needs to be handled sensitively. However, if shareholders can benefit, then so too should our employees, and we will implement the correct and appropriate incentives for all our employees. In this respect, we will be introducing an AESOP scheme for employees as soon as possible and will be attempting to align the remuneration of our employees with the interests of shareholders.

What is the timetable?
In 12 months' time, Babcock should be a materially different group. This group will, in a series of manageable steps, have moved from basically an engineering group into one which supplies support services and facilities management to the military and civil markets. This is a great managerial challenge, but the rewards to all stakeholders should be significant.

BMH
Material processing technologies and engineered systems.

BMH businesses have less potential to fit in to our strategy of focusing on support services. As a consequence we shall be seeking to divest these operations.

204.7m
Turnover £ (2000: £228.9m)


225
207 209 211 213 215
208 210 212 214 216
Elektronik
401 403 405 407
402 404 406 408

< Cabling installed 225 miles of new cabling installed by BES on HMS Ark Royal.

> Hours per year 17,000 hours per year flown by HCS instructors training RAF, RN and Army pilots at the Joint Elementary Flying Training School.


84

< Rights of Way 84 miles of rights of way acquired by BMH to run the three parallel pipelines required for the TEPPCO contract.

> Litres of paint applied
163,000 litres of paint applied to HMS Ark Royal at Rosyth.

< Parachute descents 40,000 parachute descents by RAF, Royal Marine and Army trainees from HCS aircraft last year.

> Kw/hrs of electricity and gas 7.7 billion kw/hrs of electricity and gas brokered by BES for clients last year.

40000


7.7bn


80m

< Gallons of treated water
80 million gallons of treated water per year provided by HCS to the 13 British Armed Forces camps in Kosovo.

> Hercules engines overhauled
70 Hercules engines overhauled last year by HCS for the RAF.

70

BES

The division's ongoing activities continued to perform well in the year as they followed the joint objectives of growth in earnings through efficiency improvement and new business. Turnover grew slightly as the size of certain refit contracts increased. The order book, excluding Hunting Defence Services, fell to £128.2 million at the year end, but five further Frigate refits were booked shortly after the year end at a value of some £75.0 million.

Acquisitions made in early 2000 together with another small acquisition in early 2001 are now fully integrated. These have been made to accelerate the process of leveraging off the substantial facilities, skills and existing business activities of the division. The minority interest in the joint venture with Studsvik AB, which was established in late 1999, was sold on to our partner towards the end of 2000.

Operations review

The year to March 2001 saw the first steps in a major transformation of Babcock into a support services business. The acquisition of Hunting Defence Services for £60.9 million substantially enhanced its position as a service supplier to the MoD and provides the springboard into the wider support services and facilities management market.

The disposal of the engineering and materials handling business commenced with the sale of the loss-making Railcare business, and further disposals are anticipated. In addition, £30.6 million of capital will be returned to shareholders, of which £27.9 million was returned in the year.

Trading conditions were mixed, with operating profits, in the core BES division, similar to the previous year at £13.6 million on a slightly higher turnover. As expected, the order book, excluding Hunting Defence Services, fell, but shortly after the year ended, confirmation was received of some £75.0 million of orders from the MoD.

Hunting Defence Services was acquired in March 2001 and so did not materially contribute to the year's results, but so far it is living up to expectations and, since the purchase, a further £20 million of orders have been confirmed.

The market for BMH's products fell sharply in the second half, causing operating profits (before exceptional items) to fall to £3.2 million. In addition, uncertainty surrounding the customer's financing arrangements for a significant project has caused a reassessment of the likelihood of the contract progressing in the near future. An operating exceptional provision against the full exposure of £9.6 million has prudently been taken. Railcare, the loss-making rail maintenance business, was sold shortly after the year end for £4.6 million with the acquirer assuming the borrowings of Railcare amounting to £2.0 million.

It is obviously disappointing to see such poor results in BMH and Railcare, but we were preparing them for sale and have recently disposed of Railcare. The continuing businesses of BES and Hunting Defence Services are in robust shape, and we are particularly pleased with the progress of our new acquisition, which will materially change the nature of our business. It is reassuring that, despite these problems and the return of capital to our shareholders, we have a strong and ungeared balance sheet.

The Directors are recommending a final dividend of 1.55p per 60p share, giving a total dividend for the year on that basis of 2.65p per share (2000: 2.55p per 50p share).

Naval refitting at Rosyth performed very well during the last year with further improvements in efficiency and cost competitiveness. The activity continues to be dominated by the refit and upgrade programme for the MoD with quality, reliability and delivery performance acknowledged by the MoD and Royal Navy. HMS Ark Royal is approaching the end of her two year upgrade in line with the plan for hand-over to the Royal Navy in July 2001. Other major warship projects in hand, being a Type 42 Destroyer and a Type 23 Frigate, are also progressing to plan with Rosyth on track to confirming its position as the premier UK warship support facility. Three minor warship refits were completed during the year with a further two in various stages of completion at the year end. The year ahead will see the arrival of the next aircraft carrier in July 2001, HMS Invincible, for a refit.

During April 2001 a new form of contract, valued at some £75.0 million, was established with the MoD, which confirms a batch of five Type 23 Frigates for Rosyth spanning four years. This contract reflects the long term relationship and partnering approach that is evolving in the defence support sector.

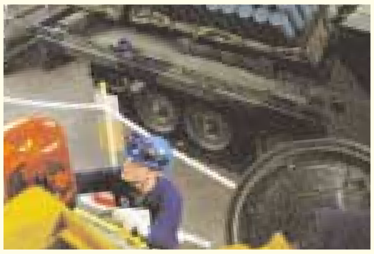
In nuclear submarine refitting there was further progress on HMS Sceptre and HMS Spartan with both submarines experiencing extensions to contract for additional work packages which are likely to extend their completion until early 2002. Although nuclear submarine refitting will be phased out over the coming 12 months, BES is well positioned to remain involved in submarine support. In April 2001, the MoD established the Warship Support Agency which is now responsible for almost every aspect of the Fleet including the Naval Base (Clyde), the operational base of the UK's strategic deterrent. As part of the drive to improve the efficiency of the Clyde Naval Base, BES is applying its experience to proposals and discussions aimed at establishing a 10 year management contract covering most activities at Faslane and Coulport from April 2002.

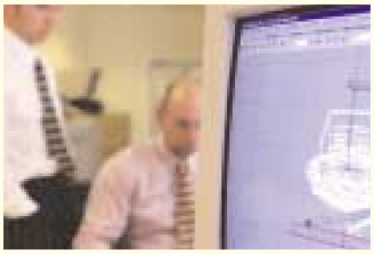
BES continues to seek the approval of the three regulators for the dismantling and disposal of decommissioned nuclear submarines which are stored at Rosyth. The regulators have indicated support for the Babcock proposals to deal with HMS Renown as the first project. Approval is anticipated by early summer from when renewed representations to allow progress will be made to the MoD.

The New Zealand dockyard operation has made considerable progress in its commercial activities and is building its reputation for reliability in the region. A growing awareness of reliability within the marine support industry has led to a number of new customers placing work with the yard and enquiries for superyacht build and conversion work are expected to lead to further growth in the year ahead.

Armstrong Technology, acquired early in 2000, is expanding its range of services and markets from its core skills which have been built around its ship and conversion design experience. After a poor start, it is encouraging to note the level of project activity is now picking up.

FBM Babcock Marine Limited (FBM) has successfully transferred its operations from the Isle of Wight to Southampton and Rosyth.





Significant costs were incurred in these moves. The first major fast ferry contract for Rosyth is nearing completion. FBM is also working on a number of new order prospects for large fast ferry and paramilitary vessels.

The Babcock Defence Systems' bid to the MoD for their new active and passive towed sonar system was unfortunately not selected.

Confirmations for 22 units of the Mega3® inter-modal freight wagons are now anticipated, after referral from the Strategic Rail Authority to the EU. Clearance has now been granted and full testing and certification achieved to UIC standards which allows its operation across Europe. Further orders are being pursued. Development work has continued over the year on the designs of other rail wagons for railway maintenance.

The Facilities Management (FM) business continues to pursue a number of new opportunities for growth in both the secure FM (Defence) and commercial sectors. The acquisitions of CMR Consultants Limited (CMR) last year and Air Power International Limited (API) in early 2001 have each provided opportunities for cross selling of other FM services and generally expanding the range of industrial support services. CMR provides a range of consultancy and procurement services to industry in energy and telecoms and API provides compressed air management and support services.

The plan for surplus land at Rosyth is under review. It considers a number of options that will consolidate the core ship-related activities and maximise the value of the surplus land thus created.

Hunting Defence Services

Hunting Defence Services comprises two related businesses. The larger business, HCS, with annualised turnover for the twelve months ending March 2001 of some £50.0 million, excluding construction work, supplies support services to the British Armed Forces. The smaller business, Acetech, with annualised turnover for the twelve months to March 2001 of some £12.0 million, supplies contract labour primarily for technical applications in the aerospace and telecommunications businesses.

HCS has a number of major contracts with the MoD. The contracts include the facilities management of RAF Cranwell, including the maintenance of the training aircraft that are based there. At nearby Barkston Heath, HCS operates the JEFTS pilot training scheme, training all of the initial pilot intake into the Royal Navy, Army and Royal Air Force. Amongst other things, this involves the operation of 45 Slingsby Firefly single propeller aircraft. 425 young people complete their initial training each year. At RAF Leeming the Hawk trainer jets are maintained for 100 Squadron. Last year an availability record of 80% was achieved, which is believed to be a world-class standard. Similar standards of Hawk availability are maintained at Culdrose where HCS pilots also fly the aircraft in support of the Royal Navy. At RAF Lyneham, landside support for the RAF's Hercules fleet is provided as part of HCS's multi-activity contract. This involves everything from the provision of ground transport to the maintenance and testing of the Hercules equipment. At RACC Bovington the Army's tank crews are trained and its tracked vehicles

maintained. In other areas HCS maintains the RAF's flight simulators and the fighter and helicopter control simulators for the Royal Navy at Yeovilton. Finally, HCS operates and maintains all 13 camps in Kosovo for British troops stationed there.

With the MoD's policy of continuing to outsource much of the non-military activities, HCS should provide the basis for rapid growth.

The long term nature of the HCS contracts provides stability of turnover but places a high premium on retaining these contracts when they are re-bid. So far, HCS's record has been exceptionally good and, based on its reputation for high quality service, there is no reason why this should not continue.

Acetech is in the business of supplying contract labour to the UK and international markets.

After the closing of its unsuccessful operation in Germany, prior to the acquisition, it has continued to grow. Shortly after the acquisition, it acquired a business based in Rosyth which was supplying contract labour to Babcock's own dockyard. In the short term, this will give a significant boost to turnover and profits.

These two businesses are consolidated into the annual accounts for only 22 days and, therefore, the contribution to both turnover and profit in the year to March 2001 is negligible.

Railcare

The Railcare business was involved in the heavy maintenance of locomotives and in the total refurbishment of passenger carriages. Demand for refurbishment has been poor. The increased competition also put pressure on margins and resulted in an operating loss (before exceptional items) of £5.0 million. The workforce was reduced by some 300 people across the year and an operating exceptional charge for redundancy of £5.7 million was incurred.

In May 2001 the business was sold to Alstom who have a much stronger strategic commitment to the rail industry and who will be able to find additional economies of scale. The estimated £6.2 million impairment in the carrying value of tangible fixed assets at the balance sheet date arising as a result of the sale of Railcare is shown as an exceptional charge.

BMH

BMH had a very difficult year, largely due to the overall economic circumstances caused by the slowdown in the American economy. BMH primarily supplies capital goods to some of the world's commodity markets and, in the face of a rapid slowdown, its turnover and order intake inevitably dropped sharply. On a like-for-like basis (excluding acquisitions), the turnover dropped by 20% compared to the year ending March 2000. A significant portion of this turnover reduction was due to the timing of large turnkey projects in the pipeline business in the United States, but almost all businesses fell compared to the previous year. The overall economic circumstances were exacerbated by the consolidation of our customer base. This led to the further suspension of capital projects, particularly in the cement, plasterboard and pulp industry,

all sectors that are important to our materials handling business. The decline in demand naturally exerted pressure on margins, and the return on sales fell to less than 2% before exceptional items.

On a like-for-like basis, the order book, which stood at £82.7 million at the beginning of the year, fell to £66.3 million by the end of the year, a reduction of some 20%. Much of this reduction came in the second half of the year. Overall, including the acquired Chronos Richardson, the order book at the end of the year was £76.4 million. There has been some improvement since the year end, due mainly to the pipeline services business booking another turnkey contract.

In a challenging market environment for cement, BMH's turnover fell by almost 20% and margins were squeezed. However, the aluminium-forming unit, which is based in the main cement division's site, had a particularly good year, growing in line with its main customer EADS. This growth is expected to continue, having won a long term supply contract to EADS. Turnover in BMH's marine terminal business held up reasonably well in the first half of the year, but collapsed quite sharply in the second half. This led to orders being booked at inadequate margins, and cost overruns caused the business to lose money over the year.

In addition, uncertainty surrounding financing arrangements for a significant project has caused a reassessment of the likelihood of the contract progressing in the near future. An operating exceptional provision against the full exposure of £9.6 million has, prudently, been taken.

The pipeline services company in the United States completed a major turnkey project in the first half of the year. Shortly after the year end, a further turnkey project was secured which, whilst not as large as the one in 2000, has significantly boosted the order book in the early part of this financial year. The profits from this will not, however, accrue until towards the end of the financial year March 2002.

In the engineered building products business new market opportunities were opened in Italy, Spain and New Zealand, supplementing BMH's traditionally strong position in North America. The North American market was, however, much weaker in this business segment, and downward price pressure caused negative margins.

Despite the commissioning of a large PCI system, for one of the world's biggest blast furnaces in the United States, the turnover in the power, iron and steel division was also down markedly.

Of the traditional market areas, only the wood and bio-energy businesses saw a favourable investment climate in the Scandinavian countries. The turnover in this business sector improved significantly on the previous year.

In June 2000 the bagging and batching equipment supplier, Chronos Richardson, was acquired. This contributed £22.5 million to the turnover in the year.

The year to March 2001 was challenging for BMH. There is little doubt that some of the difficulties were exacerbated by the announcement of our intention to sell the business. This remains the intention, but a targeted sale of some of the individual businesses is more likely to generate shareholder value, and this is the process which is now being pursued.

Babcock Africa
Babcock Africa manages operations, primarily in the Republic of South Africa, but also in contiguous countries. It is the last remaining business with associations with Babcock's boilermaking past, but is materially changing its role. It now has service contracts with Eskom, the South African electricity utility, whereby we manage the boiler plants at their power stations. The contracts are based on efficiency targets and, as such, are moving quite clearly into a support services role. The other main part of Babcock's activities in South Africa is the distribution of heavy-duty construction vehicles and the through-life maintenance of such items. As these businesses expand, the results in South Africa will improve.

N R Young Group Finance Director
18 June 2001

Financial review

The group's financial statements reflect a year of significant change. £30.6 million of capital will be returned to shareholders (of which £27.9 million was returned in the year), several acquisitions were completed, most notably the defence services business of Hunting plc for £64.6 million including costs, and in May, following the end of the financial year, the group's 60% share of Railcare was sold for £4.6 million to Alstom, who in addition assumed the borrowings of Railcare amounting to £2.0 million. Trading in the year was adversely affected by the difficult market conditions facing Railcare and the progressively weaker markets across BMH.

Turnover and margins
As a result group turnover fell by 6.3% from £470.7 million to £441.0 million and turnover from continuing operations fell by 3.8% from £414.8 million to £398.9 million. This reduction was driven by BMH and Railcare where turnover fell by £24.2 million and £13.7 million respectively. BES turnover increased by £8.3 million or 4.5%.

Operating profit from continuing operations before operating exceptional items and goodwill declined from £22.0 million to £14.7 million with those operations acquired during the year reporting a breakeven performance on turnover of £26.5 million. Railcare, shown as a discontinued operation, made an operating loss before goodwill amortisation of £5.0 million compared to £0.8 million a year earlier as its markets weakened dramatically. Operating margins from continuing operations before operating exceptional items and goodwill fell from 5.3% a year earlier to 3.7% with BES remaining at a similar level but BMH falling to 1.6% from 4.4%.

Operating exceptional charges were made in respect of the following matters. A provision of £9.6 million was taken by BMH in respect of commitments under a contract that is stalled pending new financing arrangements and where the timing of that finance remains uncertain. Costs of £0.4 million were incurred on the integration of recently acquired operations. Finally, there were costs of £5.7 million (2000: £2.4 million) for a programme of redundancies at Railcare.

The total net goodwill amortisation credit reduced from £2.1 million to £1.5 million as a result of recent acquisitions.

Non-operating exceptional items
The non-operating exceptional charge of £6.2 million is a provision for the loss on the disposal of Railcare and reflects the estimated impairment in the value of its tangible fixed assets held at the balance sheet date in the light of its disposal on 23 May 2001.

Interest
Interest receivable in the year of £3.7 million (2000: £4.3 million) shows the impact of the lower net cash balances following the return of capital to shareholders, acquisitions made and progressively softening interest rates.

Taxation
Excluding the net goodwill amortisation credit of £1.5 million and the non-operating exceptional loss of £6.2 million the effective tax rate of 7.9% is lower than the standard UK rate of 30% due to the net effect of the utilisation of tax losses, surplus advanced corporation tax and short term timing differences not equalised through deferred tax. At 31 March 2001 the group had trading losses carried forward for tax purposes in excess of £70 million.

Earnings per share and dividends
Basic loss per share was 2.44p (2000: earnings 13.26p). Basic earnings per share excluding non-operating exceptional items and goodwill amortisation was 0.55p (2000: 11.43p).

The Board is recommending a final dividend of 1.55p per 60p ordinary share in issue making a total for the year on that basis of 2.65p (2000: 2.55p per 50p ordinary share).

Balance sheet
Group shareholders' funds reduced in the year by £33.8 million to £110.2 million. This reflects the loss of £7.7 million, the return of capital to shareholders which cost £28.8 million, £3.4 million of shares issued as a result of options being exercised and foreign exchange losses of £0.7 million (2000: £1.1 million) on the translation of the net assets and results of overseas subsidiaries into sterling.

Notwithstanding the return of capital to shareholders and the acquisitions made in the year the group was virtually ungeared at 31 March 2001 with net debt of £1.3 million (2000: net funds of £103.9 million).

Pension schemes
The group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The total pension cost charged against the operating profits of the group was £1.2 million (2000: £6.2 million).

	Average rate to £1 2001	Average rate to £1 2000	Year end rate to £1 2001	Year end rate to £1 2000
US Dollars	**1.48**	1.61	**1.42**	1.59
Euro	**1.62**	1.57	**1.61**	1.67
Swedish Krona	**13.97**	13.62	**14.67**	13.78
South African Rand	**10.82**	9.95	**11.39**	10.44

Principal exchange rates

At 31 March 2001 the group carried a £79.2 million (2000: £78.7 million) pension prepayment in its balance sheet in respect of the group's principal pension schemes. This represents a prepayment of future contributions to be made by the group companies to the schemes and will be realised by the group over the service lives of the employees in the schemes.

Cash flow
Total cash outflow in the year was £98.9 million (2000: inflow £24.7 million).

The cash outflow from operations was £11.0 million (2000: inflow £38.1 million). With earnings before interest, taxes, depreciation and amortisation, or EBITDA, at £6.2 million (2000: £29.8 million) the remaining cash outflow from operations has arisen from an increase in working capital. After several years of strong cash inflow from operations driven, in part, by a favourable working capital picture, the group experienced an increase in working capital of £17.2 million. This was caused largely by a £16.2 million reduction in advance payments and payments in advance of turnover from £39.5 million to £23.3 million.

Taxes paid in the year reduced by £1.3 million to £0.7 million.

Net capital expenditure and financial investment was £7.2 million compared to £9.1 million in the previous year.

Acquisitions and disposals
The net cash outflow in the year relating to acquisitions and disposals was £59.6 million (2000: £8.2 million).

Payments to acquire subsidiary undertakings net of cash balances in the acquired companies were £64.6 million. This includes £1.1 million (2000: £0.6 million) in respect of acquisitions made in previous years. The total amount outstanding in respect of deferred consideration for all acquisitions made up to 31 March 2001 is £7.3 million (2000: £10.7 million). Further details of acquisitions can be found in note 29 to the Financial Statements.

The group received the final £5.0 million of deferred consideration relating to the disposal in 1995 of its Energy division.

Treasury
Clearly established treasury policies and procedures are reviewed and approved by the Board on a regular basis. Divisional and operating company compliance with these policies and procedures is subject to periodic review by internal audit. Speculative transactions are prohibited.

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

The group also enters into derivative transactions, principally forward foreign currency contracts. The purpose of these is to manage the currency risks arising from foreign currency transactions. The use of derivative financial instruments other than forward foreign exchange contracts is prohibited without the prior approval of the Group Finance Director.

The main risks arising from the group's financial instruments are foreign currency risk, liquidity risk and interest rate risk.

Foreign currency risk
The group's foreign currency exposure management policy requires subsidiaries to hedge transactional currency exposures against the currency in which their results are measured. Forward foreign exchange contracts are used to hedge selected future sales and purchases, which may be either contracted or uncontracted. Gains and losses on these contracts are recognised at the same time as the transaction to which the hedge relates.

The group's accounting policy is to translate the profits of overseas companies using average exchange rates and the net assets of overseas companies using year end exchange rates. It continues to be the group's policy not to hedge foreign currency exposures on the translation of its overseas profits and net assets to sterling although foreign currency borrowings are used from time to time to match foreign currency assets and liabilities.

The principal exchange rates used by the group in translating overseas profits and net assets into sterling are set out in the table above.

If the 2001 results of foreign subsidiaries had been translated into sterling using the same average exchange rates as 2000, the group turnover would have been £3.0 million higher and the group operating profit £0.2 million lower.

Liquidity risk
The group invests its surplus funds in financial instruments with maturity profiles necessary to ensure the availability of those funds as required. The group also maintains committed bank facilities available as a standby in the UK and certain overseas countries. The amount of undrawn committed facilities at 31 March 2001 is set out in note 21 to the Financial Statements.

Interest rate risk
The group is exposed to interest rate risk on its short term borrowings, deposits, and other liquid financial instruments. These short term borrowings and investments are at both fixed and floating rates as set out in note 21 to the Financial Statements.

Credit risk
The group controls credit risk by entering into financial instruments only with highly credit-rated and authorised counterparties. Counterparty authorisations and positions are monitored on a regular basis.

Share price performance
During the past year the company's share price has fluctuated between 74.65p and 128.5p. At market close on 15 June 2001 it stood at 105.0p which represents a market capitalisation of £154.0 million.

Following the acquisition of Hunting Defence Services and the return of capital to shareholders the group's balance sheet remains strong and provides an excellent platform from which to pursue its corporate strategy.

Directors and Company Secretary

G A Campbell (Age 54)
Joined the Board as Group Chief Executive on 10 October 2000. Appointed Chairman on 1 January 2001. Former Chairman of Acordis Group, which had been formed through combining the fibres operations of Akzo Nobel and Courtaulds plc and, previously, Chief Executive of Courtaulds plc. Currently a non-executive Director of British Nuclear Fuels plc, IChemE Ltd, International Process Technologies Ltd and Wade Allied Holdings Ltd and is a Trustee Director of the British Heart Foundation. Mr Campbell is a past President of the Institution of Chemical Engineers.

M S Easton (Age 50)
Joined the Group as Managing Director of Babcock Engineering Services Division on 18 May 1997 and appointed to the Board on 31 July 1997. Former Managing Director and Chief Executive of Yarrow Shipbuilders Ltd and previously Production Director at Cammell Laird Shipbuilders Ltd.

The Rt Hon Lord Hesketh KBE (Age 50)**
Joined the Board on 6 October 1993. Appointed non-executive deputy Chairman on 26 April 1996. A non-executive director of BAE SYSTEMS PLC and Chairman of British Mediterranean Airways Limited. Former Government Chief Whip in the House of Lords, and prior to that, Industry Minister at the Department of Trade and Industry. Chairman of Babcock International Group PLC's Senior Appointments and Remuneration Committee and a member of its Audit Committee.

D J Shah (Age 48)*
Joined the Board on 15 June 1999. Mr Shah is Vice President, Acquisitions and Divestments in BP PLC. A member of DTI's Renewable Energy Advisory Committee since 1995 and UK Panel for European Environmental Awards. Formerly responsible for BP Amoco's Forties Pipeline System and General Manager for their Grangemouth complex. A past Chairman of the European Solar Industry Association and formerly Managing Director and Chief Executive of BP Solar International. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

Dr G Schäfer (Age 61)
Appointed Managing Director of BMH Technologies Division on 1 September 1996 and joined the Board on 31 July 1997. Has some 25 years' experience in the materials handling industry and was previously Chief Executive of Claas KGaA.

M J Turner CBE (Age 52)*
Joined the Board on 5 June 1996. Mr Turner is Chief Operating Officer of BAE SYSTEMS PLC and a member of the Supervisory Board of Airbus. He was President of the Society of British Aerospace Companies from 1996–1997. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

A E Wheatley (Age 63)*
Joined the Board on 1 January 1993. Non-executive Director of Legal & General Group PLC and Deputy Chairman of Ashtead Group PLC. Chairman of Babcock International Group PLC's Audit Committee and a member of its Senior Appointments and Remuneration Committee.

N R Young (Age 48)
Joined the Board as Group Finance Director on 31 July 1997. Former Group Finance Director of First Technology PLC and previously Group Finance Director of United Scientific Holdings PLC (now Alvis plc).

Company Secretary
H M Mahy (Age 40)
Joined the Group on 15 February 1993 and was appointed as Group Company Secretary and General Counsel on 1 February 1999. A Barrister and Chartered Insurance Practitioner, she was formerly Group Legal and Commercial Manager and previously Director – Legal and Commercial of Babcock King-Wilkinson Ltd. Prior to this she was deputy head of the commercial and legal department at Crown Agents.

* Denotes independent non-executive Director.

**Denotes senior independent non-executive Director.

Directors' report

The Directors present their Report and the audited Financial Statements of the group for the year ended 31 March 2001.

Result and dividends

The loss attributable to shareholders for the financial year was £3.9 million (2000: profit £22.5 million). An interim dividend of 1.1p per 60p ordinary share was declared in the year (2000: 0.90p per 50p ordinary share). The Directors propose to recommend the payment on 10 August 2001 of a final dividend of 1.55p on each of the ordinary shares of 60p entitled thereto and in issue on 13 July 2001. The retained loss for the financial year was £7.7 million (2000: profit £18.1 million).

Business review and group structure

The Operations and Financial reviews of the group's activities and future developments are set out on pages 12 to 19. Other matters material to an appreciation of the group's position are contained in the Chairman's statement. The principal subsidiary and associated undertakings are set out on page 57.

Acquisitions

Details regarding the group's acquisitions during the course of the year are set out in note 29 on pages 54 and 55.

Research and development

Product development and innovation is a continuous process. The group continues to commit resources to research and development where this activity is necessary to the evolution and growth of its business.

Charitable and political donations

During the year the group donated £13,012 (2000: £28,998) to charitable organisations. No donations were made during the year for political purposes.

Supplier payments

It is the general policy of both the company and the group to develop relationships with suppliers which include making payment consistent with established practices agreed with suppliers. In view of the international nature of the group's activities there is no universal code or standard on payment practices but subsidiary companies are expected to establish terms of trade consistent with the above policy and with the markets in which they operate, to ensure that suppliers are made aware of the terms of payment and to abide by them. The company had no trade creditors at either the current or previous financial year end.

Directors

The names of the present Directors, together with brief biographical notes, are shown on page 20.

Sir John Parker retired as a Director on 31 December 2000. Mr M S Easton and Mr N R Young retire by rotation under the provisions of Article 101 of the company's Articles of Association and, being eligible, offer themselves for re-election. Should either or both of Mr Easton or Mr Young fail to be re-elected at the forthcoming Annual General Meeting, the remaining period of their appointment as Directors would be 12 months. Mr G A Campbell, who was appointed to the Board on 10 October 2000, retires under the provisions of Article 108 of the company's Articles of Association and, being eligible, offers himself for election.

Directors' interests

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

Directors' interests in the shares of the company are shown on pages 27 and 28.

Significant shareholdings

As at 15 June 2001, the company has been notified of the following major interests in its ordinary shares which represent 3% or more of its issued ordinary share capital in accordance with Sections 198 to 208 of the Companies Act 1985:

Name	Number of 60p ordinary shares	%
Phillips & Drew Fund Management Limited	16,525,576	11.27
HSBC Asset Management (Europe) Limited	14,840,982	10.12
Fidelity International Limited	8,609,196	5.87
Lazard Freres & Co., LLC	6,838,362	4.66
Legal & General Investment Management Limited	5,857,764	4.00
Zurich Financial Services	5,720,000	3.90

Sharesave Scheme
The Babcock International Group PLC Sharesave Scheme which was launched in December 1997, was fully subscribed. The Scheme matured on 1 February 2001 and during the period to 31 March 2001 4,325,868 options were exercised. The group's employees on 31 March 2001 had options remaining under the Scheme over 484,819 shares at an option price of 62.3p.

Personnel
The group comprises a diverse range of companies that have all developed and implemented progressive policies, within the overall framework of each Division, to ensure that Babcock's principle of recognising the talent of our employees and encouraging improvement is actively followed. This includes structured training and development programmes ranging from apprentice to technician and management. Several of our sites have Investors in People status.

Communication systems include regular cascade briefings, director/employee briefings throughout the organisation, employee consultation, weekly newsletters, newspapers, e.mail and the Babcock website. In many of our companies there is a regular briefing on market prospects and company performance to Trade Union representatives, resulting in a highly constructive and healthy dialogue.

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

Employee involvement in the group's performance is also encouraged via share save and profit share schemes in some cases. These are generally adopted under United Kingdom laws, but are extended to group companies operating in other countries where this is permissible and appropriate.

Health, safety and the environment
We maintain as a primary objective the highest standards of safety of our employees, the public and the environment. All companies operate comprehensive health, safety and environmental management programmes and these (including risk assessment activities, incidents, claims and benchmarking data) are subject to regular Board overview.

Business ethics
The group requires strict compliance by its companies and employees with the laws and standards of conduct of the countries in which they do business. This includes legislation implementing recent anti-corruption conventions. Employees are required to avoid conflicts of interest regarding company business, to act lawfully and ethically, and to be responsible for communicating in good faith non-compliance issues of which they become aware.

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

Annual General Meeting
This year's Annual General Meeting will be held at The Berkeley Hotel, Wilton Place, Knightsbridge, London SW1X 7RL on Tuesday, 24 July 2001, at 12 noon. The notice of meeting is on page 58 of this document.

Special business
Resolutions 6(1) to 6(3) set out in the notice of Annual General Meeting constitute special business.

Resolution 6(1), which will be proposed as a Special Resolution, renews the general authority for the company to make market purchases of its own ordinary shares for cancellation. The renewed authority, in respect of up to 10% of the company's issued share capital as at 18 June 2001, is exercisable with a minimum purchase price of 60p per share and a maximum price which will not be 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. The authority will expire on 23 July 2002 or, if earlier, on the conclusion of the Annual General Meeting of the company to be held in 2002. The Directors have no present intention to use this power, but would 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 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 15 June 2001 was 10,024,974, representing 6.83% of issued share capital. If the full authority to buy back shares were to be used, the said outstanding options would represent 7.60% of issued share capital.

Resolutions 6(2) and 6(3), which will be proposed as Ordinary Resolutions, request authority to amend the Rules of the Babcock 1999 Approved Executive Share Option Scheme and The Babcock 1999 Unapproved Executive Share Option Scheme ('the Option Schemes'). The amendments are intended to remove the current limit, of four times salary, on the value of shares over which options to subscribe for new shares may be held by an employee at any time. Instead there is a new limit of twice the greater of the individual's gross rate of basic annual salary and bonus (excluding any company pension contributions and any other perquisites and benefits-in-kind) for the financial year including the date of grant, and the preceding financial year, on the initial aggregate market value of shares over which options may be granted. The move away from an overall four times salary limit to an annual limit is in line with the most recent ABI guidance. It also codifies what has in fact been the company's practice of phasing option grants over several years. The changes to the Approved Scheme will only take effect once the Inland Revenue has confirmed that the approved status of the Approved Scheme will not thereby be affected.

Auditors
Arthur Andersen are willing to continue in office and Resolutions will be proposed at the Annual General Meeting to reappoint them as auditors and to authorise the Directors to fix their remuneration.

Corporate governance

Statement of compliance with the Combined Code

During the year ended 31 March 2001 the company complied with the requirements of the Principles of Good Governance and Code of Best Practice (the 'Combined Code').

The company has combined the post of Chairman and Chief Executive Officer in one person. The Board considers it has a strong, independent group of non-executive Directors (including a non-executive Deputy Chairman) and is well balanced. The Deputy Chairman, Lord Hesketh, is recognised as the senior independent director to whom any concerns can be conveyed.

The group recognises the importance of, and is committed to, high standards of corporate governance. The principles of good governance set out in Section 1 of the Combined Code have been applied in the following way:

a) Directors

The Board currently comprises four executive Directors and four non-executive Directors. The Board is confident that the constitution of the Board, including the non-executive Directors, ensures a balance of power and authority, such that no one individual has unfettered powers of decision.

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

Directors' remuneration

Full details of Directors' remuneration and a statement of the company's policy on executive Directors' remuneration are set out on pages 24 to 28.

Relations with shareholders

The company maintains an active dialogue with its institutional shareholders. The Annual General Meeting is used as an important opportunity for communication with both institutional and private shareholders.

b) Accountability and audit

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

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

Control environment

The group operates decentralised, profit-responsible units reporting through a Divisional management structure with clear delegated levels of authority and an established system of internal control.

Identification and evaluation of risks and control objectives

The Board has the primary responsibility for identifying the major business risks facing the group and developing appropriate policies to manage those risks. Given the nature of the group's business the principal risks relate to out-turn on contracts. All tenders for significant contracts are therefore referred to group head office for review and approval prior to tender submission to ensure that the terms of the tender meet group criteria. Progress on all significant contracts undertaken is monitored within the Division and at least quarterly by group head office.

Information and communication

Comprehensive budgeting systems are in place to develop annual budgets covering the key aspects of each Division's business. The budgets are subject to review by central management, prior to approval by the Board. Revised forecasts for the year are prepared on a regular basis. Actual performance is compared each month with budgets, forecasts and prior year, with written commentary on significant variances from approved plans.

Control procedures

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

Monitoring
The internal control system is monitored and supported by an internal audit function that operates and reports to senior management and the Audit Committee on the group's worldwide operations. The work of the internal auditors is focused on the areas of greatest risk to the group determined by senior management and the audit department, and by evaluations of business risks and controls by individual company management. These activities are supported by quality assurance audits and regular review visits by group management. The external auditors are engaged to express an opinion on the group's Annual Report and Financial Statements and the results of their reviews are reported to the Audit Committee.

The Board of Directors has reviewed the effectiveness of the system of internal controls in place.

Statement of Directors' responsibilities

Accounts, including adoption of going concern basis
Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and group and of the profit or loss of the group for that period.

After making enquiries, the Directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

In preparing the accounts, 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 applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

Other matters
The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Remuneration report

Senior Appointments and Remuneration Committee
The remuneration and emoluments of the executive Directors are determined by the Senior Appointments and Remuneration Committee ('the Committee'). The Committee is comprised solely of all the non-executive Directors of the company, namely:

The Rt Hon Lord Hesketh (Committee Chairman), D J Shah, M J Turner, A E Wheatley.

The biographical details of these Directors are set out on page 20.

The non-executive Directors exercise their judgements independently of the executive Directors, making use of independent external advice as required from a leading independent firm of compensation and benefit consultants. They do not participate in any of the company's share option, pension or bonus schemes.

Service contracts
Mr G A Campbell, Mr M S Easton, and Mr N R Young, each have service agreements on a one year rolling basis. Dr G Schäfer's service agreement was varied in August 2000 so that he now has a fixed period contract expiring on his 63rd birthday in November 2002. Dr Schäfer's normal retirement date of 62 was extended so that the company could continue to benefit from his expertise and experience in the BMH Technologies Division sale process. The Committee's view is that, although it may be appropriate to provide an initially longer period of fixed notice when an individual joins the Board, the norm for a rolling notice period should be one year. Each service contract is subject to termination upon retirement. Other than Dr Schäfer no executive Directors have separate predetermined compensation provisions exceeding one year's salary and benefits in kind and the amount of any bonus earned in the preceding year.

Policy on executive Directors' remuneration
The company seeks to provide total reward packages that are effective in attracting, retaining and motivating, in a fair and economical manner, executive Directors of the experience and calibre required to develop its businesses profitably in the interests of shareholders, customers, employees and other stakeholders in the company. In order to achieve this the company must provide a competitive package of rewards and incentives linked to performance.

Directors' remuneration
The total reward package for the executive Directors includes the current rewards of basic salary, benefits in kind, such as cars and medical insurance, annual bonuses, and the long term rewards of share options and pension benefits. In determining the remuneration of the executive Directors, the Committee has considered practices in the wider market, in particular those of competitor companies. The Directors' emoluments for the year ended 31 March 2001 are set out in the table below:

Directors	Salary or fee £'000	Bonus £'000	Benefits £'000	Other* £'000	**Total 2001 £'000**	Total 2000 £'000
Executive						
Mr G A Campbell (Chairman)	152	86	–	–	**238**	–
M S Easton	180	67	9	9	**265**	237
Dr G Schäfer	213	–	13	–	**226**	300
N R Young (Group Finance Director)	180	81	15	8	**284**	220
Sir John Parker**	239	191	14	428	**872**	538
Non-executive						
The Rt Hon Lord Hesketh KBE	50	–	–	–	**50**	47
D J Shah	25	–	–	–	**25**	19
M J Turner CBE	25	–	–	–	**25**	23
A E Wheatley	35	–	–	–	**35**	33
I G S Hartigan**	–	–	–	–	**–**	7
Total	1,099	425	51	445	**2,020**	1,424

*Tax paid in respect of supplementary pension contributions over the 'earnings cap'.
**Former Directors.

Benefits in kind comprise mainly company car benefits and membership of the company's group Healthcare Scheme. Benefit levels provided to the executive Directors are consistent with those provided by other major companies. They do not form part of pensionable earnings under any of the company's pension arrangements.

Non-executive Directors' fees are determined by the executive Directors. The basic fee paid to the non-executive Directors other than Lord Hesketh and Mr Wheatley is £25,000 per annum. Lord Hesketh's basic fee is £50,000 per annum to reflect his additional responsibilities as Deputy Chairman. Mr Wheatley's basic fee is £35,000 per annum to reflect his Chairmanship of the Audit Committee. No fees for other services were paid to non-executive Directors during the year. Non-executive Directors' fees are set at a level which will attract individuals with the necessary experience and ability to make a significant contribution to the company's affairs. They have written terms of service and their contracts are terminable at will, although it is intended that their initial appointment will be for a three year term. At the Board's discretion a further term may be offered (generally for four years). They are free to resign at any time.

Directors' pensions

Babcock International Group Pension Scheme

Mr M S Easton and Mr N R Young are both members of the upper tier of the Babcock International Group Pension Scheme.

Details of the Directors' pension entitlements under the Babcock International Group Pension Scheme are set out in the following table:

Director	Increase in pension accrued, in excess of inflation, during the year ended 31 March 2001 £'000	Transfer value of the increase in pension accrued during the year ended 31 March 2001 £'000	Accrued pension entitlement at 31 March 2001 £'000	Accrued pension entitlement at 31 March 2000 £'000
M S Easton	**3**	**32**	**12**	9
N R Young	**3**	**26**	**11**	8
Sir John Parker*	**1**	**15**	**11**	10

*Former Director.

1) Inflation has been assumed to be 3.3% 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. The value represents a liability of the employing company – not a sum to be paid or due to the individual director – and cannot, therefore, be added meaningfully to annual remuneration.

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

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

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

Other pension arrangements

For UK based executive directors whose earnings exceed the Inland Revenue earnings cap, the company will, on request, establish a Funded Unapproved Retirement Benefit Scheme (FURBS) and take out additional life assurance cover to provide additional retirement and life assurance benefits based on salary in excess of the earnings cap.

Mr M S Easton and Mr N R Young participate, and Sir John Parker participated, in these arrangements.

Contributions to Sir John Parker's FURBS were set at a level that would, in conjunction with his benefits from the upper tier of the Babcock International Group Pension Scheme and benefits from former employers' schemes, provide him with a target pension of 50% of his pensionable salary at retirement. The arrangement operated as a money purchase benefit at retirement with a minimum defined benefit guaranteed by the company. The final actuarial review was conducted as at 8 April 2001, the date that Sir John Parker left the employment of the group. Contributions ceased during the year and no further contributions are payable. The equivalent pension increase accruing to Sir John Parker during the year as a result of these arrangements, excluding inflation, was £5,461. The transfer value of this increase, calculated in accordance with Actuarial Guidance Note GN11, was £100,987. At 31 March 2001 the pension entitlement accrued was £82,521 (2000: £74,096).

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

Dr G Schäfer, who is based in Germany, has personal pension arrangements to which the group contributes. Mr G A Campbell has no pension arrangements with the company.

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

Director	2001 £'000	2000 £'000
M S Easton	**13**	10
Dr G Schäfer	**17**	17
N R Young	**12**	11
Sir John Parker*	**642**	236
	684	274

*Former Director.

Directors' share interests

The beneficial interests of the Directors, including family interests, were as follows:

Director	At 31 March 2001	At 1 April 2000
G A Campbell	**9,685 (b)**	–
M S Easton	**22,355 (b)**	10,000 (a)
The Rt. Hon. Lord Hesketh KBE	**8,249 (b)**	9,900 (a)
	2,000 (c)	–
Dr G Schäfer	**–**	–
Mr D J Shah	**8,333 (b)**	–
M J Turner CBE	**16,666 (b)**	20,000 (a)
A E Wheatley	**8,333 (b)**	10,000 (a)
N R Young	**14,022 (b)**	–
Sir John Parker*	**23,214 (b)**	27,857 (a)

*Former Director.
(a) Ordinary shares of 50p each
(b) Ordinary shares of 60p each
(c) Non-cumulative redeemable 'B' preference shares of 18p each

There were no changes in the Directors' interests in shares between 31 March 2001 and 18 June 2001.

Long term incentives

i) Executive share option schemes Discretionary grants of share options are the principal form of long term incentive provided for the executive Directors and other senior executives throughout the group and are controlled by the Committee, which considers such schemes to be an important component in the overall executive remuneration package. The exercise prices of options granted are not set at a discount to the market value of the company's shares at the date of grant.

Directors may normally exercise their options between the third and tenth anniversary of the date of grant. There are no performance criteria attached to the right to exercise options under the Babcock International Group PLC Approved Executive Share Option Scheme and the Babcock International Group PLC Unapproved Executive Share Option Scheme. Under the Babcock 1999 Approved Executive Share Option Scheme and the Babcock 1999 Unapproved Executive Share Option Scheme, which were approved by shareholders at the company's 1999 Annual General Meeting to replace the two previous schemes, performance criteria apply. The Committee is currently of the view that, given the nature of the company's business, performance criteria for the vesting of options under its Executive Share Option Schemes will be based on total shareholder return ('TSR') rather than growth in earnings per share. The company's performance will be assessed in relation to a range of comparable companies and, in so far as the company's TSR performance is in the top quartile, share option awards will vest in full; in so far as the company's performance falls below the median, no options will vest. It is the company's present intention that, unless there are exceptional circumstances, the maximum grant per year to any individual will not exceed 1 times base annual salary. No Directors exercised any options under the Executive share option schemes during the year of account. Options held by Mr M S Easton, Dr G Schäfer and Mr N R Young were granted in the years subsequent to their appointment as Directors. There have been no changes between 31 March 2001 and 18 June 2001.

The recruitment package negotiated at the time of the appointment of Mr G A Campbell as Chief Executive of the company in advance of the retirement of the former Chairman and Chief Executive, Sir John Parker, included the issue of a share option contract by the Trustee of the Babcock Employees' Share Trust. The Trustee subsequently granted to Mr Campbell, on 22 November 2000, an option to purchase a maximum of 560,975 shares in the company equivalent in value to twice Mr Campbell's rate of basic salary. The option takes the form of a bilateral contract between the Trustee and Mr Campbell on terms, including performance criteria, which mirror those governing options granted under The Babcock 1999 Unapproved Executive Share Option Scheme (the 'Unapproved Scheme'), save only that if the company comes under the control of another person or persons in consequence of a general takeover offer, such option shall become immediately exercisable in respect of all of the shares over which it is held. A summary of the provisions of the Unapproved Scheme was sent to shareholders as an appendix to the Chairman's letter dated 29 June 1999 prior to the approval of the Unapproved Scheme by shareholders at the company's subsequent Annual General Meeting on 30 July 1999.

The provisions of the option contract cannot be altered to the advantage of Mr Campbell without the prior approval of the company's shareholders in general meeting. The benefits under the option contract are not pensionable.

ii) Babcock International Group PLC Sharesave Scheme The scheme, which was introduced in December 1997, and matured on 1 February 2001, was linked to a save-as-you-earn contract which participants entered into with a building society nominated by the company to save a regular monthly sum by deduction from earnings of up to £224 per month for three years. Subject to common service criteria, the scheme was open to all UK employees (including executive Directors) of the group. Options are exercisable during the six month period from maturity to 1 August 2001.

The option price was calculated by reference to the average of the mid-market quotation of a share as shown by the London Stock Exchange Daily Official List for the three business days immediately preceding 26 November 1997 ('the offer date') discounted by 20%.

Long term incentives continued

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

Director	Option scheme	Number of options at 1 April 2000	Granted during the year	Exercised during the year	Lapsed during the year	**Number of options at 31 March 2001**	Exercise price (p)	Mid market price at date of exercise (p)	Notional gain on exercise of share options £	Exercisable from	Expiry date
G A Campbell	e	–	560,975			**560,975**	123.00			Nov 2003	Nov 2010
M S Easton	a	35,502				**35,502**	84.50			Jun 2000	Jun 2007
	b	130,178				**130,178**	84.50			Jun 2000	Jun 2007
	b	56,909				**56,909**	82.00			Dec 2000	Dec 2007
	c	14,022		14,022		**–**	62.30	99.00	5,146	Feb 2001	Aug 2001
	b	239,700				**239,700**	89.00			Jul 2001	Jul 2008
	b	179,591				**179,591**	122.50			Jul 2002	Jul 2009
	d		186,858			**186,858**	96.30			Jun 2003	Jun 2010
Dr G Schäfer	b	304,288				**304,288**	77.00			Sep 1999	Sep 2006
	b	340,017				**340,017**	82.00			Dec 2000	Dec 2007
	b	316,614				**316,614**	89.00			Jul 2001	Jul 2008
	d	180,020				**180,020**	118.00			Sep 2002	Sep 2009
	d		225,268			**225,268**	96.30			Jun 2003	Jun 2010
N R Young	a	34,383				**34,383**	87.25			Aug 2000	Aug 2007
	b	210,125				**210,125**	87.25			Aug 2000	Aug 2007
	c	14,022		14,022		**–**	62.30	110.00	6,688	Feb 2001	Aug 2001
	b	250,936				**250,936**	89.00			Jul 2001	Jul 2008
	b	188,298				**188,298**	122.50			Jul 2002	Jul 2009
	d		54,675			**54,675**	96.30			Jun 2003	Jun 2010
Sir John Parker*	a	1,012,971				**1,012,971**	114.51			Dec 1996	Apr 2002
	c	14,022		14,022		**–**	62.30	99.00	5,146	Feb 2001	Aug 2001
	b	11,878				**11,878**	89.00			Jul 2001	Apr 2002
	d	256,907			121,774	**135,133**	118.00			Sep 2002	Sep 2009

a Babcock International Group PLC Approved Executive Share Option Scheme
b Babcock International Group PLC Unapproved Executive Share Option Scheme
c Babcock International Group PLC Sharesave Scheme
d Babcock 1999 Unapproved Executive Share Option Scheme
e Share Option Agreement

The company's mid-market share price at close of business on 31 March 2001 was 93.50p. The highest and lowest mid-market share prices in the year ended 31 March 2001 were 128.50p and 74.65p respectively.

Annual performance-related bonus scheme

All senior executives in the group participate in bonus schemes primarily related to the performance of the business or businesses with which they are involved. The executive Directors participate in a bonus scheme related to the performance of the group and to more specific personal targets set by the Committee. Under the bonus scheme, the maximum potential bonus of Mr M S Easton, Dr G Schäfer and Mr N R Young, is limited by the Committee to 50% of their base salaries. Mr G A Campbell's maximum potential bonus is limited by the Committee to 60% of his base salary.

The group performance element of their bonus is determined by the extent to which the trading performance of the group achieves the targets and parameters set by the Committee at the beginning of each year. The Committee has absolute discretion to alter them to reflect changed circumstances, for example material changes in accounting standards or changes in the structure of the group. Bonuses awarded under this element of the bonus scheme are included within the table on page 25.

At the beginning of the financial year under review the Committee also agreed a range of personal performance targets for the executive Directors based on the group's overall priorities. Each Director was appraised by the Committee on progress under each target and bonuses were awarded accordingly. These are also included within the table on page 25.

Annual bonuses do not form part of pensionable earnings.

2001/2002 performance-related bonuses

For the year 2001/2002 the Committee have decided to continue to apply the performance-related bonus schemes together with more specific personal targets, compatible with the Board's strategic and operational priorities for the year.

Approval of report

Approved by the Directors on 18 June 2001.

By order of the Board

H M Mahy Secretary
18 June 2001

Auditors' report to the shareholders of Babcock International Group PLC

We have audited the Financial Statements on pages 30 to 57 which have been prepared under the historical cost convention and the accounting policies set out on pages 35 and 36. We have also examined the amounts disclosed relating to the emoluments, share options, long term incentive scheme interests and pension benefits of the directors which form part of the remuneration report on pages 24 to 28.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report including, as described on page 24, preparing the Financial Statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority and by our profession's ethical guidance.

We report to you our opinion as to whether the Financial Statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' Report is not consistent with the Financial Statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions with the company and the group is not disclosed.

We review whether the corporate governance statement on pages 23 and 24 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by 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 company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited Financial Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Statements and of whether the accounting policies are appropriate to the circumstances of the company and of the group, consistently applied and adequately disclosed.

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

Opinion

In our opinion the Financial Statements give a true and fair view of the state of affairs of the company and of the group at 31 March 2001 and of the group's loss and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen Chartered Accountants and Registered Auditors

1 Surrey Street,
London WC2R 2PS

18 June 2001

Group profit and loss account
For the year ended 31 March 2001

	Notes	2001 Before exceptional items £'000	2001 exceptional items £'000	2001 Total £'000	2000 Before exceptional items £'000	2000 exceptional items £'000	2000 Total £'000
Continuing operations		**372,430**	**–**	**372,430**	414,832	–	414,832
Acquisitions		**26,472**	**–**	**26,472**	–	–	–
		398,902	**–**	**398,902**	414,832	–	414,832
Discontinued operations		**42,139**	**–**	**42,139**	55,856	–	55,856
Group turnover	2	**441,041**	**–**	**441,041**	470,688	–	470,688
Cost of sales	3	**(359,344)**	**(9,630)**	**(368,974)**	(386,086)	–	(386,086)
Gross profit		**81,697**	**(9,630)**	**72,067**	84,602	–	84,602
Net operating expenses before goodwill amortisation		**(72,040)**	**(6,162)**	**(78,202)**	(63,476)	(2,384)	(65,860)
Goodwill amortisation		**1,473**	**–**	**1,473**	2,057	–	2,057
Net operating expenses	3	**(70,567)**	**(6,162)**	**(76,729)**	(61,419)	(2,384)	(63,803)
Continuing operations		**15,708**	**(9,897)**	**5,811**	23,387	–	23,387
Acquisitions		**(190)**	**(174)**	**(364)**	–	–	–
		15,518	**(10,071)**	**5,447**	23,387	–	23,387
Discontinued operations		**(4,388)**	**(5,721)**	**(10,109)**	(204)	(2,384)	(2,588)
Group operating profit/(loss)	2	**11,130**	**(15,792)**	**(4,662)**	23,183	(2,384)	20,799
Share of operating loss of joint ventures and associates	2	**(163)**	**–**	**(163)**	(45)	–	(45)
Loss on sale of operations	5	**–**	**(6,200)**	**(6,200)**	–	–	–
Profit on disposal of tangible fixed assets		**–**	**–**	**–**	–	1,037	1,037
Profit/(loss) on ordinary activities before interest		**10,967**	**(21,992)**	**(11,025)**	23,138	(1,347)	21,791
Net interest and similar charges	6			**3,715**			4,250
(Loss)/profit on ordinary activities before taxation				**(7,310)**			26,041
Tax on (loss)/profit on ordinary activities	8			**205**			(4,528)
(Loss)/profit on ordinary activities after taxation				**(7,105)**			21,513
Minority interests	27			**3,244**			940
(Loss)/profit for the financial year				**(3,861)**			22,453
Dividends paid and proposed	10			**(3,807)**			(4,318)
Retained (loss)/profit for the financial year	26			**(7,668)**			18,135
(Loss)/earnings per share							
– Basic	11			**(2.44p)**			13.26p
– Diluted	11			**(2.42p)**			13.03p
Earnings per share before non-operating exceptional items and goodwill							
– Basic	11			**0.55p**			11.43p
– Diluted	11			**0.55p**			11.23p

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

Group balance sheet
As at 31 March 2001

	Notes	2001 £'000	2001 £'000	2000 £'000	2000 £'000
Fixed assets					
Intangible assets	12				
Development costs			**1,507**		1,771
Goodwill					
– Goodwill		**88,279**		27,801	
– Negative goodwill		**(14,916)**		(18,703)	
			73,363		9,098
			74,870		10,869
Tangible assets	13		**37,213**		45,872
Investments	15				
Investments in joint ventures					
– Share of gross assets		**2,548**		2,473	
– Share of gross liabilities		**(2,069)**		(1,688)	
		479		785	
Investments in associates		**537**		470	
Other investments		**1,624**		689	
			2,640		1,944
			114,723		58,685
Current assets					
Stocks	16		**27,975**		24,021
Debtors – due within one year	17	**98,806**		106,523	
Debtors – due after more than one year	17	**81,181**		77,498	
			179,987		184,021
Cash and bank balances			**25,228**		112,215
			233,190		320,257
Creditors – amounts due within one year	18		**(199,291)**		(191,162)
Net current assets			**33,899**		129,095
Total assets less current liabilities			**148,622**		187,780
Creditors – amounts due after more than one year	19		**(2,542)**		(2,954)
Provisions for liabilities and charges	22		**(32,699)**		(33,024)
Net assets			**113,381**		151,802
Capital and reserves					
Called up share capital	25		**90,588**		84,747
Share premium account	26		**37,542**		67,134
Capital redemption reserve	26		**27,863**		–
Profit and loss account	26		**(45,835)**		(7,949)
Equity interests			**107,390**		143,932
Non-equity interests			**2,768**		–
Shareholders' funds			**110,158**		143,932
Equity minority interests	27		**3,223**		7,870
			113,381		151,802

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

Company balance sheet
As at 31 March 2001

	Notes	2001 £'000	2000 £'000
Fixed assets			
Investment in subsidiary undertakings	14	**136,301**	136,301
Investment in own shares	15	**1,536**	567
		137,837	136,868
Current assets			
Debtors	17	**2,720**	458
Cash and bank balances		**70,332**	83,730
		73,052	84,188
Creditors – amounts due within one year	18	**(28,460)**	(33,823)
Net current assets		**44,592**	50,365
Net assets		**182,429**	187,233
Capital and reserves			
Called up share capital	25	**90,588**	84,747
Share premium account	26	**37,542**	67,134
Capital redemption reserve	26	**27,863**	–
Profit and loss account	26	**26,436**	35,352
Equity interests		**179,661**	187,233
Non-equity interests		**2,768**	–
Shareholders' funds		**182,429**	187,233

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

The Financial Statements on pages 30 to 57 were approved by the Board on 18 June 2001 and signed on its behalf by:

G A Campbell Director

N R Young Director

Group cash flow statement

For the year ended 31 March 2001

	Notes	2001 £'000	2001 £'000	2000 £'000	2000 £'000
Cash (out)/inflow from operating activities	28a		**(10,977)**		38,146
Returns on investments and servicing of finance					
Net interest and similar charges		**3,895**		4,105	
Dividends paid to minority shareholders	27	**(1,400)**		(1,007)	
Net cash inflow from returns on investments and servicing of finance			**2,495**		3,098
Taxation					
UK corporation tax received/(paid) (including ACT)		**77**		(971)	
Overseas tax paid		**(820)**		(1,100)	
Net cash outflow from taxation			**(743)**		(2,071)
Capital expenditure and financial investment					
Payments to acquire tangible fixed assets		**(6,553)**		(9,739)	
Payments to acquire own shares		**(969)**		(567)	
Payments to invest in joint ventures		**(150)**		(20)	
Receipts from sale of tangible fixed assets		**509**		1,231	
Net cash outflow from capital expenditure and financial investment			**(7,163)**		(9,095)
Acquisitions and disposals					
Payments to acquire subsidiary undertakings	28d	**(64,622)**		(6,607)	
Receipts/(payments) on sale of subsidiary undertakings	28d	**5,000**		(1,575)	
Net cash outflow from acquisitions and disposals			**(59,622)**		(8,182)
Equity dividends paid			**(4,335)**		(3,891)
Cash (out)/inflow before management of liquid resources and financing			**(80,345)**		18,005
Management of liquid resources			**–**		6,618
Financing					
Shares issued for cash		**3,356**		109	
Redemption of 'B' preference shares		**(28,713)**		–	
Increase in borrowings		**7,207**		241	
Repayments of capital element of finance lease rentals		**(399)**		(247)	
Net cash (out)/inflow from financing			**(18,549)**		103
(Decrease)/increase in cash in the year	28b		**(98,894)**		24,726

The accompanying notes are an integral part of this group cash flow statement.

Group statement of total recognised gains and losses
For the year ended 31 March 2001

	2001 £'000	2000 £'000
(Loss)/profit for the financial year	**(3,861)**	22,453
Currency translation differences on foreign currency net investments and related loans	**(649)**	(1,067)
Total recognised gains and losses relating to the year	**(4,510)**	21,386

Reconciliation of movements in group shareholders' funds
For the year ended 31 March 2001

	2001 £'000	2000 £'000
Shareholders' funds at start of year	**143,932**	126,755
Ordinary shares issued in the year	**3,356**	109
Redemption of 'B' preference shares in the year	**(28,813)**	–
Total recognised (losses)/gains relating to the year	**(4,510)**	21,386
Dividends	**(3,807)**	(4,318)
Net movement in shareholders' funds	**(33,774)**	17,177
Shareholders' funds at end of year	**110,158**	143,932

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

Notes to the financial statements

1. Accounting policies

Basis of accounting The Financial Statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards.

Basis of consolidation The group Financial Statements include the Financial Statements of the company and all of its subsidiary undertakings made up to 31 March. Acquisitions are included from the date of acquisition and the results of businesses disposed of or terminated are included in the results for the year up to the date of relinquishing control or closure and analysed as continuing or discontinued operations.

The group Financial Statements include the appropriate share of the results and net assets of joint ventures and associated undertakings based on the latest available Financial Statements. Associated undertakings are those in which the group has a long term investment in the voting equity and over which it exerts significant influence. Joint ventures are those entities in which the group has a long term interest and shares control with another party or parties.

Acquisitions for which the consideration includes an issue of shares which are eligible for 'merger relief', are stated in the company's balance sheet at the nominal value of the shares issued together with the fair value of any other consideration given, plus the costs of the relevant acquisition.

Goodwill When the fair value of the consideration for an acquired undertaking exceeds the fair value of its separable net assets the difference is treated as purchased goodwill and is capitalised and amortised through the profit and loss account over its estimated economic life. The estimated economic life of goodwill is between ten and twenty years.

Where the fair value of the separable net assets exceeds the fair value of the consideration for an acquired undertaking the difference is treated as negative goodwill and is capitalised and amortised through the profit and loss account in the period in which the non-monetary assets acquired are recovered. In the case of fixed assets this is the period over which they are depreciated, and in the case of current assets, the period over which they are sold or otherwise realised.

Tangible fixed assets Tangible fixed assets are stated at cost less depreciation and any provision for permanent diminution in value. Depreciation is provided on a straight line basis to write off the cost of fixed assets over their estimated useful lives to their estimated residual value at the following annual rates:

Freehold land	Nil
Freehold buildings	2% to 10%
Leasehold property	Over period of lease
Plant and machinery	6.6% to 33.3%
Motor vehicles	20% to 33.3%

Leases Assets acquired under finance leases are capitalised and the outstanding capital element of instalments is included in creditors. The interest element is charged against profits so as to produce a constant periodic rate of charge on the outstanding obligations. Depreciation is calculated to write the assets off over their expected useful lives or over the lease terms where these are shorter. Rentals under operating leases are charged to the profit and loss account on a straight line basis.

Investments Fixed asset investments are stated at cost less provision for permanent diminution in value. Current asset investments that are listed on a recognised Stock Exchange are stated at market value. Other current asset investments are stated at the lower of cost and market value.

Stocks and work in progress Stocks are valued at the lower of cost and net realisable value. In the case of finished goods and work in progress, cost comprises direct materials and labour and an appropriate proportion of overheads.

Long term contracts Long term contracts are those which extend over more than one accounting period.

Long term contract balances are valued at costs incurred, less amounts transferred to cost of sales, and after deducting attributable payments on account and providing for foreseeable losses.

Management reviews are conducted at least quarterly to assess the progress of each significant contract, the costs to be incurred and the expected outcome of any disputes with customers or subcontractors. Where the ultimate profitability of a contract can be assessed with reasonable certainty having made prudent allowance for future risks and uncertainties, profit is recognised in proportion to the contract work completed. Immediate provision is made for all foreseeable losses.

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

Deferred taxation Provision is made for deferred taxation, using the liability method, on all timing differences, including those arising in relation to pension costs, to the extent that it is probable that a liability or asset will crystallise in the foreseeable future. No provision is made for any tax arising in the event of the distribution of profits retained by overseas subsidiaries, joint ventures and associates.

1. Accounting policies (continued)

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

Exchange gains and losses arising on foreign currency borrowings used to finance subsidiary undertakings are taken to reserves to the extent that they can be offset against the exchange differences arising on the equity investment. Except as disclosed below, assets and liabilities of foreign subsidiary undertakings are translated on consolidation into sterling at the rate of exchange ruling at the balance sheet date and the results are translated using the average exchange rate for the period. These consolidation differences on exchange are taken to reserves. All other exchange differences are dealt with in the profit and loss account.

Where it is considered that the results of an overseas undertaking are more dependent on sterling than its own reporting currency the Financial Statements of the undertaking are consolidated using the temporal method, thereby treating all transactions as though they had been entered into by the undertaking itself in sterling.

Turnover In respect of long term contracts, turnover represents amounts transferred to cost of sales during the period plus attributed profit. Other turnover comprises the invoiced value of goods and services supplied by the group. Turnover excludes sales taxes and intra-group transactions.

Pension costs The group operates various pension schemes established in accordance with local conditions and practices in the countries concerned. For those schemes that operate on a defined benefit basis, contributions are based on periodic actuarial calculations and are charged so as to spread the cost of pensions over the expected service lives of the employees who are members of the scheme.

Derivative financial instruments The group uses derivative financial instruments, principally forward foreign exchange contracts, to reduce exposure to foreign exchange risk. The group does not hold or issue derivative financial instruments for speculative purposes.

For a forward currency exchange contract to be treated as a hedge, the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged items and must also reduce the risk of foreign currency exchange movements on the group's operations. Gains and losses on these contracts are deferred and recognised in the profit and loss account, or as adjustments to the carrying amount of fixed assets, only when the hedged transaction has itself been recognised in the profit and loss account.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss is recognised at that time.

2. Segmental information

The segmental information reflects the current composition of the group.

	2001 Group turnover £'000	2001 Group operating profit/(loss) before operating exceptional items £'000	2001 Group operating exceptional items £'000	2001 Group operating profit/(loss) £'000
Continuing operations				
BES				
Continuing operations	**190,284**	**13,185**	**(267)**	**12,918**
Acquisitions	**3,930**	**413**	**–**	**413**
	194,214	**13,598**	**(267)**	**13,331**
BMH				
Continuing operations	**182,146**	**3,554**	**(9,630)**	**(6,076)**
Acquisitions	**22,542**	**(367)**	**(174)**	**(541)**
	204,688	**3,187**	**(9,804)**	**(6,617)**
Unallocated costs and other income	**–**	**(2,111)**	**–**	**(2,111)**
	398,902	**14,674**	**(10,071)**	**4,603**
Goodwill amortisation				
Continuing operations	**–**	**1,080**	**–**	**1,080**
Acquisitions	**–**	**(236)**	**–**	**(236)**
	–	**844**	**–**	**844**
Total continuing operations	**398,902**	**15,518**	**(10,071)**	**5,447**
Discontinued operations				
BES (Railcare)	**42,139**	**(5,017)**	**(5,721)**	**(10,738)**
Goodwill amortisation	**–**	**629**	**–**	**629**
Total discontinued operations	**42,139**	**(4,388)**	**(5,721)**	**(10,109)**
Group total	**441,041**	**11,130**	**(15,792)**	**(4,662)**

	2000 Group turnover £'000	2000 Group operating profit/(loss) before operating exceptional items £'000	2000 Group operating exceptional items £'000	2000 Group operating profit/(loss) £'000
Continuing operations				
BES	185,925	13,706	–	13,706
BMH	228,907	10,118	–	10,118
Unallocated costs and other income	–	(1,865)	–	(1,865)
	414,832	21,959	–	21,959
Goodwill amortisation	–	1,428	–	1,428
Total continuing operations	414,832	23,387	–	23,387
Discontinued operations				
BES (Railcare)	55,856	(833)	(2,384)	(3,217)
Goodwill amortisation	–	629	–	629
Total discontinued operations	55,856	(204)	(2,384)	(2,588)
Group total	**470,688**	**23,183**	**(2,384)**	**20,799**

The acquisitions included in the BES segment are Hunting Defence Services and Air Power International Limited.

The acquisition of Chronos Richardson Limited is included within the BMH segment.

The turnover, not included above, relating to joint ventures was £3.6 million (2000: £0.2 million). The loss of £163,000 (2000: £45,000) from joint ventures and associates relates to the BES segment.

2. Segmental information (continued)

Group turnover By geographic area of origin	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2001						
Continuing operations	**181,990**	**106,774**	**41,566**	**31,483**	**10,617**	**372,430**
Acquisitions	**12,100**	**9,264**	**4,283**	**–**	**825**	**26,472**
	194,090	**116,038**	**45,849**	**31,483**	**11,442**	**398,902**
Discontinued operations	**42,139**	**–**	**–**	**–**	**–**	**42,139**
Group total	**236,229**	**116,038**	**45,849**	**31,483**	**11,442**	**441,041**
2000						
Continuing operations	179,823	116,790	79,661	26,127	12,431	414,832
Discontinued operations	55,856	–	–	–	–	55,856
Group total	235,679	116,790	79,661	26,127	12,431	470,688

Group turnover By geographic area of destination	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2001						
Continuing operations	**176,232**	**61,874**	**44,230**	**37,968**	**52,126**	**372,430**
Acquisitions	**7,771**	**8,251**	**4,309**	**90**	**6,051**	**26,472**
	184,003	**70,125**	**48,539**	**38,058**	**58,177**	**398,902**
Discontinued operations	**42,139**	**–**	**–**	**–**	**–**	**42,139**
Group total	**226,142**	**70,125**	**48,539**	**38,058**	**58,177**	**441,041**
2000						
Continuing operations	180,069	65,546	84,581	31,193	53,443	414,832
Discontinued operations	55,856	–	–	–	–	55,856
Group total	235,925	65,546	84,581	31,193	53,443	470,688

Group operating (loss)/profit (before goodwill amortisation) By geographic destination	United Kingdom £'000	Rest of Europe £'000	North America £'000	Africa £'000	Rest of the World £'000	Group Total £'000
2001						
Continuing operations	**10,913**	**(7,530)**	**288**	**415**	**645**	**4,731**
Acquisitions	**604**	**(578)**	**(385)**	**–**	**231**	**(128)**
	11,517	**(8,108)**	**(97)**	**415**	**876**	**4,603**
Discontinued operations	**(10,738)**	**–**	**–**	**–**	**–**	**(10,738)**
Group total	**779**	**(8,108)**	**(97)**	**415**	**876**	**(6,135)**
2000						
Continuing operations	11,840	2,934	6,537	581	67	21,959
Discontinued operations	(3,217)	–	–	–	–	(3,217)
Group total	8,623	2,934	6,537	581	67	18,742

2. Segmental information (continued)

Operating net assets By activity	2001 £'000	2000 £'000
BES	**23,559**	18,124
BMH	**15,027**	14,508
Unallocated	**15,857**	21,589
Operating net assets	**54,443**	54,221
By geographic area		
United Kingdom	**47,425**	37,866
Europe	**(3,062)**	1,828
North America	**1,566**	5,426
Africa	**7,612**	8,144
Rest of the World	**902**	957
Operating net assets	**54,443**	54,221
Investment in own shares	**1,536**	567
Net (debt)/cash	**(212)**	105,277
Finance lease obligations	**(1,126)**	(1,377)
Taxation	**(12,354)**	(13,187)
Dividends	**(2,269)**	(2,797)
Net goodwill	**73,363**	9,098
Non-operating assets	**58,938**	97,581
Net assets	**113,381**	151,802

BES and the United Kingdom include £0.5 million (2000: £0.5 million) of operating net assets in respect of associates.

BES and the Rest of the World include £0.5 million (2000: £0.8 million) in respect of joint ventures.

3. Net operating expenses

	Cost of sales £'000	Distribution expenses £'000	Administration expenses £'000	Goodwill amortisation £'000	Net operating expenses £'000
2001					
Continuing operations	**312,447**	**13,362**	**41,870**	**(1,080)**	**54,152**
Acquisitions	**17,807**	**2,236**	**6,577**	**236**	**9,049**
	330,254	**15,598**	**48,447**	**(844)**	**63,201**
Discontinued operations	**38,720**	**96**	**14,061**	**(629)**	**13,528**
Group total	**368,974**	**15,694**	**62,508**	**(1,473)**	**76,729**
2000					
Continuing operations	337,814	14,487	40,572	(1,428)	53,631
Discontinued operations	48,272	99	10,702	(629)	10,172
Group total	386,086	14,586	51,274	(2,057)	63,803

In 2001, cost of sales includes £9.6 million in respect of operating exceptional items (2000: £nil).

In 2001, administration expenses from existing continuing operations includes £0.3 million of operating exceptional items (2000: £nil) in respect of post acquisition integration costs arising from the acquisition of FBM last year. In 2001, administration expenses includes £0.2 million (2000: £nil) in respect of post acquisition integration costs arising from the acquisition of Chronos Richardson on 20 June 2000. In 2001, administration costs of discontinued operations includes £5.7 million (2000: £2.4 million) of operating exceptional items relating to redundancy costs in Railcare.

4. Operating (loss)/profit

	2001 £'000	2000 £'000
Operating (loss)/profit is stated after charging/(crediting)		
Depreciation on tangible fixed assets		
Owned	**11,844**	10,661
Leased assets	**275**	193
Loss on the disposal and write-off of tangible fixed assets	**193**	161
Operating lease rentals		
Plant and machinery	**1,242**	706
Land and buildings	**4,130**	3,825
Short term plant hire	**420**	497
Auditors' remuneration	**510**	400
Research and development		
Expenditure	**2,692**	2,235
Amortisation charge (note 12)	**264**	200
Net goodwill amortisation	**(1,473)**	(2,057)

In addition to the amounts disclosed above, the group's auditors and their associates were paid £435,000 (2000: £314,000) in relation to non audit services in the UK of which £277,000 (2000: £186,000) has been capitalised in costs of investments.

5. Exceptional items

(a) Operating exceptional items

A provision of £9.6 million was made by BMH in respect of commitments under a contract that is stalled pending new financing arrangements and where the timing of that finance remains uncertain.

Costs of £0.4 million were incurred on the integration of recently acquired operations.

Costs of £5.7 million (2000: £2.4 million) were incurred for a redundancy programme at Railcare.

(b) Non-operating exceptional items

The non-operating exceptional charge of £6.2 million in respect of the provision for the loss on disposal of Railcare reflects the estimated impairment in the value of its tangible fixed assets held at the balance sheet date in the light of its disposal on 23 May 2001.

6. Net interest and similar charges

	2001 £'000	2000 £'000
Interest payable and similar charges		
Bank loans and overdrafts	**(967)**	(540)
Finance lease interest	**(209)**	(220)
	(1,176)	(760)
Income from current asset investments	**–**	364
Other interest receivable and similar income	**5,042**	4,726
	5,042	5,090
Share of joint ventures	**(93)**	(4)
Share of associates	**(58)**	(76)
	(151)	(80)
	3,715	4,250

7. Employee costs

	2001 £'000	2000 £'000
Particulars of employees, including executive Directors, are as follows:		
Employee costs		
Wages and salaries	**137,821**	138,117
Social security costs	**16,121**	15,628
Other pension costs (note 24)	**1,192**	6,180
	155,134	159,925

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

	2001 Number	2000 Number
Engineering and technology	**4,961**	5,386
Administration and management	**1,346**	1,165
	6,307	6,551

The number of people employed by the group at 31 March 2001 was 7,737 (2000: 6,198).

Information in respect of Directors' remuneration and share interests is contained within the Directors' Report on pages 24 to 28.

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

	2001 £'000	2000 £'000
United Kingdom corporation tax charge at 30%	**3,239**	6,059
Double taxation relief	**(6)**	(480)
	3,233	5,579
Consortium relief	**(1,275)**	–
Advance corporation tax written back	**(1,595)**	(2,971)
Deferred taxation (note 23)	**(1,244)**	1,006
Overseas taxation	**433**	1,445
Share of associates	**(4)**	(23)
Adjustments in respect of prior years		
UK – Deferred tax	**672**	–
– Current tax	**(352)**	(104)
Overseas	**(73)**	(404)
	(205)	4,528

Excluding the net goodwill credit of £1.5 million and the non-operating exceptional loss of £6.2 million, the effective rate of 7.9% is lower than the standard UK rate of 30% due to the net effect of utilisation of tax losses, surplus advance corporation tax and short term timing differences not equalised through deferred tax. There is no tax relief arising in respect of the non-operating exceptional loss.

9. Company profit

The company has taken advantage of the exemption granted by Section 230 of the Companies Act 1985 whereby no individual profit and loss account of the company is disclosed. Included in the group profit for the financial year is a profit of £24.5 million (2000 profit: £4.5 million) dealt with in the Financial Statements of the company.

10. Dividends

	2001 £'000	2000 £'000
Ordinary shares		
Interim dividend paid of 1.1p per 60p share (2000: 0.90p per 50p share)	**1,538**	1,521
Final dividend proposed of 1.55p per 60p share (2000: 1.65p per 50p share)	**2,269**	2,797
	3,807	4,318

11. Earnings per share

Earnings per ordinary share have been calculated by dividing the profit attributable to shareholders for the financial year by the weighted average number of ordinary shares in issue during the year.

	2001 Number	2000 Number
Weighted average number of shares in issue for basic earnings per share	**158,325,306**	169,379,969
Dilutive effect of share options	**1,008,474**	2,899,170
Weighted average number of shares in issue for diluted earnings per share	**159,333,780**	172,279,139

	2001 £'000	**2001 Basic (pence)**	**2001 Diluted (pence)**	2000 £'000	2000 Basic (pence)	2000 Diluted (pence)
(Loss)/profit loss attributable to shareholders	**(3,861)**	**(2.44)**	**(2.42)**	22,453	13.26	13.03
Add loss on sale or termination of a business	**6,200**	**3.92**	**3.89**	–	–	–
Less profit on sale of tangible fixed assets	**–**	**–**	**–**	(1,037)	(0.61)	(0.60)
Profit before non-operating exceptional items	**2,339**	**1.48**	**1.47**	21,416	12.65	12.43
Less net goodwill amortisation	**(1,473)**	**(0.93)**	**(0.92)**	(2,057)	(1.22)	(1.20)
Profit before non-operating exceptional items and goodwill	**866**	**0.55**	**0.55**	19,359	11.43	11.23

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

During the year, there was a five for six share consolidation. Further details are given in note 25.

12. Fixed assets – intangible assets

Group	Goodwill £'000	Negative goodwill £'000	Development costs £'000	**Total £'000**
Cost				
At 1 April 2000	38,715	(34,406)	6,731	**11,040**
On acquisition of subsidiaries (note 29)	63,778	–	–	**63,778**
Adjustment in the year (note 29)	(986)	–	–	**(986)**
At 31 March 2001	**101,507**	**(34,406)**	**6,731**	**73,832**
Accumulated amortisation				
At 1 April 2000	(10,914)	15,703	(4,960)	**(171)**
(Charge)/credit for the year	(2,314)	3,787	(264)	**1,209**
As at 31 March 2001	**(13,228)**	**19,490**	**(5,224)**	**1,038**
Net book value at 31 March 2001	**88,279**	**(14,916)**	**1,507**	**74,870**
Net book value at 31 March 2000	27,801	(18,703)	1,771	**10,869**

13. Fixed assets – tangible assets

Group	Freehold property £'000	Leasehold property £'000	Plant and machinery £'000	**Total £'000**
Cost				
At 1 April 2000	31,084	375	71,010	**102,469**
Exchange adjustments	206	2	(28)	**180**
On acquisition of subsidiaries (note 29)	165	52	13,701	**13,918**
Additions	269	13	6,297	**6,579**
Disposals/assets written off	(199)	(136)	(10,070)	**(10,405)**
At 31 March 2001	**31,525**	**306**	**80,910**	**112,741**
Accumulated depreciation				
At 1 April 2000	(12,258)	(156)	(44,183)	**(56,597)**
Exchange adjustments	(165)	(3)	(275)	**(443)**
On acquisition of subsidiaries (note 29)	–	(1)	(9,977)	**(9,978)**
Charge for the year	(2,495)	(47)	(9,577)	**(12,119)**
Disposals/assets written off	–	51	9,758	**9,809**
Provision for impairment (note 5)	(3,587)	–	(2,613)	**(6,200)**
At 31 March 2001	**(18,505)**	**(156)**	**(56,867)**	**(75,528)**
Net book value at 31 March 2001	**13,020**	**150**	**24,043**	**37,213**
Net book value at 31 March 2000	18,826	219	26,827	**45,872**

The net book value of plant and machinery includes £1.1 million (2000: £1.4 million) in respect of assets held under finance leases or hire purchase contracts, comprising cost of £1.8 million less depreciation of £0.7 million.

The net book value of freehold property includes land amounting to £5.0 million (2000: £4.7 million) which has not been depreciated.

14. Fixed assets – investments in subsidiary undertakings

Company	Shares £'000	Loans £'000	**Total £'000**
Cost			
At 1 April 2000 and 31 March 2001	91,851	44,450	**136,301**

Information on the principal subsidiary undertakings is given on page 57.

15. Fixed assets – investments

	Group					Company
	Joint ventures £'000	Associates £'000	Investments in own shares £'000	Other investments £'000	**Total £'000**	Investments in own shares £'000
At 1 April 2000	785	470	567	122	**1,944**	567
Exchange adjustment	(59)	–	–	(4)	**(63)**	–
Additions	150	–	969	–	**1,119**	969
Disposals	–	(20)	–	(30)	**(50)**	–
Share of profits or losses	(397)	87	–	–	**(310)**	–
At 31 March 2001	**479**	**537**	**1,536**	**88**	**2,640**	**1,536**

Our investment in the associated company, Studsvik Roysth Nuclear Services Ltd, established in late 1999, was sold on to our partner Studsvik AB towards the end of 2000.

Information on associated undertakings is given on page 57.

During the year the company acquired 466,801 of its own ordinary shares with a nominal value of 50p each, representing 0.3% of the then issued share capital and 560,975 of its own ordinary shares with a nominal value of 60p each, representing 0.4% of the then issued share capital, at a total cost of £969,000 through the Babcock Employee Share Trust (the 'Trust') in respect of its potential obligation under the Babcock 1999 Executive Share Option Schemes. The Trust's acquisition of ordinary shares during the year represented 0.6% of the issued share capital at 31 March 2001. The company meets the operating expenses of the Trust.

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

At 31 March 2001, the Trust held 1,352,661 ordinary shares with a nominal value of 60p per share and a total market value of £1,265,000, representing 0.9% of the issued share capital at that date. The company elected to pay dividends to the Trust at the rate of 0.001p per share during the year. All the Trust's shares are under option to employees.

16. Stocks

	2001 £'000	**2001 £'000**	2000 £'000	2000 £'000
Long term contract balances		**–**		1,714
Other stocks and work in progress				
Raw materials and consumables	**12,944**		11,659	
Work in progress	**14,138**		13,292	
Finished goods and goods for resale	**7,148**		4,041	
	34,230		28,992	
Less: Progress payments	**(2,959)**		(4,232)	
Provisions	**(3,296)**		(2,453)	
		27,975		22,307
		27,975		24,021

17. Debtors

	Group 2001 £'000	Group 2000 £'000	**Company 2001 £'000**	Company 2000 £'000
Due within one year:				
Trade debtors	**56,469**	48,700	**–**	–
Amounts recoverable on contracts	**23,294**	26,361	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**2,337**	24
Amounts owed by joint ventures	**–**	1,708	**–**	–
Prepayments and accrued income	**12,039**	12,829	**–**	–
Pension scheme prepayments	**256**	3,135	**–**	–
Other debtors	**6,748**	13,790	**383**	434
	98,806	106,523	**2,720**	458
Due after more than one year:				
Trade debtors	**173**	254	**–**	–
Amounts owed by joint ventures	**–**	79	**–**	–
Pension scheme prepayments	**78,985**	75,563	**–**	–
Other debtors	**2,023**	1,602	**–**	–
	81,181	77,498	**–**	–

Other debtors, due within one year, at 31 March 2001 includes £nil (2000: £4.8 million) of deferred consideration relating to the disposal of the group's former Energy Division.

18. Creditors – amounts due within one year

	Group 2001 £'000	Group 2000 £'000	**Company 2001 £'000**	Company 2000 £'000
Bank overdrafts (note 20)	**16,512**	5,270	**–**	16,743
Bank loans (note 20)	**7,548**	–	**7,500**	–
Other loans (note 20)	**1,221**	1,507	**–**	–
Obligations under finance leases (note 20)	**611**	372	**–**	–
Advance payments	**864**	2,747	**–**	–
Payments received in advance of turnover	**22,458**	35,691	**–**	–
Trade creditors	**37,798**	36,875	**–**	–
Contract accruals and provisions	**66,359**	58,884	**–**	–
Bills of exchange payable	**220**	789	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**17,798**	14,094
Other creditors	**7,189**	5,928	**829**	125
Corporation and overseas taxes	**6,560**	7,567	**–**	–
Other taxes and social security	**7,141**	5,645	**–**	–
Accruals and deferred income	**22,541**	27,090	**64**	64
Proposed dividend	**2,269**	2,797	**2,269**	2,797
	199,291	191,162	**28,460**	33,823

19. Creditors – amounts due after more than one year

	Group 2001 £'000	Group 2000 £'000
Other loans (note 20)	**159**	161
Obligations under finance leases (note 20)	**515**	1,005
Payments received in advance of turnover	**–**	1,068
Trade creditors	**95**	36
Other creditors	**1,510**	684
Corporation and overseas taxes	**263**	–
	2,542	2,954

20. Borrowings

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

	2001 Bank loans and overdrafts £'000	**2001 Other loans £'000**	**2001 Finance lease obligations £'000**
Within one year	**24,060**	**1,221**	**611**
Between one and two years	**–**	**159**	**302**
Between two and five years	**–**	**–**	**213**
	24,060	**1,380**	**1,126**

	2000 Bank loans and overdrafts £'000	2000 Other loans £'000	2000 Finance lease obligations £'000
Within one year	5,270	1,507	372
Between one and two years	–	161	526
Between two and five years	–	–	479
	5,270	1,668	1,377

20. Borrowings (continued)

Security arrangements	Group 2001 £'000	Group 2000 £'000
Loans and overdrafts		
Secured against specific trade debtors of subsidiary undertakings	**–**	116
Unsecured borrowings	**25,440**	6,822
	25,440	6,938

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

21. Derivatives and other financial instruments

The Financial review on pages 18 and 19 provides an explanation of the role that financial instruments have had during the period in creating or changing the risks that the group faces in its activities.

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

As permitted by FRS13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Interest rate profile The group's financial assets comprise cash deposits of £25.2 million (2000: £112.2 million). Cash deposits are placed on money markets at call, seven-day and monthly rates.

The interest rate profile of the group's financial assets and liabilities (excluding short term debtors and creditors) is as follows:

	2001 Financial assets	**2001 Financial liabilities**		
Currency	**Total and floating rate £'000**	**Total £'000**	**Floating rate £'000**	**Fixed rate £'000**
Sterling	**7,735**	**22,715**	**22,138**	**577**
Euro-zone currencies	**10,528**	**1,134**	**978**	**156**
US Dollar	**3,944**	**–**	**–**	**–**
South African Rand	**1,191**	**2,668**	**2,324**	**344**
Other currencies	**1,830**	**49**	**–**	**49**
	25,228	**26,566**	**25,440**	**1,126**

	2000 Financial assets	2000 Financial liabilities		
Currency	Total and floating rate £'000	Total £'000	Floating rate £'000	Fixed rate £'000
Sterling	92,968	6,326	5,789	537
Euro-zone currencies	15,867	391	167	224
US Dollar	2,870	222	217	5
South African Rand	48	1,188	649	539
Other currencies	462	188	116	72
	112,215	8,315	6,938	1,377

The weighted average interest rates of the Sterling, Euro-zone and Rand fixed rate financial liabilities, which comprise finance lease obligations, are 9.0%, 5.0% and 11.6% (2000: 9.0%, 5.0% and 20.5%) respectively. The weighted average period for which these interest rates are fixed is two years.

The interest rate on floating rate financial assets and liabilities is linked to LIBOR in the case of sterling and the relevant bank rate for those denominated in other currencies.

21. Derivatives and other financial instruments (continued)

Borrowing facilities The group had undrawn committed borrowing facilities at 31 March 2001, in respect of which all conditions precedent had been met, as follows:

	2001 £'000	2000 £'000
Expiring in one year or less	**–**	25,643
Expiring in more than one year but not more than two years	**42,500**	–
	42,500	25,643

Currency exposures The Financial Review on page 19 explains that it is the group's policy not to hedge foreign currency exposures on the translation of its overseas profits and net assets to sterling. Such movements are dealt with through the group statement of total recognised gains and losses. It is group policy for subsidiaries to hedge transactional currency exposures against the currency in which their results are measured.

The table below shows the group's currency exposures; in other words, those transactional exposures that give rise to net currency gains or losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating (or 'functional') currency of the operating unit involved.

As at 31 March 2001, these exposures were as follows:

	Net foreign currency monetary assets/(liabilities)					
Functional currency of group operation	**Sterling £'000**	**US Dollars £'000**	**Euro-zone currencies £'000**	**Swedish Krona £'000**	**Other £'000**	**Total £'000**
Sterling	**–**	**–**	**3**	**2**	**–**	**5**
US Dollars	**–**	**–**	**14**	**30**	**–**	**44**
Euro-zone currencies	**(22)**	**(406)**	**–**	**487**	**(324)**	**(265)**
Swedish Krona	**(101)**	**36**	**(112)**	**–**	**(3)**	**(180)**
Other	**–**	**–**	**(91)**	**7**	**–**	**(84)**
Total	**(123)**	**(370)**	**(186)**	**526**	**(327)**	**(480)**

As at 31 March 2000, these exposures were as follows:

	Net foreign currency monetary assets/(liabilities)					
Functional currency of group operation	Sterling £'000	US Dollars £'000	Euro-zone currencies £'000	Swedish Krona £'000	Other £'000	Total £'000
Sterling	–	–	3	2	–	5
US Dollars	–	–	–	–	(416)	(416)
Euro-zone currencies	(1)	105	–	(1)	(216)	(113)
Swedish Krona	49	(218)	113	–	738	682
Other	(2)	(117)	393	1	(11)	264
Total	46	(230)	509	2	95	422

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

As at 31 March 2001, the group also held open various forward foreign currency contracts that the group had taken out to hedge expected future foreign currency movements.

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

	2001 Book value £'000	**2001 Fair value £'000**	2000 Book value £'000	2000 Fair value £'000
Forward foreign currency contracts	**38,888**	**42,069**	44,554	46,226

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

21. Derivatives and other financial instruments (continued)

Changes in the fair value of instruments used as hedges are not recognised in the Financial Statements until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	Gains £'000	Losses £'000	Net £'000
Unrecognised gains and losses on hedges at 1 April 2000	2,252	(580)	1,672
Gains and losses arising in previous years that were recognised in the year ended 31 March 2001	(1,895)	473	(1,422)
Gains and losses arising before 1 April 2000 that were not recognised in the year ended 31 March 2001	357	(107)	250
Gains and losses arising that were not recognised in the year ended 31 March 2001	3,426	(495)	2,931
Unrecognised gains and losses on hedges at 31 March 2001	3,783	(602)	3,181
Of which:			
Gains and losses expected to be recognised in the year ending 31 March 2002	3,753	(601)	3,152
Gains and losses expected to be recognised in the year ending 31 March 2003 or later	30	(1)	29

22. Provisions for liabilities and charges

	Pensions and similar obligations (a) £'000	Deferred taxation (note 23) £'000	Deferred consideration (b) £'000	Insurance provisions (c) £'000	Closure or disposal of businesses (d) £'000	Total £'000
At 1 April 2000	4,879	6,640	10,656	6,546	4,303	33,024
On acquisitions of subsidiaries	3,173	–	750	–	–	3,923
Exchange adjustments	160	(38)	31	–	15	168
Provided in the year	482	(378)	–	1,148	–	1,252
Utilised in the year	(315)	(44)	(2,004)	(1,182)	(30)	(3,575)
Advance corporation tax set off	–	(194)	–	–	–	(194)
Reclassified from/(to) creditors	234	–	(333)	–	–	(99)
Written back to goodwill as no longer required	–	–	(1,800)	–	–	(1,800)
At 31 March 2001	**8,613**	**5,986**	**7,300**	**6,512**	**4,288**	**32,699**

(a) Provisions for unfunded pension liabilities principally in respect of BMH's German operations.

(b) The deferred consideration arises principally from the acquisition of the Rosyth Dockyard (£6.0 million). This is payable on the occurrence of the offer of a contract for the refit of a second aircraft carrier, provided that effectively 70% of the allocated programme, as set out in the privatisation agreement, has by then been awarded to Rosyth Dockyard. It is anticipated that the deferred consideration will be payable by March 2002. Other amounts arising include amounts relating to the acquisition of Air Power International Limited on 29 January 2001 which are limited to a maximum of £0.8 million. It is anticipated that this deferred consideration will be payable over the next 24 months. A maximum of £0.3 million relates to the acquisition of Armstrong Technology Associates Limited, and it is anticipated that the deferred consideration will be payable over the next 24 months. A maximum of £0.2 million relates to the acquisition of AKI Dryer Manufacturers Inc and is payable, based on performance, within the next six months.

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

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

23. Deferred taxation

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

	2001 Provided £'000	2000 Provided £'000	**2001 Full potential £'000**	2000 Full potential £'000
Accelerated capital allowances	**(31)**	275	**(1,479)**	(696)
Reversal of pension surpluses	**14,095**	13,931	**23,455**	23,609
Other timing differences	**(47)**	402	**(7,179)**	(6,226)
Tax losses	**(687)**	(818)	**(25,293)**	(22,993)
	13,330	13,790	**(10,496)**	(6,306)
Recoverable advance corporation tax	**(7,344)**	(7,150)	**(9,212)**	(10,633)
	5,986	6,640	**(19,708)**	(16,939)

There is no unprovided deferred taxation liability in the company.

24. Pension funding

The group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The major schemes are of the defined benefit type with assets held in separate funds. The total pension costs charged to the operating result of the group were as follows:

	2001 £'000	2000 £'000
UK schemes	**3,939**	8,643
Overseas schemes	**1,042**	1,036
	4,981	9,679
Interest on pension scheme surpluses	**(3,789)**	(3,499)
	1,192	6,180

The group's principal defined benefit schemes are in the UK. In each case the scheme is funded by payments to separate trustee administered funds and the pension cost is assessed in accordance with the advice of independent, qualified actuaries. The details of the latest formal actuarial valuations of these schemes are as follows:

	Railcare	Rosyth Royal Dockyard	Babcock International Group
Date of last formal actuarial valuation	31.12.98	31.3.00	1.4.98
Number of active members at 31 March 2001	553	2,294	181
Method of funding	Attained age	Projected unit	Projected unit
Results of last formal actuarial valuation:			
Market value of assets	£66 million	£460 million	£401 million
Level of funding	110%	124%	118%
Principal valuation assumptions:			
Excess of investment returns over earnings increases	2.25%	1.50%	2.00%
Excess of investment returns over pension increases	3.75%	3.00%	4.50%
Annual rate of dividend growth	3.75%	*	4.00%

*It is assumed that dividend income is reinvested.

Surpluses in respect of the group's principal pension schemes are carried as prepayments in the balance sheet at £79.2 million (2000: £78.7 million) and are being charged with the regular pension cost of scheme members.

As a result of the level of surplus, the group's contributions to each of the principal pension schemes are currently suspended.

25. Called up share capital

Authorised	Ordinary shares of 50p Number	Ordinary shares of 60p Number	Redeemable 'B' preference shares of 18p Number
At 1 April 2000	229,000,000	–	–
194,444,444 redeemable 'B' preference shares issued	–	–	194,444,444
229,000,000 50p shares converted to 60p shares	(229,000,000)	190,833,333	–
As at 31 March 2001	**–**	**190,833,333**	**194,444,444**

Authorised	Ordinary shares of 50p £'000	Ordinary shares of 60p £'000	Redeemable 'B' preference shares of 18p £'000
At 1 April 2000	114,500	–	–
194,444,444 redeemable 'B' preference shares issued	–	–	35,000
229,000,000 50p shares converted to 60p shares	(114,500)	114,500	–
As at 31 March 2001	**–**	**114,500**	**35,000**

Allotted, issued and fully paid	Ordinary shares of 50p Number	Ordinary shares of 60p Number	Redeemable 'B' preference shares of 18p Number
At 1 April 2000	169,493,035	–	–
Ordinary 50p shares issued on exercise of options	680,159	–	–
170,173,194 redeemable 'B' preference shares issued	–	–	170,173,194
170,173,194 50p ordinary shares converted to 60p ordinary shares	(170,173,194)	141,810,995	–
154,794,431 redeemable 'B' preference shares redeemed	–	–	(154,794,431)
Ordinary 60p shares issued on exercise of options	–	4,555,736	-
As at 31 March 2001	**–**	**146,366,731**	**15,378,763**

Allotted, issued and fully paid	Ordinary shares of 50p £'000	Ordinary shares of 60p £'000	Redeemable 'B' preference shares of 18p £'000	Group Total £'000
At 1 April 2000	84,747	–	–	84,747
Ordinary 50p shares issued on exercise of options	340	–	–	340
170,173,194 redeemable 'B' preference shares issued	–	–	30,631	30,631
170,173,194 50p ordinary shares converted to 60p ordinary shares	(85,087)	85,087	–	–
154,794,431 redeemable 'B' preference shares redeemed	–	–	(27,863)	(27,863)
Ordinary 60p shares issued on exercise of options	–	2,733	-	2,733
As at 31 March 2001	**–**	**87,820**	**2,768**	**90,588**

On 23 October 2000, following approval at an EGM on 10 October 2000, the company made a bonus issue of 170,173.194 redeemable 'B' preference shares of 18p each with a nominal value of £30.6 million out of the share premium account. In accordance with the terms of the issue, 154,794,431 of the 18p shares, with a nominal value of £27.9 million, were redeemed on 23 October 2000. Further redemptions can be made at the shareholders' option on 23 April 2001 and at the company's option on any date after 23 April 2001 until 23 October 2002.

Also on 23 October 2000, there was a five for six share consolidation of the 170,173,194 50p ordinary shares resulting in an issued share capital of 141,810,995 60p ordinary shares.

25. Called up share capital (continued)
Of the 4,555,736 60p ordinary shares, having a nominal value of £2.7 million, issued in respect of the exercise of options, 4,325,868 with a nominal value of £2.6 million were subscribed for by the Babcock International Group PLC Qualifying Employee Share Ownership Trust (the 'QUEST') at a market value of £4.3 million. These shares were allocated to employees, including executive Directors, in satisfaction of options exercised under the Babcock International Group PLC Sharesave Scheme. The company provided £1.7 million to the QUEST for this purpose. The premium on issue, that involved no cash outflow from the group, has been credited against the retained profits of the company (see note 26).

Since the cash repaid to shareholders, in connection with the redemption, was equivalent to the fair value of the shares consolidated, under the provisions of FRS14, there is no requirement to restate the earnings per share in respect of the prior year.

Outstanding share options The company has granted options to subscribe for ordinary shares of the company under Executive Share Option Schemes and the Sharesave Scheme. At 31 March 2001, the outstanding options were as follows:

Scheme	Number of shares under option	Subscription price per share	Exercise period
Executive share option schemes	5,567	244.730p	11.07.1994 to 10.07.2001
	5,567	271.675p	09.07.1995 to 08.07.2002
	1,012,971	114.510p	15.12.1996 to 14.12.2003
	57,000	132.500p	16.12.1997 to 15.12.2004
	50,000	151.000p	03.01.1999 to 02.01.2006
	304,288	77.000p	19.09.1999 to 18.09.2006
	215,000	74.500p	19.12.1999 to 18.12.2006
	160,000	62.500p	31.03.2000 to 30.03.2007
	165,680	84.500p	19.06.2000 to 18.06.2007
	244,508	87.250p	11.08.2000 to 10.08.2007
	396,926	82.000p	24.12.2000 to 23.12.2007
	2,804,899	89.000p	20.07.2001 to 19.07.2008
	775,195	122.500p	08.07.2002 to 07.07.2009
	1,462,522	118.000p	09.09.2002 to 08.09.2009
	1,614,712	96.330p	23.06.2003 to 22.06.2010
	560,975	123.000p	22.11.2003 to 21.11.2010
	9,835,810		
Sharesave scheme	484,819	62.300p	01.02.2001 to 01.08.2001
Total outstanding share options	10,320,629		

The company has taken advantage of the exemption available not to apply UITF Abstract 17 to the discounting on options granted under the Sharesave Scheme.

Options granted to Directors are summarised in the Directors' Report on pages 27 and 28 and are included in the outstanding options set out above.

26. Reserves

Group	Share premium account £'000	Capital redemption reserve £'000	Profit and loss account £'000	Total £'000
At 1 April 2000	67,134	–	(7,949)	59,185
Shares issued on exercise of options	1,989	–	–	1,989
Amounts deducted in respect of shares issued to the QUEST (see note 25)	–	–	(1,706)	(1,706)
Arising on issue and redemption of redeemable 'B' preference shares	(31,581)	27,863	(27,863)	(31,581)
Loss on foreign currency translation	–	–	(649)	(649)
Retained profit for the financial year	–	–	(7,668)	(7,668)
At 31 March 2001	**37,542**	**27,863**	**(45,835)**	**19,570**

Company	Share premium account £'000	Capital redemption reserve £'000	Profit and loss account £'000	Total £'000
At 1 April 2000	67,134	–	35,352	102,486
Shares issued on exercise of options	1,989	–	–	1,989
Amounts deducted in respect of shares issued to the QUEST (see note 25)	–	-	(1,706)	(1,706)
Arising on issue and redemption of redeemable 'B' preference shares	(31,581)	27,863	(27,863)	(31,581)
Retained profit for the financial year	–	–	20,653	20,653
At 31 March 2001	**37,542**	**27,863**	**26,436**	**91,841**

27. Equity minority interests

	£'000
At 1 April 2000	7,870
Share of losses	(3,244)
Dividends paid to minority interests	(1,400)
Other movements	(3)
At 31 March 2001	**3,223**

28. Group cash flow statement

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

	2001 £'000	2000 £'000
Group operating (loss)/profit	**(4,662)**	20,799
Depreciation and amortisation charges	**10,910**	8,997
Decrease in stocks	**2,628**	3,101
Decrease/(increase) in debtors	**13,449**	(526)
(Decrease)/increase in creditors	**(33,595)**	5,963
Increase/(decrease) in provisions	**103**	(349)
Other items	**190**	161
Net cash flow from operating activities	**(10,977)**	38,146

The post-acquisition operating cash flow relating to Hunting Defence Services is an inflow of £0.5 million and that relating to Chronos Richardson is an outflow of £2.8 million.

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

	2001 £'000	2000 £'000
(Decrease)/increase in cash in the year	**(98,894)**	24,726
Cash flow from increase in debt and lease financing	**(6,808)**	6
Cash flow from decrease in liquid resources	**–**	(6,618)
Change in net funds resulting from cash flows	**(105,702)**	18,114
Loans and finance leases on acquisition of subsidiaries	**(209)**	(115)
New finance leases	**(26)**	(839)
Translation differences	**699**	(1,188)
Movement in net (debt)/funds in the year	**(105,238)**	15,972
Net funds at 1 April	**103,900**	87,928
Net (debt)/funds at 31 March	**(1,338)**	103,900

c) Analysis of changes in financing during the year:

	At 1 April 2000 £'000	Cash flow £'000	New finance leases £'000	Subsidiaries acquired £'000	Exchange movement £'000	**At 31 March 2001 £'000**
Cash in hand and at bank	112,215	(87,615)	–	–	628	**25,228**
Overdrafts	(5,270)	(11,279)	–	–	37	**(16,512)**
	106,945	(98,894)	-	–	665	**8,716**
Debt	(1,668)	(7,207)	–	(48)	(5)	**(8,928)**
Finance leases	(1,377)	399	(26)	(161)	39	**(1,126)**
	(3,045)	(6,808)	(26)	(209)	34	**(10,054)**
Total	103,900	(105,702)	(26)	(209)	699	**(1,338)**

28. Group cash flow statement (continued)

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

	2001 Disposals £'000	**2001 Acquisitions £'000**	2000 Disposals £'000	2000 Acquisitions £'000
Net cash consideration	**5,000**	**(66,328)**	–	(6,713)
Net cash acquired	**–**	**1,706**	–	106
Other payments	**–**	**–**	(1,575)	–
Net cash flow	**5,000**	**(64,622)**	(1,575)	(6,607)

i) The cash flow for disposals is the receipt of the final £5.0 million from Mitsui for deferred consideration following the 1995 sale of the group's former energy division.

ii) The bulk of the cash outflow for acquisitions relates to the acquisition of Hunting Defence Services on 9 March 2001. The net cash outflow was £62.4 million including £0.7 million of cash acquired with the business and £1.8 million of costs. After allowing for a net £1.0 million of cash within the businesses, a further £1.1 million was spent on bolt-on acquisitions.

Following the acquisition of FBM Marine Limited on 16 March 2000, a deferred consideration payment of £0.9 million was made to The Hong Kong Parkview Group (HKPV). This payment was triggered by the placing of an order for a fast ferry. In the period £1.0 million was received from HKPV following agreement of completion accounts.

A total of £2.0 million of deferred consideration payments were made on acquisitions completed in prior periods.

Further details on acquisitions are given in note 29 below.

29. Acquisitions

The principal acquisition, on 9 March 2001, was that of Hunting Defence Services for a total consideration of £62.1 million . Hunting Defence Services is a multi-skilled organisation which undertakes a wide range of technical support and logistical tasks primarily for the Royal Air Force and the Army under long term contracts. It also provides technical and other skilled personnel to the aerospace and telecommunications industries. For the financial year to 31 December 2000, Hunting Defence Services reported a profit before tax of £6.3 million. A summarised profit and loss account and statement of total recognised gains and losses of Hunting Defence Services for the period 1 January 2001 to 9 March 2001, being the period from the beginning of its financial year to the effective date of acquisition, are shown below:

	Period 1 January 2001 to 9 March 2001 £'000
Turnover	**11,934**
Profit before interest and tax	**1,178**
Interest	**268**
Profit before tax	**1,446**
Tax	**(85)**
Profit for the financial period and total recognised gains relating to the period	**1,361**

During the year, the group made two other acquisitions. These were: a bagging and batching company, the Chronos Richardson Group, on 20 June 2000 for total consideration of £1.7 million; and a compressed air supply company, Air Power International Ltd, on 29 January 2001 for total consideration of £1.0 million.

The following table sets out the book value of the identifiable assets and liabilities acquired as a result of these acquisitions and their fair value to the group. Due to the proximity of the Hunting Defence Services acquisition to the group's financial year end, the fair value of the assets acquired have been included on a provisional basis. The final consideration payable for the Hunting acquisition is to be determined by a completion accounts process and therefore, final amounts payable have been estimated.

29. Acquisitions (continued)

As a substantial acquisition for the group, details of the Hunting acquisition are shown separately below:

	Hunting Defence Services book and fair value £'000	Other acquisitions book value £'000	Other acquisitions fair value adjustments £'000	Other acquisitions fair value to the group £'000	Group Total £'000
Tangible fixed assets	2,003	1,997	(60)	1,937	3,940
Stocks and work in progress	236	4,991	(87)	4,904	5,140
Debtors	7,881	8,088	(90)	7,998	15,879
Cash at bank	741	1,353	–	1,353	2,094
Creditors: amounts falling due within one year					
Bank overdrafts	–	(388)	–	(388)	(388)
Bank loans	–	(48)	–	(48)	(48)
Finance lease obligations	(157)	(4)	–	(4)	(161)
Other creditors	(8,013)	(11,299)	–	(11,299)	(19,312)
Provisions for liabilities and charges	–	(3,173)	–	(3,173)	(3,173)
Net assets	2,691	1,517	(237)	1,280	3,971
Fair value of consideration:					
Cash	62,089			1,690	63,779
Deferred consideration	–			991	991
Costs	2,500			479	2,979
	64,589			3,160	67,749
Goodwill arising	61,898			1,880	63,778

The fair value adjustments are to reflect the circumstances and conditions at the date of acquisition. The adjustments relate to Chronos Richardson and comprise the write-off of obsolete fixed assets and stock and provision for uncollectable debts.

In addition to the current year acquisitions, adjustments have been made to the provisional numbers included last year for the acquisition of FBM. Net assets have been reduced by £1.7 million relating to provisional numbers included in debtors. A payment of £1.0 million has been received from the vendors, as a reduction in consideration following finalisation of the completion accounts. £1.8 million of deferred consideration will not now be payable. Additionally, provisional numbers included for the fixed assets of Armstrong Technology Associates Ltd have been reduced by £0.1 million. The goodwill arising on acquisitions has been adjusted accordingly.

30. Financial commitments

Capital commitments

	2001 £'000	2000 £'000
Authorised future capital expenditure of the group at 31 March that was contracted for but not provided for in the Financial Statements	**327**	919

The company had no capital expenditure contracted for at 31 March 2001 (2000: £nil).

Operating lease commitments

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

	2001 Land and buildings £'000	2001 Plant machinery and vehicles £'000	2000 Land and buildings £'000	2000 Plant machinery and vehicles £'000
Leases expiring:				
Within one year	**265**	**426**	405	588
Within two to five years	**1,851**	**780**	1,418	377
Thereafter	**2,141**	**37**	2,124	35
	4,257	**1,243**	3,947	1,000

Company The company has an operating lease commitment for land and buildings as at 31 March 2001 with an annual commitment expiring after more than five years of £1.7 million (2000: £1.7 million).

31. Contingent liabilities

a) The company has guaranteed or has joint and several liability for bank facilities of £74.5 million (2000: £36.9 million) provided to certain group companies.

b) Throughout the group, contingent liabilities exist in respect of guarantees, performance bonds and indemnities issued on behalf of group companies by banks and insurance companies in the ordinary course of business. At 31 March 2001 these amounted to £86.6 million (2000: £91.7 million), of which the company had counter-indemnified £57.3 million (2000: £64.6 million).

c) The company has given guarantees on behalf of group companies in connection with the completion of contracts within specification, including responsibility for maintenance.

d) Pursuant to the Rosyth Royal Dockyard privatisation agreement, the following charges and security interests have been granted by Rosyth Royal Dockyard Limited (RRDL) in favour of the Ministry of Defence (MoD).

i) Strategic Assets RRDL has undertaken certain obligations in respect of those fixed assets acquired at Rosyth Royal Dockyard considered by the MoD to be of strategic importance to HM Government (known as 'Strategic Assets'), including an obligation not to dispose of or destroy such assets or their replacements. In addition, in the event of the insolvency of RRDL or of Babcock Rosyth Defence Limited, the MoD will have the option to repurchase from RRDL any or all of a narrower class of Strategic Assets ('Relevant Strategic Assets') at market value or, in respect of certain assets, at the lower of market value and cost. RRDL's obligations in respect of the MoD's repurchase option are secured by:

a) fixed charges over those Relevant Strategic Assets consisting of interests in land; and
b) a floating charge over the remaining Relevant Strategic Assets.

ii) Development Clawback 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 RRDL and the MoD dated 30 January 1997. By way of security for the MoD's rights to such share, the company has granted a fixed charge (standard security) over the Dockyard in favour of the Authority.

e) The company has given certain indemnities in the course of disposing of companies. The company believes that these are unlikely to have a material effect on the group's financial position.

Principal subsidiary and associated undertakings

BES
Engineering, technology support services and facilities management to the defence, rail, marine and 'secure facilities' sectors:

- Acetech Personnel Limited
- Air Power International Limited
- Armstrong Technology Associates Limited
- Babcock Defence Systems Limited
- Babcock Engineering Services Limited
- Babcock New Zealand Holdings Limited (New Zealand)
- Babcock New Zealand Limited (New Zealand)
- Babcock Rosyth Defence Limited
- Babcock Rosyth Engineering Limited
- Babcock Rosyth Industries Limited
- CMR Consultants Limited
- FBM Babcock (Lairdside) Limited
- FBM Babcock Marine Holdings (UK) Limited
- FBM Babcock Marine Limited
- FBMA Marine Inc. (50%) (Philippines)**
- Hiberna FM Limited
- Prime Serve Scotland Limited
- Railcare Limited (60%)
- Rosyth Regeneration Limited (20%)*
- Rosyth Royal Dockyard Limited

BMH
Materials processing technologies and engineered systems:

- Babcock Africa (Pty) Limited (South Africa)
- Babcock Africa Contracting (Pty) Limited (South Africa)
- Babcock Holdings (Finland) Oy (Finland)
- Babcock Holdings (Sweden) AB (Sweden)
- Babcock Holdings (USA), Inc (USA)
- BMH AKI Dryers Inc (USA)
- BMH Americas Inc (USA)
- BMH Asia Pacific (Pte) Limited (Singapore)
- BMH China Ltd (Hong Kong)
- BMH Chronos Asia Pacific Sdn Bhd (Malaysia)
- BMH Chronos Richardson Ltd (49%) (Thailand)
- BMH Chronos Richardson GmbH (Germany)
- BMH Chronos Richardson Inc (USA)
- BMH Chronos Richardson Limited
- BMH Chronos Richardson SA (France)
- BMH Chronos Richardson Srl (Italy)
- BMH Chronos Richardson India (Private) Ltd (40%) (India)
- BMH Claudius Peters GmbH (Germany)
- BMH do Brazil Ltda (Brazil)
- BMH Eagleton Inc (USA)
- BMH Iberica SA (Spain)
- BMH Italiana Srl (Italy)
- BMH Kellve AB (90%) (Sweden)
- BMH Limited
- BMH Marine AB (Sweden)
- BMH SA (France)
- BMH Technologies GmbH (Germany)
- BMH Wood Technology AB (Sweden)
- BMH Wood Technology Oy (Finland)
- Chronos Holdings Limited

Others

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

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

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

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

*Denotes undertakings recognised and accounted for as associated undertakings.

**Denotes undertakings recognised and accounted for as joint ventures.

Notice of meeting

Notice is hereby given that the twelfth Annual General Meeting of the members of Babcock International Group PLC will be held at The Berkeley Hotel, Wilton Place, Knightsbridge, London SW1X 7RL, on Tuesday, 24 July 2001, at 12.00 noon for the transaction of the following business:

1. To receive and adopt the Directors' and Auditors' Reports and the audited Financial Statements of the company for the year ended 31 March 2001.

2. To declare a final dividend for the year ended 31 March 2001.

3.1) To elect Mr G A Campbell as a Director of the company;

3.2) To re-elect Mr M S Easton as a Director of the company;

3.3) To re-elect Mr N R Young as a Director of the company.

4. To reappoint Arthur Andersen as Auditors to the company.

5. To authorise the Directors to fix the remuneration of the Auditors.

6. As special business, to consider and, if thought fit, to pass the following Resolutions:

Special Resolution
1) That the company is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163 of the Companies Act 1985) of ordinary shares of 60p each ('ordinary shares') in the capital of the company provided that:

a) the maximum number of ordinary shares hereby authorised to be purchased shall be 14,662,468;

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 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 23 July 2002 or at the conclusion of the next Annual General Meeting of the company (whichever is the earlier) unless such authority is renewed prior to such time; and

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

Ordinary Resolution
2) That:

a) subject to the approval of the Board of Inland Revenue, the Directors be and they are hereby authorised to amend the rules of The Babcock 1999 Approved Executive Share Option Scheme (the 'Approved Scheme') by replacing the individual four times salary limit in rule 4.3 of the Approved Scheme with a new limit on the market value of shares over which options may be granted to an individual in any year and making other consequential amendments as described in the explanatory notes; and

b) the Directors be authorised to amend further the rules of the Approved Scheme to take account of any comments of the Inland Revenue so as to maintain the approved status of the Approved Scheme.

Ordinary Resolution
3) That the Directors be and they are hereby authorised to amend the rules of The Babcock 1999 Unapproved Executive Share Option Scheme (the 'Unapproved Scheme') by replacing the individual four times salary limit in rule 3.1 of the Unapproved Scheme with a new limit on the market value of shares over which options may be granted to an individual in any year and making other consequential amendments as described in the explanatory notes.

By order of the Board

H M Mahy Secretary
18 June 2001

Registered Office:
Badminton Court
Church Street
Amersham
Buckinghamshire HP7 0DD

Notes:
1) A holder of ordinary shares is entitled to attend and vote at the meeting and may appoint a proxy to attend and, on a poll, vote on his or her behalf. The proxy need not be a member of the company.

2) A holder of ordinary shares who holds his shareholding in uncertificated form 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.

3) A form of proxy is enclosed and, to be effective, must be completed in accordance with the instructions printed thereon and returned so as to be received by the Registrars of the company not less than 48 hours before the time appointed for the meeting. Completion of a form of proxy will not affect the right of a member to attend and vote in person at the meeting.

4) The register of Directors' interests in the share capital of the company, together with copies of service agreements under which Directors of the company are employed, are available for inspection at the company's registered office during normal business hours until the date of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

Five year financial record

	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Group turnover	**441.0**	470.7	495.0	568.3	646.0
Operating (loss)/profit	**(4.8)**	20.8	22.8	14.0	1.9
Exceptional items	**(6.2)**	1.0	6.1	(18.7)	(25.6)
(Loss)/profit on ordinary activities before interest	**(11.0)**	21.8	28.9	(4.7)	(23.7)
Net interest and similar charges	**3.7**	4.2	2.5	0.2	1.0
(Loss)/profit on ordinary activities before taxation	**(7.3)**	26.0	31.4	(4.5)	(22.7)
Tax on ordinary activities	**0.2**	(4.5)	(5.3)	(2.9)	(1.7)
(Loss)/profit on ordinary activities after taxation	**(7.1)**	21.5	26.1	(7.4)	(24.4)
Minority interests	**3.2**	1.0	(0.6)	(1.3)	(1.2)
(Loss)/profit attributable to shareholders	**(3.9)**	22.5	25.5	(8.7)	(25.6)
Fixed assets	**114.7**	58.7	47.9	50.7	55.1
Net current assets	**33.9**	129.1	122.8	97.9	102.0
Non-current liabilities and provisions	**(35.2)**	(36.0)	(34.1)	(33.8)	(28.2)
Total net assets	**113.4**	151.8	136.6	114.8	128.9
Shareholders' funds	**110.2**	143.9	126.8	105.7	119.5
Minority interests	**3.2**	7.9	9.8	9.1	9.4
	113.4	151.8	136.6	114.8	128.9
(Loss)/earnings per share – basic	**(2.44)p**	13.26p	15.07p	(5.12)p	(15.11)p
Dividends per share	**2.65p**	2.55p	2.20p	1.80p	1.50p

Shareholder information

Financial calendar
Financial year end
31 March 2001

2000/01 preliminary results announced 19 June 2001

Annual General Meeting
24 July 2001

Final dividend payment date (record date 13 July 2001)
10 August 2001

Registered office and company number
Badminton Court
Church Street
Amersham
Buckinghamshire HP7 0DD

Registered in England
Company number 2342138

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

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

Auditors
Arthur Andersen
1 Surrey Street
London WC2R 2PS

Principal UK bankers
The Royal Bank of Scotland plc
Waterhouse Square
138-142 Holborn
London EC3P 3HX

HSBC Bank plc
27-32 Poultry
London EC2P 2BX

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

Stockbrokers
Cazenove Group PLC
12 Tokenhouse Yard
London EC2R 7AN

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

Return of capital to shareholders
A return of capital to ordinary shareholders by way of a bonus issue of redeemable 'B' shares of 18p each, out of the company's share premium account, was approved at an Extraordinary General Meeting of the company held on 10 October 2000.
The majority of shareholders elected to have their 'B' shares redeemed on 23 October 2000 and 23 April 2001. Holders of 'B' shares at 23 March 2001 were paid a dividend of 0.41834p per share on 23 April 2001 in respect of the six month period ended on that date.

Taxation
A guide to the general tax position of United Kingdom shareholders under the return of capital described above is given in Part IV of the circular to shareholders dated 15 September 2000. Copies of the Part IV guide are available, on request, from the company Secretary, at Babcock International Group PLC's Registered Office.

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

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

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

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

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Babcock International Group PLC
Badminton Court
Church Street
Amersham
Buckinghamshire HP7 0DD

Telephone 01494 727296
Fax 01494 721909
Website www.babcock.co.uk