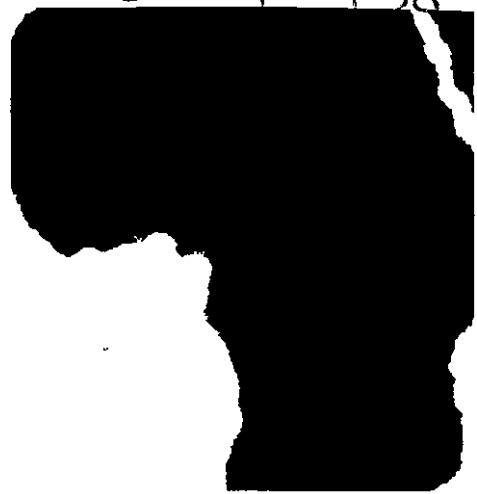


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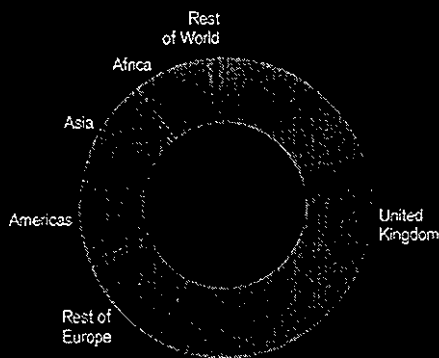
Babcock International Group PLC annual report and accounts 1998



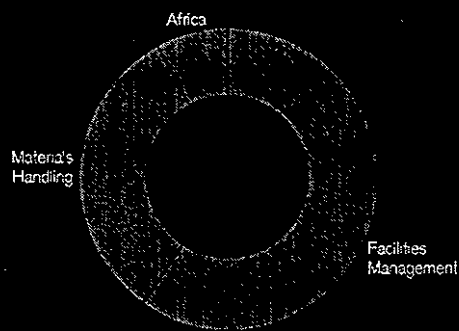
Global engineering solutions annual report and accounts 1998

Babcock
International





Sales by destination



Sales by activity

- Total turnover £559.3m (£611.4m)*
- Trading profit before interest £19.6m (£14.6m)*
- Net cash £21.1m (£29.3m)
- Earnings per share excluding exceptional items 5.93p (loss 0.01p)
- Dividends per share 1.80p (1.50p)

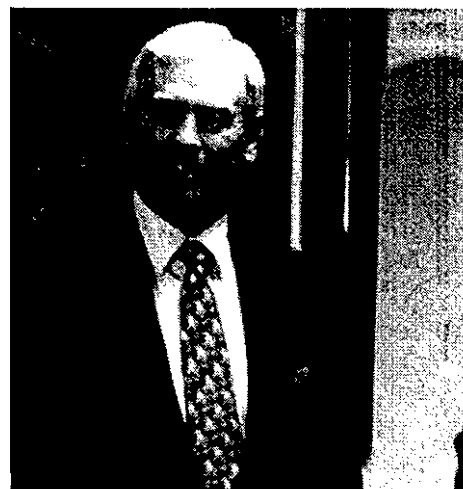
* Including operating operations

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Babcock today

Babcock International Group PLC is a multinational engineering group, headquartered in the UK and operating from companies and offices in 16 countries. It delivers products, systems and support services to the global bulk materials handling and processing industries and to the maritime, defence and rail sectors. It executes business in more than 60 countries.

Chairman's statement



Overview

1997/98 has been a year of significant progress in which we have successfully implemented our strategy, announced a year ago, to deal with the Group's underperforming businesses of Process, Environmental and Africa. We have now either exited or substantially refocused these businesses and, as a result of these actions, the Group's exposure to the major risks associated with heavy contracting has been significantly reduced. We enter the new financial year with profitable continuing operations, capable of generating further improvements in performance.

Results summary

The audited results for 1997/98 are detailed on page 33. The accounts reflect the adoption of the requirements of the two Financial Reporting Standards 9 and 10 issued during the year that relate to associated companies and joint ventures, and goodwill and intangible assets respectively.

In summary, the turnover including share of joint ventures, from continuing operations was £559.3 million (1997: £611.4 million) and the corresponding trading profit was £19.6 million (1997: £14.6 million) after adverse foreign exchange translation of £0.7 million.

The turnover including share of joint ventures, from all operations (including discontinued operations), was £591.7 million (1997: £671.7 million). The corresponding trading profit was £14.0 million (1997: £1.9 million).

The earnings per share before exceptional items were 5.93p (1997: loss 0.01p).

After accounting for exceptional items (associated with disposals and discontinued operations) amounting to £18.7 million, the loss before tax was £4.5 million (1997: loss £22.7 million).

The loss per share was 5.12p (1997: loss per share 15.11p).

At the year end the net cash balance was £21.1 million (1997: £29.3 million).

Dividend

The Board is recommending a final dividend of 1.11p, in the form of a Foreign Income Dividend, making a total of 1.80p for the year (1997: 1.50p), an increase of 20%.

Order book

The Group's year-end order book for its continuing operations was £333.9 million (1997: £224.0 million).

Facilities Management

In the first full year of ownership of the Rosyth Dockyard a very good performance was achieved on the MoD core refit programme, with all nuclear submarines and surface ships having been delivered on or ahead of schedule and within targeted cost. The results were impacted by one-off costs associated with exiting the loss-making commercial Joinery business, completing the ship life extension project ("Sir Bedivere") and absorbing the cost of a dispute over essential changes in working practices at the New Zealand Dockyard. The outstanding claim with the MoD on Sir Bedivere has been satisfactorily resolved and the vessel has now successfully completed its sea trials and is due for imminent delivery.

Under the leadership of the new Divisional Managing Director, Murray Easton, a major cost reduction and performance improvement programme has been planned in detail to improve competitiveness. The management is committed to implement this programme over the next three years and the first results should be seen during the financial year 1998/99. To support the drive for increased efficiency, extensive changes in working practices are being introduced, complemented by the necessary training for our employees.

The embryo businesses of Sub Sea Engineering & Defence Systems have progressed satisfactorily and further development is being planned. In particular the Sonar 2087 project could open up substantial opportunities.

Railcare and Babcock Water Engineering both turned in solid performances and are well positioned to do so again in the new financial year.

Business developments include a rail freight wagon concept which is making encouraging progress, with its aim of diverting freight from our roads and onto rail.

Materials Handling

The Division continued to improve its profitability despite continuing losses in the Wood Technology operations. The strength of sterling had an adverse translation impact on profit of £0.7 million in the year.

Now that we have successfully exited the North American Wood Technology business, this leaves the Scandinavian Wood Technology business as a profitable entity. Although it has been exposed to the price and demand cycles of the wood pulp and paper industries, this has been offset by its success in the important Scandinavian bio-energy market.

In our determination to build and maintain market leadership and improve performance, product development efforts have been intensified across the Division. As a result new and improved products, with enhanced intelligence, are being brought to market.

The Division made some 35% of its sales in 1997/98 to the Asia/Australasia market. Whilst it has reduced its reliance on winning business from certain of the Asian countries, it still sees good prospects in others.

Meanwhile we see prospects for further success in the USA, South American and European markets and, accordingly, additional sales resources have been assigned.

South Africa

Our South African business has returned to operating profit under its new management team. All significant contract claims outstanding at the beginning of the year have been satisfactorily resolved and debt has been further reduced.

The business has been substantially derisked by reducing its exposure to construction activities which have suffered historically in a highly competitive environment. This approach will continue to be

pursued in the coming year, placing greater emphasis on engineering and maintenance services. Following the above actions, we believe that the prospects are encouraging for a satisfactory performance.

Business disposals and closures

During the first half of the year, Babcock Environmental in the USA was closed and the Process Division sold to AMEC plc. In the second half, the South African business, Delta Controls was sold and we exited the loss making US Wood Technology business in Atlanta.

Directors

On the 31 July 1997 the composition of the Board was significantly strengthened with the appointments of Nigel Young (Group Finance Director), Dr Gernot Schäfer and Murray Easton (respectively Managing Directors of Materials Handling and Facilities Management Divisions). This has created a more effective and balanced Board structure.

Employees

Our employees have had to deal with many changes over the past few years and I would like to take this opportunity to thank them for their significant contribution and continued loyalty.

Outlook

The fundamental restructuring of Babcock has been substantially completed. Our balance sheet remains ungeared and we have business plans and a competent management team in place to deliver growth. We are currently evaluating a number of small, technology-based, acquisitions and we will pursue more significant acquisitions where we can see a good fit and added value for our shareholders.

Our overriding aim is to strengthen and build market leadership in our main business activities and in addition create new opportunities in related fields through our global network and knowledge of international markets.

I am confident that we are now in a strong position to deliver value improvements to our shareholders.



Worldwide operations

North America and Canada

South America

Europe

New Zealand

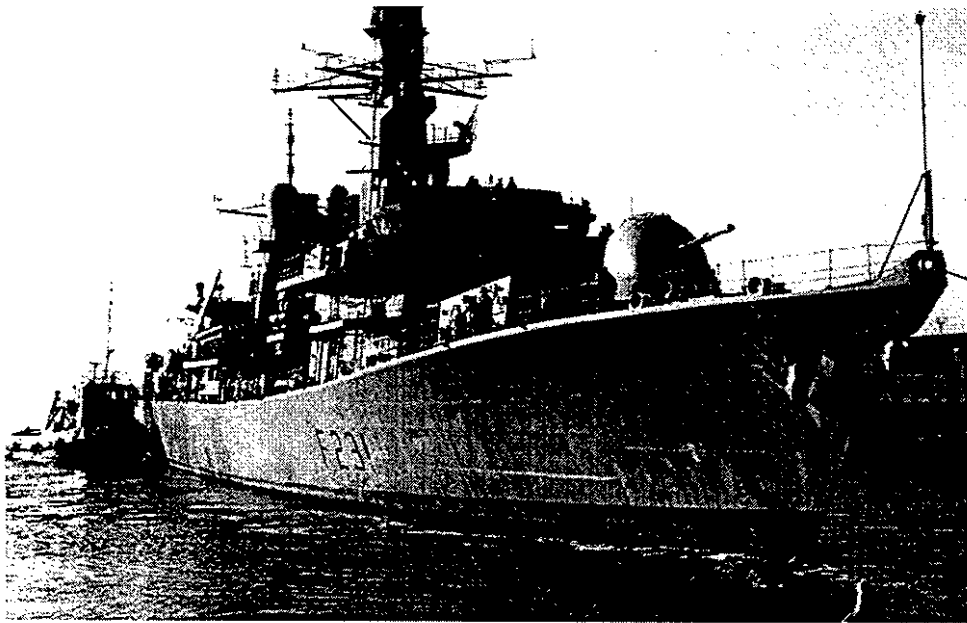
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Africa

Asia

Main offices
▽ Contracts

Review of operations



FACILITIES MANAGEMENT DIVISION

Facilities Management Division operates in the defence, maritime, rail and water industries. It is engaged in:

- Refitting of Royal Navy warships and nuclear submarines at Rosyth Dockyard and providing services at the Faslane submarine base in Scotland.
- Maintaining and refitting the Royal New Zealand Navy fleet at the Devonport Dockyard in Auckland.
- Submarine through-life support services and surface ship sonar design from its defence systems operations at Weymouth and Rosyth.
- Sub-sea oil extraction module fabrication at Rosyth.
- Water and waste water engineering through its joint venture with Yorkshire Water plc (Babcock Water Engineering Limited).

- Rail carriage maintenance and refurbishment through its jointly owned venture with Siemens (Railcare Ltd).

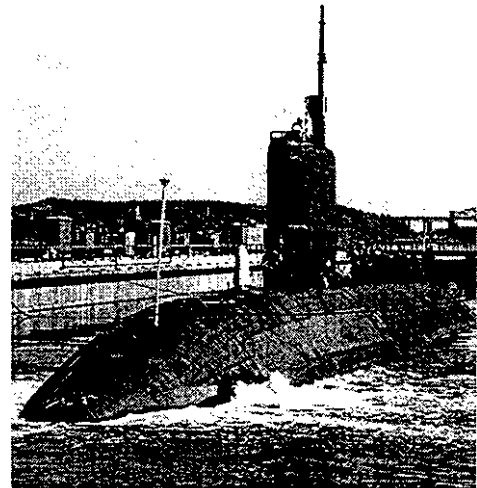
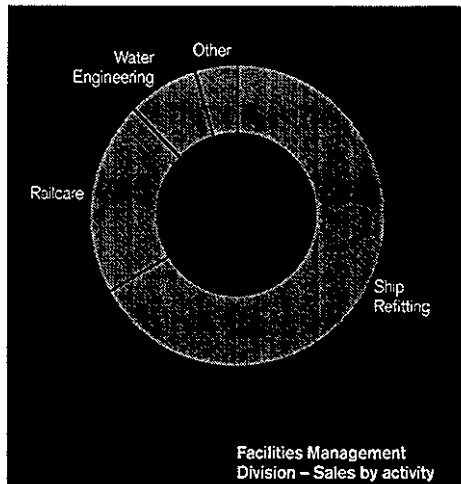
During the year, the Division made a trading profit including share of joint ventures and associates of £12.5 million (1997: £15.0 million) on turnover of £335.3 million (1997: £351.8 million). The order book at the end of the year was £249.0 million (1997: £109.7 million).

Naval Refitting – UK

The acquisition, last year, of Rosyth Dockyard brought with it a ten year programme of work from the MoD valued at approximately £1.5 billion. This programme will provide a solid basis to enable the Dockyard to manage the transition to competitive tendering for naval ship refitting and submarine services. A systematic review across all areas of the Dockyard, identifying significant cost

above left: The Type 23 Frigate, HMS Argyll, recently commenced refit at Rosyth. This major project was the first won in open competition since privatisation of the dockyard.

above right: HMS Splendid arriving at Rosyth for capability update for Tomahawk land attack missile.



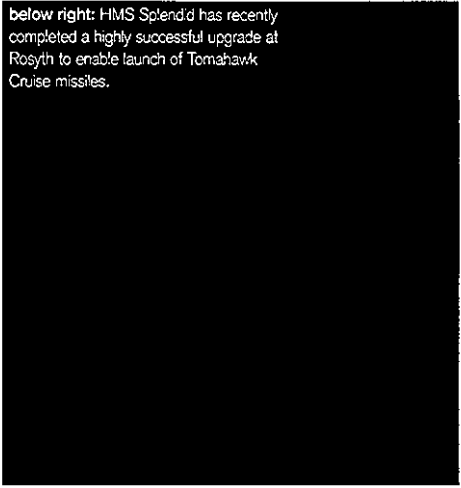
savings and efficiency improvements, has been completed. The first results of the implementation programme are planned to come through in the new financial year 1998/99.

Work performed during the year, on the allocated programme of naval ship and nuclear submarine refits, was in line with target. The level of work carried out on nuclear submarines was high and included refitting work for HMS Superb, HMS Sovereign and HMS Sceptre, as well as the decommissioning of HMS Repulse. A key achievement during the year was the weapons capability update for the fitting of the Tomahawk cruise missile system to HMS Splendid. This unique refit was carried out to an extremely tight timescale in the entrance dock at Rosyth which has recently been substantially upgraded by the MoD to meet all the requisite nuclear safety standards. It is now regarded as the most modern nuclear dock in the UK.

Refitting work undertaken during the year against the allocated programme for large surface ships included the type 42 destroyers, HMS Cardiff, HMS Exeter and HMS Southampton. In addition five minor warship refits were successfully completed as well as a number of conversion packages.

The only major MoD activity undertaken outside the allocated programme during the year related to the one-off, ship life extension project, RFA Sir Bedivere. This unique contract has presented major challenges for both the Ministry and the Dockyard. Following successful sea trials at the end of May 1998, the ship is due for imminent delivery. During the extensive commissioning programme for this vessel, technical defects were encountered in certain equipment supplied by third parties that necessitated replacement and reinstallation. Delays also arose due to poor performance by two major subcontractors which led to additional costs being incurred.

below right: HMS Splendid has recently completed a highly successful upgrade at Rosyth to enable launch of Tomahawk Cruise missiles.



The negotiations with the MoD, referred to at the half-year, in respect of major variations to contract, have now been satisfactorily concluded.

In November Rosyth won the first major refit contract tendered in open competition since privatisation. This contract to refit the Type 23 frigate HMS Argyll was won against strong competition. This is one of only two major surface ship refits that the MoD plan to put out to competitive tender before late 2000. The second is HMS Lancaster, another Type 23 frigate, for which the Division will be bidding this summer.

Babcock New Zealand

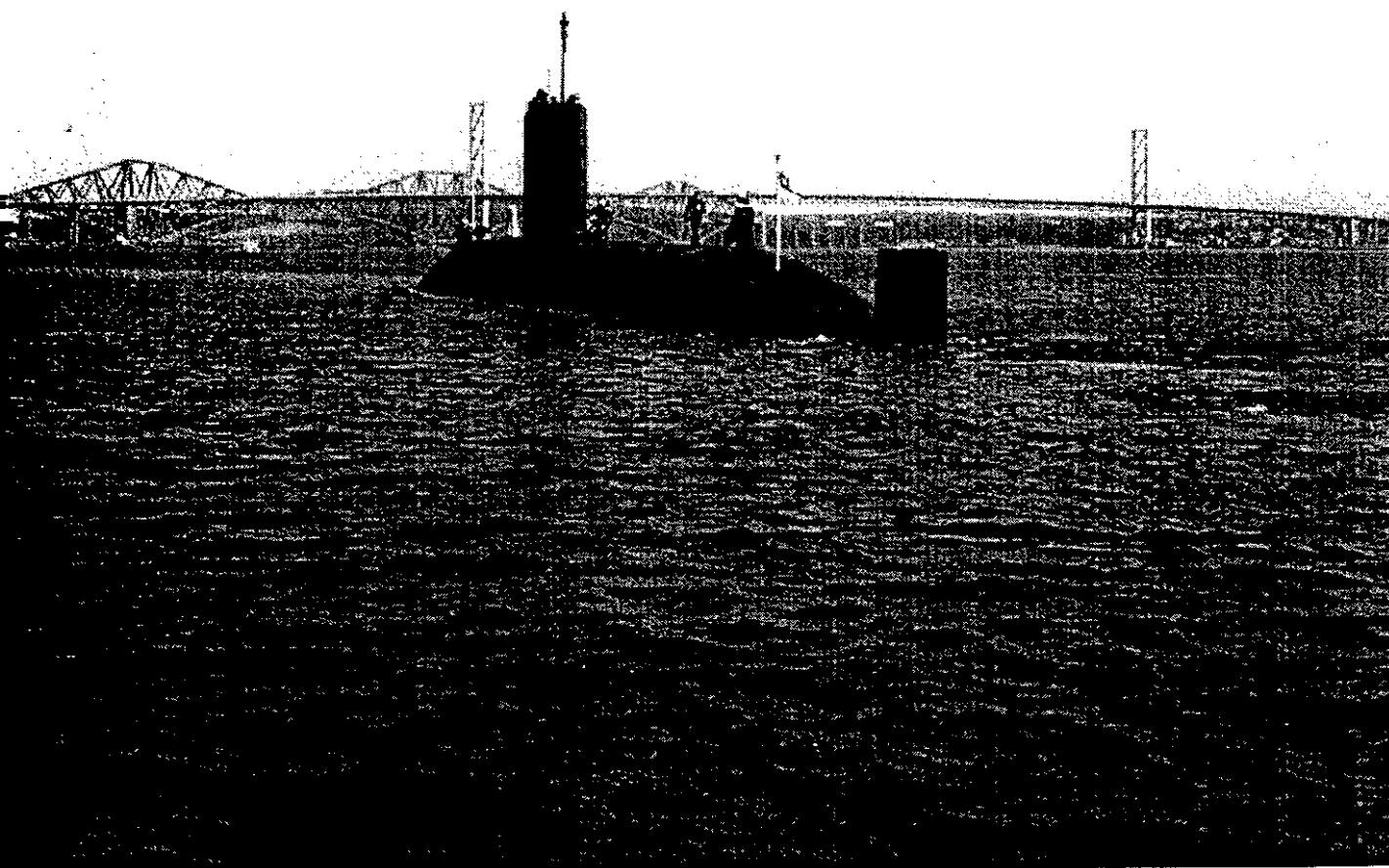
Turnover declined in the year as a result of a reduction in the size of the Royal New Zealand Navy's operational fleet. With planned defence activity now substantially less than envisaged at the start of the contract in 1994, the Dockyard is seeking to increase its commercial business. The trading results for the year were adversely

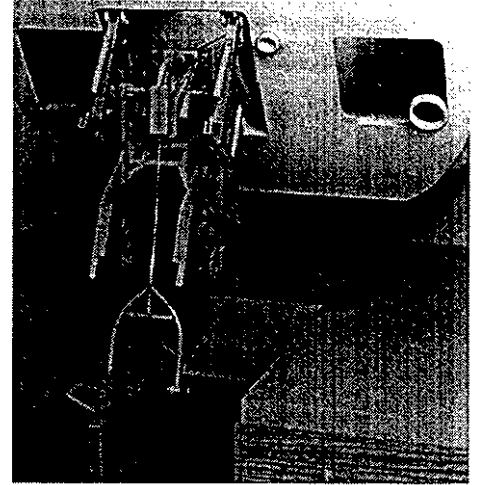
affected by significant costs arising from a labour dispute associated with the introduction of modern working practices.

New Businesses

The embryo businesses outside naval refitting whose activities relate to sonar systems, sub-sea engineering and rail all performed satisfactorily during the year.

The Division's sonar development activities undertaken by Babcock Defence Systems were focused during the year on the project definition contract for the Royal Navy's new towed array sonar (Sonar 2087). Following successful trials in the Mediterranean, good progress on the sonar system design and configuration has been achieved. Babcock, together with its project partners, will be submitting offers to the MoD as one of two final competitors for design, production, and support of the new suite of sonar equipment which will ultimately be fitted to the Type 23 frigate fleet.





above right: Model of the Royal Navy's future warship mounted low frequency active towed sonar system being developed by the Babcock Defence Systems Limited led international consortium.

opposite: The Rosyth workforce have an excellent reputation for the quality of refitting and commissioning of weapon and engineering equipments.

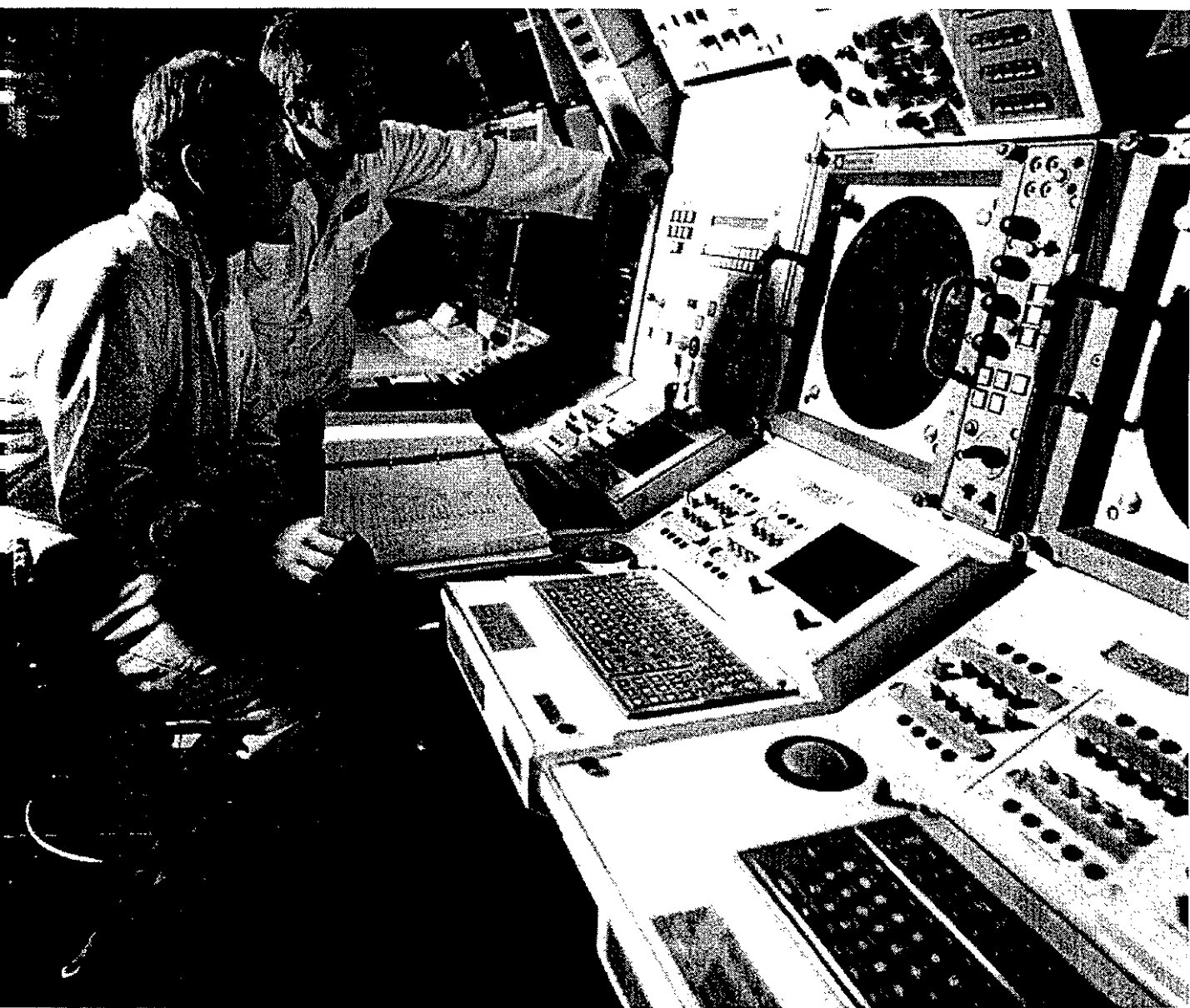
The total contract is likely to be worth approximately £300 million. Other technical and systems support activity includes work on both Astute and Trafalgar class submarines and is progressing well.

Nuclear engineering specialists from Rosyth continue to provide submarine support services at Faslane. In an extension of this activity the Company has bid, in association with Rolls Royce Marine Systems and GEC Marine, for a wide-ranging in-service submarine support contract for the MoD.

The sub-sea engineering business delivered manifolds and associated equipment for new oil fields west of Shetland operated by BP and Shell and is currently working on a contract for a Conoco field.

The rail business at Rosyth, which undertook the re-livery of GNER IC225 passenger coaches, began the development of a new concept in rail freight wagons, known as Mega 3. This new concept will enable modern truck semi-trailers and the largest freight containers to be transported on the UK inter-modal rail system within the constraints of the existing gauge. This development, which is being supported by Scottish Enterprise and others, is targeted to achieve certification from the regulatory authorities during the financial year 1998/99.

"Rosyth 2000", in which the Division has a 20% interest, has now begun initial development work on the site of the former naval base adjacent to Rosyth Dockyard with the aim of attracting new industries on to the site.



Rosyth has now exited the commercial Joinery business, given its unsatisfactory financial performance, and the trading results reflect these losses and the cost of withdrawal.

Railcare

Railcare had a successful year in which it further consolidated its position in the privatised rail industry. It achieved a solid trading performance as a result of further improvements in operating efficiencies. New long term agreements for the maintenance of passenger rolling stock have been signed with the three rolling stock companies (ROSCOs). These replace the contracts inherited at privatisation. Customers included the Great Western Trains Company Limited, Great North Eastern Railway Limited, Connex (The Brighton Belle), the WAGN 317 and Thameslink fleets. The work involved

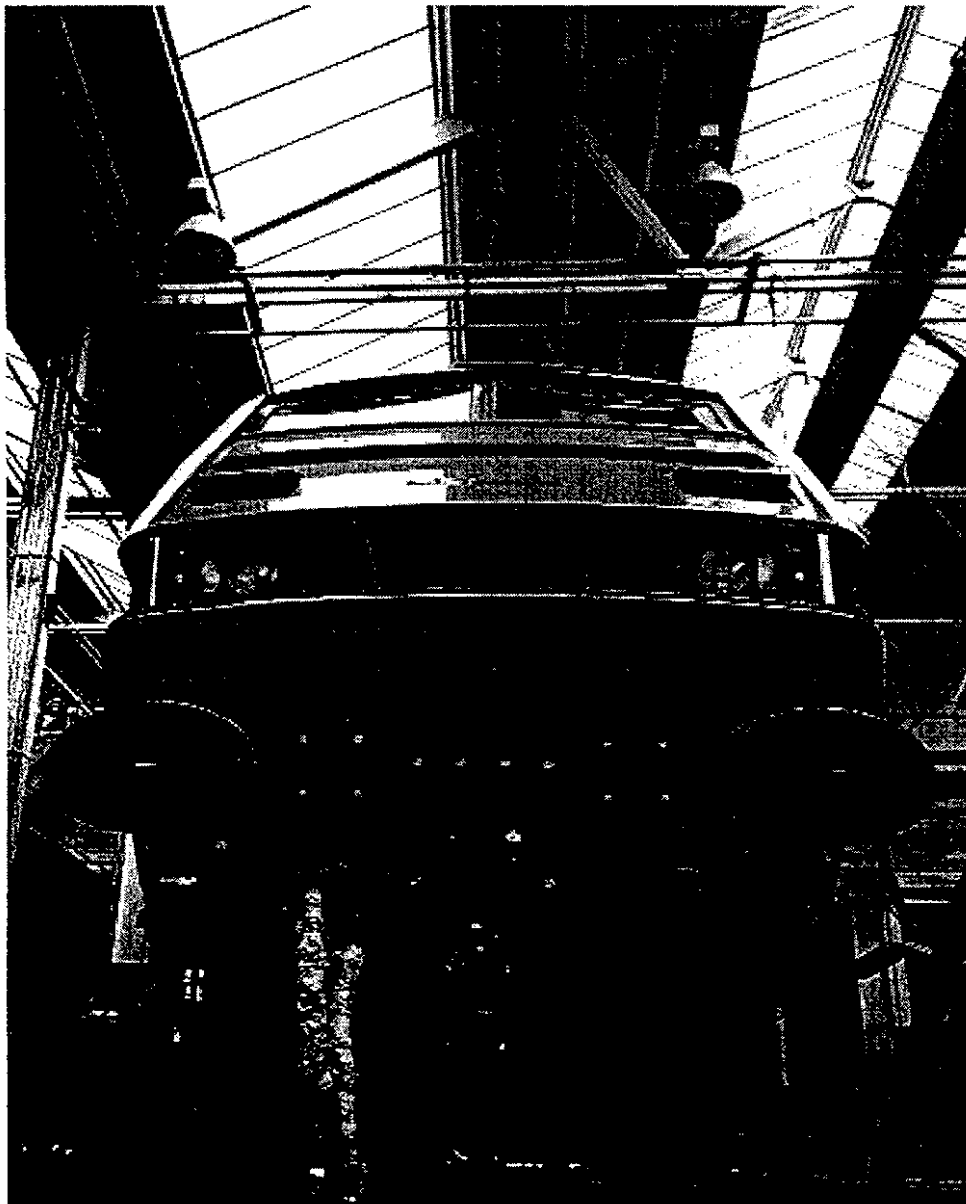
both exterior livery and complete internal redesign and refurbishment. Railcare continues to pursue various opportunities within the current and changing structure of ownership in the rail industry. In addition, it sees a substantial maintenance and refurbishment opportunity in the forthcoming private sector involvement in London Underground. Railcare has an excellent reputation in executing work for the Underground and should be well positioned to take advantage of this new prospect.

Babcock Water Engineering

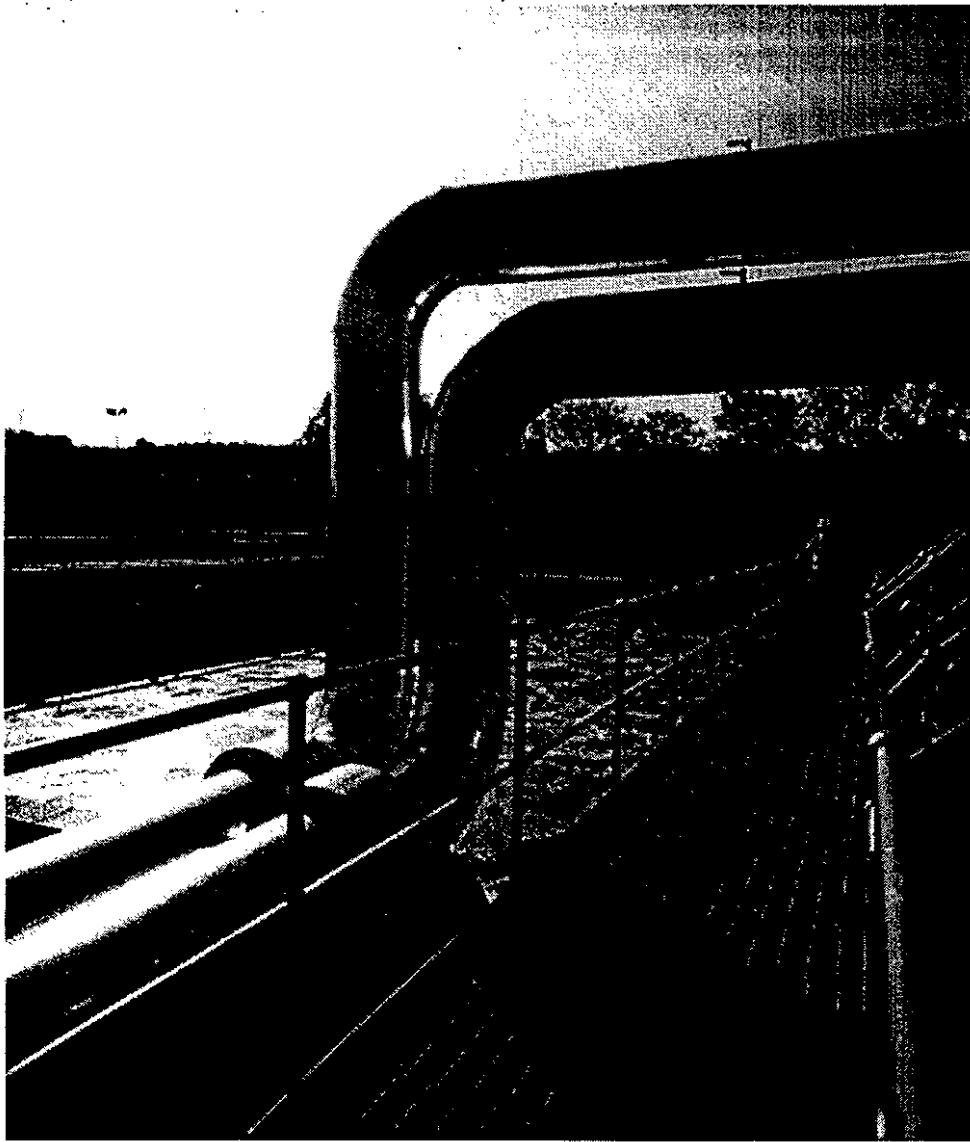
Babcock Water Engineering had another successful year during which it has seen its strong relationship with Yorkshire Water supplemented by success with a number of the other UK water authorities and initial success in overseas markets. It has continued to win work in the clean and waste water markets,

below left: Driving vehicle operated by Virgin Rail receiving heavy overhaul and engineering modifications to improve reliability.

opposite: Recently installed spray paint facility at Railcare, Wolverton.







left: CASS[™] activated sludge treatment plant at the Upper Brighthouse sewage treatment works.

right: BMH Manne Siwertel 5000S mobile ship unloader at Runcorn Docks, Manchester Ship Canal unloading.

far right: Sodium sulphate delivered from Spain to be used in the manufacture of washing powder.

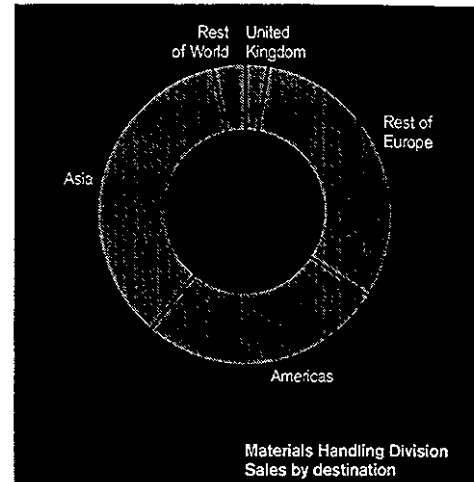
both as a consultant and a contractor. Significant contracts executed during the year included the completion of a 91 mega litres per day water treatment works at Eccup, the installation of a CASS[™] sewage treatment works at Upper Brighthouse which is the largest of its type in Europe, and the engineering and key equipment supply for a 500,000 population CASS[™] plant in Thailand. The Babcock CASS[™] waste water treatment technology is now installed in nine plants, either completed or under construction, with a value exceeding £43 million.

MATERIALS HANDLING DIVISION

The Division provides engineering solutions and equipment worldwide to a broad range of bulk material handling and processing applications in the cement, energy, iron and steel, building materials, pipelines and marine terminal sectors.

Turnover in the year was £181.0 million (1997: £188.8 million) and operating profits were £6.5 million (1997: £5.9 million). This improvement in operating profits was achieved despite an adverse impact from foreign currency translation of £0.7 million. The Division's order book at the year end was £71.9 million (1997: £96.7 million), approximately one-quarter of the reduction being accounted for by currency movements. A number of major contracts which were due to be signed in the last quarter of the year were delayed. The order intake has now recovered, with the booking of several major orders during the first two months of the current year.

The Division has continued to focus upon improving margins in its core businesses through organic growth, with an emphasis on market driven product development, and investment in highly qualified project management and employee education and



training. It also continues to invest in its extensive global network in order to be close to its customers. Organic growth opportunities will be supplemented by technology-based acquisitions which would strengthen the Division's core technologies or provide access to new and adjacent markets.

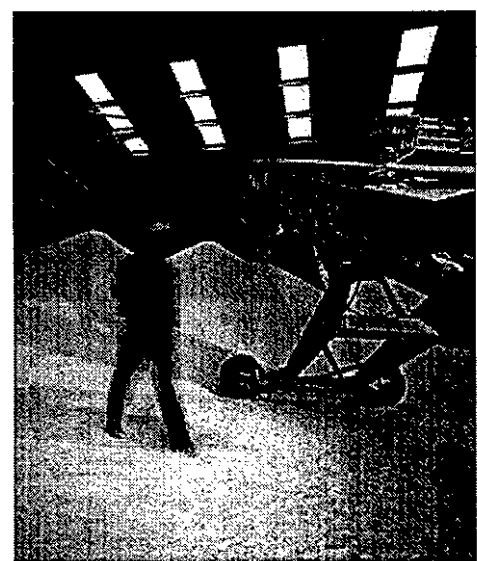
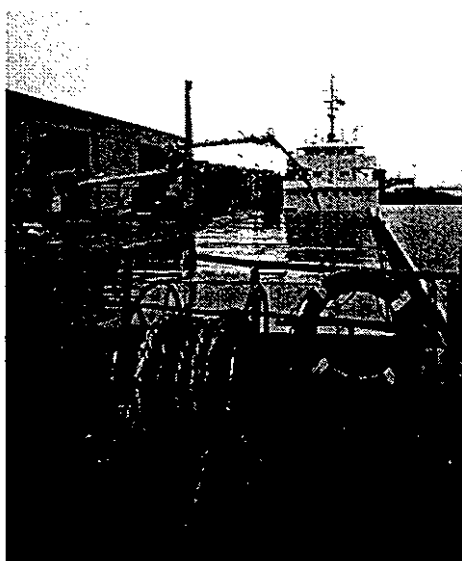
During the year, the Division reduced its exposure to the cyclical pulp and paper industry by closing its loss making wood technology operations in the USA and granting an exclusive distributorship agreement for North and Latin America to Beloit Corporation. The remainder of the Wood Technology Group will focus on the profitable wood technology business in Scandinavia where the Division enjoys a leading position in the bio-fuel energy market.

The Division's turnover by destination was 34% to Europe, 27% to the Americas, 35% to Asia and 4% to other parts of the world. Sales to those Far East countries which at present face economic difficulties contributed approximately 15% of the Division's turnover during the year. Order intake from those countries in the coming year is planned

to be significantly lower. As a consequence, sales resources are being switched to other more economically favourable parts of the world, including the USA, Eastern Europe and certain South American countries.

A particular highlight during the year in the cement business was a contract signed by BMH Claudius Peters AG for Taiwan Cement Corporation for their new Hoping works. This contract, which incorporates three clinker coolers, uses the most recent BMH Claudius Peters AG technology. The contract also included six blending silos, ten storage silos, an aeroside system for cement transportation and the installation of truck bulk loading equipment. A second major contract for cement clinker cooler and silo technology, including plant installation, controls and instrumentation, was awarded by Blue Circle Industries PLC for their Dunbar works in the UK.

BMH Americas won major orders in the year for the design and supply of complete gypsum wall board plants from customers in North and South America



and Eastern Europe. As a result of these successes the Company is now emerging as one of the three main global players in this sector.

In the energy sector, the completion of a turnkey grinding and injection system in the largest integrated iron and steel plant in South America owned by Companhia Siderurgica Nacional in Volta Redonda, Brazil, was significant. A key milestone in minerals grinding was the successful commissioning and start-up of the largest coal grinding mill ever built by the Division with SSAB Tunnplat AB in their Lulea Steel Plant in Sweden.

BMH Marine AB, in co-operation with BMH Claudius Peters AG, secured another important contract for a turnkey cement terminal. The customer, Sin Heng Chan (Singapore) Pte. Ltd, required 21 silos to be converted from grain to cement storage and the supply of other ancillary equipment. Hand over is scheduled for mid 1998. BMH Wood Technology in Scandinavia won significant contracts in the Nordic region for both bio-energy plant and machinery and wood processing plant for the pulp and paper sector.

Valuable alliances have been established during the year with leading international partners in various of the Division's businesses in order to enhance their technology portfolio and to strengthen their market position. Of particular importance was an alliance with Gamma Metrics, a US company and world

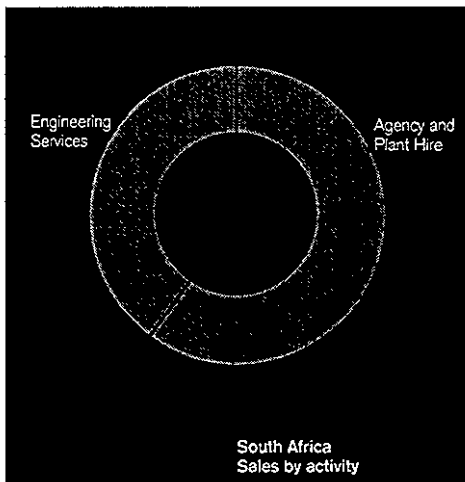
market leader in its field. The Division and Gamma Metrics will jointly market raw material blending beds with on-line analyser control, which have the potential to improve significantly kiln operation in modern cement plants.

The Division's pipeline engineering activities of Eagleton Engineering had a successful year. Significant turnkey projects included a 56 mile propylene pipeline for BASF Corporation and an 80 mile CO₂ pipeline with pump station for Petro Source Carbon Company. An 18 mile propylene pipeline for Diamond Shamrock Refining and Marketing Co. was completed in August 1997.

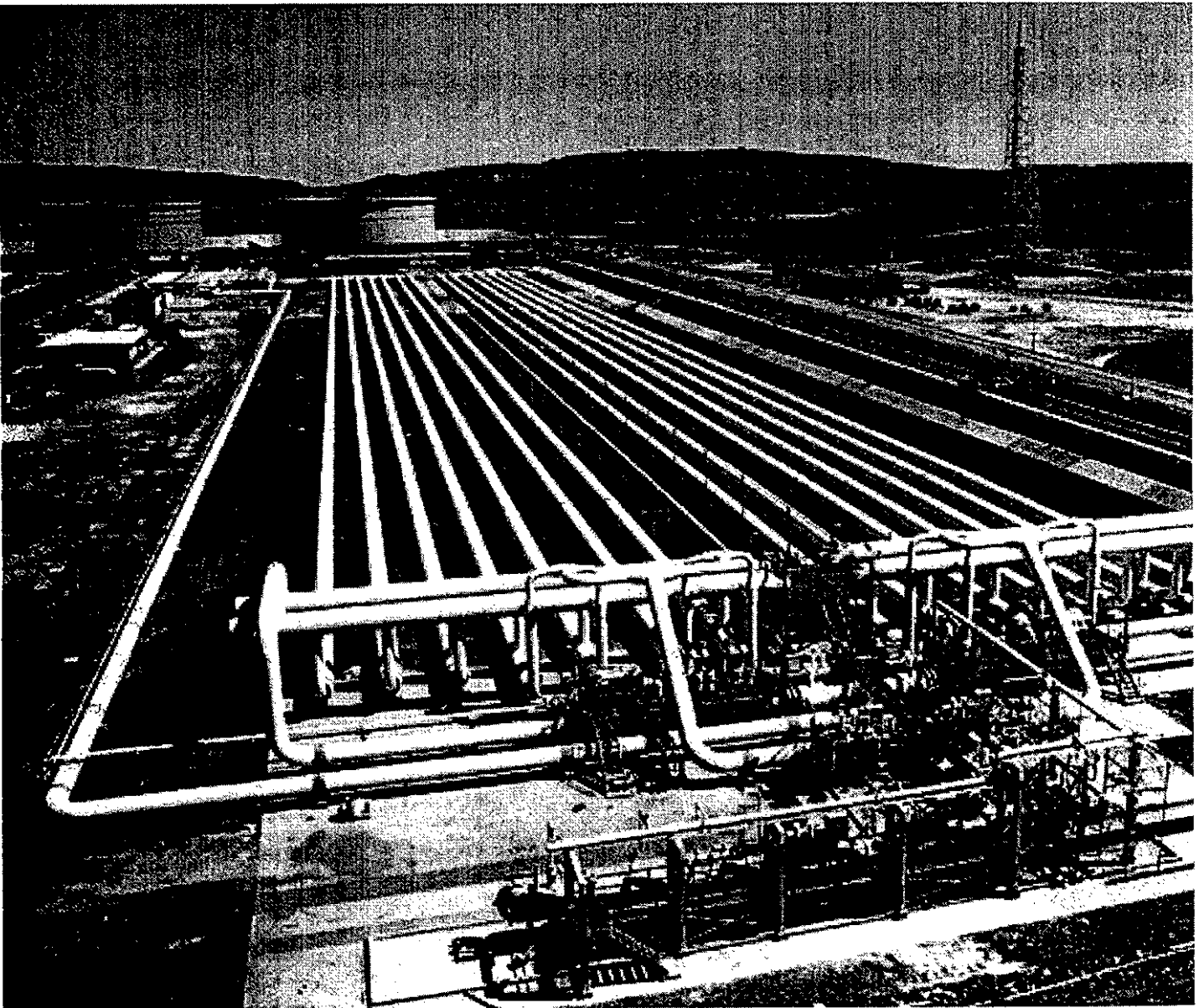
SOUTH AFRICA

The South African activities, which represented less than 8% of the Group's turnover from continuing operations during the year, are now predominantly focused on the supply of engineering services to the power generation and petrochemical industries in Southern Africa, as well as on agency and plant hire. As a result of this strategic refocus the Company, on a reduced turnover of £43.0 million (1997: £70.9 million), returned to operating profit of £0.6 million after suffering a loss of £4.0 million in the previous year.

The year also saw the sale of Delta Controls, a reduction in working capital and the resolution of significant outstanding contractual claims.



below: Woodside Petroleum Slug Catcher in Western Australia designed by Egleton Engineering. The world's largest slug catcher used to remove large quantities of liquids from natural gas.



Financial review

18 The Financial Review should be read in conjunction with the Chairman's Statement, the Review of Operations contained on pages 6 to 17 and the segmental information contained in the notes to the Financial Statements.

Group results

As a result of the strategic restructuring undertaken during the year, turnover including share of joint ventures reduced from £671.7 million to £591.7 million. The amount from continuing operations decreased during the year by 8.5% to £559.3 million.

The Group profit and loss account reflects the early adoption of the requirements of FRS9 and FRS10, which relate to associated companies and joint ventures, and goodwill and intangible assets respectively. The adoption of FRS10 resulted in a net credit in the year of £1.9 million (1997: charge £0.7 million). This includes a £0.4 million (1997: £0.4 million) amortisation charge relating to joint ventures.

Group operating profit before goodwill amortisation from continuing operations increased in the year by 14% or £2 million to £15.8 million. After including the operating profit from joint ventures and associates before goodwill amortisation, the increase is 16% to £17.7 million (1997: £15.3 million). Operating profit by class of business is shown in the segmental analysis on page 40.

If the results of the Group's foreign subsidiaries had been translated using the same average exchange rates as in 1997, Group turnover from continuing operations would have been £29.2 million higher

and Group operating profit from continuing operations £0.7 million higher. The principal average exchange rates to £1 Sterling used by the Group in translating foreign currency earnings were, United States Dollar 1.65 (1997: 1.60), German Deutschmark 2.93 (1997: 2.48), South African Rand 7.78 (1997: 7.43).

The net exceptional items of £18.7 million in the year all relate to sales or closures of businesses.

The exceptional items relating to sales of businesses include a profit of £0.7 million arising from the disposal of the Delta Controls business in South Africa in December 1997 and a loss of £18.6 million relating to the sale of the Group's Process Division in September 1997. A loss of £0.8 million arose in the year relating to the costs of closing Material Handling Division's North American Wood business.

Earnings per share excluding exceptional items increased from a loss of 0.01 pence per share (as restated) to earnings of 5.93 pence per share.

The Group's effective tax rate excluding exceptional items and goodwill was 23.4%. This rate is lower than the standard UK rate of 31% due to the utilisation of brought forward tax losses and different tax rates in certain overseas territories.

The Board has recommended an increased final dividend of 1.11p to be paid as a Foreign Income Dividend (FID), giving total dividends for the year of 1.80p (1997: 1.50p). The benefit to the Group from the payment of FIDs is the full recovery of ACT.

Balance sheet

In addition to the impact of the introduction of FRS10 Goodwill and Intangible Assets, which is detailed in note 1 to the accounts, shareholders' funds decreased by £13.9 million during the year. This reduction reflected the retained loss for the year of £11.7 million, and foreign exchange losses of £2.2 million arising on retranslation of the Group's overseas equity investments. The principal year end exchange rates to £1 Sterling used by the Group in translating foreign currency net assets were, United States Dollar 1.68 (1997: 1.64), German Deutschmark 3.08 (1997: 2.74), South African Rand 8.37 (1997: 7.26).

No development costs have been capitalised during the year. Development costs already capitalised are being amortised over three years, with a current year charge to the profit and loss account of £1.1 million.

The Group's net cash balances at the year end were £21.1 million, a reduction of £8.2 million from the previous year but £15.8 million higher than the level at 30 September 1997.

Cash flow

The Group's cash inflow from operating activities in the year was £10.1 million (1997: £1.7 million). Net interest, tax and dividend payments amounted to a cash outflow in the year of £6.1 million (1997: £5.8 million). Capital expenditure less disposal proceeds amounted to £7.7 million (1997: £6.4 million) and the cash outflow relating to disposals was £2.4 million compared to a cash outflow on acquisitions and disposals in the previous year of £18.0 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 to the operating result for the Group for the year amounted to £5.8 million (1997: £6.5 million). The surpluses in respect of the Group's principal pension schemes are carried as prepayments in the balance sheet at £72.5 million (1997: £69.3 million) and are being charged with the regular pension costs of scheme members as a result of a suspension of the Group's contributions. The interest effect of these surpluses has been to reduce the gross pension charge for the year by £3.3 million (1997: £4.0 million).

Risk management and treasury

The Group does not hedge book profit translation exposures to exchange rate changes but its policy is to hedge foreign exchange transactions generally through the use of the forward market and to a lesser extent currency options. The Group does not use financial instruments in managing its balance sheet exposure to currency retranslation, but seeks as a general rule to match assets and liabilities in the same currency by a combination of direct borrowing and by hedging loans made to subsidiaries.

The Group operates clearly established treasury procedures that are subject to periodic review by internal audit. It does not undertake speculative transactions and its policies are subject to review by the Board.



Board of Directors

20



Company Secretary

above left to right: Executive Directors
Dr G. Schäfer, Dr T J Parker
(Chairman), Mr N R Young
and Mr M S Easton

left to right: Non-Executive Directors
Lord Hesketh (Deputy Chairman),
Mr I G S Hartigan,
Mr M J Turner and Mr A E Wheatley

Company Secretary
Mr J Allen

Dr T J Parker (Age 56)

Joined the Board as Deputy Chairman and Chief Executive on 4 October 1993. Appointed Chairman on 21 July 1994. Former Chairman and Chief Executive of Harland and Wolff Holdings PLC and, previously, Deputy Chief Executive of the British Shipbuilders Corporation and currently is a non-executive Director of GKN plc and BG plc. Dr Parker is a Fellow of the Royal Academy of Engineering and President of the Royal Institute of Naval Architects.

M S Easton (Age 47)

Joined the Company as Managing Director of the Babcock Facilities Management Division on 18 May 1997 and appointed to the Board on 31 July 1997. Former Managing Director and Chief Executive of Yarrow Shipbuilders Limited and previously Production Director at Cammell Laird Shipbuilders Limited.

I G S Hartigan (Age 64)*

Joined the Board on 1 October 1994. Retired in 1993 after 24 years' service with British Petroleum Company PLC where his positions included Managing Director of BP Shipping, President of BP North America and Regional Co-ordinator for Asia Pacific. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

The Rt Hon Lord Hesketh KBE (Age 47)*

Joined the Board on 6 October 1993. Appointed non-executive Deputy Chairman on 26 April 1996. A non-executive Director of British Aerospace PLC and executive 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.

Dr G Schäfer (Age 58)

Appointed Managing Director of the Babcock Materials Handling Division on 1 September 1996 and joined the Board on 31 July 1997. Has some 20 years' experience in the Materials Handling industry and was previously Chief Executive of Claas KGaA.

M J Turner (Age 49)*

Joined the Board on 5 June 1996. An executive Director of British Aerospace PLC where he has particular responsibilities for commercial aircraft and defence export business. He is Deputy President of the Society of British Aerospace Companies. Member of Babcock International Group PLC's Audit and Senior Appointments and Remuneration Committees.

A E Wheatley (Age 60)*

Joined the Board on 1 January 1993. Non-executive Director of Legal & General Group PLC and N M Rothschild & Sons Limited. Chairman of Foreign & Colonial Special Utilities Investment Trust PLC and Deputy Chairman of Ashtead Group PLC. Trustee of the Victoria & Albert Museum and non-executive Trustee Director of V & A Enterprises Limited. Chairman of Babcock International Group PLC's Audit Committee and a member of its Senior Appointments and Remuneration Committee.

N R Young (Age 44)

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

J Allen (Age 57)

Joined the Company as Group Company Secretary on 4 December 1989. A Chartered Secretary, he was formerly Deputy Group Secretary of Ladbroke Group PLC and, previously, Group Secretary of Stone International plc and of Electronic Rentals Group p.l.c.

Registered office and Company number

Badminton Court, Church Street
Amersham, Buckinghamshire HP7 0DD
Company number 2342138

Registrars

Following the sale on 12 March 1998 by The Royal Bank of Scotland plc ("RBS") of its registration business, the Company's Registrars are now Computershare Services PLC, a UK subsidiary of Computershare Limited, an Australian listed IT and registration services company, in which RBS has a 20% stake.

Shareholder enquiries relating to shareholding, dividend payments, change of address, loss of share certificate etc. should be addressed to Computershare Services PLC, PO Box No. 82, Caxton House, Redcliffe Way, Bristol. BS99 7NH.

Auditors

Arthur Andersen
1 Surrey Street
London WC2R 2PS

Stockbrokers

Merrill Lynch
PO Box 293
20 Farringdon Road
London EC1M 3NH

*Denotes a non-executive Director.

Directors' report

The Directors present their Report and the audited Financial Statements of the Group for the year ended 31 March 1998.

Result and dividends

The loss attributable to shareholders for the financial year was £8.7 million (1997: loss £25.6 million). An interim dividend of 0.690p per share was declared in the year (1997: 0.625p per share).

The Directors propose to recommend the payment on 12 August 1998 of a final dividend of 1.11p on each of the ordinary shares of 50p entitled thereto and in issue on 10 July 1998. If approved, the dividend will be paid as a Foreign Income Dividend. The retained loss for the financial year was £11.7 million (1997: loss £28.1 million).

Business review and Group structure

The Operating and Financial Reviews of the Group's activities and future developments are set out on pages 6 to 19. Other matters material to an appreciation of the Group's position are contained in the Chairman's Statement on pages 2 and 3. The principal subsidiaries and associates are set out on page 59.

Disposals

Details regarding the Group's disposals during the course of the year are set out in note 28 on page 57.

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 £21,695 (1997: £42,135) 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.

Risk associated with the year 2000 problem

Some computer and embedded systems have historically stored and referred to dates using the last two digits of the year only, potentially leading to incorrect treatment of dates or other processing faults before, during and after the year 2000. This issue has been widely recognised across the business community, and most, if not all, substantial companies have introduced programmes to ensure that the year 2000 problem is properly addressed before the year 2000.

Although not regarding itself as having any factors in its business which would make it particularly susceptible to risks from the year 2000, the Group is aware of the problems associated with year 2000 and is acting in accordance with best practice in this area.

The Group is reviewing and modifying its computer systems, mainly by upgrading or replacing package systems. Operations are exposed to the failure of third party suppliers and customers to deal with their year 2000 issues, and also to possible liability on equipment supplied. We are taking all reasonably practicable steps to mitigate these risks, both in relation to past projects and those which are currently being undertaken. The Group is discussing coverage under current and future insurance policies with its brokers.

Given the diversified nature of the Group, the Board has delegated detailed implementation to the Managing Directors of the Divisions and individual operating units, with suitable controls operating at a Group level. These controls consist of regular reporting on the state of compliance by the operating units, together with regular reviews to ensure that this compliance programme is adequately performed and documented at an operating company level.

The Group has in general made use of existing staff to review computer systems, so that no significant incremental costs have arisen in this review. Any changes required to provide year 2000 compliance are expected to be included as part of the normal upgrading of computer packages and equipment.

Directors

The names of the present Directors, together with brief biographical notes, are shown on page 21.

Dr T J Parker and Mr M J Turner retire by rotation under the provisions of Article 95 of the Company's Articles of Association and, being eligible, offer themselves for re-election.

Mr N R Young, Mr M S Easton and Dr G Schäfer, all of whom were appointed to the Board on 31 July 1997, retire under the provisions of Article 101 of the Company's Articles of Association and, being eligible, offer themselves for re-election.

Should Dr T J Parker fail to be re-elected at the forthcoming Annual General Meeting, the remaining period of his appointment as an executive Director would be 12 months. In the case of Mr M J Turner the remaining period of his appointment as a non-executive Director would be ten months. Should Mr N R Young, Mr M S Easton or Dr G Schäfer fail to be re-elected, the remaining period of their appointments as executive Directors would be 12 months in each case. Mr N R Salmon resigned his Directorship on 31 May 1997 at which date he left the Company's employment. Sir Frank Gibb and Mr E A S Porter retired at the 1997 Annual General Meeting.

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 in the Senior Appointments and Remuneration Committee's Report on pages 30 and 31.

Significant shareholdings

The Company has been notified of the following

interests in its ordinary shares which represent 3% or more of its issued ordinary share capital at 8 June 1998:

Name	No. of 50p ordinary shares	%
PDFM Limited	43,572,287	25.73
Fidelity International Limited	22,003,138	13.00
The Capital Group Companies, Inc.	15,880,200	9.38

Sharesave scheme

The Babcock International Group PLC Sharesave Scheme was launched in December 1997 and was fully subscribed. The Group's participating employees now have options under the Scheme over 6,727,766 shares at an option price of 62.3p.

Personnel

The Group comprises a number of companies which have developed voluntary practices and procedures for employee involvement and training appropriate to their own circumstances and needs. The Group encourages such an approach and believes that this promotes a better understanding of the issues facing the individual business in which the employee works. The performance of the Group is communicated to all staff; copies of the Annual Report and Financial Statements, together with preliminary and interim profit announcements, are made available to them.

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

Health & Safety

The Group recognises that the securing of the health, safety and welfare at work of their employees is a major responsibility of management. The Group requires that all necessary steps are taken by each Division in the Group to maintain standards and procedures which discharge the duties laid down in

all Statutes, Regulations and Orders concerned with Health & Safety applicable in the Group company's country of operation.

The Environment

The Group recognises a responsibility and obligation to care for the environment and minimise any unacceptable adverse impact of its operations through positive environmental control. The maintenance of a high standard of environmental performance forms an integral part of business policy that is transmitted to employees and Company contacts. These policies are pursued throughout the Group and, as a minimum, require compliance with existing environmental legislation and regulation in the relevant country.

Annual General Meeting

This year's Annual General Meeting will be held at the Barber-Surgeons' Hall, Monkwell Square, London, EC2 on Wednesday, 29 July 1998 at 12 noon. The notice of meeting is on pages 60 to 62.

Special business

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

Resolution 6(1), which will be proposed as a Special Resolution, authorises the Directors to allot for cash equity securities not exceeding in aggregate an amount equal to 5% of the current issued share capital of the Company as if the pre-emption rights contained in section 89 of the Companies Act 1985 did not apply to such allotment. The authority conferred by this resolution will, unless revoked or renewed, expire on 30 October 1999, or the conclusion of the next Annual General Meeting of the Company (whichever is earlier).

Resolution 6(2), 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 present issued share capital, would expire on 31 December 1999 or, if earlier, on the conclusion of the 1999 Annual General Meeting. We have not previously used these powers but it is

our intention to consider doing so in the current year in order to reduce the cost of capital in Babcock. The extent of any such purchases – which in any case will be well below the 10% mandate – will be driven principally by market conditions and the need to create shareholder value.

Resolution 6(3), which will be proposed as a Special Resolution, effects four minor amendments to the Articles of Association. As currently written, the Company's Articles of Association require Company reports and circulars, dividend payments and other shareholder communications to be sent to a shareholder's last known address, even when it is known that such shareholder has moved and cannot be traced. The proposed amendments will permit the Company's Registrars to cease sending documentation or paying dividends if two such communications or dividend payments are returned undelivered or unrepresented.

Your Directors believe that each of Resolutions 6(1) to 6(3), as set out on pages 60 to 62, to be proposed at the Annual General Meeting is in the best interests of the Company and unanimously recommend shareholders to vote in favour of each of these Resolutions, as they intend to do in respect of their own beneficial holdings totalling 71,757 ordinary 50p shares, representing 0.04% of the present issued share capital of the Company.

Auditors

Binder Hamlyn, having become part of the Andersen Worldwide organisation in 1994, resigned during the year in order that Arthur Andersen could be appointed. Special notice of the Resolution appointing the Auditors has been given to the Company in accordance with section 388 (1) of the Companies Act 1985.

Approval of report

This Report was approved by the Directors on 8 June 1998.

By order of the Board

J Allen Secretary
8 June 1998



Corporate governance

Statement of compliance

During the year the Company complied with all currently applicable requirements of the Code of Best Practice published in December 1992 by the Committee on the Financial Aspects of Corporate Governance ("the Committee"). Following the issue of the Greenbury Report in 1995 the Company has, to the extent practicable, complied with the recommendations of that Report. The Report of the Senior Appointments and Remuneration Committee is set out on pages 27 to 31.

The Company's corporate governance initiatives represent an endorsement of the principles of openness, integrity, and accountability upon which the Cadbury Code of Best Practice and the recommendations of the Greenbury Report were developed.

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.

Internal financial controls

The Board of Directors has overall responsibility for the Group's system of internal financial controls, and for monitoring its effectiveness. Whilst no system of internal financial control can provide absolute assurance, the system established is designed to give reasonable 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. In 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 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. Financial controls and procedures are detailed in the Group Policies and Authorities manuals. These controls include defined procedures for seeking and obtaining approval for both significant commitments and organisational changes.

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26 Monitoring

The Board has delegated to executive management the implementation of a system of monitoring internal controls which relies on self assessment questionnaires, quality assurance audits and the internal audit function, as well as regular review visits by Group management. The results of these reviews, together with those from the external Auditors, are reported to the Audit Committee and the Board.

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

Statement of Directors' responsibilities

Company law requires the Directors to prepare Financial Statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss of the Group for that period. In preparing those Financial Statements, the Directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

Report of the Senior Appointments and Remuneration Committee

27

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)
Mr I G S Hartigan
Mr A E Wheatley
Mr M J Turner

The biographical details of these directors are set out on page 21.

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

Dr T J Parker has a service contract with the Company which was entered into upon his appointment in 1993 for an initial three year term which expired on 31 December 1996 and now continues on a one year rolling contract basis. Mr Salmon, who had a similar arrangement, left the Company's employment on 31 May 1997. Mr M S Easton and Dr G Schäfer both have service agreements. Mr Easton's agreement is on a one year rolling basis and Dr Schäfer's agreement, which was for an initial three year term expiring 29 July 1999, will thereafter continue on a one year rolling basis. 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.

Following the expiry of Dr Schäfer's initial three year term on 29 July 1999, no executive Directors will have separate, predetermined compensation provisions exceeding one year's salary, pension benefits 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.

The Committee confirms that it complies with Section A of the best practice provisions annexed to the Listing Rules of the London Stock Exchange regarding remuneration committees.

In framing its policy, the Committee has given full consideration to Section B of the best practice provisions annexed to the Listing Rules of the London Stock Exchange and the wider recommendations of the Greenbury Report on Directors' Remuneration.

28 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, pensions and other long-term incentives. In determining the remuneration of the executive Directors, the Committee considered practices in the wider market and in a group of comparator companies.

The Directors' emoluments for the year ended 31 March 1998 are set out in the table below:

Directors	Salary or fee £'000	Bonus £'000	Benefits £'000	Other ^a £'000	Total 1998	Total 1997
Executive						
Dr T J Parker ^d (Chairman)	276	165	17	92	550	395
M S Easton ^e	90	14	7	3	114	–
Dr G Schäfer ^e	122	56	12	–	190	–
N R Young ^e (Group Finance Director)	107	61	9	–	177	–
Non-executive						
I G S Hartigan	20	–	–	–	20	20
The Rt Hon Lord Hesketh KBE	40	–	–	–	40	62
M J Turner	20	–	–	–	20	17
A E Wheatley	30	–	–	–	30	30
Former						
N R Salmon ^b	41	–	2	7	50	335
Sir Frank Gibb ^c	15	–	–	–	15	60
E A S Porter ^c	57	–	5	5	67	220
Total	818	296	52	107	1,273	1,139

^a Tax paid in respect of supplementary pension contributions over the "earnings cap".

^b Left the Company on 31 May 1997.

^c Retired from Board 30 July 1997.

^d Salary increase of 5.5% effective from 1 June 1997 to reflect assumption of joint role of Chairman and Chief Executive.

^e Appointed 31 July 1997.

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 £20,000 per annum. Lord Hesketh's basic fee is £40,000 per annum to reflect his additional responsibilities as Deputy Chairman and Mr Wheatley's basic fee is £30,000 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 are appointed for an initial term of three years. At the Board's discretion a further term may be offered (generally for four years). They are free to resign at any time.

Pensions benefits

Contributions to a pension scheme based on relevant annual remuneration up to the permitted maximum of £84,000 in 1997/98, the earnings cap, are exempted from income tax. The executive Directors of the Company are all affected by the earnings cap. In respect of their remuneration up to the earnings cap during the year under review, each of Dr T J Parker, Mr M S Easton and Mr N R Young is (and Mr N R Salmon was) a member of the upper tier of the Babcock International Group Pension Scheme ("the Scheme"). Mr E A S Porter had equivalent personal pension arrangements. The Scheme is a defined benefit scheme. In addition they were all members of the Babcock Supplementary Pension Scheme, a money purchase scheme, which provides benefits above the earnings cap. In the case of Dr T J Parker it will, in conjunction with his benefits from the upper tier of the Scheme and benefits from former employers' schemes, provide a target pension of 50% of his basic salary on retirement at age 60. There has been no change in the benefit provisions of the two schemes during the year 1997/98.

The following table indicates the increase in value of the retirement benefits of the three executive Directors provided by the Scheme. The increase in transfer value has been provided by the independent Actuary appointed by the Trustee of the Scheme. As noted in the Hampel Committee report, the transfer value represents a liability to the Company but not a sum paid or due to the individual.

Name	Pension at 31 March 1997 £	Revalued pension to 31 March 1998 £	Pension 31 March 1998 £	Pension accrued during year £	Transfer value £	Members' contributions £	Transfer value in excess of members' contributions £
Dr T J Parker	4,795	4,987	6,300	1,313	23,980	12,600	11,380
N R Young	-	-	1,867	1,867	22,485	5,333	17,152
M S Easton	-	-	1,866	1,866	24,970	4,518	20,452

Notes

- The pension at 31 March 1997 has been revalued to 31 March 1998 in the case of Dr Parker at the rate of 4%.
- The transfer value of the pension accrued during the year is calculated on the basis agreed with the Trustee of the Scheme and is the prescribed basis to be used for minimum funding requirement purposes.
- The figures in the above table make no allowance for the cost of death in service benefits under the Scheme.
- The figures in the above table make no allowance for any benefits in respect of earnings received in excess of the earnings cap which for 1997/98 was £84,000.
- In calculating the pension for Mr Young and Mr Easton, no account has been taken of retained benefits. If the members have significant such benefits, the pension shown may be restricted to a lower amount and the figures may need to be correspondingly reduced.

The following table sets out the amounts of the Company contributions made to the Babcock Supplementary Pension Scheme and personal pension arrangements on behalf of the Directors.

Directors	1998 £'000	1997 £'000
Executive		
Dr T J Parker	138	127
M S Easton	8	-
N R Young	8	-
Former		
N R Salmon	11	64
E A S Porter	18	53
Total	183	244

30 Share interests

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

Directors	Babcock 50p ordinary shares At 31 March 1998	Babcock 50p ordinary shares At 1 April 1997 or on appointment
Dr T J Parker	27,857	7,857
M Easton	—	—
I G S Hartigan	4,000	4,000
Lord Hesketh	9,900	9,900
Dr G Schäfer	—	—
M J Turner	20,000	20,000
A E Wheatley	10,000	10,000
N R Young	—	—

There were no changes in the Directors' interests in shares between 31 March 1998 and 8 June 1998.

The Company's Register of Directors' Interests contains full details of the Directors' shareholdings and options to subscribe for shares in Babcock International Group PLC. The Register is available for inspection by shareholders upon request.

Long-term incentives

i) Share options

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.

The aggregate value of the options granted within a ten year period to any Director must not exceed four times the value of basic emoluments. 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 the options that have been granted. Options were granted in full, based on his remuneration at that time, to Dr T J Parker as part of the compensation arrangements necessary to secure his services. No Directors exercised any options during the year of account. Options held by Mr M S Easton, Dr G Schäfer and Mr N R Young were granted in the year subsequent to their appointment as Directors. There have been no changes between 31 March 1998 and 8 June 1998. The position with regard to Directors' share options at the end of the year is disclosed in the table below.

Directors	Number of options	Exercise price (p)	Exercisable from	Expiry date
Dr T J Parker	1,012,971	114.510	Dec 1996	Dec 2003
M S Easton	165,680	84.500	Jun 2000	Jun 2007
	56,909	82.000	Dec 2000	Dec 2007
Dr G Schäfer	304,288	77.000	Sep 1999	Sep 2006
	340,017	82.000	Dec 2000	Dec 2007
N R Young	244,508	87.250	Aug 2000	Aug 2007

Note: The Company's mid-market share price on the Stock Exchange Daily Official List on 31 March 1998, the last trading day of the Company's year of account, was 73p. The Company's highest and lowest mid-market share prices in the year to 31 March 1998 were 101p and 62p respectively.

Long-term incentives continued

ii) Babcock International Group Sharesave Scheme

The scheme, which was introduced in December 1997, is linked to a save-as-you-earn contract which participants enter 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 is open to all UK employees (including executive Directors) of the Group. Options are normally exercisable during a period of six months following the expiry of the three year savings period.

The option price is calculated by reference to the average of the mid-market quotation of a share as shown by the Stock Exchange Daily Official List for the three business days immediately preceding 26 November 1997 ("the offer date") discounted by 20%. Details of options granted to executive Directors in 1997/1998 and outstanding, are set out below.

Directors	Number of options	Exercise price (p)	Grant date	Exercisable from
Dr T J Parker	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001
M S Easton	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001
N R Young	14,022	62.3	24 Dec 1997	1 Feb 2001 – 1 Aug 2001

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 schemes, the maximum potential bonus earnings of the executive Directors is limited by the Committee to 60% of their respective basic salaries.

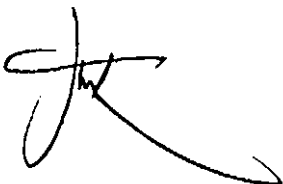
The Group performance element of their bonus is determined by the extent to which the trading performance of the Group achieves the targets and parameters set by the Committee at the beginning of each year. The Committee has absolute discretion to alter them to reflect changed circumstances, for example material changes in accounting standards or changes in the structure of the Group.

At the beginning of (and in the case of the three new executive Directors, during) the financial year under review the Committee also agreed a range of personal performance targets for three of the four executive Directors for 1997/98, based on the Group's overall priorities. Each Director was appraised by the Committee on progress under each target and bonuses were awarded accordingly.

Bonuses awarded are set out in the table on page 28 and do not form part of pensionable earnings.

1998/99 performance related bonuses

For the year 1998/99 the Committee have again 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.



The Rt Hon Lord Hesketh KBE Chairman of the Senior Appointments and Remuneration Committee
8 June 1998

Auditors' report

32 Auditors' report to the shareholders of Babcock International Group PLC

We have audited the Financial Statements on pages 33 to 59 which have been prepared under the historical cost convention and the accounting policies set out in note 1 on pages 38 to 40. 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 Senior Appointments and Remuneration Committee report on pages 27 to 31.

Respective responsibilities of Directors and Auditors

As described on page 26, the Company's Directors are responsible for the preparation of the Financial Statements. It is our responsibility to form an independent opinion, based on our audit, on those Statements and to report our opinion to you.

Basis of 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 the affairs of the Company and of the Group at 31 March 1998 and the Group's loss and cash flows for the year then

ended and have been properly prepared in accordance with the Companies Act 1985.

Corporate governance matters


In addition to our audit of the Financial Statements, we have reviewed the Directors' statements on pages 25 and 26 concerning the Company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and their adoption of the going concern basis in preparing the Financial Statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v).

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Company's system of internal financial control or its corporate governance procedures nor on the ability of the Company and Group to continue in operational existence.

Opinion

With respect to the Directors' statements on internal financial control and going concern on pages 25 and 26, in our opinion the Directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the Financial Statements.

Based on enquiry of certain Directors and officers of the Company, and examination of relevant documents, in our opinion the Directors' statement on pages 25 and 26 appropriately reflects the Company's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).



Arthur Andersen Chartered Accountants
and Registered Auditors

1 Surrey Street
London WC2R 2PS

8 June 1998

Group profit and loss account

For the year ended 31 March 1998

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	Notes	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000	1997 As restated £'000
Turnover including share of joint ventures		559,263	32,441	591,704	671,721
Less: share of joint ventures turnover		(23,447)	–	(23,447)	(25,696)
Group turnover	2	535,816	32,441	568,257	646,025
Cost of sales	3	(457,054)	(30,912)	(487,966)	(569,834)
Gross profit		78,762	1,529	80,291	76,191
Net operating expenses excluding goodwill amortisation	3	(62,936)	(7,159)	(70,095)	(75,078)
Group operating profit before goodwill amortisation		15,826	(5,630)	10,196	1,113
Goodwill amortisation	3	2,333	–	2,333	(277)
Group operating profit/(loss)	2	18,159	(5,630)	12,529	836
Share of operating profit of joint ventures and associates	2	1,488	–	1,488	1,072
Trading profit including share of joint ventures and associates	2	19,647	(5,630)	14,017	1,908
Profit/(loss) on the sale or termination of operations	4	660	(19,374)	(18,714)	(26,571)
Costs of a fundamental restructuring	4	–	–	–	(452)
Loss on the disposal of fixed assets	4	–	–	–	(511)
Liquidator's distribution in respect of a former Group business	4	–	–	–	1,972
Profit/(loss) on ordinary activities before interest		20,307	(25,004)	(4,697)	(23,654)
Net interest and similar charges	5			152	980
Loss on ordinary activities before taxation	6			(4,545)	(22,674)
Tax on loss on ordinary activities	8			(2,860)	(1,693)
Loss on ordinary activities after taxation				(7,405)	(24,367)
Minority interests	26			(1,271)	(1,209)
Loss for the financial year				(8,676)	(25,576)
Dividends paid and proposed	10			(3,048)	(2,539)
Retained loss for the financial year	25			(11,724)	(28,115)
Loss per share	11			(5.12p)	(15.11p)

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

Group balance sheet

As at 31 March 1998

	Notes	1998 £'000	1998 £'000	1997 As restated £'000	1997 As restated £'000
Fixed assets					
Intangible assets	12				
Development costs			422		1,574
Goodwill					
– Goodwill		19,520		22,131	
– Negative goodwill		(26,560)		(30,527)	
			(7,040)		(8,396)
			(6,618)		(6,822)
Tangible assets	13		51,478		55,894
Investments	15				
Investments in joint ventures					
– Goodwill		1,715		2,109	
– Share of gross assets		9,816		11,424	
– Share of gross liabilities		(6,359)		(8,359)	
			5,172		5,174
Investments in associates			526		733
Other investments			128		138
			5,826		6,045
			50,686		55,117
Current assets					
Stocks	16		24,820		28,132
Debtors – due within one year	17	138,556		158,681	
Debtors – due after more than one year	17	74,012		81,816	
			212,568		240,497
Cash and bank balances			50,707		52,833
			288,095		321,462
Creditors – amounts due within one year	18		(190,162)		(219,462)
Net current assets			97,933		102,000
Total assets less current liabilities			148,619		157,117
Creditors – amounts due after more than one year	19		(7,646)		(10,535)
Provisions for liabilities and charges	21		(26,162)		(17,641)
Net assets	2		114,811		128,941
Capital and reserves					
Called up share capital	24		84,656		84,656
Share premium account			67,111		67,111
Profit and loss account	25		(46,094)		(32,227)
Equity shareholders' funds			105,673		119,540
Minority interests	26		9,138		9,401
			114,811		128,941

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

Company balance sheet

As at 31 March 1998

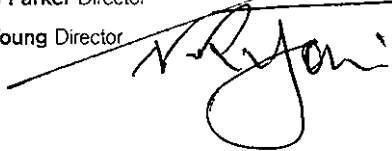
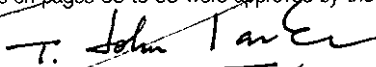
	Notes	1998 £'000	1997 £'000
Fixed assets			
Investment in subsidiaries	14	136,301	136,301
Current assets			
Debtors – due within one year	17	2,525	26,031
Debtors – due after more than one year	17	–	370
Cash and bank balances		63,468	34,611
		65,993	61,012
Creditors – amounts falling due within one year	18	(16,430)	(16,667)
Net current assets		49,563	44,345
Net assets		185,864	180,646
Capital and reserves			
Called up share capital	24	84,656	84,656
Share premium account		67,111	67,111
Profit and loss account	25	34,097	28,879
Equity shareholders' funds		185,864	180,646

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

The Financial Statements on pages 33 to 59 were approved by the Board on 8 June 1998 and signed on its behalf by:

Dr T J Parker Director

N R Young Director



Group cash flow statement

For the year ended 31 March 1998

	Notes	1998 £'000	1998 £'000	1997 £'000	1997 £'000
Cash flow from operating activities	27		10,058		1,683
Net interest and similar charges		(795)		659	
Dividends paid to minority shareholders	26	(1,160)		(713)	
Returns on investments and servicing of finance			(1,955)		(54)
UK corporation tax received/(paid) (including ACT)		379		(255)	
Overseas tax paid		(1,835)		(1,456)	
Taxation			(1,456)		(1,711)
Payments to acquire tangible fixed assets		(7,964)		(8,784)	
Payments to acquire intangible fixed assets		—		(261)	
Receipts from sale of tangible fixed assets		241		2,598	
Capital expenditure and financial investment			(7,723)		(6,447)
Payments to acquire subsidiaries	27	—		(19,470)	
Cash outflow on sale of subsidiaries	27	(2,424)		(86)	
Receipts from minorities	26	61		68	
Investment in associates		—		(500)	
Distribution received from liquidator of IBH		—		1,972	
Acquisitions and disposals			(2,363)		(18,016)
Equity dividends paid			(2,649)		(4,021)
Cash outflow before management of liquid resources and financing			(6,088)		(28,566)
Management of liquid resources			(3,439)		2,537
Repayment of borrowings		(2,076)		(1,401)	
Repayments of capital element of finance lease rentals		(1,769)		(617)	
Financing			(3,845)		(2,018)
Decrease in cash in the period	27		(13,372)		(28,047)

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

Statement of total recognised gains and losses

For the year ended 31 March 1998

	1998 £'000	1997 £'000 As restated
Loss for the financial year	(8,676)	(25,576)
Currency translation differences on foreign currency net investments and related loans	(2,143)	(5,932)
Total recognised gains and losses relating to the year	(10,819)	(31,508)
Prior year adjustment (note 1)	(7,434)	—
Total gains and losses recognised since the last annual accounts	(18,253)	(31,508)

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Reconciliation of movements in shareholders' funds

For the year ended 31 March 1998

	1998 £'000	1997 As restated £'000
Shareholders' funds at start of year, as previously reported	125,827	133,528
Prior year adjustment (note 1)	(6,287)	20,059
Shareholders' funds at start of year, as restated	119,540	153,587
Total recognised gains and losses relating to the year	(10,819)	(31,508)
Dividends	(3,048)	(2,539)
Net movement in shareholders' funds	(13,867)	(34,047)
Shareholders' funds at end of year	105,673	119,540

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

Notes to the financial statements

1) Basis of accounting

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

Change in accounting policy and prior year adjustment

During the year the UK Accounting Standards Board issued two new Financial Reporting Standards ("FRS"); FRS9 Associates and Joint Ventures and FRS10 Goodwill and Intangible Assets. The Group has implemented both of these new standards in the current year.

Where necessary the comparative figures have been restated.

a) FRS9 introduces new definitions of associates and joint ventures and revises the disclosures required for each. The implementation of FRS9 has had no effect on the previously reported profit after taxation or the financial position of the Group.

b) FRS10 requires purchased goodwill and intangible assets to be capitalised and amortised through the profit and loss account over their useful economic lives. All goodwill including negative goodwill and goodwill applicable to joint ventures that was previously written off directly to other reserves has been reinstated in the balance sheet by way of a prior year adjustment. Where goodwill or negative goodwill relates to subsidiaries, it has been included within intangible assets. Goodwill relating to joint ventures is included in investments. Cumulative amortisation and impairment of goodwill as at 31 March 1996 has been written off against brought forward reserves at that date.

The original cost of goodwill and negative goodwill reinstated at 31 March 1997 is £35.6 million (1996: £31.6 million) and £34.4 million (1996: £4.8 million) respectively. £4.8 million (1996: £4.8 million) of the goodwill related to joint ventures.

Goodwill and negative goodwill amortised in periods ended on or before 31 March 1996 was £6.5 million and £2.5 million respectively. £2.3 million of the goodwill amortised related to joint ventures.

The amount of goodwill whose value had been impaired and written off prior to 31 March 1996 was £2.7 million.

In the year ended 31 March 1998, the net amount of goodwill amortised was £1.9 million (1997: charge £0.7 million). This includes the amortisation of goodwill relating to joint ventures of £0.4 million (1997: £0.4 million) and a credit for negative goodwill of £4.0 million (1997: £1.4 million).

Basis of consolidation

The Group Financial Statements include the Financial Statements of the Company and all of its subsidiaries 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 associates' results and net assets based on the latest available Financial Statements. Associates 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%
Short 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 lease 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.

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 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 and amortised over the shorter of the project life and three years.

All other research and development expenditure 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.

40 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 subsidiaries 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 subsidiaries 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.

2) Segmental information

The previous years' segmental analyses have been restated to reflect the current composition of the Group. The water engineering and pipeline engineering businesses that were formerly part of the Process Division have been included within the Facilities Management and Materials Handling Divisions respectively. The Group's share of joint ventures turnover relates to the Facilities Management Division.

	Group Turnover 1998 £'000	Group Operating profit 1998 £'000	Share of operating profit of joint ventures and associates 1998 £'000	Trading profit including share of joint ventures and associates 1998 £'000	Group Turnover 1997 As restated £'000	Group Operating profit 1997 As restated £'000	Share of operating profit of joint ventures and associates 1997 As restated £'000	Trading profit including share of joint ventures and associates 1997 As restated £'000
Continuing operations								
Facilities Management	311,819	10,640	1,882	12,522	326,089	13,573	1,442	15,015
Materials Handling	181,026	6,486	—	6,486	188,755	5,904	—	5,904
South Africa	42,971	633	—	633	70,900	(4,037)	—	(4,037)
Unallocated costs and other income	—	(1,933)	—	(1,933)	—	(1,618)	—	(1,618)
	535,816	15,826	1,882	17,708	585,744	13,822	1,442	15,264
Goodwill amortisation	—	2,333	(394)	1,939	—	(277)	(394)	(671)
Total continuing operations	535,816	18,159	1,488	19,647	585,744	13,545	1,048	14,593
Discontinued operations	32,441	(5,630)	—	(5,630)	60,281	(12,709)	24	(12,685)
	568,257	12,529	1,488	14,017	646,025	836	1,072	1,908

2) Segmental information continued

Group turnover – by geographic area of origin	1998	1998	1998 Total £'000	1997	1997	1997 Total As restated £'000
	Continuing operations £'000	Discontinued operations £'000		Continuing operations As restated £'000	Discontinued operations As restated £'000	
United Kingdom	306,508	18,192	324,700	311,944	29,317	341,261
Rest of Europe	125,152	520	125,672	159,907	1,817	161,724
Africa	42,971	–	42,971	70,900	–	70,900
North America	45,922	11,002	56,924	23,602	17,384	40,986
Middle East	–	2,727	2,727	–	11,763	11,763
Rest of the World	15,263	–	15,263	19,391	–	19,391
	535,816	32,441	568,257	585,744	60,281	646,025

Group turnover – by geographic area of destination	1998	1998	1998 Total £'000	1997	1997	1997 Total As restated £'000
	Continuing operations £'000	Discontinued operations £'000		Continuing operations As restated £'000	Discontinued operations As restated £'000	
United Kingdom	303,982	14,422	318,404	308,210	18,050	326,260
Rest of Europe	58,638	79	58,717	69,647	468	70,115
Africa	46,525	903	47,428	79,428	1,553	80,981
North America	31,353	9,244	40,597	27,079	17,384	44,463
Middle East	2,816	4,500	7,316	4,315	19,973	24,288
Rest of the World	92,502	3,293	95,795	97,065	2,853	99,918
	535,816	32,441	568,257	585,744	60,281	646,025

Group operating profit – by geographic area	1998	1998	1998 Total £'000	1997	1997	1997 Total As restated £'000
	Continuing operations £'000	Discontinued operations £'000		Continuing operations As restated £'000	Discontinued operations As restated £'000	
United Kingdom	9,117	(4,139)	4,978	11,337	(5,568)	5,769
Rest of Europe	3,464	45	3,509	5,284	265	5,549
Africa	633	–	633	(4,037)	–	(4,037)
North America	2,990	(1,590)	1,400	1,161	(7,809)	(6,648)
Middle East	–	54	54	–	403	403
Rest of the World	(378)	–	(378)	77	–	77
	15,826	(5,630)	10,196	13,822	(12,709)	1,113
Goodwill amortisation	2,333	–	2,333	(277)	–	(277)
	18,159	(5,630)	12,529	13,545	(12,709)	836

2) Segmental information continued

	1998 £'000	1997 As restated £'000
Operating net assets – by activity		
Facilities Management	72,207	74,064
Materials Handling	(4,733)	(3,513)
South Africa	9,238	11,531
Unallocated	31,986	33,977
Operating net assets	108,698	116,059

Operating net assets – by geographic area

United Kingdom	120,356	112,606
Europe	(14,587)	(70)
North America	(4,594)	(8,028)
Africa	9,238	13,555
Rest of the World	(1,715)	(2,004)
Operating net assets	108,698	116,059
Net cash	21,051	29,256
Finance lease obligations	(1,200)	(2,413)
Taxation	(6,533)	(6,193)
Dividends	(1,880)	(1,481)
Net goodwill	(5,325)	(6,287)
Net assets	114,811	128,941

Facilities Management and the United Kingdom include £4.0 million (1997: £3.6 million) of operating net assets in respect of joint ventures and associates.

3) Cost of sales and net operating expenses

	1998 Continuing operations £'000	1998 Discontinued operations £'000	1998 Total £'000	1997 Continuing operations As restated £'000	1997 Discontinued operations As restated £'000	1997 Total As restated £'000
Group turnover	535,816	32,441	568,257	585,744	60,281	646,025
Cost of sales	457,054	30,912	487,966	511,596	58,238	569,834
Net operating expenses						
Distribution costs	10,480	–	10,480	13,181	–	13,181
Administration costs						
– Goodwill amortisation	(2,333)	–	(2,333)	277	–	277
– Other administration costs	52,456	7,159	59,615	47,145	14,752	61,897
	50,123	7,159	57,282	47,422	14,752	62,174
	60,603	7,159	67,762	60,603	14,752	75,355

4) Exceptional items

	1998 £'000	1997 £'000
(Loss)/profit on the sale or termination of operations		
- Sale of Process Division	(18,620)	-
- Sale of Delta Controls	660	-
- Termination of North American Wood Technology operations	(754)	-
- Sale of Energy Division	-	765
- Termination of Babcock Environmental (Caldwell)	-	(27,336)
	(18,714)	(26,571)
Costs of a fundamental restructuring		
- Restructuring of Materials Handling Division	-	(452)
Profit/(loss) on the disposal of fixed assets		
- Profit on disposal of Materials Handling Division fixed assets	-	794
- Loss on disposal of associates	-	(1,305)
	-	(511)
Liquidator's distribution in respect of former Group business	-	1,972
	(18,714)	(25,562)

The tax charge in respect of exceptional items amounts to £nil (1997: £nil).

5) Net interest and similar charges

	1998 £'000	1997 £'000
Interest payable and similar charges		
- Bank loans and overdrafts	(2,937)	(2,355)
- Finance lease interest	(65)	(236)
- Other interest	-	(122)
	(3,002)	(2,713)
Interest receivable	3,102	3,664
	100	951
Share of joint ventures	44	29
Share of associates	8	-
	152	980

6) Loss on ordinary activities before taxation

Loss on ordinary activities before taxation is stated after charging/(crediting):

	1998 £'000	1997 £'000
Depreciation on tangible fixed assets		
– Owned	9,387	6,996
– Leased assets	214	575
Profit on the disposal of tangible fixed assets	(57)	(229)
Operating lease rentals		
– Plant and machinery	1,673	2,576
– Land and buildings	4,973	5,607
– Short-term plant hire	1,248	968
Auditors' remuneration	378	526
Research and development		
– Expenditure	1,705	1,108
– Amortisation charge (note 12)	1,074	1,172

In addition to the amounts disclosed above, the Group auditors and their associates were paid £219,000 (1997: £316,000) in relation to non-audit services in the UK.

7) Employee costs

Particulars of employees, including executive Directors, are as follows:

	1998 £'000	1997 £'000
Employee costs		
– Wages and salaries	165,891	178,087
– Social security costs	16,295	17,519
– Other pension costs (note 23)	5,796	6,543
	<hr/> 187,982	<hr/> 202,149

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

	1998 Number	1997 Number
Production and distribution	6,495	7,593
Administration and management	1,225	1,436
	<hr/> 7,720	<hr/> 9,029

The number of people employed by the Group at 31 March 1998 was 7,620 (1997: 8,858).

Information in respect of Directors' remuneration and share interests is contained within the Report of the Senior Appointments and Remuneration Committee on pages 27 to 31.

8) Tax on loss on ordinary activities

	1998 £'000	1997 £'000
United Kingdom corporation tax charge at 31% (1997: 33%)	1,231	1,655
Double taxation relief	(1,088)	(1,193)
	143	462
Consortium relief	(564)	(475)
Advance corporation tax written off	263	359
Deferred taxation (note 21)	923	(1,194)
Overseas taxation	1,530	2,113
Share of joint ventures	548	422
Share of associates	17	6
	2,860	1,693

No tax relief is attributable to the exceptional charges of £18.7 million.

Excluding the exceptional charges of £18.7 million and the net goodwill credit of £1.9 million, the effective rate of 23.4% is lower than the standard UK rate of 31% due to the utilisation of brought forward tax losses and different tax rates in certain overseas territories. The deferred tax charge also benefits from the reduction in the rate of UK corporation tax.

Advance corporation tax written off is due to a reduction in the amount paid in previous years that is available for set off against the deferred tax balance.

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 loss for the financial year is a profit of £8,266,000 (1997: £2,495,000) dealt with in the Financial Statements of the Company.

10) Dividends

	1998 £'000	1997 £'000
Ordinary shares		
– Interim dividend paid of 0.69p per share (1997: 0.625p)	1,168	1,058
– Final dividend proposed of 1.11p per share (1997: 0.875p)	1,880	1,481
	3,048	2,539

11) Loss per share

Loss per ordinary share has been calculated by dividing the loss for the financial year by 169,312,544 (1997: 169,312,544) ordinary shares being the weighted average number of shares in issue during the year.

12) Fixed assets – intangible assets

	Goodwill £'000	Negative goodwill £'000	Development costs £'000	Total £'000
Cost				
At 1 April 1997, as previously reported	–	–	3,593	3,593
Prior year adjustment (note 1)	28,041	(34,406)	–	(6,365)
At 1 April 1997, as restated	28,041	(34,406)	3,593	(2,772)
Exchange adjustment	–	–	(338)	(338)
On disposal of subsidiaries	(977)	–	–	(977)
At 31 March 1998	27,064	(34,406)	3,255	(4,087)
Accumulated amortisation				
At 1 April 1997, as previously reported	–	–	(2,019)	(2,019)
Prior year adjustment (note 1)	(5,910)	3,879	–	(2,031)
At 1 April 1997, as restated	(5,910)	3,879	(2,019)	(4,050)
Exchange adjustment	–	–	260	260
Charge for the year	(1,634)	3,967	(1,074)	1,259
At 31 March 1998	(7,544)	7,846	(2,833)	(2,531)
Net book value at 31 March 1998	19,520	(26,560)	422	(6,618)
Net book value at 31 March 1997	22,131	(30,527)	1,574	(6,822)

13) Fixed assets – tangible assets

Group	Freehold property £'000	Short-term leasehold property £'000	Plant and machinery £'000	Total £'000
Cost				
At 1 April 1997	34,752	1,759	85,205	121,716
Exchange adjustments	(1,515)	(65)	(2,739)	(4,319)
Reclassification	1,439	(1,439)	–	–
On disposal of subsidiaries	–	(16)	(7,238)	(7,254)
Additions	1,006	73	8,099	9,178
Disposals	–	–	(1,320)	(1,320)
Assets written off	(3,357)	–	(23,918)	(27,275)
At 31 March 1998	32,325	312	58,089	90,726
Accumulated depreciation				
At 1 April 1997	(8,538)	(355)	(56,929)	(65,822)
Exchange adjustments	484	13	1,933	2,430
Reclassification	(266)	266	–	–
On disposal of subsidiaries	–	1	5,333	5,334
Charge for the year	(2,856)	(22)	(6,723)	(9,601)
Disposals	–	–	1,136	1,136
Assets written off	3,357	–	23,918	27,275
At 31 March 1998	(7,819)	(97)	(31,332)	(39,248)
Net book value at 31 March 1998	24,506	215	26,757	51,478
Net book value at 31 March 1997	26,214	1,404	28,276	55,894

The net book value of plant and machinery includes £0.6 million (1997: £0.8 million) in respect of assets held under finance lease or hire purchase contracts, comprising cost of £0.8 million less depreciation of £0.2 million.

The net book value of freehold property includes land amounting to £4.8 million (1997: £6.2 million) which has not been depreciated.

14) Fixed assets – investment in subsidiaries

	Shares £'000	Loans £'000	Total £'000
Cost			
At 1 April 1997 and 31 March 1998	91,851	44,450	136,301

Information on the principal subsidiaries is given on page 59.

15) Fixed assets – investments

	Joint ventures excluding goodwill	Goodwill	Joint ventures including goodwill	Associates	Other investments	Total
At 1 April 1997, as previously reported	–	–	–	3,798	138	3,936
Prior year adjustment (note 1)	–	2,109	2,109	–	–	2,109
Reclassification on adoption of FRS9 (note 1)	3,065	–	3,065	(3,065)	–	–
At 1 April 1997, as restated	3,065	2,109	5,174	733	138	6,045
Exchange adjustment	–	–	–	(45)	(10)	(55)
Goodwill amortisation	–	(394)	(394)	–	–	(394)
Transfer to current assets	–	–	–	(139)	–	(139)
Share of retained profits	392	–	392	(23)	–	369
	3,457	1,715	5,172	526	128	5,826

(a) Joint ventures

Following the adoption of FRS9 and FRS10 the Group's 50% shareholding in Babcock Water Engineering Ltd has been reclassified as a joint venture and the goodwill related to the business has been reinstated in full less accumulated amortisation. The prior year adjustment to reinstate goodwill relating to joint ventures comprises the original goodwill arising of £4.8 million less accumulated amortisation of £2.7 million.

The Group's 50% share, excluding goodwill, of the results and net assets of Babcock Water Engineering Ltd is as follows:

	1998 £'000	1997 £'000
Turnover	23,447	25,696
Profit before tax	1,940	1,483
Taxation	(548)	(422)
Profit after taxation	1,392	1,061
Fixed assets	1,180	890
Current assets	8,636	10,534
Gross assets	9,816	11,424
Creditors due within one year	(6,233)	(8,216)
Provisions for liabilities and charges	(126)	(143)
Gross liabilities	(6,359)	(8,359)
Net assets	3,457	3,065

(b) Associates

Information on associates is given on page 59.

16) Stocks

	1998 £'000	1998 £'000	1997 £'000	1997 £'000
Long-term contract balances	403		502	
Less: Attributable payments on account	(211)		-	
		192		502
Other stocks and work in progress				
- Raw materials and consumables	10,457		10,257	
- Work in progress	15,380		20,848	
- Finished goods and goods for resale	6,504		6,440	
	32,341		37,545	
Less: Progress payments	(6,124)		(7,860)	
Provisions	(1,589)		(2,055)	
		24,628		27,630
		24,820		28,132

17) Debtors

	Group 1998 £'000	Group 1997 £'000	Company 1998 £'000	Company 1997 £'000
Due within one year:				
Trade debtors	71,083	84,387	-	-
Amounts recoverable on contracts	33,854	53,311	-	-
Amounts owed by subsidiaries	-	-	2,085	24,630
Amounts owed by joint ventures	746	677	-	-
Prepayments and accrued income	9,875	9,806	-	-
Pension scheme prepayments	4,860	1,161	-	-
Other debtors	18,138	9,339	440	1,401
	138,556	158,681	2,525	26,031
Due after more than one year:				
Trade debtors	-	1,567	-	-
Pension scheme prepayments	67,656	68,163	-	-
Other debtors	6,356	12,086	-	370
	74,012	81,816	-	370

Other debtors, due within one year, at 31 March 1998 includes £7.2 million (1997: £nil) of deferred consideration relating to the Group's former Energy Division disposal. Other debtors, due after more than one year, includes £4.1 million (1997: £10.5 million) relating to the same item.

50 18) Creditors – amounts due within one year

	Group 1998 £'000	Group 1997 £'000	Company 1998 £'000	Company 1997 £'000
Bank overdraft (note 20)	22,172	13,175	–	–
Bank loans (note 20)	5,232	8,355	–	–
Other loans (note 20)	2,077	1,580	–	–
Obligations under finance leases (note 20)	304	1,993	–	–
Advance payments	7,498	6,441	–	–
Payments received in advance of turnover	26,652	31,649	–	–
Trade creditors	41,568	60,528	–	–
Contract accruals and provisions	42,649	46,996	–	–
Bills of exchange payable	1,248	577	–	–
Amounts owed to subsidiaries	–	–	14,069	14,070
Amounts owed to joint ventures	1,983	4,143	–	–
Amounts owed to associates	–	108	–	–
Other creditors	12,443	13,043	481	482
Corporation and overseas taxes	2,567	2,264	–	634
Other taxes and social security	5,729	8,169	–	–
Accruals and deferred income	16,160	18,960	–	–
Proposed dividend	1,880	1,481	1,880	1,481
	190,162	219,462	16,430	16,667

Other creditors includes US\$3.25 million of deferred consideration for Eagleton Engineering Company.

19) Creditors – amounts due after more than one year

	Group 1998 £'000	Group 1997 £'000
Bank loans (note 20)	37	150
Other loans (note 20)	138	317
Obligations under finance leases (note 20)	896	420
Advance payments	–	332
Payments in advance of turnover	–	288
Trade creditors	38	38
Other creditors	6,463	8,819
Corporation and overseas taxes	74	171
	7,646	10,535

Other creditors includes £6.0 million of deferred consideration payable for Rosyth Dockyard and US\$0.75 million of deferred consideration payable for Eagleton Engineering Company. Except for the Rosyth Dockyard deferred consideration, which it is anticipated will be payable after more than five years, all of the above obligations fall due for repayment within five years.

20) Borrowings**Repayment details**

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

	1998 Bank loans and overdrafts £'000	1998 Other loans £'000	1998 Finance lease obligations £'000	1997 Bank loans and overdrafts £'000	1997 Other loans £'000	1997 Finance lease obligations £'000
Within one year	27,404	2,077	304	21,530	1,580	1,993
Between one and two years	37	19	287	89	10	306
Between two and five years	–	119	609	61	307	114
	27,441	2,215	1,200	21,680	1,897	2,413

Security arrangements

	Group 1998 £'000	Group 1997 £'000
Loans and overdrafts		
Secured against specific trade debtors of subsidiaries	112	1,624
Unsecured borrowings	29,544	21,953
	29,656	23,577

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

21) Provisions for liabilities and charges

	Pensions and similar obligations £'000	Deferred taxation £'000	Other £'000	Total £'000
At 1 April 1997	4,614	6,103	6,924	17,641
Exchange adjustments	(505)	(133)	(86)	(724)
Provided in the year	273	923	16,902	18,098
Utilised in the year	(37)	–	(7,606)	(7,643)
Reclassified to creditors	38	(1,270)	(241)	(1,473)
Advance corporation tax set-off	–	263	–	263
At 31 March 1998	4,383	5,886	15,893	26,162

Other provisions at 31 March 1998 include £7.1 million of insurance provisions within the Group's captive insurance company (1997: £5.9 million) and £7.6 million (1997: £nil) of provisions for onerous contracts.

22) Deferred taxation

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

	1998 Provided £'000	1997 Provided £'000	1998 Full potential £'000	1997 Full potential £'000
Accelerated capital allowances	(322)	(724)	(441)	(724)
Reversal of pension surpluses	12,532	12,386	22,545	22,926
Other timing differences	(585)	362	(372)	362
Tax losses	(81)	-	(23,514)	(24,200)
	11,544	12,024	(1,782)	(1,636)
Recoverable advance corporation tax	(5,658)	(5,921)	(14,375)	(15,400)
	5,886	6,103	(16,157)	(17,036)

There is no unprovided deferred tax liability in the Company.

23) 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:

	1998 £'000	1997 £'000
UK schemes	7,841	8,573
Overseas schemes	1,243	1,928
	9,084	10,501
Interest on pension scheme surpluses	(3,288)	(3,958)
	5,796	6,543

23) Pension funding continued

The Group's principal defined benefit schemes are in the UK. On 1 December 1997 the Group's South African pension scheme was converted from a defined benefit to a defined contribution scheme. 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:

	UK Schemes Railcare	UK Schemes Rosyth Dockyard	UK Schemes Babcock Group
Date of last formal actuarial valuation	1.4.96	31.12.95	1.4.95
Number of active members at 31 March 1998	949	3,134	230
Method of funding	Attained age	Projected unit	Projected unit
Results of last formal actuarial valuation:			
- Market value of assets	£62.0 million	£252.0 million	£338.0 million
- Level of funding	116.00%	120.00%	114.00%
Principal valuation assumptions:			
- Excess of investment returns over earnings increases	2.00%	1.50%	2.00%
- Excess of investment returns over pension increases	4.00%	3.00% to 6.00%	6.00%
- Annual rate of dividend growth	4.00%	4.50%	4.00%

Surpluses in respect of the Group's principal pension schemes are carried as prepayments in the balance sheet at £72.5 million (1997: £69.3 million) and are being charged with the regular pension cost of scheme members as a result of a suspension of the Group's contributions.

54 24) Share capital

	1998 £'000	1997 £'000
Authorised		
229,000,000 (1997: 229,000,000) ordinary shares of 50p each	114,500	114,500
Allotted, issued and fully paid		
169,312,544 (1997: 169,312,544) ordinary shares of 50p each	84,656	84,656

Executive share option schemes

The Company operates two executive share option schemes for senior executives and employees. Options to acquire ordinary shares granted to executives and senior employees within the Group and outstanding at 31 March 1998 were as follows:

Number of shares	Option price (p)	Option period
231,583	280.655	04.09.1992 to 03.09.1999
11,134	233.505	13.12.1992 to 12.12.1999
50,100	226.770	29.06.1993 to 28.06.2000
126,925	244.730	11.07.1994 to 10.07.2001
116,344	271.675	09.07.1995 to 08.07.2002
199,275	145.940	24.06.1996 to 23.06.2003
1,012,971	114.510	15.12.1996 to 14.12.2003
1,171,000	132.500	16.12.1997 to 15.12.2004
290,000	151.000	03.01.1999 to 02.01.2006
304,288	77.000	19.09.1999 to 18.09.2006
570,110	74.500	19.12.1999 to 18.12.2006
91,409	68.500	07.02.2000 to 06.02.2007
160,000	62.500	31.03.2000 to 30.03.2007
219,328	84.500	19.06.2000 to 18.06.2007
104,536	84.500	11.07.2000 to 10.07.2007
244,508	87.500	11.08.2000 to 10.08.2007
396,926	82.000	24.12.2000 to 23.12.2007

Babcock International Group PLC Sharesave Scheme

During the year 6,727,766 shares, under option, were granted to 1,887 employees at an option price of 62.3p for a subscription cost of £4,191,398.

These options are exercisable between 1 February 2001 and 1 August 2001.

Options granted to Directors are summarised in the Report of the Senior Appointments and Remuneration Committee on pages 30 and 31 and are exercisable within the option periods set out above.

25) Reserves

	Profit and loss account £'000	Other reserves – goodwill £'000	Group Total £'000	Company Total £'000
At 1 April 1997	(24,793)	(1,147)	(25,940)	28,879
Prior year adjustment	(7,434)	1,147	(6,287)	–
At 1 April 1997, as restated	(32,227)	–	(32,227)	28,879
Exchange translation differences	(2,143)	–	(2,143)	–
Retained result for the year	(11,724)	–	(11,724)	5,218
At 31 March 1998	(46,094)	–	(46,094)	34,097

Exchange losses of £0.1 million arising on the translation of foreign currency borrowings have been offset in reserves against exchange differences arising on the translation of foreign equity investments.

26) Minority interests

	£'000
At 1 April 1997	9,401
Exchange translation difference	(12)
On disposal of subsidiaries	(423)
Shares issued to minority shareholders	61
Share of profits	1,271
Dividend payable to minority shareholders	(1,160)
At 31 March 1998	9,138

The balance at 31 March 1998 includes non-equity minority interests of £nil (1997: £308,000).

27) Group cash flow statement

(a) Reconciliation of Group operating profit/(loss) to net cash flow from operating activities:

	1998 £'000	1997 As restated £'000
Group operating profit/(loss)	12,529	836
Depreciation and amortisation charges	8,342	9,020
Decrease/(increase) in stocks	311	(3,627)
Decrease in debtors	199	1,253
Decrease in creditors	(12,446)	(1,986)
(Increase)/decrease in provisions	1,180	(3,584)
Other items	(57)	(229)
Net cash flow from operating activities	10,058	1,683

6 27) Group cash flow statement continued

(b) Reconciliation of net cash flow to movement in net debt:

	1998 £'000	1997 £'000
Decrease in cash in the period	(13,372)	(28,047)
Cash inflow from increase in debt and lease financing	3,845	2,018
Cash (outflow)/inflow from decrease in liquid resources	3,439	(2,537)
Change in net funds resulting from cash flows	(6,088)	(28,566)
Loans reclassified	122	20
Loans and finance leases disposed of with subsidiary	753	-
New finance leases	(1,185)	(807)
Translation differences	(594)	534
Movement in net funds in period	(6,992)	(28,819)
Net funds at 1 April	26,843	55,662
Net funds at 31 March	19,851	26,843

(c) Analysis of changes in financing during the year:

	At 1 April 1997 £'000	Cash flow £'000	New finance leases £'000	Reclassified £'000	Subsidiary disposed £'000	Exchange movement £'000	At 31 March 1998 £'000
Cash in hand and at bank	48,770	(3,180)	-	-	-	(2,385)	43,205
Overdrafts	(13,175)	(10,192)	-	-	-	1,195	(22,172)
	35,595	(13,372)	-	-	-	(1,190)	21,033
Debt	(10,402)	2,076	-	122	247	473	(7,484)
Finance leases	(2,413)	1,769	(1,185)	-	506	123	(1,200)
	(12,815)	3,845	(1,185)	122	753	596	(8,684)
Liquid resources	4,063	3,439	-	-	-	-	7,502
Total	26,843	(6,088)	(1,185)	122	753	(594)	19,851

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

	1998 Disposals £'000	1997 Acquisitions £'000	1997 Disposals £'000
Net cash consideration	213	(20,472)	186
Cash acquired/(disposed of)	1,786	1,002	(272)
Cash payments relating to onerous contracts	(4,423)	-	-
Net cash flow	(2,424)	(19,470)	(86)

28) Disposals

	Delta Controls £'000	Process Division £'000	Total £'000
Sale proceeds	965	-	965
Costs of disposal	(52)	(700)	(752)
Net cash consideration	913	(700)	213
Net assets disposed of:			
Goodwill	-	977	977
Fixed assets	107	1,813	1,920
Stock	1,367	-	1,367
Debtors	1,253	19,480	20,733
Cash	1	2,699	2,700
Creditors	(2,475)	(19,049)	(21,524)
Provisions for onerous contracts	-	12,000	12,000
Profit/(loss) on sale	660	(18,620)	(17,960)

Notes:

(a) On 15 September 1997 the Group sold its Process Division, excluding those companies in the water engineering and pipeline engineering businesses, to AMEC plc for a nominal consideration.

(b) On 1 December 1997 the African operation sold its Delta Controls business to Yokogawa for £1.0 million.

29) Financial commitments**Capital commitments****Group**

Authorised future capital expenditure of the Group was as follows:

	1998 £'000	1997 £'000
Contracted for but not provided for in the Financial Statements	1,139	470

Company

The Company had no capital expenditure contracted for at 31 March 1998 (1997: £nil).

58 29) Financial commitments continued

Operating lease commitments

Group

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

	1998 Land and buildings £'000	1998 Plant machinery and vehicles £'000	1997 Land and buildings £'000	1997 Plant machinery and vehicles £'000
Lease expiring:				
Within one year	172	768	559	554
Within two to five years	1,901	653	1,219	1,141
Thereafter	2,836	502	3,922	657
	4,909	1,923	5,700	2,352

Company

The Company has an operating lease commitment for land and buildings as at 31 March 1998 with an annual commitment expiring after more than five years of £1.5 million (1997: £1.5 million).

30) Contingent liabilities

a) The Company has guaranteed or has joint and several liability for bank facilities of £78.7 million (1997: £93.5 million) for certain Group companies. Of the £78.7 million counter-indemnified by the Company, £18.0 million relates to a guarantee given in respect of Mitsui Babcock Energy Ltd. The Company has a counter-indemnity from Mitsui Engineering and Shipbuilding Co., Ltd in respect of this guarantee.

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 1998 these amounted to £75.3 million (1997: £68.7 million), of which the Company had counter-indemnified £45.4 million (1997: £29.7 million). Of the £45.4 million counter-indemnified by the Company, £5.5 million relates to guarantees given in respect of Mitsui Babcock Energy Ltd. The Company has a counter-indemnity from Mitsui Engineering and Shipbuilding Co. Ltd in respect of these guarantees.

c) In addition, the Company has given guarantees on behalf of Group companies in connection with the completion of contracts within specification, including responsibility for maintenance. These include the unlimited counter-indemnity given to FKI plc at the time of demerger in respect of guarantees given by FKI plc on behalf of companies acquired at that time.

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

Principal subsidiaries and associates

Facilities Management

Babcock Facilities Management Limited
Babcock Rosyth Defence Limited
Rosyth Royal Dockyard Limited
Babcock Defence Systems Limited
Babcock Rosyth Industries Limited
Rosyth 2000 Limited (20%)*
Railcare Limited (60%)
Babcock New Zealand Holdings Limited
(New Zealand)
Babcock New Zealand Limited (New Zealand)
Babcock Celsius Tech New Zealand Limited
(New Zealand) (60%)
Babcock Water Engineering Limited (50%)**
Babcock Water Engineering LP (USA)

Materials Handling

Babcock Holdings (Sweden) AB (Sweden)
BMH Wood Technology AB (Sweden)
BMH Marine AB (Sweden)
BMH Kellve AB (Sweden) (90%)
BMH Wood Technology Oy (Finland)
BMH Americas Inc (USA)
BMH Iberica SA (Spain)
BMH Italiana Srl (Italy)
BMH SA (France)
BMH Claudius Peters AG (Germany)
BMH Division GmbH (Germany)
BMH China Ltd (Hong Kong)
BMH Asia Pacific (Pte) Limited (Singapore)
BMH Limited
BMH do Brazil Ltda (Brazil)
Eagleton Engineering Company (USA)
Babcock Holdings (USA), Inc. (USA)

South Africa

Babcock Africa (Pty) Limited (South Africa)
Babcock Africa Contracting (Pty) Limited
(South Africa)

Others

Babcock Holdings Limited
Babcock Investments Limited
Babcock International Limited
Babcock International Holdings Limited
Babcock Management Limited
Babcock Overseas Investments Limited
Babcock International Holdings BV (Netherlands)
Cleveland Insurance Limited (Isle of Man)

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 subsidiaries.

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 associates.

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

Notice of meeting

50 Notice is hereby given that the ninth Annual General Meeting of the members of Babcock International Group PLC will be held at The Barber-Surgeons' Hall, Monkwell Square, London EC2, on Wednesday, 29 July 1998 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 1998.

2) To declare a final dividend for the year ended 31 March 1998.

3) To re-elect those Directors retiring by rotation (Article 95) or following appointment (Article 101) in accordance with the Company's Articles of Association, namely;

i) Dr T J Parker (Article 95)

ii) Mr M J Turner (Article 95)

iii) Mr N R Young (Article 101)

iv) Mr M S Easton (Article 101)

v) Dr G Schäfer (Article 101)

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 which will be proposed as Special Resolutions.

Special Resolution

1) That the Directors be authorised at any time when they are generally authorised for the purpose of section 80 of the Companies Act 1985, to allot equity securities (as defined in section 94 of the

Companies Act 1985) for cash as if section 89(1) of the Companies Act 1985 did not apply to any such allotment provided that this power shall be limited:

a) to the allotment of equity securities in connection with an issue in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all such shareholders are proportionate (as nearly as may be practicable having regard to the interests of the Company as a whole) to the respective numbers of ordinary shares held by them on the record date for such allotment, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or legal or practical problems under the laws of, or the requirements of, any recognised regulatory body or any Stock Exchange, in any territory;

b) to the allotment of equity securities pursuant to the terms of any share schemes for Directors and employees of the Company or any of its subsidiaries approved by the Company in General Meeting; and

c) to the allotment otherwise than pursuant to subparagraphs a) and b) above of equity securities not exceeding in aggregate an amount equal to 5% of the issued share capital of the Company, being at the date of the passing of this Resolution, 8,465,627 ordinary shares of 50p each.

Provided further that the authority contained in this Resolution shall, unless revoked or renewed in accordance with section 95(3) of the Companies Act 1985, expire on the date which is 15 months after the date of the passing of this Resolution or (if earlier) on the conclusion of the Annual General Meeting of the Company (or any adjournment thereof) next following the date of the passing of this Resolution save that the Directors shall be entitled to make at any time before the expiry of the power hereby conferred any offer or agreement which might require equity securities to be allotted after the expiry of such power.

Special Resolution

2) 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 50p each ("ordinary shares") in the capital of the Company provided that:

- a) the maximum number of 50p ordinary shares hereby authorised to be purchased shall be 16,931,254;
- b) the minimum price which may be paid for each ordinary share is not less than the nominal value thereof exclusive of expenses;
- 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 ten business days preceding the day of purchase;
- d) the authority hereby conferred shall expire on 31 December 1999 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.

Special Resolution

3) That the Articles of Association of the Company be amended as follows:

- (i) by the addition of a new Article numbered 140A as follows:

"The Company may stop paying dividends by cheque or other payment order to a shareholder if cheques or other payment orders for two consecutive dividends are returned to the Company or are not cashed provided that the Company shall recommence the payment of dividends by cheque or other payment order if such shareholder, or a person automatically entitled to the shares held by such shareholder by law, claims such dividends prior to the expiry of the 12 year period in respect of such dividends in some other way."

(ii) by the addition of the words "Subject to Article 153A" at the beginning of Article 153.

(iii) by the addition of a new Article numbered 153A as follows:

"The Company shall not be required to send a copy of the documents referred to in Article 153 to:

- (a) more than one joint holder of shares or debentures of the Company; or
- (b) any person for whom the Company does not have a current address.

provided that any such persons may receive a copy of such documents free of charge by applying to the Company's Registered Office."

(iv) by the addition of a new Article numbered 162A as follows:

"This Article 162A shall apply if on two consecutive occasions notices or other communications have been sent by post to a member at his registered address (or, in the case of a member whose registered address is not within the United Kingdom, any address given by him to the Company for the service of notices) but have been returned undelivered. The member shall not be entitled to receive any subsequent notice or other communication until he has given to the Company a new registered address (or, in the case of a member whose registered address is not within the

United Kingdom, a new address for the service of notices). For the purposes of this Article 162A, references to a communication include references to a cheque or other instrument of payment; but nothing in this Article 162A shall entitle the Company to cease sending any cheque or other instrument of payment for any dividend, unless it is also entitled under Article 140A to do so. This Article 162A is subject to the provisions of the Act."

By order of the Board

J Allen Secretary
8 June 1998



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.

Shareholder information

Financial calendar

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Financial year end	31 March 1998
1997/98 preliminary results announced	8 June 1998
Annual General Meeting	29 July 1998
Final dividend dates:	
– Ex-dividend	6 July 1998
– Record date	10 July 1998
– Payment date	12 August 1998
Half year results announced	19 November 1998
Interim dividend payable	28 January 1999

Financial record

	1998 £m	1997 As restated £m	1996 £m	1995 £m	1994 £m
Group Turnover	568.3	646.0	723.4	755.1	805.2
Trading profit/(loss)	14.0	1.9	(19.7)	5.3	(8.9)
Exceptional items	(18.7)	(25.6)	22.3	2.4	(29.5)
(Loss)/profit on ordinary activities before interest	(4.7)	(23.7)	2.6	7.7	(38.4)
Net interest and similar charges	0.2	1.0	0.5	0.1	(2.8)
(Loss)/profit on ordinary activities before taxation	(4.5)	(22.7)	3.1	7.8	(41.2)
Tax on ordinary activities	(2.9)	(1.7)	(1.4)	(1.7)	(1.0)
(Loss)/profit on ordinary activities after taxation	(7.4)	(24.4)	1.7	6.1	(42.2)
Minority interests	(1.3)	(1.2)	(0.9)	(0.8)	(3.3)
(Loss)/profit attributable to shareholders	(8.7)	(25.6)	0.8	5.3	(45.5)
Fixed assets	50.7	55.1	62.1	64.5	62.8
Net current assets	97.9	102.0	105.8	81.8	19.5
Non-current liabilities and provisions	(33.8)	(28.2)	(27.1)	(20.5)	(35.0)
Total net assets	114.8	128.9	140.8	125.8	47.3
Shareholders' funds	105.7	119.5	133.5	125.3	43.8
Minority interests	9.1	9.4	7.3	0.5	3.5
	114.8	128.9	140.8	125.8	47.3
(Loss)/earnings per share	(5.12)p	(15.11)p	0.47p	3.20p	(38.00)p
Dividends per share	1.80p	1.50p	3.00p	2.00p	-

The financial record for periods prior to 1997 have not been restated for the effect of implementing FRS9 and FRS10.

