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Babcock International Group PLC
Annual Report and Accounts 2011

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How we add value

10 →

What sets us apart

10–15 →

Overview

Group overview	01
Headline results	02
Chairman's introduction	03
What we do	04
How we add value	06
A transformational year	08
What sets us apart	10
How we have performed	16

Business review

Financial review	18
Operating review	24
Corporate responsibility	34
Factors that could affect the business	39

Governance

Directors and Company Secretary	46
Governance statement	49
Report of the Nominations Committee	54
Report of the Audit and Risk Committee	55
Other statutory and regulatory information, including Directors' responsibility statement	57
Remuneration report	64

Group accounts

Independent auditors' report to the members of Babcock International Group PLC	81
Group income statement	82
Group statement of comprehensive income	83
Group statement of changes in equity	83
Group balance sheet	84
Group cash flow statement	85
Notes to the Group financial statements	86

Company accounts

Independent auditors' report to the members of Babcock International Group PLC	125
Company balance sheet	126
Notes to the Company financial statements	127

Other information

Principal, joint ventures and associated undertakings	131
Shareholder information	132
Five-year financial record	133

Directors' report

The Directors present the Annual Report and Accounts for the year ended 31 March 2011. This page and pages 1 to 80, inclusive, of this Annual Report and Accounts comprise a Report of the Directors that has been drawn up and presented in accordance with English company law and the liabilities of the Directors in connection with that report shall be subject to the limitations and restrictions provided by such law. In particular, Directors would be liable to the Company (but not to any third party) if the Directors' report contains errors as a result of recklessness or knowing misstatement or dishonest concealment of a material fact, but would not otherwise be liable.

Forward-looking statements

Certain statements in this Annual Report and Accounts are forward-looking statements. Such statements may relate to Babcock's business, strategy and plans. Statements that are not historical facts, including statements about Babcock's or its management's beliefs and expectations, are forward-looking statements. Words such as "believe", "anticipate", "estimates", "expects", "intends", "aims", "potential", "will", "would", "could", "considered", "likely" and variations of these words and similar future or conditional expressions are intended to identify forward-looking statements but are not the exclusive means of doing so. By their nature, forward-looking statements involve a number of risks, uncertainties or assumptions, some known and some unknown, that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements, many of which are beyond Babcock's control. Please see pages 39 to 45 which set out some of these risks and uncertainties. These risks, uncertainties or assumptions could adversely affect the outcome and financial effects of the plans and events described herein. Forward-looking statements contained in this Annual Report and Accounts regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Nor are they indicative of future performance and Babcock's actual results of operations and financial condition and the development of the industry and markets in which Babcock operates may differ materially from those made in or suggested by the forward-looking statements. You should not place undue reliance on forward-looking statements because such statements relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements reflect Babcock's judgement at the time of preparation of this Annual Report and Accounts and are not intended to give any assurance as to future results. Except as required by law, Babcock is under no obligation to update (and will not) or keep current the forward-looking statements contained herein or to correct any inaccuracies which may become apparent in such forward-looking statements.

Overview
Business review
Governance
Group accounts
Company accounts

2011 was a transformational year for Babcock.

The acquisition of VT established us as the UK's leading engineering support services company.

We have strengthened our positions in our core markets and we have significantly enhanced our range of skills, capabilities and experience.

Our business is fully aligned with our customers' requirements to ensure we drive the financial and operational efficiencies they require.

The successful integration of VT into the Group has created a strong platform for future growth in both the UK and overseas.

Headline results

Revenue

£2,894.5m
+50%

Underlying operating profit

£286.9m
+74%

Underlying basic earnings per share

55.03p
+7%

Underlying profit before tax

£228.2m
+57%

Operating profit

£157.5m
+6%

Basic earnings per share

31.28p
-32%

Underlying results

Throughout the overview and business review sections, unless otherwise stated, revenue, operating profit, operating return on revenue, net finance costs, profit before tax and earnings per share refer to results before amortisation of acquired intangibles and exceptional items and including the Group's share of joint ventures (jv) and including investment income arising from IFRIC12 (Accounting for Service Concession Arrangements). Collectively these adjustments are made to derive the underlying operating results of the business. A reconciliation of statutory to underlying results is set out on page 18

The underlying figures provide a consistent measure of business performance year-to-year thereby enabling comparison and understanding of Group financial performance

Chairman's introduction

2011 has been another good year for Babcock. Our financial results demonstrate the underlying strength of the business we have created through the acquisition of VT

Following the General Election in May, many commentators were concerned that the coalition Government's determination to deal with the UK's fiscal deficit and achieve savings, through its Comprehensive Spending Review (CSR) and Strategic Defence and Security Review (SDSR), would negatively impact the Group The outcome of these reviews, along with our ongoing discussions with the Ministry of Defence (MoD) and Cabinet Office have, in fact, been positive. We have identified a number of opportunities where our enhanced capabilities following the VT acquisition mean we are better placed to assist them with the delivery of savings on current projects as well as through new outsourcing initiatives, without affecting the financial expectations of the Group

Headline results

Revenue for the year was £2 9 billion (2010 £1 9 billion) a 50% increase and operating profit was £286 9 million (2010 £164 7 million) a 74% increase, the financial results benefiting from both the acquisition of VT as well as organic growth across the Group Profit before tax increased by 57% to £228 2 million (2010 £145 2 million) Earnings per share has increased to 55 03 pence per share (2010 51 37 pence per share)

The Board remains committed to ensuring our shareholders share in the ongoing success of our business Reflecting our confidence in the strength of our business and the opportunities the Group has for future growth, we are recommending a final dividend of 14 20 pence per share, this will give a total dividend for the year of 19 40 pence per share an increase of 50% (2010 17 60 pence per share, comprising two interim dividends of 12 80 pence per share and 4 80 pence per share) The dividend will be paid on 9 August 2011, to shareholders on the register at close of business on 8 July 2011

The Board

In November 2010, Lord Hesketh resigned from his position as Non-Executive Deputy Chairman Alexander had been a member of the Board since 1993 and I would like to thank him for the significant contribution he made to the development of the Company during that time

As I mentioned in my report last year, following the appointment of Archie Bethel and Kevin Thomas as Executive Directors we would be seeking to appoint at least one new Non-Executive Director to retain an appropriate balance of executive and non-executive knowledge and experience on the Board

This year I was pleased to welcome Ian Duncan to the Board Ian has a wealth of financial experience and will be taking over from John Rennocks as Chairman of the Audit and Risk Committee following the AGM in July In March we announced that John would be retiring from the Board on 31 December 2011

In April we announced that Kate Swann, CEO of WH Smith PLC, would be joining the Board on 1 June as a Non-Executive Director Kate brings a wealth of commercial experience and I look forward to welcoming her to the Board

Our people

Through the acquisition of VT we now have more than 27,000 employees across the globe On behalf of the Board, I would like to thank them all for their ongoing commitment to ensuring our customers achieve the very highest standards of operational excellence and the superior levels of customer service they have come to expect – from both Babcock and VT

Outlook

We remain confident that in the current economic climate, our markets continue to provide excellent long-term growth prospects with potential for significant further outsourcing opportunities In this environment, strengthened by the acquisition of VT, the scale of our operations, the breadth of our expertise and our track record of delivering both operational and financial efficiencies place us in a strong position from which to benefit

The Board remains confident in the outlook for the Group We have excellent long-term visibility, through our £12 billion order book, our £8 5 billion bid pipeline which is growing as new outsourcing opportunities are created and our involvement in long-term programmes delivering critical support for our customers We look forward to making further good progress this year and thereafter

Signature removed

Mike Turner CBE
Chairman

We have continued to make good progress – building on the strength of last year's results, the acquisition of VT has created an excellent platform for future growth.

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What we do

Our structure

Marine and Technology

Employees 8,836

Image removed

Divisional Chief Executive
Archie Bethel

Key activities

Submarines

Through life support, refit, refuelling, decommissioning and base-porting

Surface ships

Warship maintenance and refit

Member of Surface Ship Support Alliance

Member of Aircraft Carrier Alliance responsible for building the next generation of aircraft carriers

Management of HMNB Devonport and HMNB Clyde

Engineering, design systems integration and platform management capabilities

Equipment support and training for the Royal Navy

Design, supply and support of naval systems and vessels

Key customers

Royal Navy

DE&S Equipment Support

Canadian and Australian Governments

Navantia

Other International Navies

Defence and Security

Employees 4 840

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Divisional Chief Executive
John Davies

Key activities

Military Flying Training System (MFTS)

Provision of infrastructure and information and communication technology to support UK military flying training

Flagship naval training and support

RSME training and training support contract

RAF Valley and Linton-on-Ouse multi activity contracts

Future Strategic Tanker Aircraft (FSTA)

IOS contracts for Hawk fast jet trainers

Light Aircraft Flying Task (LAFT)

White fleet management

Provision of in excess of 15 000 vehicles

Construction vehicles fleet management

Own, maintain, repair and replace in excess of 2,000 construction vehicles

Key customers

Royal Navy

Army

RAF

BAE Systems

Support Services

Employees. 9 918

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Divisional Chief Executive
Kevin Thomas

Key activities

Nuclear

Outage support for operational reactors

Decommissioning activities

Mechanical system design and engineering

Safety and risk analysis

Energy

High voltage power transmission maintenance and upgrade

Facilities Management

South West and East Regional Prime Contracts for MoD

Mobile Asset Management

Emergency Services fleet management

Communication

Mobile telecommunications network upgrade

BBC World Service

Education

Integrated school improvement services

Educational consultancy

Provision of vocational, safety and fire and rescue training

Specialised apprenticeship training

Airports

Support for airport baggage handling systems at Heathrow, Gatwick and Schipol

Key customers

MoD Defence Estates

Sellafield Ltd

British Energy (part of EDF Energy)

National Grid

EDF Energy Networks

Metropolitan Police

Surrey County Council

BAA

International

Employees. 3 745

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Group Chief Executive
Peter Rogers

Key activities

Africa

Maintenance and engineering support for power station boilers

Construction erection and maintenance of high voltage power lines

Sole distributor for Volvo and DAF equipment to mining and infrastructure construction companies

Middle East

Civilian and military flight training

Support to the Royal Oman Air Force

United States

Base and logistical support

Fixed and rotary wing aircraft maintenance

Communications' infrastructure integration

Key customers

Volvo

African mining and construction industries

Eskom

US defence forces

Our performance by division

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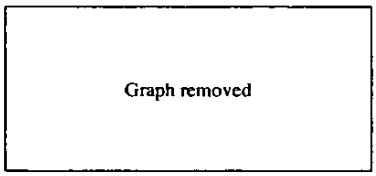
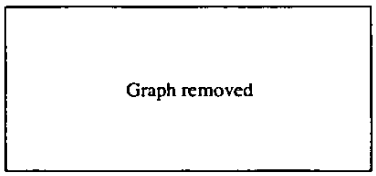
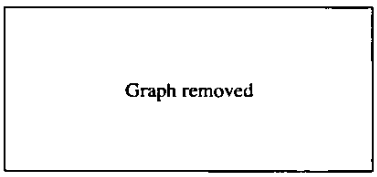
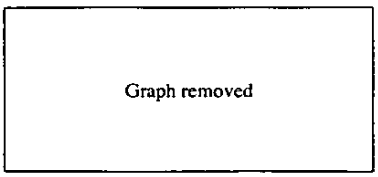
Our customer profile

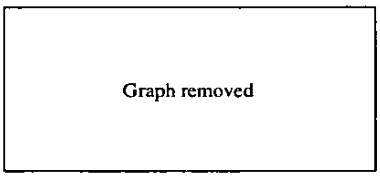


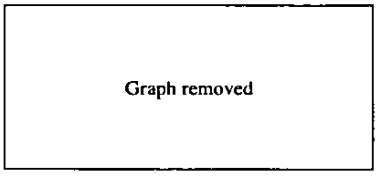


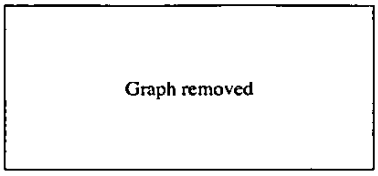
Our track record

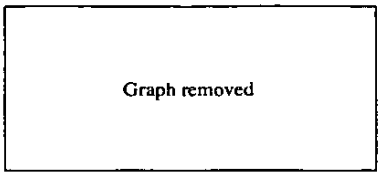






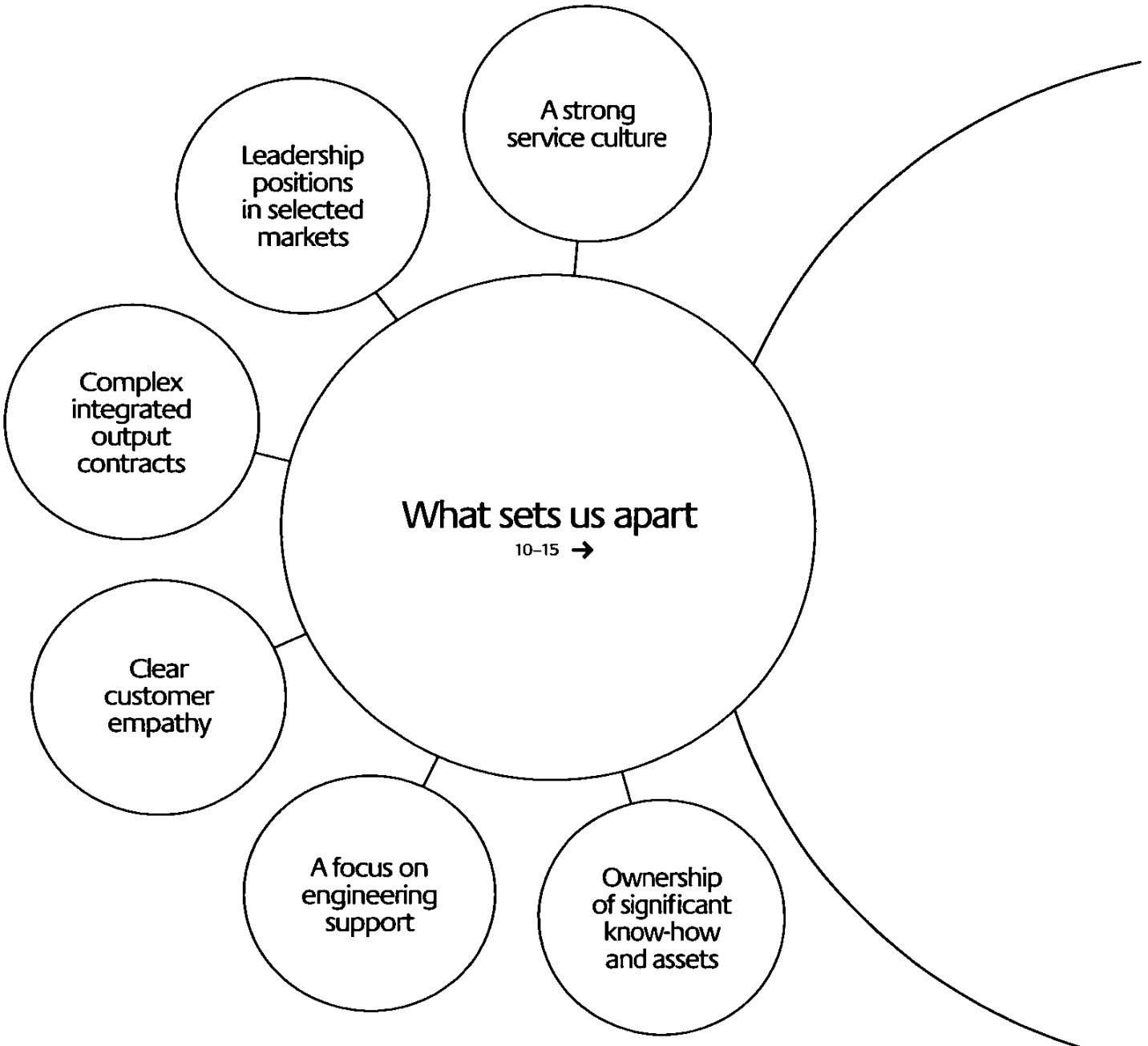






How we add value

In today's market place, where organisations are seeking to reduce costs, drive efficiencies and improve their standards of service, we are strongly positioned to meet our customers' demands by offering a distinctive engineering support service.



Minimal corporate bureaucracy
Delegated authority to our customer facing representatives
Stringent central financial controls
Strong cash flow to support future growth opportunities
Best practice health and safety
Our core business principles
trusted to deliver™
Our unique value chain enables us to:
Deliver operational excellence
Deliver efficiency and value
Build a strong order book
Generate increased revenue
Deliver sustainable value
are government departments, public bodies or large private companies
own large strategically important assets
operate in highly regulated markets
require long-term engineering solutions
Our customers

A transformational year
Q&A with Peter Rogers

Delivering our strategy – creating a strong platform for future growth.

Peter Rogers, Group Chief Executive, answers questions on the Group's strategy, how it led to the acquisition of VT Group plc in 2010 and how the strategy will support the Group's ambitions for the future.

Our strategy

We are the UK's leading engineering support services company. Our objective is to grow from this position in both the UK and overseas thus delivering superior and sustainable value for our shareholders In order to achieve this we will focus on the following strategy:

Leading market positions

Preferred customers

Customer focused, long-term relationships

Integrated engineering and technical expertise

Balance risk and reward

Excellent safety record

Q Babcock today is a very different company from the one you joined in 2002. How has that transformation come about?

A When I joined Babcock in June 2002, the Board had already announced its strategy to become a support services company Since that time we have been consistently pursuing that objective through a series of acquisitions and disposals all of which have met and strengthened our strategic objectives (set out opposite) and created our role in our core markets The VT acquisition was the largest transaction in this process and it established our position as the UK's leading engineering support services company, reinforcing our platform for future growth

In addition to changing the shape and performance of the Group through acquisitions, we have achieved significant organic growth, within our core business areas, which has strongly enhanced our financial position over the years.

Q What does it mean to be the UK's leading engineering support services company?

A Our expertise is vital to our understanding of our customers and the environments in which they operate This enables us to develop long-term relationships whilst becoming embedded within their organisations Both Babcock and VT had engineering heritages which we wanted to retain and build on. In an environment where engineering knowledge and skills are scarce, we have developed an experienced workforce of significant scale and depth that is highly regarded by our customers

As market leaders we can provide our employees with a wide range of experiences for their professional development whilst ensuring our broad range of expertise can meet all our customers' technical requirements throuwgh the full life cycle of their assets

Q How did you select the markets in which you operate?

A We perform comprehensive market analysis as we like to work in highly regulated environments where we can support customers who own large assets or infrastructures that are vital to the delivery of critical services We have also chosen to enter markets where we believed there would be significant long-term growth opportunities and maximum demand for our high quality engineering and technical expertise

Q What did the acquisition of VT add to the Babcock business?

A The acquisition of VT had a clear and compelling strategic logic. We acquired a high quality business with complementary, engineering based skills and experience along with a similar business culture to our own Together we have a stronger position in our core markets, and in the current economic climate we are able to offer a broader range of skills and capabilities to support our customers in both defence and civil markets We firmly believed the acquisition would create significant opportunities for the Group, and this has become clearer as we have progressed through the integration process In the operational reviews that follow we set out some of the opportunities that we are currently pursuing

Q Many of your customers are operating within tight financial constraints at the moment. How can you help them?

A Our customers are seeking to address some of these budgetary pressures by outsourcing more of their engineering support and training requirements All our businesses are focused on helping our customers achieve the financial and operational efficiencies they need and we have a demonstrable track record of delivering these In the next few pages we set out our business model and describe what it is that sets us apart These pages demonstrate how we meet our customers' requirements in this more difficult economic climate

Q How would you characterise the growth opportunities for the Group?

A Following the acquisition of VT we are now pursuing growth opportunities in three areas

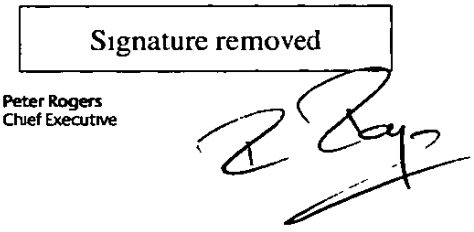
Grow existing contracts
We have a number of large, long-term contracts and agreements, such as our training and support contract at the Royal School of Military Engineering and our Terms of Business Agreement with the MoD. We can use these existing arrangements to deliver additional services whilst continuing to focus on driving efficiencies

Grow existing customers
The new and complementary skills VT has brought to the Group have enabled us to build on the strong relationships we have with our existing customers to offer them a broader range of services

Grow new customers
We seek to be leaders in all our chosen markets We believe the Group's enlarged platform provides many opportunities to create new outsourcing opportunities in our current markets, transferring existing capabilities and knowledge to new customers in both the UK and overseas.

Q What does the year ahead look like for Babcock?

A We have seen a steady rise in the bid pipeline to £8 5 billion as new contracts and outsourcing opportunities come to market We will remain focused on continuously delivering cost savings and efficiencies to our customers whilst embarking on selective new long-term opportunities This year will be an exciting period for Babcock as we approach existing and new opportunities with an innate confidence in our enhanced capabilities, knowledge base, customers and markets



Peter Rogers
Chief Executive

What sets us apart

A strong service culture

Our people take ownership of performance – all day, every day. We do the right thing by our customers and have an outstanding track record: we are trusted to deliver™.

→ A recent review of Babcock's performance makes us the highest placed company in the Ministry of Defence 2010 assessment of their Key Suppliers, so far

→ We were recently presented with the Professional Services Award at the BBC's Global News Reith Awards for our exceptional effort in protecting the BBC Asia relay station in Thailand from severe flooding and maintaining transmission. Inspirational leadership and great teamwork avoided a potential disaster. Although there was a threat to the homes of many staff, they remained on site to lead the efforts. The response of the staff was beyond the call of duty and a great reflection of the relationship that the BBC has with the Babcock team

→ The Terms of Business Agreement with the Ministry of Defence confirms Babcock's long term strategic role. This is a fundamental cornerstone of our relationship with the MoD, providing support to the Royal Navy

→ Babcock took over Volkswagen Group's (VWG) UK apprenticeship programme in 2008 with over 800 learners at various stages of progression. The success of this initial contract resulted in the award of additional contracts to manage the VWG technical training (around 20 000 training man days per year) and the Technical Service Centre at the Volkswagen National Learning Centre in Milton Keynes

"Their genuine partnership approach with Volkswagen Group United Kingdom Ltd has helped raise the standard of training and has significantly improved the efficiency of our operation. In the current climate, they have proved a very valuable partner"

Richard Welch
Network Learning & Development Manager – Volkswagen Group United Kingdom Ltd

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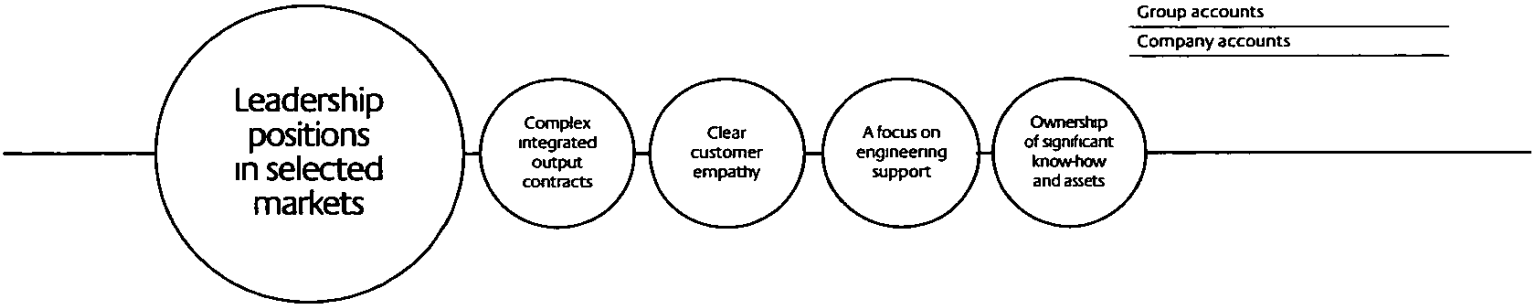

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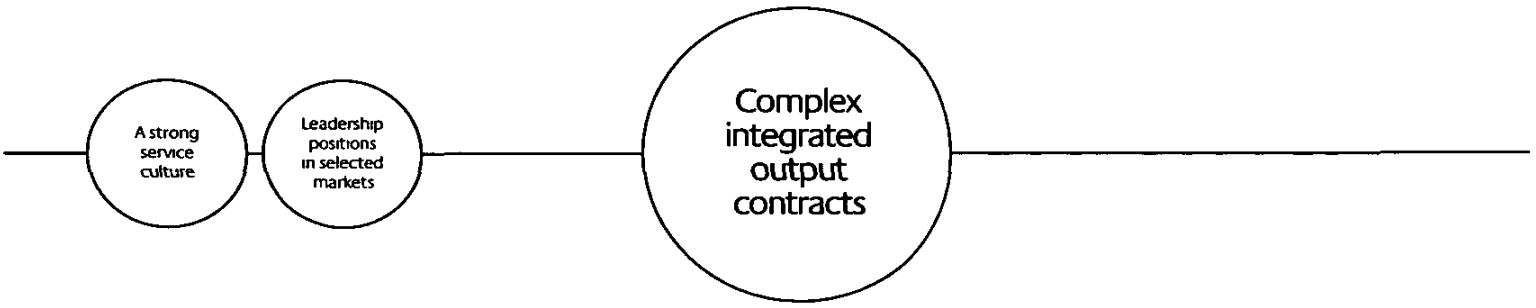
We hold leadership positions in selected markets that allow us to have the depth of knowledge and economies of scale to serve our customers efficiently.

- The largest supplier of support services to the Ministry of Defence
- Number 1 support provider to the Royal Navy
- The largest nuclear support services company in the UK
- The leading provider of training services to the Ministry of Defence
- A leading UK supplier of complex, dispersed fleet management
- The leading apprentice training supplier in the UK.
- One of the leading engineering support services companies in South Africa
- The UK's largest integrated school improvement service provider
- One of two key suppliers in the UK power transmission sector
- A leading player in the UK rail infrastructure market and the largest conventional track renewals company in the UK.

77%
Of our business holds market leading positions

What sets us apart



"From training delivery to facilities management, the Babcock team at RSME show the agility to deliver and adapt to our continually changing requirements while meeting budgetary targets – a challenge dealt with head on with long-term objectives always front of mind."

Colonel Mark Burnett RE OBE
Chief of Staff Royal School of Military Engineering

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We deliver complex integrated outputs while saving our customers money. We specialise in large, long-term contracts delivering the bespoke needs of our customers.

→ Warship Modernisation Initiative (Clyde) enhances the quality of outputs at HM Naval Base Clyde Running since 2002 the contract has delivered operational savings of £137 million resulting in a four year contract extension signed in 2009

→ Surface Ship Support Alliance is successfully sustaining warship availability while improving the linkage between the cost of support and its influence on outputs.

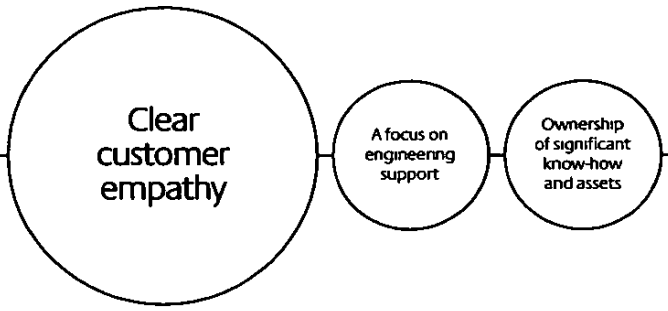
→ RAF Valley MAC and Hawk IOS contract ensures the availability of the entire UK-based Hawk TMk1 fleet and provides logistical airfield and administrative support to RAF Valley delivering significant cost savings to the customer

→ 30-year contract with the Royal School of Military Engineering brings together the best qualities of industry, academia and UK Armed Forces to deliver acclaimed training and infrastructure support

4,000
Soldiers training per year

315,500
Man training days to 4 000 soldiers by 270 instructors

+300
Royal Engineers freed up for frontline duty



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Our mindset and behaviours focus on listening to our customers, understanding their real needs and offering affordable solutions. We are willing to take on delivery risk, so our interests are aligned with our customers. We are easy to do business with.

→ Since 2003, we have managed and maintained British Airways' (BA) fleet of 6 300 vehicles to ensure 24/7 availability Throughout the duration of the contract we have maintained 99% critical availability levels, reduced the overall cost of the contract year on-year by 16% and been part of the BA package delivering 65,000 tonnes of CO_2 savings New initiatives are introduced each year we seek to improve on the prior year's performance working in line with our customer s business objectives

→ Surrey County Council is promoting our educational improvement offering to other local authorities through Babcock 4S Critical to the success of this contract is our strong relationship which sees us work with local authorities to find new ways to improve educational attainment, whilst simultaneously driving down costs

→ Our BMW apprenticeship programme was rated as Grade 1 - Outstanding in a 2010 Ofsted inspection Building on this success, we have now introduced Leadership and Management Training to the portfolio of training delivered to BMW and are in the process of bidding to supply training to BMW Group worldwide

→ By outsourcing fleet management, customers can transfer the risk of ownership and responsibility associated with the operation and maintenance of vehicles In 2011 Babcock was named Emergency Services Supplier of the Year for continual innovation and improvement which has delivered improved efficiency and operational capability for the Metropolitan Police Service fleet of c 3,700 vehicles

"We enjoy a partnership that encourages us continuously to develop our contract and explore innovative methods and processes to deliver better for less"

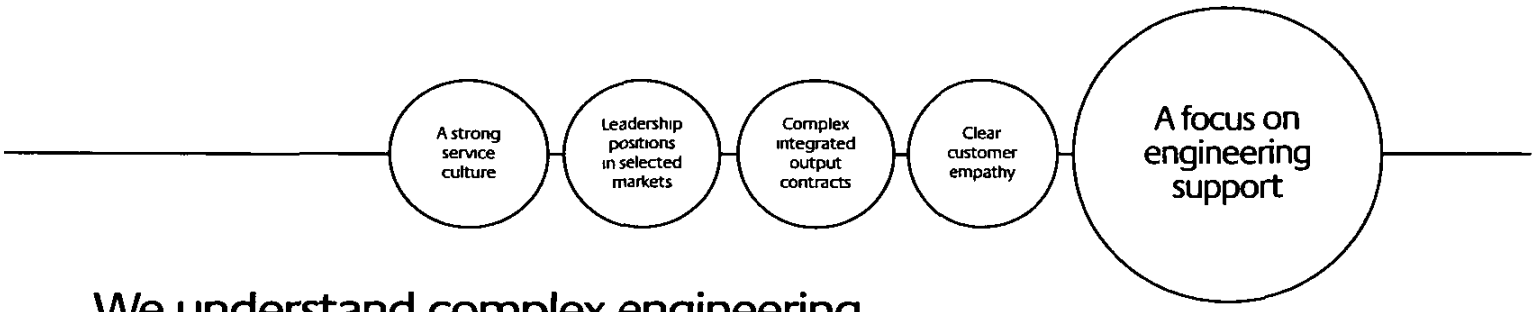
A spokesman for the Metropolitan Police Service

93.5%
Availability

<4 hour
Delivering a 4 hour response

100%
Successful fleet safety

What sets us apart



We understand complex engineering. Our services are critical to our customers' output, often in specialist secure environments. We optimise the solution but are not incentivised to sell more kit.

- Support and refit of 60% of the Royal Navy fleet
- Over 3,000 nuclear experienced personnel
- Operation of six nuclear licensed sites (civil and defence)
- Ownership of a high-end engineering consultancy often working in house to deliver integrated solutions
- Management of Scotland's largest nuclear clean up and demolition project at the Dounreay nuclear facility

"Restoring the 140-acre Dounreay site is one of the most complex nuclear decommissioning tasks in the UK and the site's history in fast reactor and fuel cycle development presents significant decommissioning challenges. The Babcock team includes some of the most highly-experienced nuclear engineers in the world, giving confidence that the project will be a success"

Mike Brown, Reactors Decommissioning Manager DSRL

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Ownership of significant know-how and assets

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We own unique infrastructure and have extensive know-how of our customers' environment, their infrastructure and equipment. We understand their complex multiple objectives and constraints. We thrive on managing complexity and uncertainty.

→ Owner of Rosyth Dockyard which holds the only dock large enough to assemble the next generation Queen Elizabeth Class aircraft carriers

→ On the Ministry of Defence C Vehicle contract, we have introduced procedures for fleet management and availability resulting in a significant increase in vehicle availability and a reduction in the total fleet size by over 35%.

→ Chapelcross Power Station, a Magnox North managed NDA decommissioning site, is now well into a three year programme to remove all the fuel from the four reactors at the site using bespoke equipment designed and installed by Babcock The new process is performing safely and reliably with a high level of regulatory and stakeholder confidence

→ Owner of Devonport Dockyard – the only facility in the UK with a nuclear license and the seismically qualified facilities to refuel nuclear submarines

100%
Providing 100% of deep overhaul work on the UK's submarine fleet

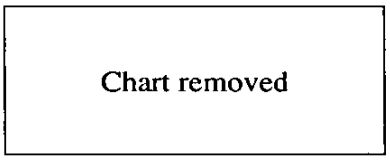
How we have performed

We have grown consistently since 2001 and our strategic objective throughout this period has been to create superior value for our shareholders.

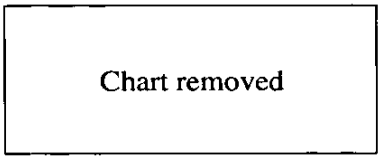
We have identified a number of Group and divisional level financial and non-financial key performance indicators (KPI)s that reflect the internal benchmarks we use to measure the success of our business and that will enable investors and other stakeholders to measure our progress.

By focusing on these areas we will ensure continuous sustainable improvement across the company and investors and other stakeholders will be able to measure our success.

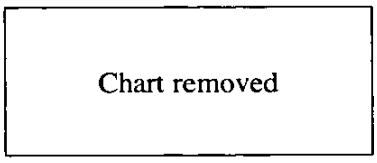
Financial KPIs



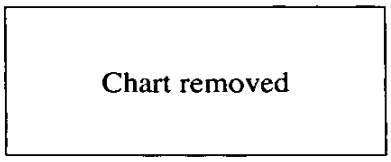
Description
Revenue growth is defined as the increase in the Group s revenue (including jvs) when compared to that of the previous year



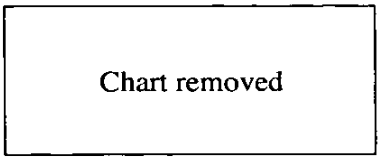
Description
Operating Cash Flow (OCF) conversion rate is defined as cash generated by operations after adding back retirement benefit cash flows in excess of cost as a percentage of operating profit (pre-exceptionals and amortisation of acquired intangibles)



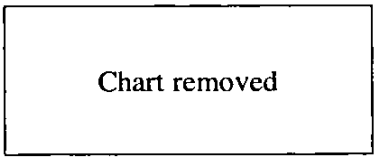
Description
Net debt/EBITDA is calculated as net debt divided by earnings (as based on financial covenants) before interest, tax, depreciation and amortisation



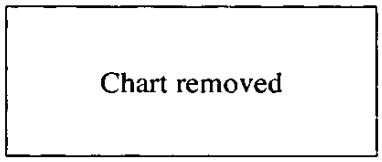
Description
Interest cover is profit before interest, tax, depreciation, amortisation and exceptionals divided by net interest payable (as based on financial covenants)



Description
Gearing ratio measures the extent to which a company is funded by debt Calculated as net debt, excluding retirement benefit deficits or surpluses, divided by shareholders funds

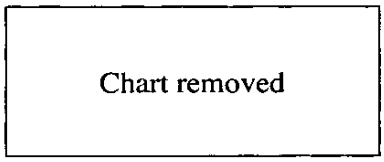


Description
Return On Invested Capital (ROIC) is defined as underlying net income before financing divided by total capital (equity, excluding retirement benefit deficits or surpluses, plus net debt)



Description
Operating Return on Revenue (ORR) is defined as underlying operating profit expressed as a percentage of revenue

Non-financial KPIs



Description
Although our ability to implement good environmental stewardship practices is on occasion set for us by our customer requirements, our target is to grow the percentage of revenue in each business segment from contracts which are ISO 14001 certified 'Best practice' refers to our environmental management controls at sites not yet ISO 14001 certified

Divisional KPIs

Following the acquisition of VT we reorganised our business into four new reporting divisions to reflect the key markets and business streams of the Group Each new division incorporates both Babcock and VT operations

We have restated 2009/10 divisional results only, to provide a comparator for this year and a base from which to calculate revenue growth

In the Operational review we use the following KPIs to measure each division's performance

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

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

24–29 →

Financial review

Positive financial momentum has been maintained in a year of substantial change.

Overview

Following the acquisition of VT Group plc (VT) in July 2010 the size and structure of the Group has changed significantly and comparisons with the previous financial year reflect this The underlying strength of our business has delivered organic revenue and operating profit growth of 5% in a period when public sector activity has been relatively low and pressure on budgets has increased Positive financial momentum has been maintained in a year of substantial change

We have made excellent progress in both the financial and operational integration of VT and the delivery of merger benefits is on schedule Our strong focus on cash has enabled us to reduce net debt rapidly to £729 million, with an operating cash conversion rate of 146%, the successful refinancing of the £400 million acquisition bridge facility, achieving a net debt to EBITDA ratio of 2 4 times

The Group's order book and bid pipeline have continued to grow and operating margins have improved further from 2010 reflecting amongst other things, the realisation of merger benefits and an increased focus on overseas markets We therefore believe that the Group has a sound financial base from which to progress in its chosen markets

Income statement

Statutory to underlying reconciliation

	Statutory	JV	JV tax	IFRIC 12	Amortisation of acquired intangibles	Change in tax rate	Exceptional	Underlying
2010/11								
Revenue	2,755.8	138.7						2,894 5
Operating profit	157 5	9 3		16 0	83 4		20 7	286 9
Share of profit from JV	6 1	(1 0)	4.1	(13.8)	4 6			0
Investment income	2 2			(2 2)				0
Net finance cost	(50 4)	(8 3)						(58 7)
Profit before tax	115 4	0	4 1	0	88 0	0	20 7	228 2
Tax	(10 7)		(4 1)		(25 4)	(2 7)	(3.9)	(46 8)
Profit after tax	104 7	0	0	0	62 6	(2 7)	16.8	181 4
2009/10								
Revenue	1,895 5	27 9						1,923 4
Operating profit	148 1	0.5			16 1			164 7
Share of profit from JV	(0 5)	0 6	(0 1)					0
Investment income	0							0
Net finance cost	(18 4)	(1 1)						(19 5)
Profit before tax	129 2	0	(0 1)	0	16 1	0	0	145 2
Tax	(20 8)		0 1		(4 5)			(25 2)
Profit after tax	108 4	0	0	0	11 6	0	0	120 0

Revenue at £2,894 5 million increased by £971 1 million a growth rate of 50% KPI Page 16 compared to 2010, of which £856 0 million arose from the VT acquisition in July 2010 Adjusting for the effect of acquisitions and disposals and for the effect of movements in foreign exchange rates, organic growth was £89 3 million or 5% Significant organic revenue growth was seen in the South African operations, which was up 36% on equipment sales buoyed by the recovery in mining markets and in Marine and Technology where revenue growth from overseas activities and Warships in the UK was strong This was offset by relative softness in Support Services (Critical Assets) power and communications revenues and a planned reduction in Rail revenue A diagrammatic representation of the increase in revenue is set out below

Chart removed

Chart removed

Operating profit is used as a consistent measure of business performance year-to-year It is stated before amortisation of acquired intangibles and exceptional items but includes the Group's share of operating profit in equity accounted joint ventures and investment income arising as a result of the application of IFRIC 12, Accounting for Service Concession Arrangements

In 2010/11 operating profit was £286 9 million, an increase of £122 2 million or 74% (2010 £164 7 million) Former VT businesses contributed £112 2 million and after adjusting for this and the effects of foreign exchange rate movements, the Group's organic growth in operating profit was £8 4 million or 5% Cost synergy benefits arising as a result of the combination with VT totalled £11 6 million in the year and we had achieved an annualised run rate of c £15 million by 31 March 2011 Significant areas of organic growth came from Marine and Technology's Warships (the aircraft carrier programme) and overseas business units, continued improvement in profitability in Support Services' Nuclear and Rail business units and a £4 5 million step up in International on an improving South Africa equipment market

The improvement in **operating return on revenue** KPI Page 17 , which increased to 9 9% (2010 8 6%), was primarily driven by growth in higher margin businesses in Support Services and Defence and Security but also through the delivery of the cost synergy benefits, which particularly benefited the Support Services and Defence and Security divisions

The integration of VT has progressed smoothly and as planned throughout the year As expected, the costs associated with the acquisition and integration have increased **exceptional** items to £20 7 million (2010· £nil) The principal drivers were reorganisation costs of £10 8 million and the costs of the acquisition transaction of £12 8 million, offset by a profit of £2 9 million on the sale of subsidiaries Further charges will be incurred on the VT integration over the course of 2011/12

The charge for **amortisation of acquired intangibles** increased significantly to £88 0 million (2010 £16 1 million) following the capitalisation of acquired intangible assets arising from the acquisition of VT and incorporates the Group's share of amortisation in joint ventures (JV) of £4 6 million (2010· £nil)

Net finance costs, including the Group's share of JV net interest expense of £8 3 million, totalled £58 7 million (2010 £19 5 million) Immediately following completion of the acquisition of VT net debt increased to c £890 million (31 March 2010 £302 3 million) and included a £400 million acquisition bridge facility designed to provide short-term funding for the acquisition This debt has now been successfully refinanced through the issue of $650 million loan notes in the US private placement market The status of the debt refinancing is explained further below The Group's share of JV interest largely arises in respect of long-term, non-recourse debt provided for Private Finance Initiative (PFI) contracts and, typically for this type of contract structure, is likely to be high in the early years through the construction phase and decreasing through the contract term, which can exceed 20 years

Profit before tax increased to £228 2 million (2010 £145 2 million) Taxation totalled £46 8 million (2010 £25 2 million), including the Group's share of JV income tax of £5 4 million (2010 £0 1 million credit) The effective rate of income tax, which is calculated by reference to the Group's underlying profit before tax and the associated tax charge (excluding prior year items) was 20 5% (2010. 19%)

Financial review continued

Earnings per share

Underlying earnings per share for the year was 55 03 pence per share (2010. 51 37 pence per share) an increase of 7% Excluding the effect of the prior year tax credits in 2009/10 growth was 9% Basic earnings per share as defined by IAS 33 was 31 28 pence per share (2010 46 29 pence per share)

Dividend

The Board is recommending an increase in the total dividend for the year ahead with earnings to 19 40 pence (2010 17 60 pence) an increase of 10% which is 2.8 times covered by underlying earnings per share (2010 2 9 times) The final dividend per share for the year 2010/11 would therefore be 14.2 pence per share (2010: second interim dividend 12 8 pence)

Cash flow and net debt

	2010/2011 £m	2009/2010 £m
Cash generated from operations	308 5	170 3
Capital expenditure (net)	(33 2)	(23 7)
Interest paid (net)	(50 0)	(18 5)
Taxation	(19 3)	(1 7)
Free cash flow	206 0	126 4
Acquisitions and disposals net of cash/debt acquired	(574 3)	(37 9)
Investments in joint ventures	0 2	–
Movement in own shares	(2 2)	(1 9)
Dividends paid	(51 5)	(36 9)
Exchange difference	(4 9)	(0 5)
Net cash (outflow)/inflow	(426 7)	49 2
Opening net debt	(302 3)	(351 5)
Closing net debt	(729 0)	(302 3)

In a long-term contracting environment the Group's focus on delivery of cash is of paramount importance and the level of cash generated is a key indicator of the financial position of its contracts as well as the business as a whole This year, with the acquisition of VT and the consequent increase in debt on the balance sheet, the benefits of ensuring optimal cash generation have been demonstrated in the rapid reduction of debt The Group's net debt position is set out below

		2010/2011 £m	2009/2010 £m
US Private Placement Loan notes			
Seven year note	2017 maturity	60 0	60 0
Seven year note	2018 maturity	93 6	–
Ten year note	2020 maturity	311 9	–
Ten year note	2019 maturity	40 0	40 0
Net debt derivative		1 0	–
PFI debt		17 3	–
Bank revolving credit facility			
Five years	2012	277 0	225 1
Overdrafts		31 6	160 6
Cash		104 3	189 6
Lease finance		4 0	6 2
Closing Net debt		(729 0)	(302 3)

Cash generated from operations was £308 5 million representing a conversion rate KPI: Page 16 relative to operating profit of 146% (2010. £170 3 million and 121%) the highest rate within the last five years for the Group Tight control of working capital and capital expenditure contributed significantly to this although payments received ahead of turnover were somewhat higher than we would normally experience and have also contributed to the high conversion rate Consequently, we anticipate that there will be some unwind of the absolute level of these payments over the course of the next financial year which could reduce the overall conversion rate for 2011/12

Capital expenditure (net) was £33.2 million (2010 £23 7 million) and the principal areas of expenditure were for dockyard infrastructure upgrades in Marine and Technology and the commencement of a major information technology (IT) project to upgrade and integrate the systems of the enlarged group post the acquisition of VT This is expected to cost in order of c £25 million of which £4 million was spent in 2010/11 with the balance expected to be spent in 2011/12

Cash interest (net) was £50 0 million (2010 £18 5 million) reflecting the additional interest expense incurred on the debt raised for the acquisition of VT Cash interest excludes that paid by joint ventures except where payments are made to the Group on loans to joint ventures

After **taxation** payments of £19 3 million (2010. £1 7 million), **free cash flow** was £206 0 million (2010 £126 4 million) an increase of 63% year-on-year

Within **acquisitions and disposals** the most significant cash event during the year was the acquisition of VT for a net cash outflow of £570 million and an analysis of the relevant cash flows is summarised below for ease of reference There were, in addition, two minor transactions in the year: the disposal of Acetech, a non-core supplier of agency labour, for £2 2 million net and the acquisition of Evergreen Unmanned Systems, a supplier of technical support to users of unmanned aerial vehicles (UAV's) for £8 9 million (US$14 million)

The Group acquired VT on 8 July 2010 for a total cost of £1 5 billion, financed by the issue of equity shares (129 0 million Babcock ordinary shares) valued at £806 million (including the costs of issuance) and from cash resources The cash element of the consideration was sourced from the Group's existing £600 million revolving credit facility and a new £400 million bridge finance facility A full analysis of the consideration and the net assets acquired is set out in note 30 to the accounts

Cash dividends paid in the year totalled £48 0 million (2010 £34 7 million) being the second interim dividend in respect of financial year 2009/10 and the interim dividend in respect of 2010/11, plus minority dividends of £3 5 million (2010 £2 2 million).

	Cash net of cash/debt acquired disposed £m	Transaction costs paid £m	Shares issued	Total £m
Acquisition of VT Group PLC	569 8	12 3	802 0	1384 1
Other acquisitions and disposals	4 5	0 5	–	5 0
	574 3	12 8	802 0	1389 1

The Group's **net cash outflow** was £426 7 million (2010 inflow £49 2 million) leaving **net debt** at the year end of £729 0 million (2010: £302 3 million) Leverage ratios, whilst higher than at the end of 2010 as a result of the VT acquisition, remain comfortable and well within covenanted levels We maintain a series of KPIs as a measure of the financial condition of the Group and these are set out in the charts on pages 16–17 The debt service ratio represented by EBITDA/net interest coverage KPI Page 16 , as calculated for covenant purposes, was 5 3 times (2010 10 2 times) against a covenanted level of over 4 times and the net debt to EBITDA ratio KPI Page 16 was 2 4 times (2010 1 6 times) compared to a covenant level of less than 3 5 times Overall, the Group's gearing ratio at 31 March 2011 KPI Page 16 was 59% (2010 74%) Whilst these ratios will inevitably 'peak' at the time of significant acquisitions the charts should demonstrate a clear downward trend post the acquisition as we continue to focus on reducing net debt Discussion of the Group's treasury policy and activity during the period is set out later in this financial review

VT acquisition

At the time of the acquisition we identified £50 million per annum of merger benefits plus £8 million of financial synergies (post tax) which would accrue as a result of the combination The integration of VT is progressing well and we had achieved an annualised run rate of merger benefits of c £15 million as well as the total £8 million of financial synergies This is ahead of our original planning assumptions, although we expect to deliver the anticipated merger benefits and in line with the timescale published at the time of the acquisition

The costs of delivering the merger benefits were estimated at £45 million at the time of the acquisition By 31 March 2011 £10 8 million had been incurred and as described above and at note 10 to the accounts, has been included in exceptional charges in the income statement

During the year we have been undertaking a review of our business portfolio as part of the strategic planning process This may lead to further changes in the structure of the Group when it is concluded later this year As part of this process the Waste operations have been identified as non-core and exit options considered

Pensions

The Group provides a number of defined benefit and defined contribution schemes for its employees The largest defined benefit schemes are the Babcock International Group Pensions Scheme, the Devonport Royal Dockyard Pension Scheme and the Rosyth Royal Dockyard Pension Scheme whose combined assets of £1 8 billion represent 70% of the total assets All the schemes are closed to new members except where defined benefit pension provision is mandated for former public sector employees transferring into the Group in relation to specific contracts

Investment strategy

An investment sub-committee operates across the three largest schemes to implement a consistent strategy with a view to de-risking the schemes as funding levels improve and when market conditions favour the purchase of derivatives to manage interest and inflation risk. Approximately 50% of the total assets of the schemes are held in diversified common growth funds with the balance in a mixture of hedging assets including bonds and derivatives.

Funding valuations

The valuation dates for the three largest schemes are set so that only one scheme is being revalued each year in order to spread the impact of market movements in assets and liabilities The valuation for the Devonport scheme is due 31 March 2011 and for the Rosyth scheme on 31 March 2012 with any consequent cash requirements being implemented from 31 March 2012 and 2013 respectively

A valuation of the Babcock Group scheme was completed by an independent actuary as at 31 March 2010 based on a market value of the assets and a prudent approach to the setting of the assumptions, as agreed with the Company, to assess and value the expected benefit payments from the scheme The valuation revealed a funding deficit of £44 million to be recovered by additional contributions paid by the employer over eight years

Defined benefit pension schemes taken on as a result of the VT acquisition had funding deficits at 31 March 2011 totalling £119 million and requiring cash contributions of £27 million in 2011/12.

The total funding deficit on all schemes, including the former VT schemes, as at 31 March 2011 was £298 million The total cash contributions expected to be paid by the Group into the pension schemes during 2011/12 are £98 million of which £30 million was paid prior to 31 March 2011 Of the balance, £8 million of the contributions are in respect of longevity swaps executed in 2009/10 and £59 million in respect of future service accrual. Recoveries of contributions for future service accrual in Marine and Technology via contractual commercial terms represent c £34 million per annum leaving £34 million to be funded from other Group contracts

Financial review continued

Accounting valuations

The IAS 19 pension valuation for accounting purposes showed a market value of the assets of £2 6 billion in comparison to a valuation of the liabilities using a discount rate based on AA corporate bond rate of £2 8 billion representing a 93% funding level

A summary of the key assumptions used to value the largest schemes is shown below The most significant impacts on the results of the valuations are the discount rate, rate of future salary increases and the rate of expected inflation. The impact of the longevity swaps transacted during 2009/10 will help to limit the impact of increasing allowance for longevity at future valuations.

	Devonport	Babcock	Rosyth
Discount rate	5 6%	5 6%	5 6%
Rate of increase in salaries	3 05%	3 05%	3 05%
Rate of increase of pensions in payment	2 75%	2 5%	3 0%
Life expectancy of a male currently aged 65	22 1	22 6	17 7

The total accounting deficit, pre-deferred tax, at 31 March 2011 was £225 million (2010 £324 million) and the expected IAS 19 service cost in 2011/12 is £47 million (2010 £46 million) The net IAS 19 charge to profit and loss after allowing for interest on scheme liabilities and expected returns on scheme assets for 2011/12 is £20 million (2010 £29 million) Further details on the Group's pension schemes can be found at note 26 to the accounts

Mergers

During 2011/12, the Group expects to complete the merger of three of the schemes operated by the VT Group into the Babcock scheme which will add a further £355 million to the assets of that scheme. The largest three schemes will then account for 85% of the total assets of all the schemes

Governance

Professional and effective pension scheme management is paramount to enable members and sponsors to be confident in the trustees' stewardship of the schemes As such, in addition to the investment sub-committee referred to above, a cross scheme governance committee has been established across the three largest schemes to improve the effectiveness of the trustee boards, sub-committees and advisers as well as to enhance trustee training and decision making Suitable measures will be introduced to ensure continuous improvement in these areas

Treasury

Treasury activities within the Group are managed in accordance with the parameters set out in the treasury policies and guidelines approved by the Board A key principal within the treasury policy is that trading in financial instruments for the purpose of profit generation is prohibited, with all financial instruments being used solely for risk management purposes.

The Group only enters into financial instruments where it has a high level of confidence of the hedged item occurring Both the treasury department and the divisions have responsibility for monitoring compliance within the Group to ensure adherence with the principal treasury policies and guidelines

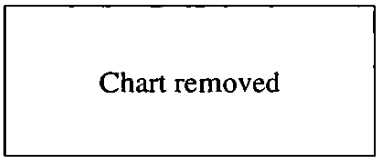
The Group's treasury policies in respect of the management of debt, interest rates, liquidity, and currency are outlined below The Group's treasury policies are kept under close review given the continuing volatility and uncertainty in the financial markets

Debt

Following the acquisition of VT Group plc in 2010, the Group took the opportunity to review its capital structure The key objectives were to ensure that the Group had an appropriate balance between continuity, flexibility and cost of debt funding through the use of borrowings, whilst also diversifying the sources of these borrowings with a range of maturities and rates of interest, to reflect the long-term nature of the Group's contracts and commitments and its risk profile

All the Group's material borrowings are arranged by the treasury department, and funds raised are lent onward to operating subsidiaries as required

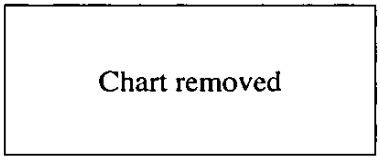
In the early part of 2011, the Group issued US$650 million of seven and ten year notes in the US Private Placement market This comprised of US$150 million of seven year money and US$500 million of ten year money. The proceeds from these notes were swapped into sterling and used to repay the £400 million acquisition facility taken out by the Group in 2010 as part of the financing of the VT acquisition



It remains the Group's intention to ensure the business is prudently funded, and to retain sufficient headroom on its facilities to fund its future growth

Interest rates

The Group's objective is to manage its exposure to interest rate fluctuations on borrowings by varying the proportion of fixed rate debt relative to floating rate debt to reflect the underlying nature of its commitments and obligations As a result, the Group does not maintain a specific set proportion of fixed versus floating debt, but monitors the mix to ensure that it is compatible with its business requirements and capital structure



Liquidity

The Group's objectives are to

Maintain adequate undrawn committed borrowing facilities

Monitor and manage bank credit risk and credit capacity utilisation

The Group's committed Revolving Credit Facility (RCF) of £600 million has an expiry date of June 2012, and is available to meet general corporate funding requirements As at the balance sheet date, work had already commenced on renegotiating this facility, and it is expected that the new RCF will be signed by summer 2011

Each of the business divisions in the Group provides regular cash forecasts for both management and liquidity purposes These cash forecasts are used to monitor and identify the liquidity requirements of the Group, and ensure that there is sufficient cash to meet operational needs while maintaining sufficient headroom on the Group's committed borrowing facilities The cash performance of the business divisions is a KPI

The Group adopts a conservative approach to the investment of its surplus cash It is deposited with strong financial institutions for short periods, with bank counterparty credit risk being monitored closely on a systematic and ongoing basis A credit limit is allocated to each institution taking account of its market capitalisation and credit rating

Currency

The Group's objective is to reduce its exposure to volatility in earnings and cash flows from movements in foreign currency exchange rates. The Group is exposed to a number of foreign currencies, the most significant being the US dollar and South African rand

Transactional risk

The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions To mitigate this risk, the Group's policy is to hedge all material transactional exposures, using financial instruments where appropriate Where possible, the Group seeks to apply IAS 39 hedge accounting treatment to all derivatives that hedge material foreign currency transaction exposures

Translational risk

The Group is exposed to movements in foreign currency exchange rates in respect of the translation of net assets and income statements of foreign subsidiaries and equity accounted investments It is not the Group's policy to hedge the translation effect of exchange rate movements on the income statement or balance sheet of overseas subsidiaries and equity accounted investments it regards as long-term investments

Operating review

We continue to grow our position as the UK's leading engineering support services company. In an environment where engineering knowledge and skills are scarce, and strengthened by the acquisition of VT, we have a workforce of significant scale and depth of knowledge that is highly regarded by our customers. Across our businesses, in both the UK and overseas, we will seek to build on this position to deliver sustainable and profitable growth for our shareholders.

UK defence market

In the current economic environment, the requirement of our major customer to reduce costs whilst maintaining operational efficiency is entirely consistent with our business model in both the Marine and Technology and the Defence and Security divisions We believe this requirement will lead to opportunities for increased outsourcing of support activities as a key driver to achieve its goals

All three of the UK's armed forces are facing a reduction in manpower numbers over the next five years although world events continue to make significant operational demands on them This dynamic is already leading to significant structural reform and a requirement within the Ministry of Defence (MoD) to maximise efficiency and optimise support to front line operations The introduction of the Defence Reform Unit reinforces this change as the MoD seeks to maximise output with reducing resources.

Following the General Election in May 2010, the Government announced it would be carrying out a Strategic Defence and Security Review (SDSR) The SDSR was published in October 2010 and sought to balance the current and future needs of the UK's armed forces in response to increasing budgetary pressure

For Marine and Technology, the SDSR included a number of positive decisions for the division and removed uncertainty around some of the key projects we are involved in

The commitment to complete the build of the two new Queen Elizabeth (QE) class aircraft carriers was welcomed as was the decision to retain all three naval bases in the UK. These decisions provide certainty of work for our Rosyth facility through to completion of the two new carriers in 2016 and 2018, at the earliest, and a continuation of our role at HMNBs Clyde and Devonport.

The Government committed to retain the current submarine-based nuclear deterrent. This provides a stable base for our submarine support operations and a key role for the division in the Vanguard life-extension project, which has been estimated at a cost of £1 3 billion for three additional long overhaul and refuelling periods.

For the Defence and Security division the cancellation of the Defence Training Rationalisation (DTR) project, provides significant opportunities for us to expand on our position as the leading military trainer in the UK for all three services In addition, there is a significant pipeline of opportunities in the equipment support market where we believe we can build on our expertise

Marine and Technology

Revenue growth
Marine and Technology

5%

Chart removed

We believe the outlook for the Marine and Technology division is extremely secure in the UK and we are well placed to deliver significant long-term growth overseas.

Operational review

At £1,019.5 million, revenue growth for the Marine and Technology division was 5% benefiting from international submarine support activities in Australia, Canada and Spain as well as from increasing activity in the Queen Elizabeth (QE) class aircraft carrier programme Equipment Support continued to benefit from further supply chain contracts for the provision of minor equipment to the UK MoD Naval communications contracts transferred into Marine and Technology following the acquisition of VT contributed £29 million in the year These improvements were offset by completion of the Jackal all-terrain, high mobility vehicles contract which generated c £55 million in 2009/10 and some change of phasing within the submarine programme

Our Terms of Business Agreement (ToBA) with the MoD provides the framework for the strategic development of our core naval businesses In return for certainty of our naval support roles through to 2025, we have committed to deliver savings of over £800 million to the MoD while sustaining or improving our overall margins In the first reporting year we have already delivered savings which are greater than anticipated Through our naval base management roles at both Devonport and Clyde, now confirmed through to 2025, in partnership with the MoD we will be seeking to drive further efficiencies The ToBA also provides the opportunity for us to identify additional outsourcing opportunities which can both enhance the service that we already provide and deliver additional cost savings to the MoD The ToBA is a significant contribution to the MoD's overall cost reduction challenge, but it also provides us with certainty and the potential for growth

In the last 12 months in our role as the Royal Navy's major warship partner, we have undertaken critical deep maintenance on a number of surface warships The amphibious assault ship HMS Bulwark completed its first major docking period at Devonport and work on HMS Northumberland is underway whilst at Rosyth maintenance and upgrade work has been carried out on the aircraft carrier HMS Illustrious, the frigate HMS Argyle and the mine warfare vessel HMS Blyth and work is underway on the frigate HMS Kent

The QE class aircraft carrier project has made significant progress in the last 12 months The new 1,000 tonne Goliath crane arrived in Rosyth as planned and will play a crucial role in the assembly programme for the two vessels As well as having responsibility for constructing some of the sections, we continue to play a major design role At our Appledore facility we are making excellent progress on the sections we are building with a number already delivered to Rosyth We expect the first major hull section from the other UK build yards to arrive in late 2011 We have also completed the delivery of major weapons handling systems for both carriers in readiness for installation We expect to benefit from the decision to reconfigure the vessels for non-STOVL aircraft, which will require significant extra packages of engineering work to be undertaken

Operating review continued

We have now completed the first full year of the long-term Submarine Engineering Support Contract, where we have a key role developing a full 'flotilla output' availability-based support arrangement This will ensure the Royal Navy has the most cost-efficient through-life support.

Work continues on the Long Overhaul Period (Refuelling) (LOP(R)) of HMS Vigilant With the reactor refuelling process now complete the project is expected to complete in late 2011 Planning and preparation work is underway for the LOP(R) on HMS Vengeance. We already have a role in the development of the new deterrent submarines but we believe the strength of our expertise in submarine support and our ownership of unique naval nuclear infrastructure will provide opportunities for enhancing our long-term role in this programme

During the year we have also undertaken a number of in-service maintenance packages on the UK submarine fleet including the first in-service maintenance package for HMS Astute The SDSR confirmed that seven Astute class submarines will be built and we already have a key role in this programme to design and deliver the weapons handling and discharge systems To date we have completed systems deliveries to the fourth Astute Class submarine and have an early order placement for systems for the fifth boat This keeps our work programme ahead of the overall Astute programme timetable.

In both Canada and Australia we are engaged in markets that remain strong Both countries are progressing with gradual reform programmes for naval support that will lead to long-term incentivised arrangements of interest to Babcock.

In Canada progress continues on the major refit of HMCS Chicoutimi and good progress is being made at our facility in Victoria In Australia we continue to develop relationships with the Australian navy and are developing our involvement in their current submarine programme through our weapons handling and discharge systems In both countries we have pre-qualified to tender for initial packages of long-term support work for surface ships We expect further progress on these and subsequent contracts during the next financial year

In other international markets our activities are focused on specific long-term naval programmes. In Spain, the S-80 submarine programme is key to future naval capability and is unaffected by broader economic pressures To date, we have delivered major sub-systems for this programme and have successfully completed testing of the Air Turbine Pumps, built at our Submarine Pumps Centre of Excellence in the UK We have also completed the concept design for weapons launch and handling systems for the South Korean indigenous submarine programme and we have been approved as a local partner for future phases of work

Our equipment support operations continue to provide engineering support for a number of key assets, as well as procurement and logistics support to all three services During 2010/11 we were down selected as sole industry bidder for the MoD's Maritime Equipment Transformation programme This contract is expected to be worth in the order of £300 million over 10 years and is the first part of the MoD's extensive programme to improve overall procurement and supply chain management.

During the year, the MoD has continued to progress the Submarine Dismantling Project and has identified our facilities at Rosyth and Devonport as the two potential sites to carry out dismantling work We are actively involved in the development of this project and would expect to see further opportunities resulting from the strength of our naval nuclear engineering capabilities

Divisional outlook

In the UK, as a result of our ToBA and through our positions on a number of key naval programmes, we are well positioned to assist the MoD and Royal Navy as they seek to reduce costs and improve operational efficiency In addition, there are a number of new opportunities where our skills, know-how and infrastructures will play a significant role Overseas, we are seeking to build on our existing submarine positions in Canada and Australia to contribute further to their submarine programmes as well as into surface ship support We believe the strength of our business model will also provide significant opportunities in a number of other international naval markets

We believe the outlook for the Marine and Technology division is extremely secure in the UK and we are well placed to deliver significant long-term growth overseas

Defence and Security

Revenue growth
Defence and Security

434%

Chart removed

We believe we are well placed to benefit as the MoD starts major outsourcing initiatives that align with our core capabilities.

Operational review

The Defence and Security division, which comprises predominantly former VT activities, saw revenues including the Group's share of joint ventures, increase to £469 million (2010 restated £88 million) Underlying growth on former Babcock continuing businesses was £19 million, or 22%, largely arising from significantly higher activity levels in the Royal School of Military Engineering (RSME) contract, partly through scope increases and partly through programme mobilisation

In addition to the extra activity at RSME, the division benefited from good performance on the Royal Navy Flagship Training contract and in the MoD 'green fleet' and 'white fleet' management contracts, where additional volume supported revenues In general, contract performance was excellent and this is reflected in the division's margin performance

The two major Private Finance Initiative (PFI) joint ventures for the Future Strategic Tanker Aircraft (FSTA) and UK Military Flying Training Systems (UKMFTS) saw the completion of the Main Operating Base (MOB) phases of both sub-contracts with associated revenues of £26 million As both contracts move into the service delivery phase in 2011/12, the Group's share of revenues from the joint ventures, which totalled £37 million in 2010/11, are expected to increase while sub-contract revenues and margins decline RAF multi activity contract revenues remained broadly stable

Activities on these two joint ventures have continued to make good progress and are performing in line with our expectations

The UKMFTS effort has been in support of Advanced Jet Training and Rear Crew Training. Following the practical completion of the construction phase in August 2010, the Advanced Jet Training (AJT) programme based at RAF Valley, Anglesey, has successfully achieved its 'Ready for Training Use' milestone sign off thus allowing occupation of the facility and the start of operations in support of fast jet pilot training Our responsibility has now moved to focus on the delivery of through life maintenance for the remaining 22 years of the PFI contract Similar success has been achieved with the Rear Crew Training element of the UKMFTS programme. The project involved the refurbishment of facilities at two sites: RAF Barkston Heath in Lincolnshire and RNAS Culdrose, Cornwall The facilities were certified as 'Ready for Training Use' in March 2011 and were occupied in April 2011, when long-term support for the facility began.

The construction phase for the Main Operating Base (MOB) in support of the FSTA programme was completed by the end of March 2011 and AirTanker Services and the RAF teams occupied the facility in May 2011 A key component in the delivery of the service is the Communications Information System (CIS) at the heart of the operation Development, delivery and integration of the CIS to support occupancy of the MOB in May 2011 and the programme has continued to meet the delivery milestones

Operating review continued

The airfield and operational support contracts continue to perform well Under the Hawk IOS and AJT contracts we supported 88 aircraft to deliver over 17,000 flying hours At RAF Linton-on-Ouse we supported 52 Tucano aircraft to deliver over 10,000 flying hours and our own fleet of 119 Grob 115e Tutor aircraft delivered over 39,000 flying hours to the Light Aircraft Flying Task contract

New business activity has focused on the next generation of contracts to deliver fixed wing flying training capability to UKMFTS We have formed a consortium with BAE Systems, Pilatus and GAMA to bid this programme. As our RAF customer looks to find efficiencies arising from the impact of SDSR we anticipate further opportunities to support aircraft and equipment capitalising upon our existing position within the military flying training system

Our training and support operations continue to deliver high levels of service across all contracts and this year the MoD's Supplier Relations Team (SRT) have evaluated contract performance as 'excelling'

Our contract for the provision of construction vehicles to the Royal Engineers now delivers over 2,000 vehicles on demand across the world in support of training and operational activities During the year we won a service extension to provide maintenance and repair of those vehicles on operations through a permanent maintenance unit based in Camp Bastion, Afghanistan

We also manage some 15,000 white fleet vehicles and a further 600 armoured and patrol vehicles on behalf of the MoD This experience leaves us well placed as the MoD reviews outsourcing options to deliver efficient support across its entire fleet of vehicles numbering around 80,000 assets

At RSME we have concluded the second year of operation with a number of significant milestones being achieved Three new buildings have been delivered and we have also begun transformation of the student training using modern learning techniques and are working closely with the customer to implement these improved processes Initial pilots have demonstrated that we can deliver additional value to our customer by leading their training transformation

We have also been awarded a contract extension to provide army training services at Bordon and Arborfield, through to 31 March 2012 at a value of c £19 million, and have been selected as Preferred Bidder for the Training Establishment Support Contract for Bordon and Arborfield, which is worth c £22 million over four years starting on 1 August 2011 and will provide support to training at both sites At Bovington we have continued to successfully deliver training for tracked vehicle drivers and maintainers alongside fleet availability management of over 300 of the armoured and patrol vehicles.

Further outsourcing of individual training offers the MoD a proven route to achieving improved service delivered at reduced cost and we therefore expect the MoD to bring a number of competitions to market Our extensive footprint in this area, combined with our understanding of our customer's ethos, positions us well for future MoD training opportunities.

Our Flagship training and facilities management contract continues to perform extremely well, customer relations remain strong and we continue to achieve high standards, with an 'excelling' SRT score this year Similarly, our International Training contracts continue to perform in line with the expectations of our customers Significant investment has supported the development of thought leadership programmes with the Royal Navy to ensure a modern training environment is maintained. This has also been supported by the installation of Learning Content Management Systems, Coaching Programmes, and Capability Management Systems across all contracts

Building upon our extensive knowledge and success of delivering crew training to international navies, we have secured a multi-million pound training contract from STX OSV Brattvaag who are contracted to build three special purpose vessels for an international client The package will provide training for the crews and base maintainers of each vessel The training being delivered by Flagship includes English language, salvage, rescue, towing, fire fighting and pollution prevention

Flagship has been selected as Preferred bidder by the Royal Navy for the Fleet Outsourced Activities Project (FOAP) The contract is for an initial period of six years and requires the provision of a variety of activities including the instructional delivery, training design and training support The contract has an initial value of c £90 million

Discussions with our customer on alternative solutions for the DTR programme are progressing well, and we expect to see further interim extensions to our training and FM contracts awarded whilst a sustainable and long-term solution is formulated

The SDSR and CSR are forcing the Royal Navy to make tough spending decisions and we are focused on offering solutions and potential training scenarios, which will leave us well placed to secure future outsourcing business.

Divisional outlook

The MoD has already started major outsourcing initiatives that align with Babcock's core capabilities and we believe we are well placed to benefit from these Following SDSR and the cancellation of the Defence Training Rationalisation project (DTR), the MoD is finalising its approach to training and support solutions for both its vehicle fleets and aircraft, areas where we have a demonstrable track record of delivering efficiencies

In addition, these programmes will encompass estate rationalisation as the MoD seeks to reduce the number of sites on which it operates. This will provide further opportunities for us to leverage our current infrastructure projects

Support Services

Revenue growth
Support Services

38%

Chart removed

We remain confident that our markets provide significant long-term growth opportunities.

Support Services market

The current economic climate continues to constrain public and private sector budgets The Comprehensive Spending Review (CSR) was broadly positive for the Support Services division and has highlighted a number of areas where spending will be protected and prioritised focusing on achieving greater efficiencies or improvements in service As a result we believe our capabilities will be in increasing demand as our customers seek greater support

Across our business we have a keen focus delivering value for our customers, supporting them to deliver more against a constrained funding background, and focusing on activities with technical demands and a clear need for client partnering to succeed We can achieve this in three ways through continued enhancement of existing contracts, by extending our customer relationships offering a broader range of services and by seeking to create new opportunities in five key growth markets

Energy

After some years of financial constraint, the UK nuclear decommissioning market is now starting to ease with a good pipeline of opportunities becoming visible The Nuclear Decommissioning Authority (NDA) achieved a positive outcome from the Government's recent Spending Review and secured an average of £3 billion funding for the next four years This work involves the dismantling of redundant nuclear reactors and the clean-up of radioactive waste at sites throughout the UK, is an essential stage ahead of the new nuclear build programme Through the acquisitions of both UKAEA Ltd and VT our skills have been enhanced and we now execute some of the most challenging decommissioning projects in the UK We estimate our current project work along with our site management work totals around 9% of the addressable market in the UK.

Babcock is one of two leading service providers in the UK power transmission sector In a market where specialist skills and knowledge are rare and in high demand, we have a team of highly skilled engineers and technicians able to deliver the design, construction and refurbishment of high voltage overhead power lines and related infrastructure

The UK's electricity networks are undergoing a substantial period of investment as the country seeks to meet challenging climate change targets and address a potentially significant increase in energy demand Current projections indicate investment of up to £3.2 billion will be required to upgrade and renew the current ageing infrastructure, provide connections for renewable generation and provide smarter grids to ensure that the demand for electricity can be met.

National Grid, is leading this investment programme and during 2010/11 completed a rights issue, raising £3 2 billion to fund a significant increase in its UK capital programme which will total £22 billion over a five year period As a key partner in the National Grid's Energy Alliance West, this increased investment will create good opportunities for the division

Operating review continued

Mobile assets

Babcock works with customers in both the public and private sector to provide comprehensive support for the management and operation of large, complex mobile asset fleets, vital to their core operations

As our customers face increasing pressure to lower costs and minimise disruption to essential activities, we have established a track record of improving the availability of assets whilst reducing total through-life costs Our independence and desire to actively support and integrate our customers' primary business activities enables us to differentiate from traditional competitors such as leasing companies and equipment manufacturers.

Education

Large scale changes are taking place across the education landscape creating opportunities for our education business. Service providers have to respond to cuts in local authority funding and increased devolvement of powers to individual schools We have developed a good track record, developing an innovative way of working with schools and local authorities to deliver outstanding educational results at significantly reduced costs The appetite for outsourcing is increasingly strong and the pipeline for schools improvement services is growing

Training

The UK apprenticeship training market remains strong As part of Budget 2011, the Chancellor of the Exchequer announced a £180 million package for 50,000 extra apprenticeship places this equates to the delivery of at least 250,000 more apprenticeships over the next four years This is in addition to the existing c 270,000 apprentices on programme per annum

Babcock delivers around 10% of all UK apprenticeships and is the largest provider of training in the UK In 2010 we accessed over £42 million of government funding on behalf of clients and learners, making us the second largest direct contract holder with the Skills Funding Agency Our core areas of operation are the engineering and service sectors Training suppliers in both sectors remain fragmented which, combined with Central Government focus on improving the skill base within the UK economy, highlights this sector for continued growth

To complement our apprenticeship training delivery, we have developed a broader training capability and are now trusted by a number of major customers to provide not just basic job skills but training for key business capabilities Focusing on the Aerospace & Defence, Automotive, Energy, Nuclear and Rail sectors, we aim to capitalise on synergies with Babcock's core operating sectors

Central and local government property

Babcock has significant experience in strategic asset management, estates and property management, hard and soft facilities management and supply chain management working extensively with government agencies, local authorities and the education sector. Our public sector customers have severely constrained budgets so to drive efficiency and raise standards they are increasingly looking to outsource services

A number of significant strategic government property opportunities are coming to the market which include the consolidation of contracting arrangements within central and local government as well as further outsourcing of services With an established position in MoD estate management, we are seeking to increase our market share in this sector

Operational review

The integration of VT businesses and subsequent restructuring has progressed rapidly and smoothly, and as result the distinction between revenue from pre-acquisition activities has become less precise However, of total Support Services revenue, including the Group's share of joint ventures, of £946 6 million for the year, approximately £269 million was from former VT businesses, leaving approximately £(9) million or (1)% representing year-on-year reduction in the old Babcock businesses Operating return on revenue at 8 4% continued to improve during the second half of the year as merger benefits were captured and good contract performance was recognised.

After a slow start to the year in Nuclear, there were clear signs of an increase in activity during the second half of the year with a number of contract awards at Sellafield and AWE contributing Infrastructure saw lower overall volume in the Regional Prime contracts as the customer cut back on its programme of extra-to-contract works, however, facilities management activity at RSME and also on the Building Schools for the Future contracts increased Revenue declined slightly in Critical Assets from programme slippage in the non-National Grid power transmission operations but activity levels remained high on both the emergency services fleet management and communications contracts Rail revenue declined year-on-year as a the High Output track renewals contract ended in 2009/10 Profits for the division benefitted from ongoing improvement in profitability in Rail, amidst signs of an overall improvement in the commercial environment Profitability in the Nuclear operations has also remained strong

There is a broad political consensus in support of the Government's response to the devastating effects of the recent earthquake and tsunami in Japan The UK nuclear industry also believes the Government's response steers the right course by not rushing to judgement while ensuring that the lessons learned through an independent and comprehensive report of the facts, which is being drawn up by the Chief Nuclear Inspector over the next six months, are fully applied in a proper way The utility companies involved in the UK nuclear new build programme expect this to be achievable and continue to develop their plans Over the past 12 months Babcock has built strong relationships with members of EdF's existing supply chain and together we have positioned ourselves to support EdF Energy's planned new builds at Hinkley Point C and Sizewell C

In the nuclear decommissioning market, our ability to demonstrate one of the widest and deepest nuclear capabilities in the market is beginning to show with the recent award of the B41 contract at Sellafield with Bechtel, expected to be in the order of £120 million for all three phases through to March 2017, supporting the earlier BEPPS win, £140 million for Phases 1 and 2 also through to 2017 The nuclear business is heavily committed to securing the Dounreay PBO contract to deliver the decommissioning of a site that we have been involved with since its original commissioning.

The Regional Prime contracts have continued to perform in line with our expectations with additional works only starting to come through in the second half of the year. Both the South West and East Prime contracts have now been formally extended through to 2014 and the Defence Infrastructure Organisation develops the replacement Next Generation Estates contracts. Building on our position as the leading facilities management partner for the MoD, in February 2011, we were awarded the £170 million, five year contract to provide services to the British Forces' establishments in Germany.

The Education and Training business has continued to perform well Our apprentice training operations have made good progress growing their footprint in the automotive sector with key contract wins with Hyundai, Fiat, Alfa Romeo and Ferrari Europe

Our Alliance with Amec and Mott MacDonald delivering overhead line engineering services to National Grid performed strongly in the year and we are working closely with National Grid as it positions itself for major capital investment programme through the coming regulatory control period Our Power business achieved zero major accidents through the year with over 3 3 million man hours worked

As previously reported, we have decided to exit our Waste operations and have signed a teaming agreement with Shanks to progress the Wakefield contract to financial close Once this has been achieved, the agreement provides a mechanism for Shanks to acquire the business. We expect this will be achieved later in this year

In addition to new contracts mentioned above, we have secured significant elements of our existing contract base with an extension to our UK Power Networks contract and successful rebids for the BAA baggage handling contract (£120 million over six years) and Radiometrics and Calibration services at Sellafield (£86 million over 12 years) Further, we are now in sole source negotiations with the BBC for the rebid of the World Service contract effective from 2012 Throughout this year we have not lost any rebids

Divisional outlook

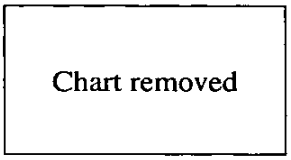
We remain confident that our markets provide significant long-term growth opportunities The current economic climate is driving our customers to seek greater value and innovation and our broad technical capability and customer focus places us in a strong position from which to benefit

Operating review continued

International

Revenue growth
International

164%



Operational review

With the addition of the former VT US business revenues of £196 million, total International divisional revenues increased by 164% The South African equipment business saw a significant rebound in sales of Volvo equipment to the mining sector which drove a 51% increase in revenue year-on-year Power station outage support work and high voltage line installation for Eskom were also seen to be more buoyant in the second half of the year helping to push total revenue from South Africa to £251 million (2010 £166 million) a 51% increase.

The US business had good success in its rebids on two major contracts but competitive pressure on margins for Department of Defence (DoD) business remains The oil and gas pipeline design and construction market was active, driving a 50% increase in revenues from Eagleton to £12 million (2010 £8 million)

Foreign currency translation gains on like-for-like revenues were £26 million (2010 £29 million)

South Africa

In South Africa, the aftermath of the global economic crisis of 2008/09 continued to be felt throughout most of 2010, however for our business this was offset by world demand for commodities Ongoing commitment to excellence through service to customers has ensured that the division maintained its prominent position in markets served and as a result, during the year we were awarded 'Silver' partnership status with Volvo Construction Equipment, one of only three international dealers to achieve this In 2010 we also added the DAF truck franchise to our operations and launched the heavy vehicle range

We have continued to experience a good level of enquiries into 2011 which is encouraging for the year ahead Many new mining projects are coming on stream and existing mining operations are being expanded This has helped our Equipment business in the latter part of 2010 and should continue to provide opportunities The relatively high cost of finance and the very conservative approach by banks to lending has hampered local demand. Parts and service revenue has grown during the year as customers chose to run their fleets for longer than normal, but it is likely that, in a number of these instances, customers will need to start replacing older machines, driving further increase in demand

Southern Africa's critical shortage of power creates large opportunities for power station support services in an effort to provide continuous supply through planned outage maintenance and breakdown services This is likely to continue unabated for the next 15 to 20 years The demand for power has driven the need for expansion of the transmission line networks and, in spite of stiff competition from foreign importers, we have won significant powerline orders

Throughout the downturn we have taken the opportunity to review and reshape our business, to strengthen our skills base and generally to prepare ourselves to take full advantage of the recovery

The business will be entering 2011/12 with a strongly improved order book Low interest rates and the current global demand for commodities are likely to stimulate investment in new mining projects The need for infrastructure investment in southern Africa remains a priority for economic growth in the region and we remain confident that such projects will come to fruition The outlook for the year ahead is encouraging We have a firm African footprint that will both contribute to and benefit from the new spirit of confidence on the continent

USA

In the US, the defence business has continued to perform in line with our expectations, despite the competitive trading environment. The DoD is reviewing its spending requirements and, as publicly stated, there is a definite desire and trend to do more with less We have responded to these conditions by developing more innovative contracting techniques and integrating solutions using key partners and suppliers

There has been further impact from the DoD's move to use small local businesses rather than large corporates to deliver contracts and, unlike the UK, its move to insource While insourcing has abated, the small business preference has increased We expect this will drive a further shift toward value added services and our customer will be looking for ways of mitigating risk

In January 2011 we were selected as one of four contractors for installation of Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) systems for the US Navy The contract includes a three year base period with an additional two year option The base contract we could expect to share in has a maximum value of $840 million and, if the option is exercised, the maximum contract value could be $1 3 billion

In July 2010, we were awarded a task order by the Naval Sea Systems Command (NAVSEA) to provide support for the Program Management Office for Naval Special Warfare (PMS NSW) This Indefinite Delivery Indefinite Quantity (IDIQ) contract has a potential value of around $50 million over five years We have been providing professional engineering services and strategic planning support to NSW and other government agencies

The Evergreen Unmanned Systems business acquired in the first half of the year has integrated into the US operations successfully, and has enabled us to offer a broader range of services to a range of government and commercial customers

Middle East

Despite the political unrest in many areas of the Middle East, we remain confident about the security of our current operations in Oman and Kuwait and believe our target markets continue to offer significant opportunities

Over the past year, through our management team in Abu Dhabi, we have been involved in active dialogue with a number of government departments and private organisations to introduce Babcock and the range and scale of the activities we are involved in as well as the strength of our track record Building on current contracts in the region and our significant expertise in the UK, we are looking at the following key areas of opportunity: military training, particularly flying training to complement our aircraft support roles, facilities management, both in the civil and defence markets, building on our extensive experience as a Prime Contractor to the UK MoD and Defence Infrastructure Organisation, Education and training, again in both civil and defence markets

Order book

Since the completion of the VT acquisition, the order book has remained stable at around £12 billion (2010 £8 billion) The ongoing strength of our order book reflects the constant flow of rebids and contract extensions as well as new contracts from the bid pipeline This provides us with excellent visibility We currently have over 65% of revenue contracted for 2011/12 and over 40% for 2012/13

In a tough economic environment and in common with peer companies, in the first half we experienced some slowdown in the number of contracts coming out to tender This trend started to reverse in the second half of the year and since the time of our half year results in November 2010 we have seen our pipeline of bids at PQQ (pre-qualification questionnaire) or ITT (invitation to tender) stage increase from around £5 billion to £8 5 billion (2010 £3 4 billion)

Corporate responsibility: supporting sustainable growth

We recognise that committing time and resources to the proper management of non-financial matters as well as financial performance is of critical importance to sustaining the long-term value and prospects of Babcock and to achieving our strategic goals. The acquisition of VT and its integration into the Babcock Group has been a further opportunity to review how we manage and evaluate our performance in areas including customer relations, human resources, health, safety and the environment. In the sections below, we look at our current principal areas of focus.

Other parts of this Annual report also touch on these areas, especially in our Operating reviews and the section 'Factors that could affect the business'.

Strengthening customer relationships

Image removed

Ensuring safety

Image removed

Developing and sustaining talent

Image removed

Running an environmentally efficient business

Image removed

Our commitment to governance and its role in sustaining long-term value

Image removed

Strengthening customer relationships

Because of the special profiles of many of our customers and the length of many of our contracts, a partnering approach which truly understands customer needs and the constraints and pressures on them is vital Collaborative working is at the heart of Babcock's business model helping us to address and often find innovative responses to the challenges our customers face and to fulfil their objectives

We have a well-embedded performance review system with the MoD, which is in its seventh year and have established customer survey and feedback arrangements with our other major clients We commit significant time and effort to monitoring, evaluating and improving our relationships with customers Customer satisfaction forms a key part of the non-financial objectives set in our senior management's annual bonus targets.

Supply chain engagement

The partnering approach we take in our relationships with our customers is also applied, where appropriate, to our supply chain Working collaboratively with our suppliers will enable us better to support the longer term requirements of our customers An example of our proactive approach to supply chain management is our involvement in the SC21 (supply chains for the 21st century) programme The programme is hosted by A|D|S and Babcock sits on SC21's Steering and Primes Working Groups Our supply chain management activity also extends to areas such as integrated business planning, joint risk and opportunity management and the hosting and facilitating of supply network engagement events

Ensuring safety

Maintaining an excellent safety record has for a long time been a major area of sustained attention across the Group Health and safety is a core value for Babcock: senior management bonuses are at risk if performance is unsatisfactory

Building on the work started with the 2008/09 safety cultural assessment, and following the acquisition of VT, our health and safety priority has been refreshed and re-emphasised, and the governance structure relating to health and safety management has been reviewed and clarified.

The Group Safety Leadership Team (SLT) composed of the Chief Executive and the Group's senior management team, the SLT is responsible for developing, agreeing and reviewing the Group's strategic approach to safety and providing leadership on safety across the Group

The Corporate Safety Steering Group (CSSG) composed of the Chief Executive and health and safety professionals from all four divisions, the CSSG reviews performance and trends, assesses the impact of legislative changes, acts on the output of the SLT and shares best practice

Divisional Safety Leadership Teams and Safety Steering Groups ensure that the Group health and safety policy, strategy and initiatives are relayed and implemented within the businesses

The annual Group Safety Conference promotes the Group safety vision, the sharing of best practice and rewards notable achievements.

Priority continues to be given to addressing behavioural and cultural attitudes underlying unsafe acts, as can be seen from the case studies in this section This year has also seen a particular focus at Group and divisional level on the interaction between safety and leadership, especially the role of first line management, with a number of initiatives and training programmes focusing on this

After their successful launch last year, Babcock's annual Safety Awards are in their second year and have seen an increase in the number of nominations coming up from business units, with a new award category being added specifically to recognise and reward our apprentices for safe behaviours

Marine and Technology

Intervention training designed to encourage and support employees to adopt a proactive role in ensuring the safety of colleagues as well as their own the training course is delivered at Devonport Royal Dockyard using professional actors recreating various scenes to demonstrate how to give and receive interventions This fresh and interactive approach to safety has been positively received by employees and helps strengthen the safety culture

Image removed

Defence and Security

"Don't Walk By" campaign An integrated safety campaign that has driven a dramatic turnaround in the safety culture and performance at the Royal School of Military Engineering This has led to the rolling accident frequency rate falling from 6 0 (12 month to Mar 10) to 2 86 (11 months to Feb 11) with the biggest improvement in the numbers of injuries to soldiers when in the training environment

Image removed

Support Services

Safe and Unsafe Acts (SUSA) campaign the primary aim of our Infrastructure business's SUSA campaign is to train employees to understand the behavioural side of safety and encourage them to take responsibility for their own and colleagues safety by improving communication through safety conversations Working together with the Customer and supply chain partners, the accident frequency rate has fallen by 61% since the launch of SUSA in 2009

Image removed

International

Safety Through Empowerment of People (STEP) programme building on the success of the training delivered as part of the STEP programme, 'Let People Talk' sessions are used at sites to follow up on the STEP training A further module has been added to the programme since February 2010 the Personal Motivators module encourages employees to reflect on why it is important to them from a personal perspective to make the right safety decision

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Corporate Responsibility: supporting sustainable growth continued

Performance

As a result of the sustained effort committed to the continual improvement of health and safety, year-on-year performance has improved, as reflected by the fall of just over 20% in both our total injuries rate and RIDDOR rate

We are also increasing our focus on near-miss incidents as an integral part of preventing accidents and injuries. Work is currently under way to improve the reporting of the severity of near-misses to give extra depth to the data being analysed and assist management in focusing on addressing areas which could lead to serious accidents before they happen.

	2007/08	2008/09	2009/10	2010/11
Total Number of Injuries	1636	2781	2530	1968
RIDDOR				
Fatalities	0	1	2	0
Major injuries	29	42	28	21
Over-three day injuries	86	148	164	130
RIDDOR totals	115	191	194	151

Chart removed

Chart removed

Developing and sustaining talent

We understand the importance of having the right people with the right skills now and in the future to deliver the exceptional service and integrated engineering and technical expertise which is the bedrock of our long-term relationships with our customers To deliver that service and expertise, we are continually improving our comprehensive talent management system, from apprentices and graduates all the way up to senior management

We firmly believe that recruitment, training and development, and succession planning are best managed primarily at the local level to ensure maximum responsiveness to local circumstances, and business unit and customer needs However, key strategic aspects are overseen or co-ordinated at a Group level to ensure consistency of approach, the identification of strategic threats and opportunities and to open up a wider range of opportunities for our employees

- Succession planning
- Talent management
- Graduates and apprentices

All these areas were reviewed and refreshed following the acquisition of VT.

Talent management

This year has seen the formalisation of the Babcock Academy Learning Framework, led by our Group Director of Organisation and Development It aims to strengthen cohesion between Babcock's strategic needs and organisational talent development This has involved adding to the Babcock Academy an Emerging Leaders Development programme for high performing graduates and junior managers The Academy has been run in conjunction with Strathclyde University since 2005. We are also improving the tools we use to ensure that we take full advantage of the many opportunities that a business the size of Babcock can provide in attracting, developing and retaining the right talent.

Graduates and apprentices

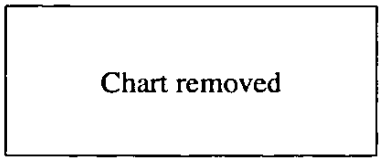
Our graduate and apprenticeship programmes are made up of tailored schemes designed to meet the specific skills and business requirements of each business unit With 75 graduates recruited in the year to 31 March 2011 (2010 101), there are currently 228 graduates on the graduate programme, 80% of whom are in engineering disciplines At the date of this report, we expect to recruit 79 graduates for the 2011/12 intake.

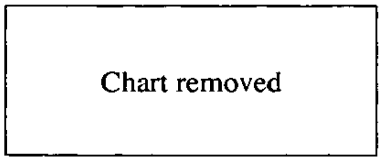
We currently have 611 apprentices across the Group (2010 572), of whom 89 were recruited during the year to 31 March 2011 (2010 170) Business requirements this year were such that fewer apprentices were required We remain committed to providing as many apprenticeship opportunities as our business requirements justify

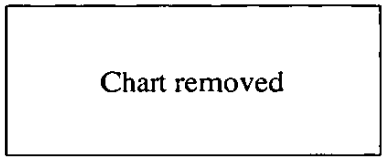
Running an environmentally efficient business

A significant amount of work is ongoing to deliver long-term efficiencies both within Babcock and for our customers in a way that is mindful of environmental impacts

The environment and carbon emissions







Diversity

Ensuring that we have access to the widest pool of talent available is a business imperative and, as such, diversity is an integral part of our talent management system Our diversity initiative, 'All together different', sends a clear message that our focus is on getting the right skills in the right job regardless of age, race, colour, ethnic origin, gender, marital status, religious beliefs, sexual orientation or disability

Community

In many places, we are the largest employer in the region We seek to engage with the communities around our sites and operations and to provide opportunities for employees to assist with local initiatives and support local charities that are important to them We have Group-wide guidelines setting out our approach to charitable donations, our commitment to the communities in which we operate and the broader interests of our customers As well as ensuring financial donations are appropriately targeted, they also encourage active engagement with the communities in which we operate through local community support programmes

At a Group level, we have continued to provide corporate sponsorship for the Soldiers, Sailors, Airmen and Families Association (SSAFA), the forces charity providing support to service families in times of need

Across the Group, our donations to charitable causes during the year amounted to £236,000 (2010 £197,000)

All of our businesses are either ISO 14001 certified or follow best environmental practice Following the acquisition of VT, we have reviewed the environmental management systems in place across the Group and one of our environmental targets is to achieve ISO 14001 certification across all divisions and business units by the end of 2012.

During the year, we obtained the Carbon Trust Standard and we have installed automatic meters wherever possible, going beyond the minimum required to obtain the Standard As a result, we are confident that we will be well positioned in the performance league table due to be published by the Environment Agency in autumn 2011 under the CRC Energy Efficiency Scheme Within the framework of our Group environmental and carbon management policies, business units set their own more detailed carbon policies covering all aspects of their business, with clear links to objectives to achieve carbon emissions reductions

Corporate Responsibility: supporting sustainable growth continued

Babcock obtained the Carbon Trust Standard with a high score of 82 5%. The Standard was obtained on the basis of data for the period 1 April 2008 to 31 March 2010 covering emissions from electricity and gas consumption, on-site energy consumption and fuel consumption in vehicles owned by Babcock. Over that period, Babcock achieved an absolute reduction in carbon emissions of 1 8% and a relative reduction of 7 2%.

	2007/08	2008/09	2009/10
Absolute footprint (tCO_2e)	131 510 2	125,590 0	126 287 0[1]
Relative benchmark (tCO_2e/£m turnover)[2]	84 5	68 4	71 0

1 Adjusted footprint following the acquisition of UKAEA in September 2009

2 Benchmark selected due to multi-disciplinary nature of the services provided by Babcock.

In line with the requirements of the Carbon Trust Standard, our target is to reduce our carbon footprint by at least 2 5% year-on-year

The MoD's Sustainable Procurement Flexible Framework

We signed the Sustainable Procurement Charter jointly with the MoD in 2008 and have since been implementing our action plan to achieve the requirements of the MoD's Sustainable Procurement Flexible Framework. We have committed to reaching Level 3 of the Framework by 2012, which we are on track to achieve We are also using the same action plan developed to meet the requirements of the Framework to promote the sustainable procurement agenda throughout the Babcock Group and to disseminate it through our supply chain

Image removed

Babcock has developed a Strategic Energy Management Plan (SEMP) with the MoD The SEMP provides an intelligent energy monitoring system and the optimisation of building controls for the client Currently Babcock is delivering the SEMP on 21 MoD sites within the South West The initiative approach to energy management has been recognised by the MoD as best practice and, together we are looking to roll out the delivery across the MoD estate

Our commitment to governance and its role in sustaining long-term value

Health and safety, employee and customer risks are identified and integrated into our risk management system overseen by the Audit and Risk Committee on behalf of the Board Where a risk is identified, the divisional Chief Executives take responsibility for mitigation steps, bringing in the experience of relevant operational teams within the business where required

Whistleblowing

We have confidential 'whistleblower' hotlines provided by independent third parties who promptly report messages received via the service to central Group senior management Callers can remain anonymous if they wish The hotlines are intended for use by employees to report concerns that they feel unable to raise with line management (or, where they have raised matters, but they are not satisfied with the response) about financial irregularities, health and safety, environmental harm or failure to comply with legal obligations Every new employee who joins Babcock is made aware of the existence of the hotlines as part of their induction, details of the hotlines are advertised at operating sites The acquisition of VT was used as an opportunity to refresh communication about the hotlines in July 2010 when all employees across the Group received an information pack describing the newly enlarged Group and reminding them of the hotlines

Ethical conduct

We are committed to the highest ethical standards and operate a strict ethical policy, which divisional Chief Executives are responsible for implementing and reporting on annually The policy covers and provides guidance on areas such as conflict of interest, unlawful and unethical acts; avoiding bribery and corruption, the use of commercial or marketing agents (especially in overseas territories), and giving and receiving gifts and hospitality Procedures across the Group have been reviewed in light of the Bribery Act

Factors that could affect the business

In the course of our day-to-day operations we face a number of risks and uncertainties. The Board considers the matters described in this section to be principal risks that face the Group as it currently stands and that could adversely affect the business, results of operations, revenue, profit, cash flow, assets and the delivery of our growth strategy. Given the size, complexity and spread of our businesses and the continually changing environment in which the Group currently operates, this cannot be an exhaustive list of such risks.

Systems and procedures are in place across the Group intended to identify, assess and mitigate major business risks. The management of risk is an integral part of our operational review process and is supplemented at Group level by independent challenge and review by the Group Risk Manager and the Audit and Risk Committee.

Introduction

In this section we describe

What the Babcock Board considers to be the key risks and uncertainties facing the Group,

The principal elements of our risk management arrangements and internal controls system for these and other risks

Key risks and uncertainties

The specific risks and uncertainties mentioned below are those we believe to be of most direct relevance and significance to Babcock today' its key business risks We do not include in this section those risks which are likely to affect businesses generally or that are in the nature of our day-to-day operations Instead, we focus on those that potentially can materially and adversely impact our growth and strategic development

Under each key risk we give a general description of our approach to managing them

1. Reliance on large contracts with a relatively limited number of major clients

Our chosen business model is that we work principally for large, complex customers, typically government departments, public sector bodies or commercially owned entities in sectors typified by regulation Many of our important customers rely, to a greater or lesser extent, on public funding The contracts we enter into are typically intended to last for five to seven years and many for much longer than that We understand these clients and this business model very well and our success in this is, we believe, amply demonstrated by our strong track record to date There are many benefits to such a business strong cash flow; lower customer credit risk, good visibility of order book and pipeline development, relative lack of volatility, scope for innovative pricing and contracting models that allow for revenue and margin growth over the lifetime of the contracts

Inevitably, though, reliance on a relatively limited number of large customers and contracts carries risks

Government policy changes and public spending constraints are potentially material risks for the Company if they lead to delays in placing work, pressure on pricing and margins, withdrawal of projects, early termination of contracts, lower contract spend than anticipated or adoption of less favourable contracting models, but they can also be sources of material opportunity;

A loss of reputation, either generally or with a specific major customer, could lead to a significant loss of existing or future business,

Key reputational dependencies include health and safety record, business ethics and our record of contract delivery and performance,

Our bid success rate is critical to our success and growth; bids for large and complex contracts are expensive to compete and, by their nature, large, longer term contracts are irregularly and less frequently available,

Being unsuccessful in a new bid, therefore, can represent a significant missed opportunity for growth, and losing rebids could mean the loss of a significant existing revenue and profit stream In addition, an unsuccessful bid or rebid can involve the writing-off of significant wasted bid costs

Factors that could affect the business continued

What we do

At the strategic level, we make it a top priority to maintain an ongoing general dialogue with our key customers, making sure that we stay close to them to gain a full and appreciative understanding of their thinking, the plans they may have, the direct and indirect influences on them and the pressures and constraints under which they must operate In this way we aim not only to be able to look ahead to see what risks there might be for us and how that might affect our strategy, but we also seek to ensure that both we and they understand what we can do to help them meet their changing needs and challenges and how we can, if necessary, adapt or innovate to meet them We strive to be proactive in this regard. The Company's Chief Executive and our Divisional Chief Executives, along with other members of our senior management team, are personally and closely involved in ensuring the strength of customer relationships

At the operational level, we aim, where we can, to structure our contracts with a view to fostering long-term co-operative working relationships with our customers, that share fairly with them the financial success or failure of contracts so that they can measure the benefits of their working with us and our commitment to them

For matters that affect our reputation, such as contract delivery, health, safety and environmental performance and our ethical conduct, we have specific internal controls and risk management mechanisms that seek to reduce the likelihood of these risks materialising and/or their impact if they do We are fully aware of the potential implications of the new Bribery Act in the UK and are updating and refining our policies in the light of its associated guidance

As regards bid success rate, all bids are subject to governance requirements, according to size, at Group or Divisional management level with continuous monitoring and review by senior Group and/or Divisional executives to ensure that resources are appropriately focused on worthwhile bids, we maximise our chances of being successful, and the financial returns will be acceptable The final submission of any significant bid or rebid requires formal approval from Group centre

2. Some of our operations carry significant health and safety or environmental risks

The safety and wellbeing of our employees and minimising the risk of our activities to third parties and the environment are core Babcock values and objectives. It is, however, in the nature of some of our operations that, if not properly managed and conducted, they could cause significant harm to employees, third parties or the environment. Apart from the adverse impact this could have on our reputation and the willingness of customers to deal with us (see Risk 1 above) this could lead to significant financial loss and claims for damages

What we do

We manage and mitigate these risks through specific governance and management arrangements, involving Group senior management as well as operational staff, that underpin the great importance we attach to them in all our operations In addition, we carry, to the extent it is available in the market on reasonable commercial terms, insurance cover relating to such risks (subject to compensation limits and deductibles), but no insurance can be certain of recovery We benefit from statutory or customer indemnities in some of our operations (for example our nuclear engineering businesses)

3. We require skilled employees, who can sometimes be in short supply

A number of our businesses (for example, our nuclear, technology and engineering businesses and those with high project management content) are complex and demand skilled personnel to deliver them The continuing success of these businesses relies on our ability to recruit, train and retain qualified and experienced professionals, technicians, engineers and project management staff In recent years industry demand for employees with these skills has been high and the numbers of suitable candidates limited. This can lead not only to increasing costs but also potential problems with resourcing contracts and bids, which could in turn threaten growth and reputation

What we do

We aim to make our businesses attractive places to work and offer competitive remuneration packages with long-term employee retention in mind We place a great deal of emphasis on and devote significant resources to apprentice and graduate recruitment, training and development, succession planning and on talent management generally

4. We rely on complex information technology arrangements

Like any modern business, Babcock's performance depends to a significant extent on having reliable IT systems Many of our contracts require us to operate our contract-supporting IT either entirely within secure customer networks or to be able to interface reliably and securely with such systems. Cyber-security presents an increasing risk to us and to our customers The challenge for Babcock is to ensure that we integrate and run our IT systems in a way that both meets demanding customer requirements and enables Babcock as a group to operate as securely and efficiently as possible This is against a background of several major acquisitions over recent years of businesses each with its own specific IT needs and systems. To this end, and following a complete review of our IT needs after the acquisition of VT Group in 2010, a major IT transformation programme is underway to update, integrate and rationalise our IT systems, which will roll out over the coming months Any such programme carries an element of operational and implementation risk.

What we do

We have a Group Chief Information Officer responsible for the integrity and development of the Group's IT systems and resources Businesses have detailed disaster recovery plans in place The IT transformation project now underway represents a major investment by the Company and aims to establish a rationalised, updated and standardised system across the Group, with independent systems as may be required under customer contracts, with a view to enhancing the reliability, security and efficiency of the those systems and how they are supported It involves the establishment of a new group data centre and centralised IT service overseeing and implementing IT strategy, procurement, support and management, with locally distributed services as appropriate The project has been devised in association with external expert support and is being monitored and implemented under formal governance procedures designed to foresee and minimise implementation risk so far as possible

5. The Group has significant defined benefit pension schemes

Defined benefit schemes deliver a specified level of pension benefit to members, the cost of which is met from member and employer contributions paid into pension scheme funds and the investment returns made in those funds over time The level of contributions required to meet pension obligations is actuarially determined based on various assumptions, which are subject to change, as to life expectancy of members, investment returns, inflation etc If, based on the assumptions being used at any time, assets in the pension scheme are judged to be insufficient to meet the calculated cost of the pension obligations there can be a significant shortfall, which the scheme trustees may require to be made up or secured by increased contributions from employers and/or employees, additional cash payments from employers and/or guarantees or other security to be provided by employers This may reduce the cash available to meet the Group's other obligations or business needs The most significant differences between assets and liabilities of the schemes can occur due to differences between the actual and assumed investment returns and changes in the assumptions as to life expectancy

Also, the Group must comply with IAS 19 when accounting for its defined benefit schemes. IAS 19 requires corporate bond related discount rates to be used to value the pension liabilities This is likely to lead to valuation variations from year-to-year due to a mismatch with the investments held in the pension schemes and because of variations in the yields available on corporate bonds and inflationary expectations This in turn can materially affect the pensions charge in the income statement in the Group's accounts from year-to-year as well as the value of the difference between the assets and the liabilities shown on the Group's balance sheet, leading to significant accounting volatility

What we do

We aim to have constructive and open relationships with the schemes' trustees and to work with them to follow appropriate investment policies for the profile of their members as well as seeking other means of eliminating or mitigating risk. For example

- "Longevity swaps" are in place for our three largest schemes to reduce our exposure to the impact of increasing life expectancy;
- A consistent long-term investment strategy has been agreed with the trustees of the schemes, intended to mitigate investment risk.
- A pan-schemes investment sub-committee is tasked with implementing the agreed investment strategy efficiently

Factors that could affect the business continued

The strategy provides the necessary framework to hedge the schemes' exposure to changes in inflation and interest rates with a view to stabilising the impact on the Group's cash requirements and accounting entries

A governance committee operating across the schemes aims to ensure the trustees follow a strong governance regime in running the schemes

The Group maintains suitable ongoing funding rates based on prudent assumptions agreed with the trustees of the schemes

A Group Pensions Manager, who reports to the Group Finance Director, keeps strategic pension matters under close review and reports regularly to the Board

6. Risks arising from acquisitions

The Group has made a series of significant acquisitions over recent years, the most recent being the acquisition of VT Group plc. There is a risk that expected benefits from acquisitions might not be fully realised. There is also a risk of acquiring unknown or understated liabilities

What we do

Before we make acquisitions we carry out a detailed valuation exercise using various valuation criteria and scenarios to assess potential returns, sensitivities and price We also carry out as thorough a due diligence exercise as we can based on information available and in the context of the transaction concerned Where possible, we seek to obtain commercially acceptable warranties and indemnities from vendors, though such protections may be restricted in time and/or amount and in some cases, such as public takeovers, are essentially not available

Risk management in Babcock

The Board has ultimate responsibility for the Company's risk management and internal control system, which are overseen on its behalf by the Audit and Risk Committee The Committee reviews aspects of the risk management and control system on an ongoing basis at its meetings and at least once a year considers the system's effectiveness on behalf of the Board The Committee seeks the views of internal and external auditors on the control system and as to how the Company's practice compares with processes in other companies Internal control systems are also monitored operationally by Group management and the internal audit service, which is provided by Ernst & Young LLP, including assessment against operational outcomes Ernst & Young acts under the overall control and direction of the Committee

At the operational level, the Group also has a Group Risk Manager reporting to the Group Finance Director The Group Risk Manager's role is, in conjunction with divisional management, to develop and keep under review a risk management process for use across the Group in identifying, assessing and evaluating risk, risk controls and risk reporting Whilst the Group Risk Manager oversees and coordinates this process centrally and is responsible for risk management reporting to the Committee, it is a key philosophy of the Group that the risk management process must be embedded within business operations and clearly 'owned' by managers Divisional Chief Executives have primary day-to-day operational responsibility for risk identification and risk management arrangements and controls within their operations

The Group Risk Manager facilitates the sharing between Divisions of risk management experience and practice A process is currently underway, following the acquisition of VT Group, for each Division's risk management and monitoring arrangements to be conformed along best practice lines

Risk assessments made at business unit level are subject to regular review and challenge by Group senior management to test the thoroughness and robustness of the judgements and evaluations made

Risk management reports and a group risk register are regular agenda items for the Audit and Risk Committee, which also receives regular reports from internal auditors

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

Further details on our internal control processes are set out on pages 43 to 45. These controls underpin our management of these key risks as well as other risks

Babcock's risk control system includes

Control (see also Key Risks above – what we do)	Explanation	Example of Risk to which the control is relevant
Health, safety and environmental monitoring, reporting and management See also the Corporate responsibility report on pages 34 to 38	At Group level, a Safety Leadership Team and Corporate Safety Steering Group ensure the development and implementation of the Group safety strategy for more detail see the Corporate responsibility report on page 35 Each Division has appropriate teams of health safety and environmental professionals responsible for developing and supporting detailed policies and procedures, investigating and reporting on incidents and promoting education and training in these areas. Divisional Boards and the Group Executive Committee receive monthly reports of health, safety and environmental performance in statistical and narrative form The Chief Executive reports regularly to the Board on any significant matters and the Board receives detailed half-yearly reports on health, safety and environmental performance External consultants are used to ensure the Group is abreast of best practice and to help in the evaluation and design of management led initiatives to maintain and improve performance Unsatisfactory performance in these areas can lead to reduction or annulment of executive bonuses	→ Harm to employees and others or to the environment; → These are things we wish to avoid for their own sake, but which also entail the risk of damage to our reputation and of substantial civil liabilities and criminal penalties.
Bid reviews The Group has a comprehensive financial policy and accounting standards manual with authority and approval mandates. All material commercial and contractual activities are overseen by Group executives and governed by the Group Policy and Procedures manual which sets out the Group s approach to doing business	All significant bids have to be approved by Group senior management, major bids being the subject of formal presentations as well as detailed written reports and risk analysis These controls are aimed at ensuring that bids are made on commercially and legally acceptable terms and to avoid wasting resources on inappropriate bids or bids where the chance of success is low	→ Bid success rate inappropriate use of bid resources; too high risk or unacceptable commercial terms, no assurance of delivery capability
Contract reviews Customer satisfaction surveys	Contracts are kept under forward-looking review to ensure that they are profit making required performance is being and will continue to be delivered and that they are properly accounted for Each division has procedures in place to monitor the ongoing performance of each contract and these are discussed at operational reviews with Group Executive management. The financial performance of all significant contracts is regularly reviewed by Group Finance. Customer satisfaction surveys help us identify any potential threats to our customer relationships so that we can act on them	→ Poor contract performance, which could lead to breach of contract, financial penalties under KPI regimes, damage to customer relationships and loss of reputation, → Unprofitable contract performance → Inaccurate contract accounting

Factors that could affect the business continued

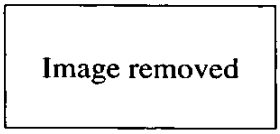
Control (see also Key Risks above – what we do)	Explanation	Example of Risk to which the control is relevant
Pensions Reporting, monitoring and proactive management of pension liabilities.	The Group has significant defined benefit pension schemes the liabilities and accounting in respect of which can have a material impact on Group results from year-to-year The Group Pensions Manager reports quarterly to the Board on strategic issues relating to the schemes and their performance He works closely with scheme trustees and advisors to identify and implement risk reduction measures.	→ Pensions exposures.
Succession plans Graduate and apprentice recruitment training and retention programmes Talent and management development plans	The Group Organisation and Development Director reports to the Board on succession planning, management/talent training and development and graduate recruitment. Management resourcing needs are discussed regularly at Board and Group Executive Committee meetings See further on this subject in the Corporate Responsibility report	→ Lack of appropriate employee and management resource
Budgets	Annual budgets and medium-term financial plans are reviewed by Group management before submission to the Board for approval Updated forecasts for the year are prepared at least quarterly	→ Threats to strategy; → Non-delivery of strategy; → Loss of business or financial control, → Breach of reporting obligations, → Financial misreporting → Operational risks.
Management and financial reporting	The Board receives details of actual financial performance each month compared against budget, forecast and the prior year, with a written commentary on significant variances from approved plans The Chief Executive reports to each Board meeting on operating performance and on matters of strategic significance Group senior management receives a monthly narrative operating report from all business units.	→ Threats to strategy → Non-delivery of strategy; → Loss of business or financial control → Breach of reporting obligations, → Financial misreporting, → Operational risks.
Internal and external audit reports	These are made regularly to the Audit and Risk Committee – see its report on pages 55 and 56 for more information	→ Threats to strategy; → Non-delivery of strategy; → Loss of business or financial control → Breach of reporting obligations; → Financial misreporting; → Operational risks.

Control (see also Key Risks above – what we do)	Explanation	Example of Risk to which the control is relevant
Clear delegations and limits of authority	There is a defined set of authority levels as between the Board and Executive Directors, Group management and divisional management, and within divisions, setting out which matters require approval at which level These are published on the Company intranet.	→ Threats to strategy; → Non-delivery of strategy → Loss of business or financial control → Breach of reporting obligations, → Financial misreporting → Operational risks.
Insurance	The Group has a large and comprehensive insurance programme, preferring to place risk in the insurance market, where available on acceptable terms rather than to self-insure or make significant use of captive insurance The Group has a full time Insurance Manager who reports annually to the Board on the strategic approach being taken to insurance and on the placing of the programme	→ Financial impact of unforeseen or unplanned events.
Disputes and litigation reporting	The Board and Group Executive Committee receive monthly summaries of material disputes and actual or potential litigation their progress and potential outcomes The Group has an experienced internal legal service deployed at Group and Divisional level, with functional reporting to the Group Company Secretary & General Counsel	→ Legal liabilities, including legacy liabilities from discontinued businesses
Credit controls	All significant credit risks are reviewed by Group Finance and an Executive Director and where appropriate and available risk limitation actions are taken	→ Credit risks
Group policies and procedures	The Group has written policies and procedures, which are kept under review, covering a range of matters intended to reduce or mitigate risk, such as health, safety and environmental policies, an Ethical Policy covering anti-corruption matters, (including procedures for the appointment and use of agents and third parties), contracting requirements and guidelines; legal matters financial and accounting matters These are available on the Group intranet and are supplemented at Divisional level by further business unit specific polices which are	→ Damage to reputation, → Mitigation of legal and commercial risks

Directors and Company Secretary

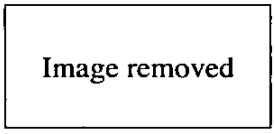
Biographies of current Directors

On this and the next page you will find short biographies of the Directors in office at the date of this Annual Report and of Kate Swann who will take office as a Non-Executive Director on 1 June 2011. On page 48 a table provides more information about them and their attendance at Board and Committee meetings. In addition to the Directors below, Lord Hesketh served on the Board during the year: from 1 April 2010 to 8 November 2010, when he resigned.



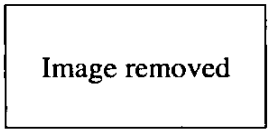
Mike Turner CBE (62)
Chairman of the Board

Mike Turner was appointed Chairman of Babcock in November 2008 after retiring from his position as chief executive of BAE Systems plc. He is a former Chairman of the UK Defence Industries Council (DIC) and is a member of the UK government's Apprenticeship Ambassadors Network. He is a non-executive director of Lazard Limited and is senior independent non-executive director of GKN plc.



Peter Rogers (63)
Chief Executive

Peter Rogers joined the Board as Chief Operating Officer in June 2002. He became Chief Executive in August 2003. He is a former director of Courtaulds PLC and Acordis BV. He is a non-executive director of Galliford Try PLC. He was elected as president of ADS (Aerospace Defence Security) with effect from 1 January 2011.



Bill Tame (56)
Group Finance Director

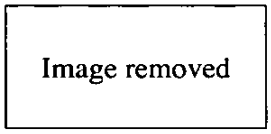
Bill Tame joined the Board as Group Finance Director in January 2002. He is a former finance director of Scapa Group PLC before which he worked for Courtaulds PLC. He is a non-executive director of Cardo PLC.

Archie Bethel CBE (58)
Chief Executive Marine and Technology

Archie Bethel became a Director on 1 May 2010. He joined the Group in January 2004. He is a Chartered Mechanical Engineer and a Fellow of the Royal Academy of Engineering. Since 2004 he has been vice-president and honorary treasurer of the Institution of Mechanical Engineers.

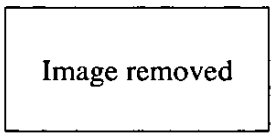
Kevin Thomas (57)
Chief Executive Support Services

Kevin Thomas became a Director on 1 May 2010. He joined the Group in June 2002. Prior to joining Babcock, he spent 12 years in facilities management, including seven years with Serco Group PLC and 15 years in local government with Merton, Surrey and Southwark Councils.



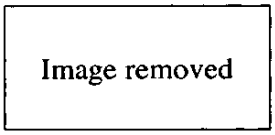
John Rennocks (65)
Senior Independent Non-Executive Director
Audit and Risk Committee Chairman

John Rennocks joined the Board as a Non-Executive Director in June 2002. He is a former finance director of Corus Group PLC and former chairman of Nestor PLC. He is chairman of Diploma PLC and Intelligent Energy Holdings PLC. He is a non-executive director of JPMorgan Overseas Investment Trust PLC and Inmarsat PLC. He will be retiring from the Board on 31 December 2011 and stepping down as Chairman of the Audit and Risk Committee on 7 July 2011.



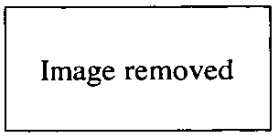
Sir Nigel Essenhigh GCB (66)
Independent Non-Executive Director

Sir Nigel joined the Board as a Non-Executive Director in March 2003 Until his retirement from the Royal Navy in late 2002 he was First Sea Lord and Chief of the Naval Staff He is chairman of NGC UK Limited, Northrop Grumman Corporation's UK holding company and chief executive of Northrop Grumman Information Systems Europe Limited



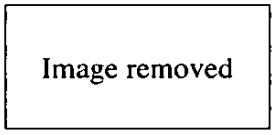
Justin Crookenden (47)
Independent Non-Executive Director;
Chairman of the Remuneration Committee

Justin Crookenden joined the Board as a Non-Executive Director in December 2005 He qualified as a chartered accountant and as a former investment banker, he worked at UBS, Barclays de Zoete Wedd and Credit Suisse First Boston – where he was managing director, UK Investment Banking



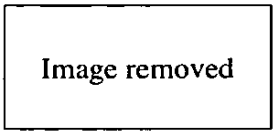
Sir David Omand GCB (64)
Independent Non Executive Director

Sir David joined the Board on 1 April 2009 He was the first UK Security and Intelligence Coordinator, responsible for the professional health of the intelligence community, national counter terrorism strategy and 'homeland security' and was the UK government's Chief Crisis Manager for civil contingencies. He served for seven years on the Joint Intelligence Committee He was previously Permanent Secretary of the Home Office, director of GCHQ (the UK Signals Intelligence and Information Assurance Agency) and Deputy Under-Secretary of State for Policy in the Ministry of Defence He left government service in 2005 He is a visiting professor in the department of War Studies, King s College London Sir David is a non-executive director of Finmecannica UK limited



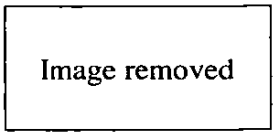
Ian Duncan (50)
Independent Non-Executive Director

Ian Duncan joined the Board as a Non-Executive Director on 10 November 2010 He was Group Finance Director of Royal Mail Holdings PLC from 2006 until June 2010 He is a Chartered Accountant and his former roles have included the position of Corporate Finance Director at British Nuclear Fuels plc and Chief Financial Officer and Senior Vice President at Westinghouse Electric Company LLC in Pennsylvania, USA. He will become Chairman of the Audit and Risk Committee on 7 July 2011



Albert Dungate (54)
Group Company Secretary and General Counsel

Albert Dungate is a Solicitor He has been Group Company Secretary and General Counsel since February 2002 He was formerly General Counsel and Company Secretary of Arjo Wiggins Appleton PLC He is Secretary to the Board and to the Audit and Risk, Remuneration and Nominations Committees.



Kate Swann (46)
Independent Non-Executive Director
(from 1 June 2011)

Kate Swann is currently Group Chief Executive of WH Smith PLC. Prior to that she was Managing Director of Argos, the leading general merchandise retailer, and before that was Managing Director of Homebase Ltd Between 2006 and 2009 she was a non-executive director of The British Land Company PLC

Directors and Company Secretary continued

The Board and its Committees during the year to 31 March 2011

Director	Role	Independent	Period of service	Board attendance (scheduled meetings)	Committee memberships: Remuneration (attended)	Audit and Risk (attended)	Nominations (attended)
Mike Turner	Chairman	n/a	3 years	11/11	–	–	2/2 Chairman
Peter Rogers	Chief Executive	No	9 years	11/11	–	–	–
Bill Tame	Group Finance Director	No	9 5 years	11/11	–	–	–
John Rennocks*	Senior Independent Director*	Yes	9 years	10/11 (absence abroad for one meeting)	9/9	4/4 Chairman*	2/2
Nigel Essenhigh	Non-Executive	Yes	8 years	11/11	9/9	4/4	2/2
Justin Crookenden	Non-Executive	Yes	5.5 years	11/11	9/9 Chairman	4/4	2/2
David Ormand	Non-Executive	Yes	2 years	11/11	9/9	4/4	2/2
Archie Bethel	Executive	No	1 year	11/11	–	–	–
Kevin Thomas	Executive	No	1 year	11/11	–	–	–
Ian Duncan (Appointed 10 November 2010)	Non-Executive	Yes	0 5 years	5/5	3/3	1/1	1/2
Lord Hesketh (Resigned 8 November 2010)	Deputy Chairman	No	18 years	4/6	–	–	1/2

* John Rennocks will be retiring from the Board on 31 December 2011 He will be succeeded by Ian Duncan as Chairman of the Audit and Risk Committee with effect from the Company's Annual General Meeting in July 2011

Governance statement

Babcock and Good Governance

"Good governance is not just a matter of having policies and procedures or ticking boxes It must be part of our culture, the way we go about things – almost without having to think about it. I and my colleagues on the Board are committed to this culture for Babcock in the interests of our customers, our employees and our shareholders The pages that follow describe the arrangements that we use to underpin this objective and comply with formal governance codes, but good governance is an ethos, an attitude, an approach – often more implicit than explicit "

Mike Turner
Chairman

The reports of the Nominations, Audit and Risk and Remuneration Committees and the information contained or referred to in the section "Other statutory and regulatory information and Directors' responsibility statement" on pages 54 to 63 form part of our Governance statement

Governance focus in the year to 31 March 2011

The table on page 50 summarises what the Board did this year Inevitably, much of the Board's governance focus this year has been on the VT acquisition, its integration and the delivery of synergy benefits Other matters accorded high governance priority included

- business and management restructuring,
- succession planning,
- management resources,
- refinancing,
- IT transformation plans;
- strategy;
- the impact of government spending plans and strategic reviews

Expected areas of focus in the year to 31 March 2012

In the financial year that started on 1 April 2011, the Board will continue to focus its attention on the same priorities as mentioned above, but will be paying particular attention to·

- strategic development,
- the challenge of increasing the rate of profitable revenue growth

Risk. the Board's responsibility

The Board acknowledges its overall responsibility for the Group's system of internal controls and for monitoring its effectiveness More information on how this responsibility is discharged is to be found on pages 43 to 45 of this Annual Report

Combined Code compliance

The principal governance rules applying to UK companies listed on the London Stock Exchange are now contained in The UK Corporate Governance Code ('the Governance Code') issued by the Financial reporting Council ('the FRC') in June 2010, but they apply for financial years commencing on or after 29 June 2010 For financial years commencing prior to that date (which is the case for the Company's financial year covered by this Annual Report) the principal governance rules were those in the FRC's Combined Code on Corporate Governance ('the Combined Code') See www frc org uk/corporate

Except as noted below under the description of Board balance, the Board considers that the Company complied with the provisions of section 1 of the Combined Code during the year under review It intends that for the financial year commenced on 1 April 2011 the Company will comply with the provisions of the Governance Code and considers that it has been doing so since that date so far as applicable

The Board and its Committees

The Board has ultimate responsibility for corporate governance, which it discharges either directly or through its Committees and the structures described in the following pages of this Annual Report

Reserved matters and delegation

The Board delegates some of its powers to committees and certain Directors Matters reserved to the Board include

- strategy;
- budget approval and monitoring of performance,
- acquisitions and disposals,
- approving significant contracts outside the ordinary course of business,
- treasury and borrowing policy; and
- ethical, social, health, safety, environmental and governance policy

Committee terms of reference and other delegated authorities are formalised and periodically reviewed

In addition to the principal committees of the Board – the Remuneration Committee, the Audit and Risk Committee and the Nominations Committee, each of which has its own report in the pages that follow – the Board from time to time establishes committees to deal with specific matters on its behalf. This was the case, for example, in the past year when special committees were established in connection with the acquisition of VT Group plc and the refinancing of part of the Company's borrowing facilities

There is also a Finance Committee consisting of any two Directors, one of whom is the Group Finance Director, to approve borrowing, guarantees, treasury and related matters in accordance with its detailed terms of reference

Governance statement continued

Matters dealt with by the Board in the year to 31 March 2011 (in addition to ongoing monitoring of operational and financial performance and matters delegated to the Audit and Risk, Remuneration and Nominations Committees) included

Topic	Areas of focus
Health, safety and environmental performance	Discussion of half-yearly reports The Chief Executive also informs the Board at its monthly meetings of any areas of management concern or attention and plans for ongoing improvement Monthly operating reports seen by the Board also contain commentary as to incidents and performance
VT acquisition (The acquisition and its terms were announced in March 2010, i e. in the preceding financial year)	Preparations for the speedy and efficient implementation and integration of the acquisition from 'day one' Management and business restructurings following the acquisition Risk mitigation in the integration process Plans to secure the synergy and other opportunities presented by the acquisition, and monitoring their progress
The impact of the UK Government's Strategic and Defence Review ('SDSR') and the Comprehensive Spending Review ('CSR')	The Board was kept abreast of and considered the implications of these reviews for the Company
Strategy	Reviewing and updating the Group's long-term strategic plans following the VT acquisition, the SDSR and CSR.
Order book and pipeline	Monthly reports of the development of the Group's order book and pipeline and the outlook for them
Business presentations	Presentations from the heads of the new Defence and Security division and VT US on their businesses, management and strategic plans Presentation on the RSME contract operations
Succession planning	Presentation on the Group's succession plans for senior management following the VT acquisition
Management and talent development	The Board was updated on the many initiatives underway further to improve management training and development and the recruitment and development of graduates and apprentices
Pension schemes	Regular reports on the position as regards the Group's defined benefit schemes, their impact on the Group and plans to manage the risks presented by them
Insurance	The Company's strategic approach to insurance in the context of risk mitigation
Financing	The Company's financing needs for the VT acquisition and general business operations, options for and the terms of refinancing were reviewed and approved, with a special committee being established to oversee this
IT	The Board received presentations on the adequacy and integration of the Group's IT systems in light of the enlarged size and scale of operations of the Group following the VT acquisition and on a major programme to transform them
Bribery Act	The Board was kept informed of developments and plans for adequate procedures to meet the Act's requirements
Board, Committee and Director annual evaluation	The Board considered and debated the results of the evaluation reviews
Tax	The Board discussed the Group's approach to tax planning
Budgets	The Board reviewed the 2010/11 budget following the VT acquisition and reviewed and approved the budgets for 2011/12 and succeeding years
Delegated authorities	The Board reviewed these in light of the enlarged Group and changed business and management structures following the VT acquisition

Board effectiveness and skills

The Board fully understands and accepts its responsibility for the success of the Company

It considers that the Company's successful track record to date supports its view that it is effective in the discharge of its duties and responsibilities and that, as can be seen from the Director biographies on pages 46 and 47, it has a balance of skills, understanding and experience directly relevant to the Group's principal customers and businesses and the political and commercial worlds in which the Group operates The Board is satisfied that each Director has the necessary time to devote to the effective discharge of their responsibilities

The Board believes that the recent appointment of Ian Duncan and the pending appointment of Kate Swann as new Non-Executive Directors, with effect from 10 November 2010 and 1 June 2011 respectively, add to the breadth and diversity of its outlook and the commercial and operational experience and expertise available to it

Balance between Independents and Non-Independents

The Combined Code and the Governance Code recommend that there should be a balance between Executive and Non-Executive Directors (particularly Independent Directors) and that at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be Independent

The Company was, for a time, not compliant with the Combined Code in this respect. On 1 May 2010, Archie Bethel and Kevin Thomas were appointed as Executive Directors to the Board As a result, the Board then consisted, disregarding the Chairman, of five Non-Independent Directors (four Executive Directors and Lord Hesketh) and four Independent Non-Executives, leaving the Independent Directors in a minority On 8 November 2010, Lord Hesketh resigned as a Director On 10 November 2010, Ian Duncan became a new Independent Non-Executive Director

Since 10 November 2010, the Board has been in compliance with the Combined Code and the Governance Code, in having five Independent Non-Executive Directors, four Executive Directors and the Chairman

On 13 June 2011, John Rennocks will have been on the Board for nine years The Board nonetheless considers that, having announced his decision to retire on 31 December 2011, his independence is not affected for the short period between June and his retirement date and he will continue as a member of the Remuneration, Nominations and Audit and Risk Committees and as Senior Independent Director until he retires at the end of December He will, however, step down from his position as Chairman of the Audit and Risk Committee at the time of the Company's Annual General Meeting in July when he will be replaced in that role by Ian Duncan

Refreshing of the Board

Since 1 April 2011 and over the last three financial years, the following changes have been made or, in the case of the current year, announced

Year	Board changes
2011/2012	Appointment of new Independent Non-Executive Director; Intended retirement of Senior Independent Non-Executive Director; Change of Chairman of the Audit and Risk Committee
2010/2011	Resignation of Deputy Chairman, Appointment of new Independent Non-Executive Director; Appointment of two new Executive Directors
2009/2010	Retirement of Non-Executive Director; Appointment of new Independent Non-Executive Director
2008/2009	Retirement of the Chairman, Appointment of a new Chairman, Appointment of new Independent Non-Executive Director; Change of Chairman of the Remuneration Committee

Chairman and Chief Executive functions

There is a clear division of responsibilities between the Chairman and Chief Executive, which is set out in a statement of their respective roles and responsibilities approved by the Board A copy of this is available on the Company's website (www babcock co uk)

Senior Independent Director

John Rennocks is, and was throughout the year, recognised by the Board as the Senior Independent Director to whom concerns can be conveyed by shareholders if they have concerns which have not been resolved through the normal channels of Chairman, Chief Executive or Finance Director The Chairman looks to him as a sounding board and he is available as an intermediary between the other Directors and the Chairman

Group Executive Committee

The Group Executive Committee is not a formal Board Committee and has no delegated powers as such It is made up of the Chief Executive, the Group Finance Director, divisional Chief Executives, the Company Secretary and General Counsel and the Group Director of Organisation and Development It is also attended by the heads of the principal overseas operations It meets ten times a year and reviews and discusses all matters of material significance to the Group's management, operational and financial performance and strategic development Minutes of its meetings are circulated to Board members

Governance statement continued

Board proceedings

General

The Board has at least ten scheduled meetings a year Additional meetings to address specific matters are held as necessary; for example, in connection with major acquisitions

The Chairman also discusses matters with Non-Executive Directors without Executive Directors or other managers present

In addition to its regular meetings, the Board has at least one special meeting each financial year to discuss Group strategy at length

Debate and discussion at Board and committee meetings is open, challenging and constructive. Directors regularly receive presentations by functional and operational senior managers

In the Board and Committee evaluation reviews, the Directors confirmed that they were satisfied with the timing and quality of the information provided

Board appointments – the process

Appointments to the Board are led by the Nominations Committee It decides upon the desired candidate profile for the post in question and this frames the search for candidates with the objective of ensuring that there is the requisite balance of skills, independence and knowledge amongst Board members

The process for the appointment of Ian Duncan and Kate Swann as Non-Executive Directors was conducted with the help of independent external search consultants, as is the Board's normal practice when seeking new Non-Executive Directors The promotion of Archie Bethel and Kevin Thomas to the Board as Executive Directors was discussed and approved by the whole Board.

Annual re-election of Directors

Directors are normally reappointed at the first Annual General Meeting following their appointment by the Board and the Company's Articles of Association require them subsequently to offer themselves for reappointment at least every three years However, in accordance with the recommendations of the Governance Code, the entire Board will be submitting itself for re-election at this year's Annual General Meeting and plans to do so in future years

Non-Executive Directors are normally expected to serve, subject to re-election, a term of at least three years but their terms of appointment allow for either the Company or the Director to terminate the appointment at any time

Evaluation

The Board commissions an external Independent review of its effectiveness and that of its committees and members at least every other year, with an internally led review in the alternate years The last external review was completed towards the end of financial year 2009/10 An internal review was carried out in November/ December 2010 by the Company Secretary by means of confidential one-on-one interviews with each Board member A summary of these interviews and the findings were then presented to the Chairman and subsequently to the whole Board at a meeting at which the findings were discussed The evaluation found all Directors to be performing satisfactorily and that the Board and its Committees were functioning well and effectively

Information and training for Directors

The Company makes arrangements for new Non-Executive Directors to receive detailed business briefings as regards the Group's operations and arranges induction visits for them to the Group's principal sites Ian Duncan has since his appointment in November 2010 visited the Group's Marine and Technology operations in Bristol and Devonport, Support Services Education and Training operations in Berkshire and Defence and Security's Royal School of Military Engineering contract at Chatham He will be making more visits in the current year, as will Kate Swann

Training for new Directors, when appropriate, is arranged with external providers General Director training that might be of potential interest or relevance to Directors generally can be arranged on request, for which the Company pays if necessary The Company Secretary briefs Board members about significant changes in the law or governance codes affecting their duties as Directors

Non-Executive Directors may at any time make visits to Group businesses or operational sites and Board visits are also made to sites The Board held its June 2010 meeting at Chatham and will be holding its October 2011 meeting at Rosyth Presentations on the Group's businesses and specialist functions are made to the Group Board from time to time

Non-Executive Directors receive copies of all minutes of meetings of the Group Executive Committee and of the principal divisional boards, together with copies of monthly divisional operating reports

Change in Chairman's significant external commitments

During the year there were no changes to Mike Turner's significant external commitments The Board is satisfied that his external commitments have no impact on the discharge of his responsibilities to the Company

Relations with shareholders

The Board is keenly aware of the importance of there being a dialogue with shareholders to ensure that the Board keeps abreast of and understands shareholders' views and opinions.

It achieves this in a variety of ways

- the Chief Executive, Group Finance Director and Head of Investor Relations regularly meet institutional shareholders, potential investors and analysts either individually or as part of group meetings,
- communication with major shareholders on specific matters such as executive remuneration, where appropriate,
- there are presentations to or conference calls with analysts and investors at the time of announcement of results or major news,
- to provide more detailed knowledge of the Group, the Company arranges seminars, investor and analyst visits to Company sites or contract operations,
- investor relations reports describing investor and analyst opinions are provided regularly to the Board,
- the Chairman, in addition to any meetings initiated by major shareholders, sends leading shareholders an annual invitation to meet him, should they wish to do so, to discuss any matter He reports on the meetings to the Board,
- at the Annual General Meeting, shareholders have the opportunity to raise questions with the Board in the meeting All the Company's Directors in office at the time attended the 2010 Annual General Meeting,
- Directors also make themselves available before and after the formal general meeting to talk informally to shareholders, should they wish to do so,
- the Company's website keeps shareholders abreast of developments It is regularly updated with press releases and analyst presentations Shareholders may register on the website to be sent news releases automatically

In the year to 31 March 2011 formal contacts* with shareholders, potential investors and analysts

Contacts with shareholders, investors and analysts	When
Letter from the Group Chairman and Remuneration Committee Chairman to leading shareholders (and follow-up meetings if requested) on proposals for CEO remuneration	May/June 2010
Letter from the Chairman to leading shareholders inviting them to meet him, should they wish to do so, and subsequent meetings	July 2010
21 meetings with analysts	Throughout
139 meetings with shareholders	November and May 2010
Roadshow in the USA	June 2010 and March 2011
Presentations to investors from divisional CEOs	December 2010 and March 2011
Results presentations and conference calls	May, September and November 2010, January and March 2011
Annual General Meeting	July 2010
Extraordinary general meeting (VT acquisition)	June 2010

* In addition to regular contact on a daily basis with analysts and shareholders responding to questions and requests for information

Report of the Nominations Committee

Committee Membership

Current membership of the Committee, and its membership during the year to 31 March 2011, is shown in the table on page 48 of this Annual Report The Company Secretary is secretary to the Committee Kate Swann will join the Committee when she takes up office as a Non-Executive Director on 1 June 2011

The Committee is chaired by the Group Chairman and is open to all the Non-Executive Directors, provided that, when it meets, the majority of its members are Independent Non-Executive Directors Other Directors are free to attend meetings of the Committee, if appropriate.

Many of the matters within the Committee's remit are addressed with all Board members present or are taken as specific items at full Board meetings.

The Committee's terms of reference (which are available to view on the Company's website) include

- evaluating the Board's structure and the balance of skills, knowledge and experience needed on the Board and the benefits of diversity,
- considering succession planning taking into account the challenges and opportunities facing the Company and the skills and expertise needed on the Board in the future, and
- identifying and nominating, for the approval of the Board, candidates to fill Board vacancies

What it did during the year

During the year, the members of the Committee addressed the following matters

- the desirability of additional Executive Directors being appointed to the Board, leading to the appointment of Kevin Thomas and Archie Bethel as Executive Directors,
- considering and approving plans for the Company's management continuity and succession needs at Executive Director and senior executive level in light of the VT acquisition and the Group's strategic plans, involving
  - discussion with the Chief Executive of succession plans for his position,
  - discussion of senior executive training and development arrangements and management resourcing needs;
- identifying current and future requirements and agreeing the desired candidate profiles for new Independent Non-Executive Directors having in mind,
  - the desired balance between Independent Non-Executive Directors and other Directors,
  - the length of service of existing Non-Executive Directors,
  - the benefits of gender diversity;
  - the increased size and scope of operations following the VT acquisition,

which, so far, has led to the appointment of·

- Ian Duncan as a Non-Executive Director with the necessary financial experience to succeed John Rennocks as Chairman of the Audit and Risk Committee and senior executive management experience in the worldwide civil nuclear industry; and
- Kate Swann as a Non-Executive Director, the first woman to serve on the Babcock Board and with extensive operational and commercial experience in the private sector

In recruiting Ian Duncan and Kate Swann, the Nominations Committee used independent search firms and consultants

Mike Turner
Committee Chairman

16 May 2011

Report of the Audit and Risk Committee

"I am pleased to present the report of the Audit and Risk Committee for the year I would like to thank Committee members, the executive management team and our auditors, both internal and external, for the open and honest discussions that take place at our meetings and the importance they all attach to its work. I shall be standing down as Committee Chairman in July and am sure that the new Chairman, Ian Duncan, will continue to enjoy this support in the years ahead "

John Rennocks
Committee Chairman

Committee's role

The table on page 56 describes what the Committee does Its formal terms of reference are available on the Company's website at www babcock.co uk

Committee membership

Current membership of the Committee, and its membership during the year to 31 March 2011, is shown in the table on page 48 of this Annual Report The Company Secretary is secretary to the Committee Kate Swann will join the Committee when she takes up office as a Non-Executive Director on 1 June 2011

Chairman

John Rennocks acted as Committee Chairman throughout the financial year and will continue to do so until 7 July 2011 when his role as Chairman will be taken over by Ian Duncan

John Rennocks is a former Finance Director of Corus Group PLC and sits or has sat on several other audit committees Ian Duncan was until June 2010 Finance Director of Royal Mail Holdings PLC. He is a Chartered Accountant and his former roles have included the position of Corporate Finance Director at British Nuclear Fuels and Chief Financial Officer and Senior Vice President at Westinghouse Electric Company LLC in Pennsylvania, USA. Both John Rennocks and Ian Duncan are considered by the Board to have the necessary recent and relevant financial experience for the role of Committee Chairman

Who attends its meetings?

The Committee invites the Group Chairman, Chief Executive, Group Finance Director and Group Financial Controller to attend its meetings Non-Executive Directors not sitting on the Committee are also welcome to attend

The Group Risk Manager attends Committee meetings for discussion of Group risk reports and related items.

Ernst & Young LLP provides internal audit services to the Company PricewaterhouseCoopers LLP is the Group's external auditor

Both auditors usually attend all or part of the Committee's meetings

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

Auditors' independence

PricewaterhouseCoopers LLP (PwC) has been the Company's external auditor since 2002, and Ernst & Young LLP have provided the internal audit service since 2003. The Committee continues to be satisfied with the performance and independence of both auditors

PwC partners overseeing the Group and divisional level audits are changed at regular intervals

Fees are re-evaluated periodically and following significant changes to the Group's size or structure

There are no contractual obligations that restrict the Company's choice of auditors

Non-audit fees

The Committee regularly considers the engagement of, and level of fees payable to, the internal and external auditors for non-audit work, considering potential conflicts and the possibility of actual or perceived threats to their independence If their use would lead to non-audit fees in the year exceeding 20% of their audit fee, the Committee Chairman's approval is required They are used for non-audit services only if it is in the Company's interest to do so For example, it was entirely appropriate and in the Company's interest for the Company to retain PwC in connection with the preparation and/or review of the public documents required for the VT Group acquisition, including a review of the Directors' working capital and going concern statements made in connection with the transaction, the investigation and evaluation of the accounting policies and practices of VT and their reconciliation with those of the Group This inevitably resulted in a significant level of non-audit fees paid to PwC in the year

What the Committee did in the year

The Committee met formally four times in the year to 31 March 2011 and, on behalf of the Board, addressed the following principal topics:

Report of the Audit and Risk Committee continued

Matters considered by the Committee in the year to 31 March 2011

Topic	Action
Financial results	The Committee reviewed full and half year financial statements and related results announcements, having received reports from external auditors Those reports drew attention to material matters that require the exercise of a significant element of management judgement and commented on the approach being taken by management and possible alternatives. These matters were discussed with management in the presence of the auditors before the Committee reached a view on the matters concerned The Chairman also met the auditors before significant Audit Committee meetings to hear their views in the absence of management
Internal controls	The Committee reviewed the Company's system of internal controls (described on pages 43 to 45) and their effectiveness A particular area of focus in the year was on management plans for the early integration of the VT Group businesses into the internal controls system of Babcock International Group
Fraud	The Group Financial Controller reported to each meeting on fraud risk, covering any suspected incidents of fraud, their investigation and remedial or preventive action
Audit plans	The Committee reviewed and approved internal and external audit plans for the year or particular audits, and requested modifications (to areas of focus or the timing of audit visits) in light of the acquisition of VT Group and the start-up of significant new contract operations
Internal audit	Each meeting considered an internal audit report on findings from audit visits to business units, including follow-up reports on any matters identified in earlier reports as requiring attention or improvement The reports contain tracking information to enable the Committee easily to see the controls performance of business units over time and how quickly any matters are addressed
Risk	The Committee received regular detailed reports identifying areas of risk at business unit, divisional and Group level The reports assess and prioritise potential impact, describe the risk mitigation steps in place and the pre- and post-mitigation assessment The reports also contain a summary of key risks for the Group, tracking how those issues change over time See pages 39 to 42 for the risks currently regarded by the Board as key risks
Whistleblowing	The Committee received regular reports of calls to the external independent whistleblowing service and how they have been investigated and dealt with, it keeps the effectiveness of the arrangements under review
Audit fees, fees for non-audit services; auditor independence	Audit and non-audit fees for the external and internal auditors were reviewed by the Committee and considered as to their effect on auditor independence.

Other statutory and regulatory information, including Directors' responsibility statement

Principal activities

The Company is the holding company for the Babcock International Group of companies whose principal activities are described in the Business review on pages • to • of this report.

Directors

Biographies of the current Directors of the Company are to be found on pages 46 and 47

The table on page 48 shows the Directors who served in the year to 31 March 2011

Reappointment of Directors at the 2011 Annual General Meeting

Directors are required by the Company's Articles of Association to submit themselves for reappointment by shareholders at the first Annual General Meeting following their appointment by the Board and at least every three years thereafter However, in accordance with recommendations in the UK Corporate Governance Code, each of the Directors in office will stand for re-election at this year's Annual General Meeting Executive Directors are entitled to not less than 12 months' notice of termination of their service agreements Non-Executive Directors, including the Chairman, have letters of appointment which can be terminated at will

Directors' interests in contracts

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

Annual General Meeting

This year's Annual General Meeting will be held at Grosvenor House, A JW Marriott Hotel, Park Lane, London W1K 7TN on Thursday, 7 July 2011, at 11 am. The notice of meeting with an explanation of the business to be conducted at it is being sent separately to shareholders (or made available to view online at www babcock co uk for those who have elected or who are deemed to have elected simply to receive notices of availability of documents)

Results and dividends

The profit attributable to the owners of the parent for the financial year was £101 1 million (2010 £106 0 million) An interim dividend of 5.20p per 60p ordinary share was declared in the year (2010 4 80p) The Directors are recommending that shareholders approve at the forthcoming Annual General Meeting a final dividend for the year of 14 20p on each of the ordinary shares of 60p to be paid on 9 August 2011 to those shareholders on the register at the close of business on 8 July 2011 Last year, in lieu of a final dividend, a second interim dividend of 12 80p per share was paid for the year to 31 March 2010

Significant shareholdings

As at 12 May 2011, the Company had been notified in accordance with Chapter 5 of the Disclosure and Transparency Rules of the following major interests in voting rights attached to its ordinary shares (which represent interests in 3% or more of its issued ordinary share capital)

Name	Number of 60p ordinary shares	%
Standard Life Investment Limited	21,619,857	6 03
Cantillon Capital Management LLC	18,094,818	5 04
FMR LLC	17,995,103	5 01
BlackRock, Inc	17,969,006	5 01
Ignis Investment Services Limited	14,059,461	3 92
Deutsche Bank AG	12,809,023	3 57
Legal & General Group Plc	11,471,276	3 20
Schroders plc	11,400,758	3 17
JPMorgan Chase & Co	11,376,214	3 17

Other statutory and regulatory information, including Directors' responsibility statement continued

Employee share schemes and plans:

The table below summarises share-based plans in existence at the date of this Report that have outstanding awards.

Name of Plan	Who it covers	Performance-related?	Summary description	Outstanding awards (vested)	Source of shares
The Approved Employee Share Ownership Plan	Open to all UK employees (including Executive Directors) who meet necessary service criteria	No	Employees can buy Company shares (partnership shares) in the market out of pre-tax income The Plan allows for the Company to award free and/or matching shares to participants, though the Company has not yet done so Shares are bought on behalf of the employee via a tax-approved employee trust which holds them on behalf of the individual participants The shares must generally be kept in trust for at least three years to obtain any tax advantages, and for five years to obtain maximum tax advantages	Not applicable	Purchased in the market
The 2009 Performance Share Plan ('the PSP')	Executive Directors and other employees as selected by the Remuneration Committee	Yes	Nil price options to acquire shares, subject to achievement of performance targets measured over a three-year period	3,002,849 (None vested)	Intention is to purchase in the market, but can be fresh issue
The Company Share Option Plan ('the CSOP')	Executive Directors and other employees (in the UK) as selected by the Remuneration Committee	Yes	HM Revenue and Customs approved performance-linked share awards in the form of options to acquire shares in the Company at their market price at the time of the award	424,099 (None vested)	Intention is to purchase in the market, but can be fresh issue
The Babcock 2003 Long-Term Incentive Plan ('the L-TIP')	Executive Directors and other employees as selected by the Remuneration Committee	Yes	This Plan was used from 2003 to 2008 to make performance-linked share awards to the Executive Directors and senior employees in the form of options granted at a nominal or nil price	424,458 (146,862 vested)	Intention is to purchase in the market, but can be fresh issue
Deferred Bonus Plan ('the DBP')	Executive Directors and other senior executives whose annual bonus plans require a proportion of the bonus earned to be deferred into Company shares	No	A mechanism for implementing the mandatory deferral of part of annual bonuses An award under the plan is structured in the form of a nil cost option to acquire that number of shares in the Company that has a market value on the date of the award equivalent to the amount of bonus deferred The award may normally only be exercised by the Executive after two years if he is still an employee No additional or matching shares can be earned	239,908 (None vested)	Purchased in the market
The Babcock 1999 Approved Executive Share Option Scheme	UK employees (including Executive Directors) who met necessary service criteria	Yes	Expired 2009 HM Revenue and Customs approved performance-linked share awards in the form of options to acquire shares in the Company at market price at the time of the award	103,575 (All vested)	Purchased in the market and fresh issue

Employee share schemes and plans – continued

Name of Plan	Who it covers	Performance-related?	Summary description	Outstanding awards (vested)	Source of shares
Babcock 1999 Unapproved Executive Share Option Scheme	Executive Directors and other employees as selected by the Remuneration Committee	Yes	Expired 2009 Options to acquire shares (at their market price on the date of grant) subject to achievement of performance targets measured over a three-year performance period	421,115 (All vested)	Purchased in the market and fresh issue
VT US Sharesave Scheme	Employees of VT Group Inc	No	The scheme allows employees to save monthly amounts to be applied, at the employee's election, to the exercise of options to acquire shares at the market price at the date of grant The outstanding options are to acquire shares in the former VT Group plc which, following the Scheme of Arrangement in connection with its acquisition by the Company in 2010, are now effectively options to acquire shares in the Company Although savings can continue to be made, the amount capable of being applied to exercise of the option is fixed at the amount saved at the date of the acquisition of VT	20,704 (All vested)	Fresh issue

Further information relating to awards under the LTIP, PSP, CSOP, DBP and the 1999 Schemes can be found in the Remuneration report on pages • to •

Shares intended to be used to satisfy existing share awards and options granted under the PSP, CSOP, L-TIP, 1999 Schemes and the DBP are held by the trustees of the Babcock Employee Share Trust and the Peterhouse Employee Share Trust The trustees of these Schemes do not intend to exercise the voting rights attached to the shares held by them. As at 16 May 2011, the total number of ordinary shares in the trusts was 776,053, which represented 0 22% of the Company's issued share capital Shares are also held by the trustees of the Approved Employee Share Ownership Plan The trustees of that plan exercise voting rights attached to those shares in accordance with directions from the employees on whose behalf they are held

The trustees of the Babcock Employee Share Trust effectively waive dividends on shares held by them – see note 24 on pages 112 and 113

Authority to purchase own shares

At the Annual General Meeting in July 2010, members authorised the Company to make market purchases of up to 35,870,029 of its own ordinary shares of 60p each That authority expires at the forthcoming Annual General Meeting in July 2011 when a resolution will be put to renew it so as to allow purchases of up to a maximum of 10% of the Company's issued share capital No shares in the Company have been purchased by the Company in the period from 8 July 2010 (the date the current authority was granted) to the date of this Report. The Company currently does not hold any treasury shares

Details of purchases of the Company's shares made in the year to 31 March 2011, or since then to the date of this Report, by the Babcock Employee Share Trust and the Peterhouse Employee Share Trust are to be found in note 24 on pages 112 and 113

Research and development

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

Charitable and political donations

During the year the Group donated £236,000 (2010 £197,000) to charitable organisations Donations were typically of relatively small individual amounts made to a range of local and national charitable organisations or events, for example schools and other educational or training institutions or charities, hospital, hospice or medical charities, charities helping serving and/or former servicemen and women, sporting events or charities, and charities intended to benefit children and young adults No donations were made during the year for political purposes

Supplier payments

The Group's policy is to pay suppliers in accordance with practices or arrangements agreed with them The Company itself had £113,000 in trade creditors at 31 March 2011 (representing 31 creditor days) and £87,000 in trade creditors at 31 March 2010 (representing 32 creditor days)

Other statutory and regulatory information, including Directors' responsibility statement continued

Qualifying third-party indemnity provisions

Under their respective Articles of Association, the Directors of the Company and of Group subsidiary companies are, and were during the year to 31 March 2011, entitled to be indemnified by, respectively, the Company and those UK subsidiaries of which they are or were Directors against liabilities and costs incurred in connection with the execution of their duties or the exercise of their powers, to the extent permitted by the Companies Act 2006 There are also qualifying third-party indemnity provisions entered into between the Company and Archie Bethel and Kevin Thomas in their capacity as Directors of International Nuclear Solutions PLC (a subsidiary of the Company) which were in force at the date of approval of this Report Qualifying pension scheme indemnity provisions are also in place for the benefit of Directors of the Group companies that act as trustees of Group pension schemes

Persons with contractual or other arrangements with the Group which are essential to the business of the Group

The majority of the Group's revenue comes from the United Kingdom Ministry of Defence through various contracts across different businesses, which together are essential to the business of the Group as a whole, as are its borrowing facilities with banks and other lenders.

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

Many agreements entered into by the Company or its subsidiaries contain provisions entitling the other parties to terminate them in the event of a change of control of the Group company concerned, which can often be triggered by a takeover of the Company The following agreements are those agreements which the Company considers to be significant to the Group as a whole that contain provisions giving the other party a specific right to terminate them if the Company is subject to a change of control following a takeover bid

Marine

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

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

In the event of a change of majority control of Babcock International Group PLC, the MoD may request information regarding the new controlling entity and in certain circumstances, including if it is not satisfied as regards the financial affairs and standing of the new entity, serve a 'Change in Circumstance' notice, and thereafter can elect to terminate the Agreement The Agreement can also be terminated if the MoD considers that unacceptable ownership, influence or control (domestic or foreign) has been acquired over Clyde and that this is contrary to the essential security interests of the UK. This might apply, for example, in circumstances where any non-UK person(s) directly or indirectly acquire control over more than 30% of the shares of the Company, though such a situation is not of itself such a circumstance unless the MoD in the given situation considers it to be so Any level of ownership by particular foreign or domestic persons may, on the facts of the case, be so treated

Articles of Association of Devonport Royal Dockyard Limited and Rosyth Royal Dockyard Limited

The Articles of Association of Devonport Royal Dockyard Limited (DRDL) and Rosyth Royal Dockyard Limited (RRDL), both subsidiaries of the Company, grant the MoD as the holder of a special share in each of those companies certain rights in certain circumstances Such rights include the right to require the sale of shares in, and the right to remove Directors of, the company concerned

The circumstances when such rights might arise include where the MoD considers that unacceptable ownership, influence or control (domestic or foreign) has been acquired over the company in question and that this is contrary to the essential security interests of the UK. This might apply, for example, in circumstances where any non-UK person(s) directly or indirectly acquire control over more than 30% of the shares of the Company, though such a situation is not of itself such a circumstance unless the MoD in the given situation considers it to be so Any level of ownership by particular foreign or domestic persons may, on the facts of the case, be so treated

The Company believes that RRDL presently has the right under its Articles of Association to request that the special share held by the MoD in RRDL be redeemed

Terms of Business Agreement ('ToBA') dated 25 March 2010 between (1) The Secretary of State for Defence (2) Babcock International Group PLC (3) Devonport Royal Dockyard Limited (4) Babcock Marine (Clyde) Limited and (5) Babcock Marine (Rosyth) Limited

The ToBA confirms Babcock as the MoD's key support partner in the maritime sector and covers the 15-year period from 2010 to 2025 The MoD may terminate the ToBA in the event of a Change in Control of the Company in circumstances where, acting on the grounds of national security, the MoD considers that it is inappropriate for the new owners of the Company to become involved or interested in the Marine division 'Change in Control' occurs where a person or group of persons that control the Company ceases to do so or if another person or group of persons acquires control of the Company

Group

Borrowing facilities

£600 million facility agreement originally dated 9 May 2007 between the Company, as borrower, The Governor and Company of the Bank of Scotland, J P Morgan plc, Lloyds TSB Bank plc, and The Royal Bank of Scotland plc, as mandated lead arrangers, The Royal Bank of Scotland plc, as facility agent, and a syndicate of other financial institutions as original lenders as since amended and restated

The facility was originally established in part to fund the acquisition of Devonport Management Limited in 2007 and in part to provide funds for general corporate purposes The facility agreement provides that in the event of a change of control of the Company, the lenders may, within a certain period, call for the prepayment of any outstanding loans and cancel the credit facility

Multi-Currency Loan Notes

On 21 January 2010, the Company issued two series of loan notes to Prudential Investment Management Inc (and certain of its affiliates) (a) £60 million 4 995% Series A Shelf Notes due 21 January 2017 (the 'Series A Shelf Notes'), and (b) £40 million 5 405% Series B Shelf Notes due 21 January 2020 (the 'Series B Shelf Notes') (together, the 'Multi-Currency Loan Notes') Each series is unsecured and unsubordinated and ranks *pari passu* with all other unsecured and unsubordinated financial indebtedness obligations of the Company Unless previously redeemed or purchased and cancelled, the Company will redeem the Series A Shelf Notes on 21 January 2017 and the Series B Shelf Notes on 21 January 2020, respectively at their principal amount. In the event of a change of control of the Company before then, the Company must offer to pre-pay the Multi-Currency Loan Notes together with a make whole premium

US Dollar Loan Notes

On 17 March 2011, the Company issued to 21 financial institutions (i) US$150,000,000 aggregate principal amount of 4 94% Series A Senior Notes due 17 March 2018 and (ii) US$500,000,000 aggregate principal amount of its 5 64% Series B Senior Notes due 17 March 2021 Each series is unsecured and unsubordinated and ranks *pari passu* with all other unsecured and unsubordinated financial indebtedness obligations of the Company In the event of a change of control of the Company before then, the Company must offer to pre-pay the Notes

Share plans

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

Contracts with employees or Directors

A description of those agreements with Directors that contain provisions relating to payments in the event of a termination of employment following a change of control of the Company is set out on page 79 One senior employee, who is not a Director of the Company, has an agreement providing for payment of 12 months' salary plus 40% in lieu of all benefits in the event of a dismissal (including constructive dismissal) by the Company within 12 months following a change of control

Share capital and rights attaching to the Company's shares

Under the Company's Articles of Association, any share in the Company may be issued with such rights or restrictions, whether in regard to dividend, voting, return of capital or otherwise, as the Company may from time to time by ordinary resolution determine (or, in the absence of any such determination, as the Directors may determine) The Directors' practice is to seek annual authority from shareholders at each year's Annual General Meeting to allot shares (including authority to allot free of statutory pre-emption rights) up to specified amounts and also to buy-back the Company's shares, again up to a specified amount

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

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

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

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

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

Other statutory and regulatory information, including Directors' responsibility statement continued

At the date of this report 358,838,092 ordinary shares of 60p each have been issued and are fully paid up and are quoted on the London Stock Exchange

Appointment and powers of Directors

A Director is appointed by ordinary resolution at a general meeting of ordinary shareholders The Directors acting as a Board also have the power to appoint a Director, but any person so appointed must be put up for reappointment by shareholders at the first Annual General Meeting following his or her appointment by the Board

Subject to its Articles of Association and relevant statutory law and to any directions as may be given by the Company in general meeting by special resolution, the business of the Company is managed by the Directors, who may exercise all powers of the Company that are not required to be exercised by the Company in general meeting

Articles of Association

The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders They are available for inspection online at www babcock co uk and can also be seen at the Company's registered office

Directors' duty to avoid conflicts of interest

The Company has adopted a formal procedure for the disclosure, review, authorisation and management of Directors' conflicts of interest and potential conflicts of interest in accordance with the provisions of the Companies Act 2006

The procedure requires Directors formally to notify the Board (via the Company Secretary) as soon as they become aware of any actual or potential conflict of interest with their duties to the Company or of any material change in existing actual or potential conflicts that may have been authorised by the Board Notified actual or potential conflicts will be reviewed by the Board as soon as possible
The Board will consider whether a conflict or potential conflict does, in fact, exist and, if so, whether it is in the interest of the Company that it be authorised and, if so, on what terms In making their judgement on this, the other Directors must have regard to their general duties to the Company A register is maintained for the Board of all such disclosures and the terms of any such authorisation Authorisations may be revoked, or the terms on which they were given varied, at any time Cleared conflicts will in any event be reviewed annually by the Board In the event of any actual conflict arising in respect of any matter, mitigating action would also be considered (for example, non-attendance of the Director concerned at all or part of Board meetings and non-circulation to him of relevant papers)

Going concern basis

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future For this reason, they continue to adopt the going concern basis in preparing the financial statements

Internal controls

There has been a process for identifying, evaluating and managing significant risks throughout the year to 31 March 2011 and up to the date of the approval of the financial statements for that year In respect of our financial reporting process and the process for preparing our consolidated accounts, management monitors the processes underpinning the Group's financial reporting systems through regular reporting and review, and data for consolidation into the Group's financial statements are reviewed by management to ensure that they reflect a true and fair view of the Group's results in compliance with applicable accounting policies

The Board, through the Audit and Risk Committee, reviews the effectiveness of the Company's internal control processes formally at least once a year The Board considers the system to be effective and in accordance with Internal Controls Guidance for Directors on the Combined Code ('the Turnbull Guidance') Further information on the principal internal controls in use in the Company is to be found on pages 43 to 45

Auditors

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

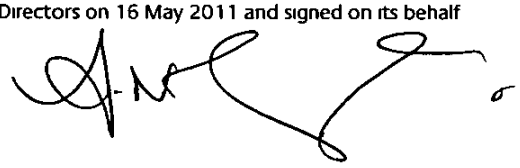
Disclosure of relevant audit information

So far as the Directors who are in office at the time of the approval of this Report are aware, there is no relevant audit information (namely, information needed by the Company's auditors in connection with the preparation of their auditors' report) of which the auditors are unaware Each such Director has taken all steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the auditors are aware of that information

Approval of report

The Directors' report for the year ended 31 March 2011, from pages 1 to 63 of this Annual Report document, has been approved by the Board of Directors on 16 May 2011 and signed on its behalf by

Albert Dungate
Company Secretary
16 May 2011



Directors' responsibility statement

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration report and the Group's and the Company's financial statements in accordance with applicable law

Company law requires the Directors to prepare financial statements for each financial year In accordance with that law, the Directors have prepared the Group's financial statements in accordance with International Financial Reporting Standards (IFRS) (as adopted in the European Union), and the Company's financial statements and the Directors' Remuneration report in accordance with applicable law and UK Generally Accepted Accounting Practice (UK GAAP) The Group's and the Company's financial statements are required by law to give a true and fair view of the state of affairs of the Group and the Company and of the profit and loss of the Group for that year In preparing those financial statements the Directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent,
- state whether IFRSs, as adopted by the European Union and applicable UK Accounting Standards, have been followed, subject to any material departures disclosed and explained in the Group's and Company's financial statements respectively; 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 keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company, and enable them to ensure that the Group's financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation and that the Company's financial statements and the Directors' Remuneration report comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the Group and the Company, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Each of the Directors listed below (being the Board of Directors at the date of this Annual report and these financial statements) confirms that to the best of his knowledge:

- the Group financial statements (set out on pages 82 to 124) which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group taken as a whole; and
- the Business review contained on pages 2 to 45 includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces

Mike Turner	Chairman
Peter Rogers	Chief Executive
William Tame	Group Finance Director
Archie Bethel	CEO, Marine and Technology
Kevin Thomas	CEO, Support Services
John Rennocks	Non-Executive Director
Sir Nigel Essenhigh	Non-Executive Director
Justin Crookenden	Non-Executive Director
Sir David Omand	Non-Executive Director
Ian Duncan	Non-Executive Director

On behalf of the Board

Mike Turner
Chairman

16 May 2011

Remuneration report

Introduction by the Chairman of the Committee

"I am pleased to present the Directors' Remuneration report for the year to 31 March 2011.

The Remuneration Committee believes that over recent years it has met the policy objective approved by shareholders of providing executive remuneration arrangements that are fair and allow for upper quartile rewards for upper quartile performance, that align Directors' and shareholders' interests and that take proper account of risk. We believe that, consistent with this policy, the rewards earned by executives to date have been justified by the Company's performance Despite the tough challenges faced by many companies over the last three years, Babcock has continued its strong financial performance, growing its EPS by over 60% over this period and regularly delivering top quartile TSR performance

The Remuneration Committee has devoted considerable time and thought over the past two years to the question of how best to ensure that the remuneration packages for your Executive Directors continue to be capable of meeting this approved policy objective against a rapidly changing background of the recent financial and economic crises and at a time of major change for the Company itself, following the acquisition last summer of VT Group and the consequent challenges that this brings for the management team to deliver the benefits of that transaction

We now feel that it is increasingly difficult for the remuneration packages, looked at in comparison to peers outside the Company, to be able to meet our objective of being capable of delivering upper quartile reward for upper quartile performance, this is unlikely to be in the long-term interests of shareholders Nonetheless, we recognise the constraints within which the Company must operate

I hope that this Report will explain this issue and show how we are trying to address it in a manner that seeks to be fair to both our management team and to shareholders "

Justin Crookenden
Committee Chairman

Overview

Our remuneration policy

The table on pages 65 to67 summarises our policy for remunerating Executive Directors, how we seek to apply it, whether we think we are succeeding in delivering it and any issues that arise in that respect It also explains arrangements for the financial year 2011/12, which started on 1 April 2011 It should be read in conjunction with the other parts of this Report which give further details on various aspects of the remuneration packages

The Committee

Members

Details of Committee members who served at any time during the year, and their attendance at Committee meetings, are shown in the table on page 48 All members were and remain independent Non-Executive Directors Kate Swann will join the Committee when she takes up office as a Non-Executive Director on 1 June 2011

The Group Chairman and the Chief Executive attend meetings by invitation, but are not present when their own remuneration is being discussed The Company Secretary attends meetings as secretary to the Committee

Advisers

Kepler Associates ('Kepler') were appointed by the Committee in late 2008 to provide it with independent analysis, information and advice on all aspects of executive remuneration and market practice, within the context of the objectives and policy set by the Committee They report directly to the Committee Chairman A representative from Kepler typically attends Committee meetings Kepler provides no other services to the Company

How often it meets

Reflecting the increasing complexity of issues around executive remuneration generally and the Board's determination to give thorough consideration to all aspects of Director remuneration in our rapidly growing Company, the Committee significantly increased the number of meetings it held this year In total there were nine meetings

Principal areas of focus for the Committee during the year to 31 March 2011

The year was, of course, dominated by the impact of the VT acquisition, which was announced in March 2010 and completed in July

Inevitably, the acquisition had direct and immediate implications for the work of the Committee.

Revising annual bonus plans and increased share award for the Chief Executive

The annual bonus plans for 2010/11 had initially been set on the basis of Babcock continuing on an 'as is' basis The substantial in-year impact of the VT acquisition and accompanying Group restructuring would, however, have made year-on-year comparison difficult and was bound to have a distorting effect on actual performance measurement The Committee, therefore, devoted much time and attention to considering this and formulating appropriate proposals that maintained a fair test of executive performance.

Details of the structure of the annual bonus schemes for 2010/11 (and also for 2011/12) are set out on pages 69 and 70 below

Apart from the immediate in-year impact of the VT acquisition on annual bonus plans, it was clear that the main strategic priority for the Group, in the medium to longer term, had become the securing of the anticipated benefits of the acquisition and the challenge of finding ongoing profitable revenue growth During the year, the Committee consulted with its major shareholders on changes to remuneration arrangements that support these objectives The Committee decided not to make any changes to base salaries, bonus potential or share plans during the year, but instead, in the case of the Chief Executive, to make use of the existing Performance Share Plan (PSP) to make an additional award in recognition of the exceptional management challenge he now faces over the next few years following the VT acquisition More information on this additional award can be found on page •

The Committee felt it was appropriate that these issues should be looked at again when considering arrangements for 2011/12 and has, as explained in the policy table, decided to repeat this additional PSP award for the Chief Executive, to move towards realignment of base salaries closer to market for the Executive Directors over the next few years, and to make a modest increase in annual bonus potential for the two new Executive Directors, as anticipated at the time of their appointment to the Board in May 2010, but otherwise to leave the shape of remuneration packages substantially unchanged

The impact of tax changes on pension benefits for high earners

Changes to the taxation of pension benefits for high earners came into force in April 2011, increasing significantly the tax charge in respect of these benefits The Company does not compensate for tax changes, but accepts that the limited number of individuals within the Company currently affected, including some of the Executive Directors, may now wish to reduce their annual pension benefit accrual As an alternative to continuing with their current rate of pension accrual and any existing supplement in lieu of pension benefits, the executives will be able, instead, to elect to take a supplement to salary, which would not be pensionable or taken into account when assessing annual bonus or share awards, of an amount (having taken into account employer's national insurance contributions payable on the supplement) broadly equivalent to, but no more than, the saving to the Company as a result of their reducing their pension accrual and giving up any existing salary supplement in lieu of pension benefits

Other matters

The Committee considered other matters, including performance-related share awards for executives generally, the Company's approach to general employee share ownership, a review of the comparator group to be used in assessing TSR performance for performance-related share awards, and the non-financial measures to be attached to annual bonus awards designed to align with the Company's strategic and risk mitigation objectives

Internal relativity

When setting Executive Directors' remuneration, the Committee takes note of pay and conditions in the wider Group Each business within the Group determines its own pay structures and remuneration in light of its own position and the employment market in which it operates Hence, general pay reviews vary across the Group The normal annual pay review process has resulted or is expected to result in general pay awards ranging from 0% to 3% depending on business unit. However, in addition, the significant changes for some employees to their roles and responsibilities (and to relevant comparators for those roles) following the VT acquisition have justified special individual reviews leading, for some, to significantly higher increases of up to 10% or more

Policy

Our approach to remunerating Babcock's Executive Directors

Our Policy	General
	To provide remuneration arrangements that allow for enhanced but fair rewards for delivery of superior performance by allowing for the possibility of upper quartile rewards for upper quartile performance, that align Directors' and shareholders' interests and take account of risk
How we seek to achieve it	Emphasis on performance-related and long-term reward
Are we delivering?	On a fair value basis around half or more of a Babcock Executive Director's package is performance-related – see charts on page 67 below In recent years, the actual total remuneration of Executive Directors has been in accordance with our policy and reflected the Company's performance However, the fair value of the overall remuneration packages for the Executive Directors is currently towards or below lower quartile *
Comments	Although the current structure of our packages reflects our emphasis on performance-related pay, to deliver on our remuneration policy of enhanced but fair rewards for the delivery of superior performance by allowing for upper quartile reward for upper quartile performance, it is necessary to consider enhancing further the variable elements of pay and/or increasing base pay.
What are we doing for 2011/12?	The Committee decided that for 2011/12 it was not appropriate to alter significantly the structure of the remuneration arrangements, in particular the variable elements, but to begin to address the level of base pay where it is at a level that undermines our general policy

* Judged against market data based on an average of size and size-adjusted sector, comparators compiled by Kepler Associates, the Committee s independent remuneration advisers

Remuneration report continued

Policy (continued)

Our policy	Fixed element (base pay)
	Base pay should be at a level that is (i) fair and (ii) capable, when taken with the gearing effect of performance-related pay, of delivering upper quartile actual remuneration for upper quartile performance
How we seek to achieve it	Fixed remuneration should be at or just below median
Are we delivering?	Market data* suggests that base pay for each of the Executive Directors was, by the end of the financial year 2010/11, at a level around or below lower quartile (and between 15% and 20% below market median)
Comments	The increasing disparity between market levels of base pay and Babcock base pay has in large part been driven by the rapid growth of Babcock. Base pay at current levels, taken together with the existing levels of gearing of performance-related rewards, makes it less likely that total actual remuneration can continue to deliver our policy as to rewarding upper quartile performance if delivered, this is unlikely to be in the long-term best interests of shareholders.
What are we doing for 2011/12?	Consistent with its general policy, the Committee intends to move base pay towards market median and narrow the 'gap' over the next few years We have restricted the rises this year to no more than c 9%. These salary increases for 2011 move Executive Director salaries to around 10% below market median (and the fair value of the remuneration package for all the Executive Directors is between lower quartile and median) The Committee believes that these increases are necessary to fulfil the Company's remuneration policy and to ensure that remuneration levels remain competitive Salary increases were around 2% in 2009 for both the Group Finance Director and Chief Executive (who were then the only Executive Directors) and, respectively, 2 5% and 4% in 2010 *

Our policy	Performance-related rewards
	Variable pay should reward long-term sustainable growth and value creation
How we seek to achieve it	Annual bonus rewards year-on-year growth in earnings as well as non-financial and financial performance against agreed targets, PSP awards reward a combination of TSR performance relative to the FTSE 350 (excluding financial services companies and investment trusts) and EPS growth over three years
Are we delivering?	The Remuneration Committee believes that the remuneration structure in place over the last few years has been appropriate, with actual total remuneration delivered over the recent years reflecting the Company's performance.
Comments	Although we have succeeded in delivering our policy in recent years, this is becoming more difficult to sustain as the fixed element of remuneration (base pay) has fallen, comparatively, relative to market* (see above)
What are we doing for 2011/12?	We have decided to increase the maximum annual bonus potential for Archie Bethel and Kevin Thomas from 120% to 125% as part of our policy, adopted on their appointment to the Board in May 2010, of bringing them, over time, into closer alignment with the arrangements for the Group Finance Director Performance-related share awards for Executive Directors, other than Peter Rogers, will be maintained at 150% of salary. In the case of Peter Rogers, the award will be (as it was last year) at the maximum of 200% of annual salary (with an extra stretch requirement for vesting of the final 50%) because we continue to regard as exceptional the management challenge facing him following the VT acquisition and in maximising the potential presented by that acquisition

Our policy	Alignment with shareholders interests
How we seek to achieve it	A major part of pay potential that is performance-related (both standalone and comparative) is delivered in the form of share awards, thus directly linking the Director's remuneration to the investment risk faced by shareholders 40% of annual bonus must be deferred into Company shares, which can normally only be accessed after two years and is subject to potential clawback, ensuring that a substantial part of the reward is exposed to the longer term performance of Babcock Performance-related share awards (PSP Awards) are subject to comparative (TSR vs peers) and standalone (EPS growth) performance over a three-year period In order further to align the interests of management and shareholders, the Committee's shareholding guidelines expect Executive Directors to hold Company shares (derived from share awards or purchased by them) equivalent in value to 200% of their base salaries.
Are we delivering?	The first annual bonus payments subject to the deferral requirement were those in respect of the year to 31 March 2010, with the associated share awards being made in July 2010 as shown on page 72 All Executive Directors currently meet or exceed the shareholding guidelines (see page 71)
What are we doing for 2011/12?	No substantive changes are being made to the structure of the annual bonus scheme, share awards or shareholding guidelines

* Judged against market data based on an average of size, and size-adjusted sector comparators compiled by Kepler Associates, the Committee's independent remuneration advisers.

Policy (continued)

Our policy	Take account of risk
How we seek to achieve it	The combination of measures (financial for share awards and both financial (including cash generation) and non-financial for annual bonus schemes) used in performance-related pay are designed to incentivise sustainable, profitable growth linked to achievement of strategic objectives and risk mitigation priorities Use of shares also exposes executives to the longer term risks in any of their decisions 20% of maximum annual bonus potential is linked to tailored non-financial measures related to agreed strategic and risk mitigation priorities In addition, the award of annual bonuses is subject to forfeiture or reduction for poor health, safety and environment performance at the discretion of the Committee
Are we delivering?	By these means we seek to balance short-term and long-term priorities as well as strategic, reputational and other business objectives The Committee is satisfied that the incentive structure for Executive Directors does not raise environmental, social or governance issues by inadvertently motivating irresponsible behaviour
What are we doing for 2011/12?	We are continuing with the same approach

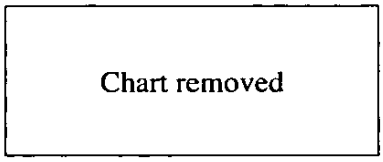
Summary of the structure of Executive Directors' remuneration packages

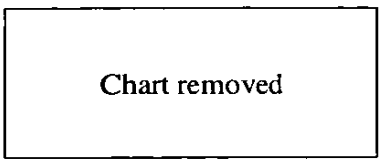
Based on our policy, the principal elements of the arrangements for Executive Director remuneration in the year to 31 March 2011 were, and for the year to 31 March 2012 are, as summarised in the table below Further details on the annual bonus schemes, share awards, and pension schemes (and pension benefits) are to be found in the following pages of this Remuneration report

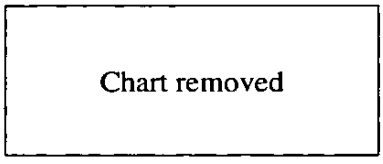
Director	Base pay 2010/11 £'000	Base pay 2011/12 £'000	Annual bonus potential 2010/11 (% of salary)	Annual bonus potential 2011/12 (% of salary)	Performance share awards 2010/11 (% of salary)	Performance share awards 2011/12 (% of salary)
Peter Rogers	500	545	150%	150%	150% + 50%=200%	150% +50%=200%
Bill Tame	320	345	150%	150%	150%	150%
Archie Bethel	275	300	120%	125%	150%	150%
Kevin Thomas	275	300	120%	125%	150%	150%

Balance of remuneration

The charts below show the relative proportions of each element of the Executive Directors' total remuneration packages. Long-term incentive awards are valued on a fair value basis The charts assume that PSP awards over shares have a value on grant equal to 150% of the Director's base salary (200% for Peter Rogers) These charts are based on annual bonus fair values (including the mandatorily deferred share element) of 72% of salary for Peter Rogers and Bill Tame and 60% of salary for Archie Bethel and Kevin Thomas, and Performance Share Plan fair values* of 65% of salary for the Directors other than Peter Rogers, and 82% of salary for Peter Rogers







* Note the fair value of PSP is its long-run average outcome This takes into account the difficulty of achieving the associated performance conditions It also takes account of factors such as volatility time value of money, risk of forfeiture correlation between the value of the share and the performance conditions etc

Remuneration report continued

Linkage of remuneration to strategic objectives, risk management and its alignment with shareholder interests

The Committee strongly believes that the remuneration of executives should be aligned with the long-term interests of shareholders and should support the key strategic and risk management objectives of the business The linkage is achieved through the performance criteria (both financial and non-financial) used in the annual bonus and long-term incentive schemes Examples include the following

Objective	Annual bonus scheme metric	Long-term incentive metric
Delivering superior returns to our shareholders	Financial measures focused on delivery of sustainable year-on-year delivery of budgets and especially on growth by rewarding superior earnings and/or profits growth whilst maintaining strict control of cash Objectives linked to improvement of the financial performance of specific business areas.	Focus on delivery of top quartile performance and returns over the longer term
Securing the strategic benefits of the VT acquisition and the synergy benefits.	Specific non-financial measures aimed at strategic benefits Financial benefits factored into budgets	As above, but with increased incentive for the Chief Executive for delivering even more stretching returns
Organic growth	Non-financial measures targeting win rates, order book and pipeline growth Specific business positioning objectives designed to underpin future growth. Financial objectives	Long-term measures and deferral of significant part of bonus ensure steps taken to meet annual objectives are not at the expense of future performance
Developing and maintaining leading market positions in the UK and selected overseas markets	Specific non-financial objectives for: • the establishment or expansion of targeted domestic and overseas markets, • securing key business development milestones; • developing detailed strategic plans for expansion into target markets	
Customer-focused, long-term relationships with strategically important customers.	Non-financial objectives linked to customer satisfaction	
Development of the Group's long-term technical and management expertise.	Non-financial objectives for example, the establishment of a more effective ongoing talent management and succession planning process Retentive nature of the requirement for deferral into shares of 40% of annual bonuses earned by senior executives	Retentive nature of the long-term schemes.
Maintenance of an excellent health, safety and environmental record	General underpin giving Remuneration Committee complete discretion over the reduction or annulment of bonus in the event of unsatisfactory performance	
Balancing risk and reward	A focus on year-on-year earnings or profit growth remains the prominent feature of the bonus schemes, placing a premium on delivery of sustainable growth, discouraging short-term risk-taking and encouraging planning for and underpinning of future prospects The use of financial metrics that are principally cash flow, profit and earnings driven rather than sales based discourages poor quality sales growth The use of non-financial objectives reinforces links to key strategic steps or risk mitigation objectives The requirement to defer 40% of any bonus into shares for two years exposes executives to the future impact of current year decisions	The long-term schemes and annual bonus schemes are mutually reinforcing, with the long-term schemes increasing the personal exposure of executives to the potentially negative consequences of short-term thinking and, as a further control, by requiring for full vesting superior performance in returns to shareholders

Annual bonus schemes

As explained in the Overview on pages 64 and 65, the Committee had to reconsider the shape of the annual bonus scheme for Directors during the year in the light of the VT acquisition

Accordingly, the Committee adopted the following structures for the year to 31 March 2011

	Peter Rogers		Bill Tame		Archie Bethel		Kevin Thomas	
Bonus element	Earned/ maximum potential % of salary	Weighting of this element	Earned/ maximum potential % of salary	Weighting of this element	Earned/ maximum potential % of salary	Weighting of this element	Earned/ maximum potential % of salary	Weighting of this element
EPS* performance	100%/100%	67%	100%/100%	67%	66%/66%	55%	66%/66%	55%
Stretching targets established against budget, with a sliding scale between threshold and maximum								
Achieving revised budgeted divisional PBIT	–	–	–	–	15%/15%	12 5%	15%/15%	12 5%
Achieving revised target year end net debt	20%/20%	13%	20%/20%	13%	–	–	–	–
Achieving revised budgeted divisional cash flow	–	–	–	–	15%/15%	12 5%	15%/15%	12 5%
Non-financial objectives	27%/30%	20%	27%/30%	20%	22.8%/24%	20%	22.8%/24%	20%
Total	147%/150%	100%	147%/150%	100%	118 8%/ 120%	100%	118.8%/ 120%	100%

* Earnings per share before amortisation of acquired intangibles and (unless the Committee decides otherwise for any item) exceptional items

Remuneration report continued

For the financial year 2011/12 the Committee has set bonus schemes structured as follows

	Peter Rogers		Bill Tame		Archie Bethel		Kevin Thomas	
Bonus element	Maximum potential % of salary	Weighting of this element	Maximum potential % of salary	Weighting of this element	Maximum potential % of salary	Weighting of this element	Maximum potential % of salary	Weighting of this element
EPS* performance	105%	70%	105%	70%	75%	60%	75%	60%
Stretching targets established against budget, with a sliding scale between threshold and maximum								
Achieving budgeted Group cash flow	15%	10%	15%	10%	–	–	–	–
Achieving budgeted divisional PBIT	–	–	–	–	12 5%	10%	12 5%	10%
Achieving budgeted divisional cash flow	–	–	–	–	12 5%	10%	12 5%	10%
Non-financial objectives	30%	20%	30%	20%	25%	20%	25%	20%
Total (maximum potential)	150%	100%	150%	100%	125%	100%	125%	100%

* Earnings per share is before amortisation of acquired intangibles the treatment of exceptional items is at the discretion of the Committee

The maximum bonus potential for Archie Bethel and Kevin Thomas is increased from 120% to 125% in a step towards bringing them into closer alignment with the Group Finance Director, as envisaged at the time of their appointment to the Board in May 2010

Deferral into shares

To ensure that a substantial part of the Director's bonus is exposed to the longer term impact of decision-making and to further align them with shareholders, 40% of any annual bonus earned by Executive Directors (and other senior executives) must be deferred into Babcock shares for two years under the Deferred Bonus Plan.

There is no provision for the Company to match or augment these deferred shares on any basis

Directors and shares

Share ownership

Directors' interests in shares

The table below shows the holdings of fully paid ordinary shares of 60p by each of the Directors (including family interests) who served in the year to 31 March 2011 or who hold office at the date of this Report in the issued share capital of the Company The interests were beneficial interests

Director	At 31 March 2011[1]	At 1 April 2010	Holding for Share Guideline purposes[2]
Chairman and Executive Directors			
Mike Turner	40,000	20,000	n/a
Peter Rogers	710,535	710,535	874%
Bill Tame	385,046	375,046	772%
Archie Bethel	108,668	100,798	256%
Kevin Thomas	113,081	93,557	280%
Non-Executive Directors			n/a
Alexander Hesketh (resigned 8 November 2010)	1,667[3]	1,667	n/a
Nigel Essenhigh	–	–	n/a
John Rennocks	28,000	–	n/a
Justin Crookenden	11,647	6,961	n/a
David Omand	–	–	n/a
Ian Duncan (appointed 10 November 2010)	–	–	n/a

1 There were no changes in these interests between 31 March 2011 and 16 May 2011 (save in the case of Archie Bethel who participates in the Company's Approved Employee Share Ownership Plan, the trustee of which makes regular monthly purchases of shares on behalf of participants in the case of Mr Bethel, this involved the purchase on 11 April of 20 shares and on 10 May of 19 shares)

2 Shown as a % of base salary applying from 1 April 2011 Calculated as at 10 May 2011 in accordance with our guidelines, these included share awards under the Deferred Bonus Plan shares subject to vested but unexercised performance-related share awards (less that number as would need to be sold to meet tax and national insurance obligations on exercise), but do not include shares covered by awards that are not yet vested

3 For Alexander Hesketh, the interest in shares shown is the interest in shares on the date he resigned as a Director

Shareholding guidelines for Executive Directors

The Committee sets shareholding guidelines for Executive Directors The current guideline is to build and maintain, over time, a personal (and/or spousal) holding of shares in the Company equivalent in value to at least twice the Director's annual base salary. The guidelines also state that normally (and subject to the Committee's discretion to allow a dispensation) an Executive Director is expected to retain at least half of any shares acquired on the exercise of a share award that remain after the sale of sufficient shares to cover tax and national insurance triggered by the exercise (and associated dealing costs) until the guideline level is achieved and thereafter maintained The Executive Directors currently meet these guidelines, as shown in the table above

Remuneration report continued

Directors and shares (continued)

Directors' share-based rewards and options (audited)

The table below shows the various share awards held by Directors under the Company's various share schemes There were no changes between 31 March 2011 and 16 May 2011 The Company's mid-market share price at close of business on 31 March 2011 was 621p. The highest and lowest mid-market share prices in the year ended 31 March 2011 were 635p and 492 80p respectively No shares vested during the year

Director	Scheme[1] and year of award	Number of shares subject to award at 1 April 2010[2]	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to award at 31 March 2011	Exercise price (pence)[3]	Market value of each share at date of award (pence)	Exercisable from[4]	Expiry date[5]
Peter Rogers	L-TIP 2008	79,080	–	–	–	79,080	nil	594 33	May 2011	Jun 2018
	PSP 2009	132,053	–	–	–	132,053	nil	544 67	Jul 2012	Jul 2013
	PSP 2010[6]	–	161,334	–	–	161,334	nil	619 83	Jul 2013	Jul 2014
	CSOP 2010[6]	–	4,840	–	–	4,840	nil	619 83	Jul 2013	Jul 2014
	DBP 2010	–	45,023	–	–	45,023	nil	619 83	Jul 2012	Jul 2013
Bill Tame	Approved 2002	21,278	–	–	–	21,278	104 33	104 33	Jan 2005	Jan 2012
	L-TIP 2008	51,402	–	–	–	51,402	nil	594 33	May 2011	Jun 2018
	PSP 2009	85,924	–	–	–	85,924	nil	544 67	Jul 2012	Jul 2013
	PSP 2010[6]	–	77,440	–	–	77,440	nil	619 83	Jul 2013	Jul 2014
	CSOP 2010[6]	–	1,258	–	–	1,258	nil	619 83	Jul 2013	Jul 2014
	DBP 2010	–	29,598	–	–	29,598	nil	619 83	Jul 2012	Jul 2013
Archie Bethel	L-TIP 2008	40,717	–	–	–	40,717	nil	594 33	May 2011	Jun 2018
	PSP 2009[6]	68,022	–	–	–	68,022	nil	544 67	Jul 2012	Jul 2013
	CSOP 2009[6]	5,507	–	–	–	5,507	544 67	544 67	Sep 2012	Sep 2019
	PSP 2010	–	66,550	–	–	66,550	nil	619 83	Jul 2013	Jul 2014
	DBP 2010	–	19,128	–	–	19,128	nil	619 83	Jul 2012	Jul 2013
Kevin Thomas	Approved 2002	16,068	–	–	–	16,068	106 33	106 33	Nov 2005	Nov 2012
	L-TIP 2008	38,320	–	–	–	38,320	nil	594 33	May 2011	Jun 2018
	PSP 2009[6]	64,030	–	–	–	64,030	nil	544 67	Jul 2012	Jul 2013
	CSOP 2009[6]	2,368	–	–	–	2,368	544 67	544 67	Sep 2012	Sep 2019
	PSP 2010	–	66,550	–	–	66,550	nil	619 83	Jul 2013	Jul 2014
	DBP 2010	–	17,825	–	–	17,825	nil	619 83	Jul 2012	Jul 2013

1 Approved = Babcock 1999 Approved Executive Share Option Scheme, L TIP = 2003 Long-Term Incentive Plan PSP = 2009 Performance Share Plan CSOP = 2009 Company Share Option Plan, DBP = 2009 Deferred Bonus Plan Further details about these plans and, where applicable, performance conditions attaching to the awards listed are to be found on pages 75 to 77 below

2 The figures for Archie Bethel and Kevin Thomas is as at 1 May 2010, the date of their appointments to the Board

3 The PSP and L-TIP awards are structured as nil priced options

4 Subject to the rules of the scheme concerned, including as to meeting performance targets.

5 Where this date is less than ten years from the date of award the Committee may extend the expiry date on one or more occasions, but not beyond the tenth anniversary of the award

6 The vesting of the CSOP award is subject to performance measures which are identical to those for the PSP award granted on the same date The CSOP and PSP awards are linked so that the maximum aggregate number of shares that can be acquired on exercise of the two awards is limited to that number of shares that had a market value on the date of the awards (and after deducting any exercise price payable on exercise of the CSOP award) equal to the relevant grant multiple of the Director's base salary at the date of the awards (the 'Limit) If there is less than full vesting it is possible for the Director to choose to exercise the CSOP to its fullest extent within the Limit and then to exercise the PSP award to the extent of any balance left within the Limit

Directors and shares (continued)

Performance-related awards made to Executive Directors in 2010

In July 2010, PSP awards were made to each of the Executive Directors Peter Rogers and Bill Tame also received CSOP awards linked, as explained in note 6 under the table on page 72, to their PSP awards

PSP vesting schedules – Executive Directors, other than the Chief Executive

In accordance with past practice, the awards for Bill Tame, Archie Bethel and Kevin Thomas were made so that they were potentially exercisable over that number of shares that had a market value on award of 150% of their qualifying base salaries

As anticipated in the last Remuneration report, the performance target attached to those awards – split between TSR performance relative to the peer group and real EPS growth (see table on page 75 for detail) – was toughened in respect of the EPS growth test compared to the awards made in 2009, in that maximum vesting for that element will require real annual compound growth of 12.5% or more over the performance period (1 April 2010 to 31 March 2013) This represented an increase from the 11% (real) EPS target applied to the 2009 awards The performance measures are illustrated in the charts below

Chart removed

Chart removed

Chief Executive

In the case of Peter Rogers, in recognition of the exceptional management challenge particularly he now faces following the VT acquisition, and following discussions with leading shareholders, the Committee made him an award equivalent in value to 200% of his base salary As regards that part of the award up to 150% of his salary, the performance measures applied were the same as for the awards to the other Executive Directors (above) In order, however, for the remainder of the award (equivalent on grant to 50% of his salary) to vest, more stretching TSR performance is required with vesting on a straight-line basis for out-performance of between 9% p.a and 12 5% p a as illustrated below

Chart removed

Chart removed

Remuneration report continued

PSP awards to be made in 2011

It is the Committee's intention to adopt the same approach and the same performance measures as followed in 2010 when making awards to Executive Directors This will involve the grant of awards to Bill Tame, Archie Bethel and Kevin Thomas over shares having on the date of grant a value equal to 150% of their base salaries The same exceptional management challenge continues to apply to Peter Rogers and his award will be of 200% of base salary, with the additional 50% being subject to the same added stretch target described above

Why TSR and EPS for Executive Directors' share awards?

The Remuneration Committee reviews the performance conditions to be attached to share awards prior to the start of each cycle to ensure they remain appropriate No material reduction in targets would be made without prior consultation with shareholders The Committee believes that continuing to use a balance of TSR and EPS performance conditions remains appropriate and provides a strong blend of performance metrics, in line with prevailing market practice

The TSR performance measure is tested by reference to the Company's relative long-term share price performance against suitable peers The use of relative TSR provides strong alignment with shareholders' interests by rewarding management for the delivery of above market returns, whilst the use of an EPS growth performance measure focuses management on continued strong financial performance and is heavily dependent on the Company's success in achieving its strategic goals

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

For certain senior managers, but not Directors, the performance targets attached to PSP awards in 2009 were set (wholly or in part) by reference to divisional profit targets and return on capital employed or operating cash flow, as appropriate to the division's business

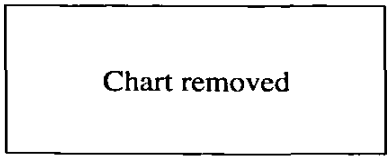
Sourcing of shares

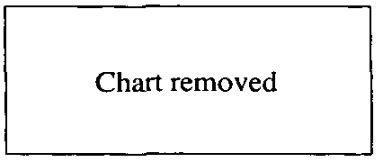
It is the intention of the Company that shares needed to satisfy share awards for Directors will be purchased in the market to the extent that they are not already held in the Group's employee share trusts at the date the options or awards are granted or are exercised, unless it is in the interests of the Company to do otherwise and issue new shares

Performance graphs

The graphs below were prepared by Kepler Associates They show the total shareholder return for a holding in the Company's shares for the period from 1 April 2006 to 31 March 2011 relative to a holding of shares representing respectively the FTSE 350 Index (excluding investment trusts) and the FTSE 350 Support Services sector The calculation of the return assumes dividends are reinvested to purchase additional equity This FTSE 350 Index (excluding investment trusts) is a broad index that allows comparison of the Company's performance against the performance of the stock market as a whole, Support Services is the sector in which the Company's share price is reported

Over the five-year period, the Company has significantly out-performed both indices An investment of £100 in the Company on 1 April 2006 would have been worth (assuming the dividends were reinvested in further Company shares) £219 at 31 March 2011





Share awards summaries

The following tables summarise the performance targets (if applicable) and other information about the schemes relevant to outstanding share awards held by Directors (see also the information about share schemes on pages 58 and 59)

Scheme	1999 Approved Option Scheme (market price options) – 2002 awards
Performance periods	1 April 2001 to 31 March 2004 (74% vested) 1 April 2002 to 31 March 2005 (100% vested)
Performance target	Comparative TSR performance Full vesting was for top quartile ranking, with 25% vesting for just above median, and straight-line vesting in between
TSR comparator group	Companies in the FTSE Engineering and Machinery Sector when the options were granted (which was the sector in which the Company's shares were then listed).
Other information	They were not subject to re-testing The exercise price was the undiscounted average of the mid-market closing price for the three business days' preceding the date of the grant. The options must be exercised before the tenth anniversary of the grant date, or earlier if there is a change of control, the Director leaves or dies, failing which they will lapse

Scheme	2003 Long Term Incentive Plan (nil price options) – 2008 awards			
Performance period	1 April 2008 to 31 March 2011			
Performance targets	EPS growth test	Proportion of total award vesting	Comparative TSR test	Proportion of total award vesting
	Real compound annual growth of 8% or more	50%	Upper quartile ranking in peer group	50%
	Real compound annual growth of 4%	12.5%	Ranking immediately above median	12.5%
	Intermediate growth between the above points	Straight-line basis between 12 5% and 50%	Intermediate ranking between the above points	Straight-line basis between 12 5% and 50%
	Real compound annual growth of less than 4%	0%	At or below median ranking	0%
TSR comparator group	For the TSR element, companies in the FTSE 350 Support Services Index on date of award these were the companies in the same FTSE sector as the Company The peer group was chosen pending a full review of longer term incentives and the appropriate peer group, which was carried out in 2008/09			
Other information	EPS was subject to adjustment at the discretion of the Committee in respect of exceptional items and is pre-acquired intangible amortisation Real EPS growth is that in excess of the change in the consumer prices index.			

Remuneration report continued

Share awards summaries (continued)

Scheme	2009 Performance Share Plan (nil price options) and Company Share Option Plan (market price options) – 2009 and 2010 awards*			
Performance period	For the 2009 awards. 1 April 2009 to 31 March 2012 For the 2010 awards· 1 April 2010 to 31 March 2013			
General Performance target	EPS growth test	Proportion of total award vesting	Comparative TSR test	Proportion of total award vesting
	Real compound annual growth of 11% (2009)/12 5% (2010) or more	50%	Outperformance of the median TSR performance for the peer group taken as a whole by 9% or more	50%
	Real compound annual growth of 4%	8 3%	TSR performance equivalent to the median for the peer group as a whole	8 3%
	Intermediate growth between the above points	Straight-line basis between 8 3% and 50%	Intermediate ranking between the above points	Straight-line basis between 8 3% and 50%
	Real compound annual growth of less than 4%	0%	Performance less than equivalent to median for the whole peer group	0%
Chief Executive's additional award in 2010 over shares equal to a further 50% of salary	If comparative TSR performance exceeds median TSR performance for the peer group taken as a whole by more than 9% per annum further shares vest (see page 73 for further details). This will affect the relative proportion of the award vesting in his case			
TSR comparator group 2009 and 2010 awards	For the TSR element the peer group is the FTSE 350 (excluding investment trusts and financial services) This group was chosen after careful review due to the fact that Babcock's closest peers straddle multiple sectors, not just support services, and the broader group makes the calibration more robust.			
Other information	Participants will be entitled to a vesting of shares under the TSR element only to the extent the Remuneration Committee is satisfied that the recorded TSR is a genuine reflection of the underlying performance of the Company over the performance period The awards are not subject to re-testing EPS is adjusted to exclude acquired intangible amortisation, but, unless the Committee decides otherwise in respect of any item, is after exceptional items Real EPS growth is that in excess of the change in the retail prices index The awards carry the right to receive on vesting any dividends that would have been paid in the period between grant and vesting but this right applies only to the shares that actually vest under the award CSOP and PSP Awards are linked so that in aggregate the holder cannot get more value from them than a standalone PSP award of shares equal to the relevant award multiple of the Director's base salary Exercise periods commence not less than three years from actual or nominal award grant date Subject to the rules of the plan, an earlier release of shares under unvested awards may be allowed by the Remuneration Committee (for example, in the event of a cessation of employment or a change in control), but of not more than a time-apportioned proportion and then only having regard to the Company's performance, though the Committee has discretion to allow a greater proportion to be released			

* 2011 awards will be as per the 2010 awards (with the performance period being 1 April 2011 to 31 March 2014)

Share awards summaries (continued)

Scheme	Deferred Bonus Plan (nil price options) 2010 awards
Performance period	Not applicable the scheme is purely a mechanism for mandatory deferral of part of the annual bonus earned Awards vest and become exercisable two years after the date of grant
Other information	Awards are subject to potential forfeiture if the holder leaves before the awards vest (other than by reason of death, disability, redundancy, retirement or the company or business in which they are employed ceasing to be part of the Group) The number of shares into which the bonus is deferred may be reduced by the Committee if the accounts by reference to which the bonus was calculated have to be materially corrected or if, in the opinion of the Committee, there is evidence that performance against performance conditions in the bonus year or the impact of that performance on the Group in respect of future financial years was or will be materially worse than was believed to be the case at the time of the original assessment The shares carry the right to dividends paid in the period of deferral, but payable only when the shares are released There is no provision for the Company to match these deferred shares on any basis

Directors' emoluments and compensation (audited)

Director	Salary or fee year ending 31 March 2011 £'000	Cash allowances in lieu of pension benefits[2] £ 000	Other cash allowances[3] £ 000	Annual bonus £'000[4]	Benefits in kind[5] £ 000	Total year ended 31 March 2011 £'000	Total year ended 31 March 2010[6] £ 000
Chairman and Executive Directors							
Mike Turner (Chairman)	255	–	–	–	–	255	255
Peter Rogers (Chief Executive)	500	100	–	735	1	1,336	1,275
Bill Tame (Group Finance Director)	320	26	17	470	18	851	831
Archie Bethel (appointed 1 May 2010)[1]	252	11	–	327	3	593	–
Kevin Thomas (appointed 1 May 2010)[1]	252	11	–	327	1	591	–
Non-Executive Directors							
Alexander Hesketh (resigned 8 November 2010)	36	–	–	–	–	36	60
John Rennocks	73	–	–	–	–	73	73
Nigel Essenhigh	48	–	–	–	–	48	48
Justin Crookenden	55	–	–	–	–	55	55
David Omand	48	–	–	–	–	48	48
Ian Duncan (appointed 10 November 2010)	19	–	–	–	–	19	–
Dipesh Shah (retired 9 July 2009)	–	–	–	–	–	–	13
Total	1,858	148	17	1,859	23	3,905	2,658

Notes

1 Emoluments for Archie Bethel and Kevin Thomas for the period from 1 April to 30 April 2010 are not included in the table as they were not Directors in that period

2 For Peter Rogers the cash allowance reflects pay in lieu of all pension benefits For the other Executive Directors the allowance is in lieu of pension benefits on that part of base salary as exceeds the applicable earnings cap for the pension scheme (see detailed explanation under Directors' pensions below)

3 Allowance in respect of expenses connected with accommodation

4 60% of the amount shown is paid in cash The balance of 40% is to be deferred into Company shares for two years

5 For Bill Tame benefits comprised medical insurance home to work travel expenses and accommodation benefits For Peter Rogers and Kevin Thomas they comprised medical insurance and for Archie Bethel they comprised medical insurance and car fuel benefit.

6 Archie Bethel and Kevin Thomas were not Directors in the year to 31 March 2010

The emoluments disclosed above do not include any amounts for the value of options or other share-based rewards

Details of share-based awards held by the Directors are to be found on page72

The fees for Alexander Hesketh reflected his additional duties as Deputy Chairman John Rennocks' fees reflect his additional duties as Chairman of the Audit and Risk Committee and as Senior Independent Director Justin Crookenden's fees reflect his additional duties as Chairman of the Remuneration Committee

Cash allowances, bonus payments and benefits in kind paid to Directors are not pensionable and do not count for share award or bonus purposes.

Remuneration report continued

Directors' pensions (audited)

Peter Rogers does not participate in a Group pension scheme or otherwise receive pension benefits from the Group Instead, he receives a supplement equal to 20% of his base salary in lieu of pension benefits It is separately identified in the table page 77 above

Bill Tame, Archie Bethel and Kevin Thomas participate in the Group's pension scheme (see below) In addition to benefits accruing under that scheme (as described below), they each received, during the year to 31 March 2011, a cash supplement in lieu of base salary in excess of the applicable scheme earnings cap at the rate of 15% of the excess (less employer's national insurance contributions), with the Director paying contributions into the scheme only on salary up to the applicable earnings cap The value of this supplement in the year to 31 March 2011 is shown separately in the table on page 77. For the year commencing 1 April 2011, each of these Directors is being offered the option of reducing his pensionable salary in return for a new cash supplement which, if accepted, would replace the existing supplement and, overall, represent no increase in cost to the Company compared to the cost of meeting their pension liabilities and the existing supplement should he choose not to take up this option

Supplements paid in lieu of pension do not count for pension, share award or bonus purposes

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

Bill Tame is a member of the senior executive tier of the Scheme Archie Bethel and Kevin Thomas are each members of the executive tier of the Scheme

The accrual rate for Bill Tame under the Scheme is one-thirtieth, and for Archie Bethel and Kevin Thomas is one-forty-fifth, of pensionable salary (i.e that part of their base salary within the applicable Scheme earnings cap) for each year of service The pension age is 60 (for Bill Tame) or 65 (for Archie Bethel and Kevin Thomas) The earnings cap adopted by the Scheme is the same as the former statutory earnings cap, index-linked in the same way.

Pension entitlements under the Scheme (defined benefit) are set out in the following table

Director	Accrued pension at 31 March 2011 £ p.a	Increase in accrued benefits during the year ended 31 March 2011 £	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2010 £	Transfer value at 31 March 2011 £	Transfer value of increase in accrued benefits less Director's contribution £	Increase in transfer value less Director's contribution £
Bill Tame	38,276	4,120	2,549	664,616	783,172	37,390	112,376
Archie Bethel	29,737	4,120	2,942	345,070	425,049	30,198	70,709
Kevin Thomas	50,260	4,120	1,997	614,086	710,028	19,818	89,792

1 Inflation has been taken as 4 6% for the purposes of calculating increases in transfer values and pension earned

2 The transfer value of the increase in pension accrued is calculated in accordance with Actuarial Guidance Note GN11, and is stated after deducting members contributions

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

4 The figures in the above table make no allowance for any benefits in respect of earnings in excess of the HM Revenue & Customs earnings cap

5 In calculating the above figures no account has been taken of any retained benefits which he may have from previous employments

6 No payments have been made to retired Directors in excess of the retirement benefit to which they were entitled on the date the benefits first became payable or if later, 31 March 1997

Membership of the Scheme also entitles the Directors to life assurance cover of four times base salary up to the applicable pensionable earnings cap The Company takes out additional life assurance cover in respect of four times the salary in excess of that cap The cost of providing that additional life assurance cover was

Director	2011 £'000	2010[1] £ 000
Bill Tame	2	2
Archie Bethel	1	-
Kevin Thomas	1	-

1 Archie Bethel and Kevin Thomas were not Directors in the year to 31 March 2010

Other pension arrangements (audited)

Before 1 April 2006, the Company provided a Funded Unapproved Retirement Benefit Scheme (FURBS) for Bill Tame in respect of his salary in excess of the earnings cap The Company contributed to the FURBS an amount equal to 20% of the excess (including employer's national insurance contributions), with him making contributions into the Company's pension scheme on his full uncapped salary

Chairman and Non-Executive Directors' remuneration (audited)

The Chairman and Non-Executive Directors receive fixed fees These fees are reviewed against market practice from time to time (by the Chairman and the Executive Directors in the case of the Non-Executive Director fees and by the Remuneration Committee in respect of the fees payable to the Chairman) The fees for the year to 31 March 2011 were those set in April 2009 Following a review against current market practice, the basic Non-Executive Directors' fee has been increased by £2,500 with effect from 1 April 2011 as described in the table below

Annual rate of fees	Year to 31 March 2011	From 1 April 2011
Chairman	£255,000	£255,000
Deputy Chairman	£60,000	n/a
Senior Independent Director	£60,000	£60,000
Basic Non-Executive Director's fee	£47,500	£50,000
Chairmanship of Audit and Risk Committee	£12,500*	£12,500*
Chairmanship of Remuneration Committee	£7,500*	£7,500*

* Committee chairmanship fees are paid in addition to the basic applicable Non-Executive Directors fee No additional fees are paid for membership of committees

Service contracts

The following table summarises the key terms (excluding remuneration, on which see above) of the Directors' service contracts or terms of appointment·

Executive Directors

Name	Date of service contract	Notice period
Peter Rogers (Chief Executive)	31 July 2003 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months from Company, 6 months from Director
Bill Tame (Group Finance Director)	1 October 2001 (amended by letters dated 5 May 2004 and 3 April 2006)	12 months from Company, 6 months from Director
Archie Bethel (Chief Executive, Marine and Technology division)	21 April 2010	12 months from Company, 6 months from Director
Kevin Thomas (Chief Executive, Support Services division)	20 April 2010	12 months from Company, 6 months from Director

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

If the Company terminates a Director's service contract, the Company will have regard to all the circumstances in determining the amount of compensation, including as to the scope for mitigation, if any, payable to him in connection with that termination

The agreements for Peter Rogers and Bill Tame (but not the agreements for Archie Bethel and Kevin Thomas) contain provisions which provide that within 90 days of the occurrence of the change of control, each may terminate his employment forthwith If he exercises this right, he is entitled, for a 12-month period, to be paid (on a monthly basis) his base salary plus 40% (compared to a maximum entitlement under the annual bonus scheme of 150%) in lieu of bonus and all other contractual entitlements From this there is to be deducted any amount that the Director receives by way of income, if it exceeds 10% of his Babcock salary, from other sources that he would not have been able to earn had he continued in employment with the Company

The agreements for Peter Rogers and Bill Tame (but not the agreements for Kevin Thomas and Archie Bethel) also provide that if the Company terminates their appointment within12 months of a change of control, they would be entitled to a termination payment equal to 100% of annual salary (plus 40% in lieu of bonus and all other benefits)

Remuneration report continued

Chairman and Non-Executive Directors

Name	Date of appointment as a Director	Date of current appointment letters	Expiry of present term of appointment (subject to annual re-election)*
Mike Turner (Chairman)	1 June 2008	14 April 2011	AGM for 2014
John Rennocks	13 June 2002	15 May 2008	Retiring 31 December 2011
Nigel Essenhigh	4 March 2003	15 May 2008	AGM for 2012
Justin Crookenden	1 December 2005	14 April 2011	AGM for 2014
David Omand	1 April 2009	19 March 2009	AGM for 2012
Ian Duncan	10 November 2010	15 October 2010	AGM 2013

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

The latest written terms of appointment are available for inspection at the Company's registered office and at the Company's Annual General Meeting The expected time commitment of Non-Executive Directors is set out in their current written terms of appointment

Outside directorships of Executive Directors

Before taking up any new outside appointment, an Executive Director must first seek the approval of the Chairman Any fees for outside appointments are retained by the Director Peter Rogers is a Non-Executive Director of Galliford Try plc During the year to 31 March 2011, he received £38,000 by way of fees for that role He is also a Non-Executive Director (and President) of ADS Group Limited, a role for which he receives no fees Bill Tame is a Non-Executive Director of Carclo PLC During the year to 31 March 2011, his fees in that role were £27,500

Regulatory and statutory

The Board considers that in all its activities the Remuneration Committee has adopted the principles of good governance as set out in the UK Corporate Governance Code and complies with the Listing Rules of the Financial Services Authority, the relevant schedules of the Companies Act and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('the Regulations') This report is divided into audited and unaudited information The Regulations require the Company's auditors to report that the 'Audited information' in this report has been properly prepared in accordance with the Regulations

This Remuneration report will be submitted for shareholder approval at the Annual General Meeting on 7 July 2011.

This Remuneration report was approved by the Board on 16 May 2011 and signed on its behalf by:

Justin Crookenden
Chairman of the Remuneration Committee
16 May 2011

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

We have audited the Group financial statements of Babcock International Group PLC for the year ended 31 March 2011 which comprise the Group income statement, the Group statement of comprehensive income, the Group statement of changes in equity, the Group balance sheet, the Group cash flow statement, and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibility statement on page 63, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the Annual Report and Accounts 2011 to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion the Group financial statements

- give a true and fair view of the state of the Group's affairs as at 31 March 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements The information given in the Corporate Governance Statement set out on pages 49-53 in the Governance Statement with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters Under the Companies Act 2006 we are required to report to you if, in our opinion

- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit, or
- a Corporate governance statement has not been prepared by the parent Company

Under the Listing Rules we are required to review

- the Directors' statement, on page 62, in relation to going concern,
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration

Other matter

We have reported separately on the parent Company financial statements of Babcock International Group PLC for the year ended 31 March 2011 and on the information in the Directors' remuneration report that is described as having been audited

Neil Grimes
Senior Statutory Auditor for and on behalf of PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors
London, United Kingdom

16 May 2011

Neil Grimes

Group income statement

For the year ended 31 March 2011	Note	2011 £m	2011 Total £m	2010 £m	2010 Total £m
Total revenue			2,894 5		1,923 4
Less joint venture revenue			138 7		27 9
Group revenue	3		2,755 8		1,895 5
Group					
Operating profit before amortisation of acquired intangibles and exceptional items	3,4 5	261 6		164 2	
Amortisation of acquired intangibles	6	(83 4)		(16 1)	
Exceptional items	6	(20 7)		–	
Group operating profit	3		157 5		148 1
Joint ventures					
Share of operating profit	3	9 3		0 5	
Investment income	3	13 8		–	
Amortisation of acquired intangibles	6	(4 6)		–	
Finance costs		(8 3)		(1 1)	
Income tax expense		(4 1)		0 1	
Share of results of joint ventures			6 1		(0 5)
Group and joint ventures					
Operating profit before amortisation of acquired intangibles and exceptional items		270 9		164 7	
Investment income		16 0		–	
Underlying operating profit*		286 9		164 7	
Amortisation of acquired intangibles		(88 0)		(16 1)	
Exceptional items		(20 7)		–	
Group investment income		(2 2)		–	
Joint venture finance costs		(8 3)		(1 1)	
Joint venture income tax expense		(4 1)		0 1	
Group operating profit plus share of joint ventures			163 6		147 6
Finance costs					
Investment income	3	2 2		–	
Finance costs	7	(59 0)		(21 8)	
Finance income	7	8 6		3 4	
			(48 2)		(18 4)
Profit before tax			115.4		129.2
Income tax expense	9		(10 7)		(20 8)
Profit for the year	5		104 7		108 4
Attributable to					
Owners of the parent			101 1		106 0
Non-controlling interest			3 6		2 4
			104 7		108 4
Earnings per share	11				
Basic			31 28p		46 29p
Diluted			31 17p		46 10p

* Including IFRIC 12 investment income but before exceptional items and amortisation of acquired intangibles

Group statement of comprehensive income

For the year ended 31 March 2011	Note	2011 £m	2010 £m
Profit for the year		104 7	108 4
Other comprehensive income			
Currency translation differences		(7 7)	10 7
Fair value adjustment of interest rate and foreign exchange hedges		7 3	–
Tax on fair value adjustment of interest rate and foreign exchange hedges		(1 5)	–
Fair value adjustment of joint venture derivatives		8 8	–
Tax on fair value adjustment of joint venture derivatives		(2 4)	–
Net actuarial gain/(loss) in respect of pensions	26	103 5	(403 5)
Tax on net actuarial (gain)/ loss in respect of pensions*		(34 0)	113 0
Other comprehensive income, net of tax		74 0	(279 8)
Total comprehensive income/(loss)		178 7	(171 4)
Attributable to:			
Owners of the parent		175 0	(174 4)
Non-controlling interest		3 7	3 0
Total comprehensive income/(loss)		178 7	(171 4)

* Includes change in UK tax rate

Group statement of changes in equity

For the year ended 31 March 2011	Share capital £m	Share premium £m	Capital redemption £m	Retained earnings £m	Hedging reserve £m	Translation reserve £m	Owners of the parent £m	Non-controlling interests £m	Total equity £m
At 1 April 2009	137 7	148 2	30 6	(16 0)	(10 7)	(1 4)	288 4	4 4	292 8
Total comprehensive loss	–	–	–	(184 6)	–	10 2	(174 4)	3 0	(171 4)
Shares issued in the financial year	0 1	0 1	–	–	–	–	0 2	–	0 2
Dividends	–	–	–	(34 7)	–	–	(34 7)	(2 2)	(36 9)
Share-based payments	–	–	–	2 7	–	–	2 7	–	2 7
Tax on share-based payments	–	–	–	0 5	–	–	0 5	–	0 5
Own shares	–	–	–	(2 1)	–	–	(2 1)	–	(2.1)
Net movement in equity	0 1	0 1	–	(218 2)	–	10 2	(207 8)	0 8	(207.0)
At 31 March 2010	137 8	148 3	30 6	(234 2)	(10 7)	8 8	80 6	5 2	85 8
At 1 April 2010	137 8	148 3	30 6	(234 2)	(10 7)	8 8	80 6	5 2	85 8
Total comprehensive income	–	–	–	170 6	12 2	(7 8)	175 0	3 7	178 7
Shares issued in the financial year	77 5	724 5	–	–	–	–	802 0	–	802 0
Dividends	–	–	–	(48 0)	–	–	(48 0)	(3 5)	(51 5)
Share-based payments	–	–	–	5 8	–	–	5 8	–	5 8
Tax on shared-based payments	–	–	–	0 5	–	–	0 5	–	0 5
Own shares	–	–	–	(2 2)	–	–	(2 2)	–	(2 2)
Non-controlling interest acquired	–	–	–	–	–	–	–	3 5	3 5
Acquisition costs	–	–	–	(2 0)			(2 0)	–	(2 0)
Net movement in equity	77 5	724 5	–	124 7	12 2	(7 8)	931 1	3 7	934 8
At 31 March 2011	215 3	872 8	30 6	(109 5)	1 5	1 0	1,011 7	8 9	1,020 6

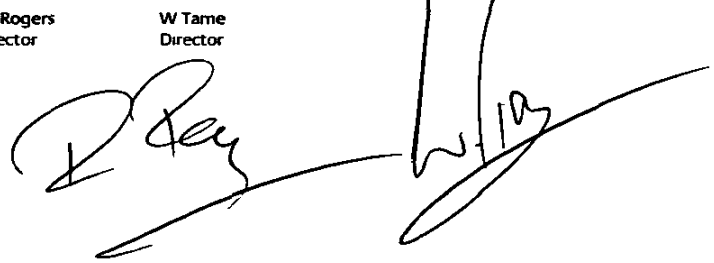
Group balance sheet

As at 31 March 2011	Note	2011 £m	2010 £m
Assets			
Non-current assets			
Goodwill	12	1,614 8	548 3
Other intangible assets	13	473 4	80 2
Property, plant and equipment	14	205 8	149 3
Investment in joint ventures	15	64 9	1 0
Loan to joint venture	15	22 1	13 3
Retirement benefits	26	12 2	–
Other financial assets – IFRIC 12		38 2	–
Trade and other receivables	18	1 9	0 4
Deferred tax	16	3 3	84 9
		2,436 6	877 4
Current assets			
Inventories	17	96 6	84 2
Trade and other receivables	18	540 3	330 9
Income tax recoverable		2 7	1 9
Other financial assets	22	1 8	1 1
Cash and cash equivalents	19	104 3	189 6
		745 7	607 7
Total assets		3,182 3	1,485 1
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	24	215 3	137 8
Share premium		872 8	148 3
Capital redemption and other reserves		33 1	28 7
Retained earnings		(109 5)	(234 2)
		1,011 7	80 6
Non-controlling interest		8 9	5 2
Total equity		1,020 6	85 8
Non-current liabilities			
Bank and other borrowings	21	799 0	329 1
Trade and other payables	20	13 6	12 3
Deferred tax	16	23 2	–
Income tax payable		–	0 2
Retirement liabilities	26	237 3	324 0
Provisions for other liabilities	23	124 4	37 1
		1,197 5	702 7
Current liabilities			
Bank and other borrowings	21	35 3	162 8
Trade and other payables	20	877 8	498 1
Income tax payable		17 3	6 9
Other financial liabilities	22	4.1	15 7
Provisions for other liabilities	23	29 7	13 1
		964.2	696 6
Total liabilities		2,161 7	1,399 3
Total equity and liabilities		3,182 3	1,485 1

The notes on pages 86 to 124 are an integral part of the consolidated financial statements The Group financial statements were approved by the Board of Directors on 16 May 2011 and are signed on its behalf by

P L Rogers
Director

W Tame
Director



Group cash flow statement

For the year ended 31 March 2011	Note	2011 £m	2010 £m
Cash flows from operating activities			
Cash generated from operations	27	308 5	170 3
Income tax paid		(19 3)	(1 7)
Interest paid		(58 6)	(22 3)
Interest received		8 6	3 8
Net cash flows from operating activities		239 2	150 1
Cash flows from investing activities			
Disposal of subsidiaries and joint ventures	31	2 2	–
Proceeds on disposal of property, plant and equipment		1 0	1 3
Proceeds on disposal of intangible assets		0 2	–
Purchases of property, plant and equipment		(30 2)	(16 8)
Purchases of intangible assets		(4 2)	(3 2)
Investment in and loans to joint venture		0 2	–
Acquisition of subsidiaries net of cash acquired	30	(486 2)	(37 9)
Net cash flows from investing activities		(517 0)	(56 6)
Cash flows from financing activities			
Dividends paid	10	(48 0)	(34 7)
Finance lease principal payments		(12 9)	(1 4)
Loans repaid		(457 5)	(130 5)
Loans raised		845 1	100 0
Dividends paid to minority interests		(3 5)	(2 2)
Net proceeds on issue of shares		–	0 2
Movement on own shares		(2 2)	(2 1)
Net cash flows from financing activities		321 0	(70 7)
Net increase in cash, cash equivalents and bank overdrafts		43 2	22 8
Cash, cash equivalents and bank overdrafts at beginning of year		29 0	6 3
Effects of exchange rate fluctuations		0 5	(0 1)
Cash, cash equivalents and bank overdrafts at end of year	29	72 7	29 0

Notes to the Group financial statements

1 Basis of preparation and significant accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of certain financial instruments The Company is a public limited company, is listed on the London Stock Exchange and is incorporated and domiciled in the UK.

Principal accounting policies

The principal accounting policies adopted by the Group and applied consistently throughout the year, are disclosed below

Basis of consolidation

The Group financial statements comprise the Company and all of its subsidiary undertakings made up to 31 March

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights If, however, more than 50% of the voting rights are owned but the Group does not govern the financial and operating policies then this investment is not consolidated as a subsidiary Acquisitions are included from the date of acquisition and the results of the businesses disposed of or terminated are included in the results for the year up to the date of relinquishing control or closure and analysed as continuing or discontinued operations

(b) Joint ventures

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

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

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

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured The following specific recognition criteria must also be met before revenue is recognised

(a) Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be reliably measured and recovery of consideration is considered probable

(b) Sale of services

Revenue from services rendered is recognised by reference to the stage of completion of the transaction The provision of services over a long-term period are accounted for under the principles of construction contracts, and the revenue recognised as set out below

(c) Long-term service contracts

Revenue from long-term service contracts is recognised by reference to the stage of completion of the contract The stage of completion is determined according to the nature of the specific contract concerned Methods used to assess the stage of completion include incurred costs as a proportion of total costs, labour hours incurred or earned value of work performed Profit attributable to the contract activity is recognised if the final outcome of such contracts can be reliably assessed An expected loss on a contract is recognised immediately in the income statement

1 Basis of preparation and significant accounting policies (continued)

Exceptional items

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

Transactions with non-controlling interests

The Group policy is to treat transactions with non-controlling interest as transactions with equity holders and therefore result in movements in reserves

Goodwill and intangible assets

(a) Goodwill

When the fair value of the consideration for an acquired undertaking exceeds the fair value of its separable net assets, the difference is treated as purchased goodwill and is capitalised When the fair value of the consideration for an acquired undertaking is less than the fair value of its separable net assets, the difference is taken directly to the income statement

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

(b) Acquired intangibles

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

(c) Research and development

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

(d) Computer software

Computer software is shown at cost less amortisation and is amortised over its expected useful lives of between three and five years.

Property, Plant and Equipment (PPE)

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

Freehold property	2% to 8%
Leasehold property	lease term
Plant and equipment	6 6% to 33 3%

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

Net debt

Net debt consists of the total of loans, bank overdrafts, cash and cash equivalents and finance leases plus any derivatives, which in part swap the currency of the debt into the functional currency of the Group

Notes to the Group financial statements continued

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

Leases

Assets under finance leases are capitalised and the outstanding capital element of instalments is included in borrowings The interest element is charged against profits so as to produce a constant periodic rate of charge on the outstanding obligations Depreciation is calculated to write the assets off over their expected useful lives or over the lease terms where these are shorter

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

Inventory and work in progress

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

Contract accounting

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

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

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

Taxation

(a) Current income tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date

(b) Deferred income tax

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

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

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

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

Foreign currencies

(a) Functional and presentation currency

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

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the local currency at the year end exchange rates

1 Basis of preparation and significant accounting policies (continued)

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement except when deferred in equity as part of the net investment of a foreign operation.

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

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

Finance costs

Finance costs are recognised as an expense in the period in which they are incurred unless they are attributable to an asset under construction, in which case finance costs are capitalised. Capitalisation of applicable interest commenced in 2009/10

Employee benefits

(a) Pension obligations

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

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

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

(b) Share-based compensation

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

The shares purchased by the Group's ESOP trusts are recognised as a deduction to equity

(c) Holiday pay

Paid holidays are regarded as an employee benefit and as such are charged to the income statement as the benefits are earned

Investments

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

Service concession arrangements

IFRIC 12 'Service concession arrangements' addresses the accounting by private sector operators involved in the provision of public sector infrastructure assets and services For all arrangements falling within the scope of the Interpretation (essentially those where the infrastructure assets are not controlled by the operator), the infrastructure assets are not recognised as property, plant and equipment of the operator Rather, depending on the terms of the arrangement, the operator recognises

- a financial asset – where the operator has an unconditional right to receive a specified amount of cash or other financial asset over the life of the arrangement, or
- an intangible asset – where the operator's future cash flows are not specified (e g where they will vary according to usage of the infrastructure asset), or
- both a financial asset and an intangible asset where the operator's return is provided partially by a financial asset and partially by an intangible asset

Notes to the Group financial statements continued

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

As a consequence of this treatment the operator recognises investment income in respect of the financial asset on an effective interest basis and amortisation of any intangible asset arising

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative is entered into and are subsequently remeasured at their fair value The Group designates certain of the derivative instruments within its portfolio to be hedges of the fair value of recognised assets or liabilities or unrecognised firm commitments

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

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

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

Dividends

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

Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances The key areas of estimates and judgements for the Group are contract accounting (see above), the accounting for defined benefit pension schemes (see note 26), impairment of goodwill (see note 12) and income tax recognition

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

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

Standards, amendments and interpretations to published standards

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 April 2010 or later periods but which the Group has not early adopted

IFRS 3 (revised), 'Business combinations' as a consequence of which £12 8 million of acquisition costs are included in exceptional costs which would have previously been cost of investment and included in goodwill

(a) Standards, amendments and interpretations effective in 2010 with minimal or no impact on the Group

- IFRS 2 (amendment), 'Share based payments'.
- IFRS 5 (amendment), 'Non-current assets held-for-sale and discontinued operations', (and consequential amendment to IFRS 1 'First time adoption')
- IAS 27 (revised), 'Consolidated and separate financial statements'
- IAS 32 (amendments), 'Financial instruments: presentation on 'classification of rights issues"
- IAS 39, Financial instruments 'Recognition and measurement – Amendments for eligible hedged items'
- IFRIC 15, 'Arrangements for construction of real estates'
- IFRIC 16, 'Hedges of a net investment in a foreign operation'
- IFRIC 17, 'Distributions of non-cash assets to owners'
- IFRIC 18, 'Transfers of assets from customers'
- 2009 Annual improvements

1 Basis of preparation and significant accounting policies (continued)

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

- IAS 24 (amendment), 'Related party disclosures', effective 1 January 2011
- 2010 Annual improvements, effective from 1 January 2011

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

- IFRIC 19, 'Extinguishing financial liabilities with equity instruments', effective 1 July 2010
- IFRIC 14, 'IAS 19 – Prepayment of a minimum funding requirement', effective from 1 January 2011

2 Financial risk management

Financial risk management

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

Interest rate risk is managed through the maintenance of a mixture of fixed and floating rate debt and interest rate swaps, each being reviewed on a regular basis to ensure the appropriate mix is maintained

The Group has two main areas of currency exposure, firstly, the US$650 US Private Placements which are swapped into Sterling and secondly, through its activities in South Africa and the USA where both translational and transactional exposure exist It is Group policy not to cover the effects of exchange rate fluctuation on translation of the results of foreign subsidiaries into the Group's functional currency, Sterling All material transactional exposures arising through trading in currencies other than the operation's functional currency must be eliminated by the use of forward cover contracts as soon as they are known of

All treasury transactions are carried out only with prime rated counterparties as are investments of cash and cash equivalents The Group's customers are mainly from government, government backed institutions or blue chip corporations and as such credit risk is considered small

Management of capital

A range of gearing and liquidity ratios are used to monitor and measure capital structure and performance, including Net debt to EBITDA (defined as net debt divided by earnings before interest, tax, depreciation and amortisation), Gearing ratio (defined as net debt, excluding retirement benefit deficits or surpluses, divided by shareholders' funds), ROIC (defined as net income divided by total capital (equity, excluding retirement benefit deficits or surpluses, plus net debt)) and EBITDA interest cover (defined as profit before interest, tax, depreciation, amortisation and exceptionals divided by net interest payable)

Foreign exchange risk

The foreign exchange exposure of Group entities on the net monetary position against their respective functional currencies expressed in the Group's presentation currency is insignificant with the largest exposure being £6 4 million (2010 Sterling to Euro £1 1 million).

Consequently, the pre tax effect on profit and equity, increase or (decrease), if the rates moved up or down by an appropriate percentage volatility, assuming all other variables remained constant would in total be £1 0 million (2010 £0 1 million) The reasonable shifts in exchange rates are based on historic volatility and range from 10% for Sterling to Euro to 15% for South African Rand to Euro and 10% Sterling to US Dollars

Notes to the Group financial statements continued

2 Financial risk management (continued)

Interest rate risk

The fair values of debt, and related hedging instruments are affected by movements in interest rates The following table illustrates the sensitivity in cash flow of interest rate-sensitive instruments to a hypothetical parallel shift of the forward interest rate curves of ±50bp (2010 ±50bp), with pre tax effect from the beginning of the year All other variables are held constant

	2011		2010	
	£m +50bp	£m -50bp	£m +50bp	£m -50bp
Net results for the year	(2 1)	2.1	(0 8)	0 8
Equity	15 8	(15.8)	1 8	(1 8)

Liquidity risk

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

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

	Less than 1 year £m	Between 1 and 2 years £m	Between 2 and 5 years £m	Over 5 years £m
At 31 March 2011				
Bank and other borrowings	35 3	280 0	5 1	513 9
Derivative financial instruments	1 2	0 5	1 1	(0 5)
Trade and other payables*	865 2	4 6	4 2	6 6
At 31 March 2010				
Bank and other borrowings	162 8	2 2	226 9	100 0
Derivative financial instruments	5 9	5 7	2 3	0 7
Trade and other payables	498 1	3 0	4 0	7 1

* Does not include other taxes and social security

The table below analyses the Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date The amounts disclosed in the table are the contractual undiscounted cash flows Held for trading contracts are economic hedges and not hedge accounted

	Less than 1 year £m	Between 1 and 2 years £m	Between 2 and 5 years £m	Over 5 years £m
At 31 March 2011				
Forward derivative contracts – cash flow hedges				
– outflow	37 7	7 8	53 3	409 0
– inflow	36 9	7 8	52 8	409 9
Forward derivative contracts – held for trading				
– outflow	12 6	8 1	–	–
– inflow	12 4	8 1	–	–
At 31 March 2010				
Forward derivative contracts – cash flow hedges				
– outflow	18 6	8 1	17 3	5 1
– inflow	18 0	8 1	16 8	4 9
Forward derivative contracts – held for trading:				
– outflow	2 4	0 4	3 2	–
– inflow	2 6	0 5	2 9	–

3 Segmental information

Following the acquisition of VT Group plc the segments have changed to reflect the new business structure announced on 12 July 2010 The segments reflect the accounting information reviewed by the Chief Operating Decision Maker (CODM) The Marine and Technology segment includes the Group's UK and International marine business, the Defence and Security segment is the remainder of the UK defence business with the exception of certain defence infrastructure contracts which fall within Support Services. Support Services also includes Education and Training, Rail, Infrastructure and Critical Assets International includes the US, South African and Middle East businesses

2011	Marine & Technology £m	Defence & Security £m	Support Services £m	International £m	Unallocated £m	Group Total £m
Continuing operations						
Total revenue	1,019 5	469 2	946 6	459 2	–	2,894 5
Joint venture revenue	–	87 3	51 4	–	–	138 7
Group revenue	1,019 5	381 9	895 2	459 2	–	2,755 8
Operating profit – Group	119 3	52 8	74 7	27.4	(12 6)	261 6
IFRIC 12 investment income – Group	–	1 6	0 6	–	–	2 2
Operating profit – share of joint ventures	–	8 5	0 8	–	–	9 3
IFRIC 12 investment income – share of joint ventures	–	10 3	3 5	–	–	13 8
Underlying operating profit	119 3	73 2	79 6	27 4	(12 6)	286 9
Joint venture share of interest	–	(4 7)	(3 6)	–	–	(8 3)
Joint venture share of tax	–	(4 0)	(0 1)	–	–	(4 1)
Acquired intangible amortisation – Group	(10 1)	(13 9)	(52 6)	(6 8)	–	(83 4)
Acquired intangible amortisation – share of joint ventures	–	(4 3)	(0 3)	–	–	(4 6)
Net finance costs	–	–	–	–	(50 4)	(50 4)
Exceptional items	–	–	–	–	(20 7)	(20 7)
Group profit before tax	109 2	46 3	23 0	20 6	(83 7)	115 4

2010	Marine & Technology (restated) £m	Defence & Security (restated) £m	Support Services (restated) £m	International (restated) £m	Unallocated (restated) £m	Group Total (restated) £m
Continuing operations						
Total revenue	973 8	87 9	687 5	174 2	–	1,923 4
Joint venture revenue	–	13 8	14 1	–	–	27 9
Group revenue	973 8	74 1	673 4	174 2	–	1,895 5
Operating profit – Group	116 5	9 2	35 9	10 9	(8 3)	164 2
Operating profit – share of joint ventures	–	0 7	(0 1)	(0.1)	–	0 5
Underlying operating profit	116 5	9 9	35 8	10 8	(8 3)	164 7
Joint venture share of interest	–	(1 0)	(0 1)	–	–	(1 1)
Joint venture share of tax	–	0 1	–	–	–	0 1
Acquired intangible amortisation – Group	(7 5)	–	(8 6)	–	–	(16 1)
Net finance costs	–	–	–	–	(18 4)	(18 4)
Group profit before tax	109 0	9 0	27 1	10 8	(26 7)	129 2

Inter divisional revenue is immaterial

Revenues of approximately £1 6 billion (2010 £1 1 billion) are derived from a single external customer These revenues are attributable to the Marine & Technology, Defence & Security, and Support Services segments

Notes to the Group financial statements continued

3. Segmental information (continued)

The segment assets and liabilities at 31 March 2011 and 31 March 2010 and capital expenditure for the years then ended are as follows

	Assets		Liabilities		Capital expenditure	
	2011 £m	2010 (restated) £m	2011 £m	2010 (restated) £m	2011 £m	2010 (restated) £m
Marine & Technology	724 2	598 0	522 2	559 1	17 4	13 4
Defence & Security	901 8	106 7	170 9	36 5	0 7	1 0
Support Services	1,072 0	368 1	304 5	214 8	5 9	2 9
International	328 1	115 7	150 0	54 5	6 7	7 2
Unallocated	156 2	296 6	1,014 1	534 4	3 7	0 5
Group total	3,182 3	1,485 1	2,161 7	1,399 3	34 4	25 0

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

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

The segmental depreciation and amortisation of intangible assets for the years ended 31 March 2011 and 31 March 2010 are as follows

	Depreciation		Amortisation of intangible assets	
	2011 £m	2010 (restated) £m	2011 £m	2010 (restated) £m
Marine & Technology	15 8	14 9	11 4	8 8
Defence & Security	2 0	0 4	14 1	0 1
Support Services	7 2	2 9	54 2	10 0
International	4 5	3 4	7 4	–
Unallocated	1 7	0 7	0 2	–
Group total	31 2	22 3	87 3	18 9

	Revenue		Assets		Capital expenditure	
Geographic analysis	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
United Kingdom	2,210 4	1,668 6	2,653 1	1,337 6	26 8	16 6
Africa	250 6	165 9	174 0	115 6	6 1	7 0
North America	258 7	50 2	328 2	24 8	0 6	1 0
Rest of World	36 1	10 8	27 0	7 1	0 9	0 4
Group total	2,755 8	1,895 5	3,182 3	1,485 1	34 4	25 0

	2011 £m	2010 £m
Analysis of revenue by category		
Sales of goods	307 6	266 6
Sales of services	2,446 1	1,627 5
Rental income	2 1	1 4
	2,755 8	1,895 5

4 Operating expenses

	2011 £m	2010 £m
Continuing operations		
Cost of sales	2,433 3	1,650 1
Distribution expenses	10 2	8 1
Administrative expenses	154 8	89 2
	2,598 3	1,747 4

5 Operating profit for the year

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

	Continuing operations	
	2011 £m	2010 £m
Employee costs (note 8)	954 5	640 5
Inventories		
– cost of inventories recognised as an expense	300 0	262 3
– increase in inventory provisions	5 1	1 2
Depreciation of Property, Plant and Equipment (PPE)		
– owned assets	29 7	21 6
– under finance leases	1 5	0 7
	31 2	22 3
Amortisation of intangible assets		
– acquired intangibles	83 4	16 1
– software and development costs	3 9	2 8
	87 3	18 9
Loss/(profit) on disposal of PPE	0 4	(0 4)
Loss on disposal of intangibles	0 2	–
Operating lease rentals payable		
– property	18 4	14 8
– vehicles, plant and equipment	11 2	11 8
Research and development	2 0	1 5
Trade receivables impairment/(release)	2 1	(1 2)
Net foreign exchange losses	0 9	0 7

Notes to the Group financial statements continued

5 Operating profit for the year (continued)

Services provided by the Group's auditor and network firms

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

	Total	
	2011 £m	2010 £m
Audit fees:		
Fees payable to the Group's auditor for the audit of the parent entity and the consolidated financial statements	0 9	0 5
Fees for other services:		
The auditing of financial statements of subsidiaries of the Company pursuant to legislation (including that of countries and territories outside Great Britain)	0 8	0 6
Tax	0 2	–
All other services	0 6	0 8
Total fees paid to the Group's auditor and network firms	2 5	1 9

Other services include £0 6 million of fees in relation to the proposed acquisition of VT Group PLC

6 Exceptional items and acquired intangible amortisation

	Group		Joint ventures		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Exceptional items						
Profit on disposal of subsidiaries (note 31)	(2 9)	–	–	–	(2 9)	–
Reorganisation cost	10 8	–	–	–	10 8	–
Acquisition costs	12 8	–	–	–	12 8	–
Exceptional items	20 7	–	–	–	20 7	–
Acquired intangible amortisation	83.4	16 1	4 6	–	88 0	16 1
	104 1	16 1	4 6	–	108 7	16 1

Exceptional items are those items which are exceptional in nature or size These include material acquisition costs and reorganisation costs

Acquisition costs above relate to the acquisition of VT Group plc (see note 30) Reorganisation costs relate to the integration of Babcock International Group PLC and VT Group plc

7 Net finance costs

	2011 £m	2010 £m
Finance costs		
Bank loans and overdrafts	33 7	8 6
Finance leases	0 4	0 4
Interest rate hedges	13 8	7 8
Amortisation of issue costs of bank loan	8 9	1 3
Other	2 2	3 7
Total finance costs	59 0	21 8
Finance income		
Bank deposits	8 6	3 4
Total finance income	8 6	3 4
Net finance costs	50 4	18 4

8 Employee costs

	2011 £m	2010 £m
Wages and salaries	823 1	552 2
Social security costs	71 6	50.4
Share-based payments (note 25)	5 8	2.7
Pension costs – defined contribution plans (note 26)	25 0	17.8
Pensions charge – defined benefit plans (note 26)	29 0	17.4
	954 5	640 5

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

	2011 Number	2010 Number
Operations	23,734	14,288
Administration and management	3,854	2,349
	27,588	16,637

Emoluments of Executive Directors are included in employee costs above and reported in the Remuneration report.

Key management compensation

Key management is defined as those employees who are directly responsible for the operational management of the key cash-generating units The employees would typically report to the Chief Executive The key management figures given below include Directors

	2011 £m	2010 £m
Salaries	7 3	7 8
Post-employment benefits	0 2	0 4
Share-based payments	2 2	1 8
	9 7	10 0

Notes to the Group financial statements continued

9 Income tax expense

	2011 £m	2010 £m
Analysis of tax charge in the year		
Current tax		
– UK current year charge	35 7	26 2
– Overseas current year charge	11 2	5 5
– UK prior year charge/(credit)	2 8	(6 7)
	49 7	25 0
Deferred tax		
– UK current year credit	(33 1)	(9 4)
– Adjustment in respect of prior year	–	4 3
– Overseas current year (credit)/charge	(0 4)	0 9
– Overseas prior year credit	(2 8)	–
– Impact of change in UK tax rate	(2 7)	–
	(39 0)	(4 2)
Total income tax expense	10 7	20 8

The tax for the year is lower than the standard rate of corporation tax in the UK (28%) The differences are explained below:

	2011 £m	210 £m
Profit before tax	115 4	129 2
Profit on ordinary activities multiplied by rate of corporation tax in the UK of 28% (2010 28%)	32 3	36 2
Effects of:		
Expenses not deductible for tax purposes	4 5	1 1
Adjustments in respect of foreign tax rates	(12 8)	(11 0)
Adjustments to tax in respect of prior period	–	(2 4)
Re-measurement of deferred tax re change in UK tax rate	(2 7)	–
Difference in respect of joint venture results	(3 6)	–
Other	(7 0)	(3 1)
Total income tax expense	10 7	20 8

As a result of the change in the UK corporate tax rate from 28% to 26% for the 2011/12 financial year, a credit of £2 7 million (2010 £nil) has been taken to the income statement in respect of the re-measurement of the year end deferred tax balances, and a charge of £5 0 million (2010 £nil) has been taken to reserves

10. Dividends

	2011 £m	2010 £m
Second interim dividend for the year ended 31 March 2010 of 12 80p (2009 10 40p) per 60p share	29 4	23 7
Interim dividend for the year ended 31 March 2011 of 5 20p (2010 4 80p) per 60p share	18 6	11 0
	48 0	34 7

In addition, the Directors are proposing a final dividend in respect of the financial year ended 31 March 2011 of 14 2p (2010 second interim dividend 12 80p) per share which will absorb an estimated £50 8 million (2010 £29 4 million) of shareholders' equity It will be paid on 9 August 2011 to shareholders who are on the register of members on 8 July 2011 These financial statements do not reflect this dividend payable Subject to approval at the Annual General Meeting on 7 July 2011

11 Earnings per share

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

Number of shares

	2011 Number	2010 Number
Weighted average number of ordinary shares for the purpose of basic EPS	323,193,144	228,890,548
Effect of dilutive potential ordinary shares share options	1,144,410	936,028
Weighted average number of ordinary shares for the purpose of diluted EPS	324,337,554	229,826,576

Earnings

	2011 Earnings £m	2011 Basic per share Pence	2011 Diluted per share Pence	2010 Earnings £m	2010 Basic per share Pence	2010 Diluted per share Pence
Earnings from continuing operations	101 1	31 28	31 17	106 0	46 29	46 10
Add back:						
Amortisation of acquired intangible assets, net of tax	62 6	19 39	19 32	11 6	5 08	5 06
Exceptional items, net of tax	16 8	5 20	5 18	–	–	–
Impact of change in UK tax rate	(2 7)	(0 84)	(0 83)			
Earnings before operations, amortisation and exceptionals	177 8	55 03	54 84	117 6	51 37	51 16

Notes to the Group financial statements continued

12. Goodwill

	2011 £m	2010 £m
Cost		
At 1 April	553 1	540 0
On acquisition of subsidiaries (note 30)	1,073 0	12 8
Exchange adjustments	(6 5)	0 3
At 31 March	1,619 6	553 1
Accumulated impairment		
At 1 April	4 8	4 8
Impairment charge	–	–
At 31 March	4 8	4 8
Net book value at 31 March	1,614 8	548 3

During the year, the goodwill was tested for impairment in accordance with IAS 36 The recoverable amount for all the cash-generating units has been measured based on a value in use calculation derived from Board approved three year budgeted cash flows and extrapolated cash flows thereafter based on an estimated growth rate of 3% (effectively zero real growth allowing for inflation) A pre-tax discount rate in the range 11% to 12% was used in the pre tax value in use calculation for the cash-generating units within each segment The Group's weighted average cost of capital post tax is approximately 8% to 9% (2010 8% to 9%)

Goodwill is allocated to the Group's cash-generating units (CGUs) based on value in use, identified according to the business segment and country of operation A segment level summary of goodwill allocation is presented below.

	2011 £m	2010 (restated) £m
Marine and Technology	386 8	295 2
Defence and Security	588 1	52 0
Support Services	547 7	199 7
International – Africa	0 1	0 1
International – North America	81 6	1 3
International – Middle East	10 5	–
	1,614 8	548 3
United Kingdom	1,520 1	544 5
Africa	0 1	0 1
North America	84 1	3 7
Middle East	10 5	–
	1,614 8	548 3

13 Other intangible assets

	Acquired intangibles £m	IFRIC 12 intangibles £m	Software £m	Development costs £m	Total £m
Cost					
At 1 April 2010	134 3	–	19 4	3 2	156 9
On acquisition of subsidiaries (note 30)	469 4	5 9	2 4	–	477 7
Additions	–	–	3 9	0 3	4 2
Disposals	–	–	(0 3)	(0 3)	(0 6)
Exchange adjustments	(1 1)	–	–	–	(1 1)
At 31 March 2011	602 6	5 9	25 4	3 2	637 1
Accumulated amortisation and impairment					
At 1 April 2010	63 6	–	9 9	3 2	76 7
Amortisation charge	83 4	0 3	3 6	–	87 3
Disposals	–	–	(0 2)	–	(0 2)
Exchange adjustments	(0 1)	–	–	–	(0 1)
At 31 March 2011	146 9	0 3	13 3	3 2	163 7
Net book value at 31 March 2011	455 7	5.6	12 1	–	473 4
Cost					
At 1 April 2009	107 2	–	16 2	3 2	126 6
On acquisition of subsidiaries	27 1	–	–	–	27 1
Additions	–	–	3 2	–	3 2
Disposals	–	–	(0 2)	–	(0 2)
Exchange adjustments		–	0 2	–	0 2
At 31 March 2010	134 3	–	19 4	3 2	156 9
Accumulated amortisation and impairment					
At 1 April 2009	47 5	–	7 3	3 1	57 9
Amortisation charge	16 1	–	2 7	0 1	18 9
Disposals	–	–	(0.2)	–	(0 2)
Exchange adjustments	–	–	0 1	–	0 1
At 31 March 2010	63 6	–	9 9	3 2	76 7
Net book value at 31 March 2010	70 7	–	9 5	–	80 2

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

Acquired intangibles are the fair value of customer relationships and order books of acquired entities

Notes to the Group financial statements continued

14 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Total £m
Cost				
At 1 April 2010	56 7	4 7	188 1	249 5
Exchange adjustments	–	–	0 7	0 7
On acquisition of subsidiaries (note 30)	11 4	0 9	48 2	60 5
On disposal of subsidiaries (note 31)	–	–	(2 0)	(2 0)
Additions	1 3	1 0	27 5	29 8
Capitalised borrowing costs	–	–	0 4	0 4
Disposals	–	(0 7)	(7 5)	(8 2)
At 31 March 2011	69 4	5 9	255 4	330 7
Accumulated depreciation				
At 1 April 2010	20 2	0 9	79 1	100 2
Exchange adjustments	–	–	0 3	0 3
Charge for the year	4 9	0 6	25 7	31 2
Disposals	–	(0 4)	(6 4)	(6 8)
At 31 March 2011	25 1	1 1	98 7	124 9
Net book value at 31 March 2011	44 3	4 8	156 7	205 8
Cost				
At 1 April 2009	56 9	3 9	168 0	228 8
Exchange adjustments	0 1	–	5 9	6 0
On acquisition of subsidiaries	–	–	0 1	0 1
Additions	0 1	0 8	20 9	21 8
Capitalised borrowing costs	–	–	0 2	0 2
Disposals	(0 4)	–	(7 0)	(7 4)
At 31 March 2010	56 7	4 7	188 1	249 5
Accumulated depreciation				
At 1 April 2009	16 8	0 6	64 3	81 7
Exchange adjustments	–	–	2 7	2 7
Charge for the year	3 6	0 3	18 4	22 3
Disposals	(0 2)	–	(6 3)	(6 5)
At 31 March 2010	20 2	0 9	79 1	100 2
Net book value at 31 March 2010	36 5	3 8	109 0	149 3

A capitalisation rate of 4% was used to determine the amount of borrowing costs eligible for capitalisation

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

	2011 £m	2010 £m
Cost	10 8	10 7
Aggregate depreciation	(5 4)	(4 1)
Net book value	5 4	6 6

15 Investment in and loan to joint ventures and other investments

	Investment in joint ventures		Loans to joint ventures		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
At 1 April						
– Net assets excluding goodwill	(0 2)	0 1	–	–	(0 2)	0 1
– Goodwill	1 2	1 4	–	–	1 2	1 4
– Loan to joint venture	–	–	13 3	12 0	13 3	12 0
	1 0	1 5	13 3	12 0	14 3	13 5
Acquisition of joint ventures (note 30)	51 2	–	8 1	–	59 3	–
Loans to/(repayments from) joint ventures	–	–	(0 4)	–	(0 4)	–
Investment in joint venture	0 2	–	–	–	0 2	–
Share of profits/(losses)	6 1	(0 3)	–	–	6 1	(0 3)
Interest accrued	–	–	1 1	1 5	1 1	1 5
Interest received	–	–	–	(0 2)	–	(0 2)
Fair value adjustment of derivative	8 8	–	–		8 8	–
Tax on fair value adjustment of derivative	(2 4)	–	–		(2 4)	–
Impairment of goodwill	–	(0 2)	–	–	–	(0.2)
At 31 March						
– Net assets excluding goodwill	63 7	(0 2)	–	–	63 7	(0 2)
– Goodwill	1 2	1 2	–	–	1 2	1 2
– Loan to joint venture	–	–	22 1	13 3	22 1	13 3
	64 9	1 0	22 1	13 3	87 0	14 3

Included within joint ventures are:

	Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
2011							
Holdfast Training Services Limited	United Kingdom	40 4	(41 0)	25 9	0 9	(0 2)	74%
ALC (Superholdco) Limited	United Kingdom	59 0	(54 9)	24 5	6 2	4 2	50%
Airtanker Limited	United Kingdom	198 5	(189 4)	31 0	1 2	0 2	13%
Airtanker Services Limited	United Kingdom	12 4	(11 8)	–	0 1	0 1	23%
Ascent Flight Training (Holdings) Limited	United Kingdom	40 9	(38 3)	9 3	–	1 0	50%
Greenwich BSF SPV Limited	United Kingdom	49 1	(47 4)	21 0	0 2	0 1	50%
Other		133 7	(64 2)	27 0	0 7	0 7	
		534 0	(447 0)	138 7	9 3	6 1	

	Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
2010							
Holdfast Training Services Limited	United Kingdom	29 4	(15.5)	13 8	0 7	(0 3)	74%
Other		6 7	(6 3)	14 1	(0 2)	(0 2)	
		36 1	(21 8)	27 9	0 5	(0 5)	

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

Notes to the Group financial statements continued

16 Deferred tax

	2011 £m	2010 £m
Deferred tax asset	3 3	84 9
Deferred tax liability	(23 2)	–
	(19.9)	84 9

The movements in deferred tax assets and liabilities (prior to offsetting of balances within the same tax jurisdiction as permitted by IAS 12) during the period are shown below

	Accelerated tax depreciation £m	ACT £m	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
At 1 April 2010	1.1	–	90 7	2 1	(9 0)	84 9
Income statement credit	–	–	8 1	–	25 5	33 6
Tax credit to equity	–	–	(29 0)	–	(1 1)	(30 1)
Prior year adjustment	–	–	–	2.3	0 5	2 8
Transfer to corporation tax	–	–	(23 1)	–	1 2	(21 9)
Acquisition of subsidiaries (note 30)	(12 4)	–	16 3	–	(90 8)	(86 9)
Effect of change in UK tax rate						
– Income statement	0 8	–	–	(0 3)	2 2	2 7
– Equity	–	–	(4 5)	–	(0 5)	(5 0)
Exchange differences	–	–	–	–	–	–
At 31 March 2011	(10 5)	–	58 5	4 1	(72 0)	(19 9)
At 1 April 2009	(9 8)	3 1	(14 2)	9 3	14 2	2 6
Income statement credit	–	–	4 8	–	3 7	8 5
Tax credit to equity	–	–	113 0	–	0 5	113 5
Prior year adjustment	–	(3 1)	–	(1 2)	–	(4 3)
Transfer to corporation tax	10 9	–	(12 9)	(6 0)	(20 3)	(28 3)
Acquisition of subsidiaries	–	–	–	–	(7 6)	(7 6)
Exchange differences	–	–	–	–	0 5	0 5
At 31 March 2010	1 1	–	90 7	2 1	(9 0)	84 9

The deferred tax in respect of 'other' includes an asset of £3 3 million (2010 £2 6 million) in respect of the Group's non-UK operations

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

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

	2011 £m	2010 £m
Deferred tax asset	(62 6)	(91 3)
Deferred tax liability	85 8	9 0
	23 2	(82 3)

Deferred tax expected to be recovered within 12 months

	2011 £m	2010 £m
Deferred tax asset	–	2 6
Deferred tax liability	(22 4)	(5 0)
	(22 4)	(2 4)

16 Deferred tax (continued)

At the balance sheet date, the Group has unused tax losses (excluding UK capital losses and advance corporation tax) of £42 8 million (2010 £52 7 million) available for offset against future profits A deferred tax asset has been recognised in respect of £13 4 million (2010 £7 5 million) of such losses, which may be carried forward No deferred tax has been recognised in respect of the remaining £29 4 million (2010 £45 2 million) due to the unpredictability of future profit streams

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £109 0 million (2010 £129 0 million) No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future

In addition to the changes in rates of corporation tax disclosed in note 9, a number of further changes to the UK corporation tax system were announced in the March 2011 Budget Statement Legislation to reduce the main rate of corporation tax from 26% to 25% from 1 April 2012 is expected to be included in the Finance Act 2011 Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014 These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements

The effect of the changes expected to be enacted in the Finance Act 2011 would be to reduce the deferred tax liability provided at the balance sheet date by £762,000 This £762,000 decrease in the deferred tax liability would decrease profit by £3,292,000 and decrease equity by £2,530,000 This decrease in deferred tax liability is due to the reduction in the corporation tax rate from 26% to 25% with effect from 1 April 2012

The proposed reductions of the main rate of corporation tax by 1% per year to 23% by 1 April 2014 are expected to be enacted separately each year The overall effect of the further changes from 25% to 23%, if these applied to the deferred tax balance at the balance sheet date, would be to further reduce the deferred tax liability by an additional £1,524,000 (being £762,000 recognised in 2013 and £762,000 recognised in 2014)

17 Inventories

	2011 £m	2010 £m
Raw materials	17 7	21 3
Work in progress and long-term contracts	20 0	12 2
Finished goods and goods for resale	58 9	50 7
Total	96 6	84 2

18 Trade and other receivables

	2011 £m	2010 £m
Current assets		
Trade receivables	233 8	118 5
Less provision for impairment of receivables	(9 9)	(4 2)
Trade receivables – net	223 9	114 3
Amounts due from customers for contract work	205 5	165 4
Retentions	6 8	5 4
Amounts owed by related parties (note 35)	26 1	7 7
Other debtors	35 7	12 1
Prepayments and accrued income	42 3	26 0
	540 3	330 9
Non-current assets		
Other debtors	1 9	0 4

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

As of 31 March 2011, trade receivables of £9 9 million (2010 £4.2 million) were impaired Impairment arises in the main, through contract disputes rather than credit defaults The amount of the provision was £9 9 million (2010 £4 2 million) The individually impaired receivables mainly relate to receivables in the International division It was assessed that a portion of these receivables is expected to be recovered

Notes to the Group financial statements continued

18 Trade receivables and other (continued)

The ageing of the net impaired receivables is as follows

	2011 £m	2010 £m
Less than three months	–	–
Three to six months	–	–
Over six months	–	–
	–	–

As of 31 March 2011, trade receivables of £36 4 million (2010 £16 3 million) were past due but not impaired These relate to a number of independent customers for whom there is no recent history of default The ageing analysis of these trade receivables is as follows

	2011 £m	2010 £m
Less than three months	21 0	12 9
Three to six months	9 4	2 3
Over six months	6 0	1 1
	36 4	16 3

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

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

	2011 £m	2010 £m
Balance at 1 April	(4 2)	(5 7)
Acquisition of subsidiaries (note 30)	(3 8)	–
Provision for receivables impairment	(2 7)	(0 9)
Receivables written off during the year as uncollectable	0 4	0 4
Unused amounts reversed	0 6	2 1
Exchange differences	(0 2)	(0 1)
Balance at 31 March	(9 9)	(4 2)

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

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

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

19 Cash and cash equivalents

	2011 £m	2010 £m
Cash at bank and in hand	100 7	177 6
Short-term bank deposits (overnight)	3 6	12 0
	104 3	189 6

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

	2011		2010	
	Total £m	Floating rate £m	Total £m	Floating rate £m
Currency				
Sterling	31 2	31 2	170 0	170 0
Euro	5 7	5 7	10 9	10 9
US Dollar	23 2	23 2	2 8	2 8
South African Rand	30 5	30 5	0 7	0 7
Canadian Dollar	6 2	6 2	2 6	2 6
Omani Rial	3 2	3 2	-	-
Australian Dollar	1.8	1 8	2 5	2 5
Other currencies	2.5	2 5	0 1	0 1
	104.3	104 3	189 6	189 6

The above balances are invested at short-term, floating rates linked to LIBOR in the case of Sterling, the prime rate in the case of South African Rand and the local prime rate for other currencies

20 Trade and other payables

	2011 £m	2010 £m
Current liabilities		
Contract cost accruals	162 4	142 8
Amounts due to customers for contract work	173 4	117 3
Trade creditors	191 7	105 9
Amounts owed to related parties (note 35)	2 8	0 1
Other creditors	51 6	16 5
Other taxes and social security	41 1	31 6
Accruals and deferred income	254 8	83 9
	877 8	498 1
Non-current liabilities		
Other creditors	13 6	12.3

Notes to the Group financial statements continued

21 Bank and other borrowings

	2011 £m	2010 £m
Current liabilities		
Bank loans and overdrafts due within one year or on demand		
Secured	1 5	–
Unsecured	31 6	160 6
	33 1	160 6
Finance lease obligations*	2 2	2 2
	35 3	162 8
Non-current liabilities		
Bank and other loans		
Secured	15 8	–
Unsecured	781 4	325 1
	797 2	325 1
Finance lease obligations*	1 8	4 0
	799 0	329 1

* Finance leases are secured against the assets to which they relate

Bank and other loans and overdrafts are denominated in a number of currencies and bear interest based on LIBOR, base rates or foreign equivalents appropriate to the country in which the borrowing is incurred The Group has entered into interest rate and currency swap, details of which are included in note 22

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

			2011
Currency	Total £m	Floating rate £m	Fixed rate £m
Sterling	423 0	304 9	118 1
Euro	2 1	2 1	–
South African Rand	3 9	3 9	–
US Dollar*	405 3	0 9	404 4
	834 3	311 8	522 5

* The US Dollar amounts have been swapped into sterling

			2010
Currency	Total £m	Floating rate £m	Fixed rate £m
Sterling	483 8	382 5	101 3
South African Rand	6 8	6 8	–
Other	1 3	1 3	–
	491 9	390 6	101 3

The weighted average interest rates of Sterling fixed rate borrowings, which comprise finance lease obligations, are 5% The weighted average period for which these interest rates are fixed is four years

The floating rate for borrowings is linked to LIBOR in the case of Sterling, the prime rate in the case of South African Rand and the local prime rate for other currencies

The exposure of the Group to interest rate changes when borrowings re-price is as follows

Total borrowings	1 year £m	1–5 years £m	>5 years £m	Total £m
As at 31 March 2011	515 1	0 9	318 3	834 3
As at 31 March 2010	230 6	161 3	100 0	491 9

21 Bank and other borrowings (continued)

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

	2011 %	2010 %
UK bank overdraft	1 5	1 5
UK bank borrowings	2 9	1 1
US private placement – fixed	5 6	5 2
US private placement – floating	3 1	–
Other borrowings	9 0–10 0	9 65–10 0
Finance leases	5 0–11 0	2 0–14 0

Repayment details

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

	2011		2010	
	Bank loans and overdrafts £m	Finance lease obligations £m	Bank loans and overdrafts £m	Finance lease obligations £m
Within one year	33 1	2 2	160 6	2 2
Between one and two years	278 6	1 4	–	2 2
Between two and five years	4 7	0 4	225 1	1 8
Greater than five years	513 9	–	100 0	–
	830.3	4 0	485 7	6 2

Borrowing facilities

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

	2011 £m	2010 £m
Expiring in less than one year	63 0	33 2
Expiring in more than one year but not more than five years	323 0	370 0
	386 0	403 2

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

	2011 £m	2010 £m
Not later than one year	2 4	2 7
Later than one year but not more than five years	2 1	4 4
More than five years	–	–
	4 5	7 1
Future finance charges on finance leases	(0 5)	(0 9)
Present value of finance lease liabilities	4 0	6 2

Notes to the Group financial statements continued

22 Financial instruments

Other financial assets and liabilities

	Fair value			
	Assets		Liabilities	
	2011 £m	2010 £m	2011 £m	2010 £m
Interest rate hedges	–	–	1 6	13 3
US private placement – currency and interest rate swaps	1 0	–	–	–
Other currency hedges	0 8	1 1	2 5	2 4
Total other financial assets and liabilities	1 8	1 1	4 1	15 7

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

The Group enters into interest rate hedges to hedge interest rate exposure and to create a balance between fixed and floating interest rates

The fair values of the financial instruments are based on valuation techniques (level 2)

Interest rate hedges

The notional principal amount of outstanding interest rate swap contracts at 31 March 2011 included £18 9 million of UK interest rate swaps and interest rate swaps in relation to the US$650 million US$ to GBP cross currency swap

In 2010 the notional principle amount of the outstanding interest rate swap and collar contracts was £160 million These were settled in full during the year

The Group held the following interest rate hedges at 31 March 2011:

	Amount £m	Fixed payable %	Floating receivable %	Maturity
Hedged				
Interest Rate Swap	1 4	5 45	1 03	31/03/2015
Interest Rate Swap	11 2	5 45	1 03	31/03/2019
Interest Rate Swap	6 3	4 745	1 03	31/03/2029
Total interest rate swaps	18 9			

	Amount US$m	Amount at swapped rates £m	Swap %	Maturity
Hedged				
Cross currency and interest rate swap	150.0	92.1	Fixed 4.94% US$ to fixed 5 4 GBP	19/03/2018
Cross currency and interest rate swap	200 0	122 9	Fixed 5 64% US$ to fixed 5 95 GBP	17/03/2021
Cross currency and interest rate swap	300 0	184 3	Fixed 5 64% US$ to floating 3 month LIBOR +margin GBP	17/03/2021
Total cross currency and interest rate swap	650 0	399 3		

22 Financial instruments (continued)

Fair value of financial assets and financial liabilities

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

	2011		2010	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Fair value of non-current borrowings and loans				
Long-term borrowings	(799 0)	(797 3)	(329 1)	(328 9)
Loan to joint venture	22 1	22 1	13 3	13 3
	(776 9)	(775 2)	(315 8)	(315 6)
Fair value of other financial assets and financial liabilities				
Short-term borrowings	(35 3)	(35 3)	(162 8)	(162 8)
Trade and other payables*	(878 8)	(877 0)	(510 4)	(508 5)
Trade and other receivables	542 2	542 2	331 3	331 3
Other financial assets – IFRIC 12	38 2	38 2	–	–
Short-term deposits	3 6	3 6	12 0	12 0
Cash at bank and in hand	100 7	100 7	177 6	177 6
Income tax payable	(17 3)	(17 3)	(6.9)	(6 9)
Income tax receivable	2 7	2 7	1 9	1 9
Other financial assets and liabilities	(2 3)	(2 3)	(14 6)	(14 6)
	(246 3)	(244 5)	(171 9)	(170 0)

* Does not include other taxes and social security

Fair values of long-term borrowings are based on cash flows discounted using a rate of 4 0% to 5 0% (2010 4 0% to 5 5%)

Notes to the Group financial statements continued

23. Provisions for other liabilities

	Insurance provisions (a) £m	Contract/ warranty (b) £m	Property and other (c) £m	Total provisions £m
At 1 April 2010	4 5	–	45 7	50 2
On acquisition of subsidiaries (note 30)	5 9	58 7	56 0	120 6
On disposal of subsidiaries (note 31)	–	–	(0 2)	(0 2)
Charged/(released) to income statement	(0 3)	0 7	11 9	12 3
Utilised in year	(1 5)	(8 0)	(19 3)	(28 8)
At 31 March 2011	8 6	51 4	94 1	154 1

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

	2011 £m	2010 £m
Current	29.7	13 1
Non-current	124 4	37 1
	154 1	50 2

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

(b) The contract/warranty provisions relate to onerous contracts and warranty obligations on completed contracts.

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

Included within property and other provisions is £40 million expected to be utilised in approximately ten years In addition within contract/warranty provisions there is £22 million expected to be materially utilised in approximately 10 years Other than this provision the Group's non-current provisions are expected to be utilised within two to five years

24 Share capital

	Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2010	229,687,601	137 8
Shares issued	129,150,491	77 5
At 31 March 2011	358,838,092	215 3
At 1 April 2009	229,574,959	137 7
Shares issued	112,642	0 1
At 31 March 2010	229,687,601	137 8

24 Share capital (continued)

Potential issues of ordinary shares

The table below shows options existing over the Company's shares as at 31 March 2011 They represent outstanding options granted under all the Company's Executive Share Option Schemes Of the total number of shares shown, 161,318 are in respect of options granted by the trustee of the Babcock Employee Share Trust and 32,118 are in respect of options granted by the trustee of the Peterhouse Employee Share Trust, both are options to acquire shares already purchased or intended to be purchased in the market by the respective trustees The balance of 331,254 shares is in respect of options granted by the Company to subscribe for newly issued shares.

Grant date	Exercise price Pence	Exercise period	2011 Number	2010 Number
25 June 2001	99 33	25/06/2004 - 24/06/2011	931	23,789
31 January 2002	104 33	31/01/2005 - 30/01/2012	21,278	21,278
24 June 2002	124 50	24/06/2005 - 23/06/2012	142,681	206,135
27 November 2002	106 33	27/11/2005 - 26/11/2012	23,414	27,616
30 June 2003	115 60	30/06/2006 - 29/06/2013	139,109	139,109
06 July 2004	126 00	06/07/2007 - 05/07/2014	197,277	222,368
			524,690	640,295

Options granted to Directors are summarised in the Remuneration report on pages 64 to 80 and are included in the outstanding options set out above

A reconciliation of option movements is shown below

	2011		2010	
	Number '000	Weighted average exercise price	Number 000	Weighted average exercise price
Outstanding at 1 April	640	£1 21	787	£1 21
Forfeited/lapsed	–	–	–	–
Exercised	(116)	£1 19	(147)	£1 23
Outstanding at 31 March	524	£1 21	640	£1 21
Exercisable at 31 March	524	£1 21	640	£1 21

Weighted average share price for options exercised during the year was 579 83p per share (2010 546 26p per share)

During the year 412,000 ordinary shares (2010 339,644) were acquired through either the Babcock Employee Share Trust or the Peterhouse Employee Share Trust (together 'the Trusts') The Trusts hold shares to be used towards satisfying awards made under the Company's employee share schemes During the year ended 31 March 2011 no shares (2010 923,686 shares) were disposed by the Trusts resulting from options exercised At 31 March 2011, the Trusts held between them a total of 776,053 (2010 364,053) ordinary shares at a total market value of £4,819,289 (2010 £2,193,419) representing 0 22% (2010 0 16%) of the issued share capital at that date The Company elected to pay dividends to the Babcock Employee Share Trust at the rate of 0 001p per share during the year, though full dividends were paid in respect of shares held by the Peterhouse Employee Share Trust. The Company meets the operating expenses of the Trusts

The Trusts enable shares in the Company to be held or purchased and made available to employees through the grant and exercise of rights or awards under the Company's employee share schemes The Trusts are discretionary settlements for the benefit of employees within the Group The Company is excluded from benefiting under them They are controlled and managed outside the UK and each has a single corporate trustee which is an independent trustee services organisation The right to remove and appoint the trustees rests ultimately with the Company The trustee of the Babcock Employee Share Trust is required to waive both voting rights and dividends payable on any share in the Company in excess of 0 001p, unless otherwise directed by the Company, but the trustee of the Peterhouse Employee Share Trust does not have the power to waive dividends due on Babcock ordinary shares and therefore receives the full amount of any dividends declared

Notes to the Group financial statements continued

25. Share-based payments

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

During the year the total charge relating to employee share-based payment plans was £5 8 million (2010 £2 7 million) all of which related to equity-settled share-based payment transactions

After tax, the income statement charge was £4 2 million (2010 £1 9 million).

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

L-TIPs

Grant or modification date	2009 TSR 24/7/08	2009 EPS 24/7/08
Share price at grant or modification date (pence)	594 3	594 3
Vesting period (years)	3 0	3 0
Expected volatility	25%	25%
Option life (years)	10 0	10 0
Expected life (years)	3 0	3 0
Expected dividends expressed as dividend yield	2 8%	2 8%
Expectations of meeting performance criteria	n/a	40%
Fair value per option (pence)	448	546
Correlation	32%	n/a

CSOP and PSP

	CSOP		PSP Main		PSP Funding	
Grant or modification date	2010 13/7/10	2009 11/9/09	2010 13/7/10	2009 11/9/09	2010 13/7/10	2009 11/9/09
Share price at grant or modification date (pence)	635 0	560 5	635 0	560 5	635 0	560 5
Vesting period (years)	3 0	3 0	3 0	3 0	3 0	3 0
Expected volatility	27 8%	26%	27 8%	26%	27 8%	26%
Option life (years)	4 0	4 0	4 0	4 0	4 0	4 0
Expected life (years)	3 0	3 0	3 0	3 0	3 0	3 0
Expected dividends expressed as dividend yield	2 8%	2 8%	Holders receive dividends	Holders receive dividends	Holders receive dividends	Holders receive dividends
Expectations of meeting performance criteria – EPS	40%	40%	40%	40%	40%	40%
Fair value per option (pence) – TSR	81 0	62 0	369 0	268 0	285 0	204 0
Fair value per option (pence) – EPS	107 0	94 0	635 0	560 5	525 0	465 0
Correlation	46%	45%	46%	45%	46%	45%

The number of PSP and CSOPs awarded in 2010 were 1,564,465 and 130,455 respectively and in 2009 were 1,093,492 and 336,358 respectively The number of L-TIPs awarded in 2008 has 427,218

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

26 Retirement benefits and liabilities

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

Defined contribution schemes

Pension costs for defined contribution schemes are as follows

	2011 £m	2010 £m
Defined contribution schemes	25 0	17 8

Defined benefit schemes

Balance sheet assets and liabilities recognised are as follows:

	2011 £m	2010 £m
Retirement benefits – funds in surplus	12 2	–
Retirement benefits – funds in deficit	(237 3)	(324 0)
	(225 1)	(324.0)

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

	Devonport Royal Dockyard Scheme	Babcock International Group Scheme	Rosyth Royal Dockland Scheme	First Engineering Scheme	VT Group Section of SIPS
Date of last formal completed actuarial valuation	31/03/08	01/04/10	31/03/09	31/12/07	31/3/10
Number of active members at above date	4,114	909	1,036	705	1,348
Actuarial valuation method	Projected unit	Projected unit	Projected unit	Projected unit	Projected unit
Results of formal actuarial valuation					
Value of assets	£850 0m	£502 9m	£335 6m	£185 2m	£319 4
Level of funding	95%	92%	90%	102%	78%
Principal valuation assumptions					
Excess of investment returns over earnings increases	2 0%	2 4%	3 5%	2 0%	c 1 4%
Excess of investment returns over pension increases	3 0%	1 3%–2 5%	2 5%	2 5%	c 1 4%

As a result of the level of surplus identified in the 2007 actuarial valuation of the Babcock International Group Pension Scheme, the Group had suspended contributions in respect of the majority of active members Following the results of the 2010 actuarial valuation, the Group is resuming contributions (the rate depends upon the section of the Scheme, but will be 20% of pensionable pay for the majority of members). The Group will also pay the following amounts – deficit contributions starting at £4 9 million for the year to 31 March 2012, £680,000 per annum to meet the cost of insuring the lump sum death-in-service benefits for DC members and members who are covered for the life assurance benefits only; and £648,000 per annum to meet the funding gap in relation to the Scheme's longevity swap

The Group's future service contribution rate for the vast majority of members in the Devonport Royal Dockyard Pension Scheme is 20 5% of pensionable pay, with additional payments of £5 million per annum to meet the funding deficit and £4 8 million per annum to meet the funding gap in relation to the Scheme's longevity swap

The Group's future service contribution rate for the Rosyth Royal Dockyard Pension Scheme is 15 0% of pensionable pay, with additional payments of £7 24 million per annum to meet the funding deficit and £2 52 million per annum to meet the funding gap in relation to the Scheme's longevity swap

The Group's contribution rate for the First Engineering Scheme is 17 1% of pensionable pay

The total future service contribution rate for the VT Group section of the Shipbuilding Industries Pension Scheme is 33 1% of pensionable pay, with additional Group payments to meet the funding deficit, starting at £10 2 million for the year to 31 March 2012

Where salary sacrifice arrangements are in place the Group effectively meet the members contributions in addition

Notes to the Group financial statements continued

26 Retirement benefits and liabilities (continued)

The Group cash contributions forecast for next year are £17 7 million to the Devonport Royal Dockyard Pension Scheme (after taking account of £14 3 million of outstanding advance contributions still to be used up), £3 5 million to the Babcock International Group Pension Scheme (after taking account of £10 million of advance contributions), £12 4 million to the Rosyth Royal Dockyard Pension Scheme (after taking account of £4 million of advance contributions), £2 1 million to the First Engineering Scheme, and £16 0 million to the VT Group section of the Shipbuilding Industries Pension Scheme Other scheme contributions of £18 0 million

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

The latest full actuarial valuation of the Group's defined benefit pension schemes have been updated to 31 March by qualified independent actuaries for IAS 19 purposes using the following assumptions

	2011 (weighted average) %	2010 (weighted average) %
Rate of increase in pensionable salaries	3 1	3 0
Rate of increase in pensions	2 9	3 1
Discount rate	5 6	5 5
Inflation rate	3 1	3 4
Expected return on plan assets	7 2	7 2
Total life expectancy – future pensioners (years)	86 6	85 2

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

	2011		2010	
	Expected rate of return %	Fair value £m	Expected rate of return %	Fair value £m
Equities	8 7	1,206 4	9 0	905 1
Property	8 0	140 9	8 0	129 9
Bonds – corporate	5 6	387 8	5 5	223 3
Bonds – government	4 4	150 6	4 6	82 6
Liability matching bonds	5 6	664 1	5 3	744 7
Cash plus infrastructure	8 0	17 4	8 0	16 2
Funds awaiting investment	7 1	134 3	7 1	35 7
Active position of longevity swap		(121 6)		(157 7)
Fair value of assets		2,579 9		1,979 8
Present value of funded obligation		(2,794 6)		(2,303 8)
Funded status		(214 7)		(324 0)
IFRIC 14 adjustment		(10 4)		–
Net liabilities recognised in the balance sheet		(225 1)		(324 0)

The amounts recognised in the Group income statement are as follows

	2011 £m	2010 £m
Current service cost	(46 0)	(23 3)
Interest on obligation	(135 6)	(107 2)
Expected return on plan assets	152 6	113 1
Total included within operating profit	(29 0)	(17 4)

26 Retirement benefits and liabilities (continued)

Amounts recorded in the Group statement of comprehensive income

	2011 £m	2010 £m
Actual return less expected return on pension scheme assets	7.8	375.5
Experience gain/(losses) arising on scheme liabilities	17.0	(41 6)
Change in assumptions relating to present value of scheme liabilities	46.3	(579 7)
Reimbursement right	36.1	(157 7)
IFRIC 14 adjustments	(3 2)	–
Exchange differences	(0 5)	–
At 31 March	103 5	(403 5)
Cumulative other comprehensive income at 31 March	(386 5)	(490 0)

Analysis of movement in the Group balance sheet

	2011 £m	2010 £m
Fair value of plan assets		
At 1 April	1,979 8	1,702 9
Acquisitions	432 5	–
Expected return	152 6	113 1
Actuarial gains	7 8	375 5
Reimbursement rights (longevity swaps)	36 1	(157 7)
Employer contributions	82 5	46 0
Employee contributions	7 1	5 9
Benefits paid	(118 1)	(105 9)
Exchange differences	(0 4)	–
At 31 March	2,579 9	1,979 8
Present value of benefit obligations		
At 1 April	2,303 8	1,652 2
Acquisitions	483 6	–
Service cost	46 0	23 3
Interest cost	135 6	107 2
Employee contributions	7 1	5 9
Actuarial (gain)/losses	(63 3)	621 3
Benefits paid	(118 1)	(105 9)
Exchange differences	(0 1)	(0 2)
At 31 March	2,794 6	2,303 8
IFRIC 14 adjustment	(10.4)	–
Net deficit at 31 March	(225.1)	(324 0)

Actual return on plan assets		
Year ending 31 March	160.4	488 6

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

Notes to the Group financial statements continued

26 Retirement benefits and liabilities (continued)

(Deficits)/surpluses in the plans

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of plan assets	2,579 9	1,979 8	1,702 9	1,983 8	1,200 9
Present value of benefit obligations	(2,794 6)	(2,303 8)	(1,652 2)	(1,841 6)	(1,147 8)
IFRIC 14 adjustment	(10 4)	–	–	–	–
(Deficits)/surpluses at 31 March	(225 1)	(324 0)	50 7	142 2	53 1

History of experience gains and losses

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Difference between the expected and actual return on scheme assets	7 8	375 5	(383 0)	(158 0)	(9 5)
Percentage of scheme assets at 31 March	0%	19%	(22%)	(8%)	(1%)
Experience gains/(losses) of scheme liabilities	17 0	(41 6)	6 1	(15 7)	(13 1)
Percentage of present value of scheme liabilities at 31 March	(1%)	(2%)	0%	1%	1%
Total amount recognised in the Group statement of comprehensive income	103 5	(403 5)	(145 6)	43 0	8 7
Percentage of present value of scheme liabilities at 31 March	4%	(18%)	(9%)	2%	1%

The changes to the Group balance sheet at March 2011 and the charges to the Group income statement for the year to March 2012, if the assumptions were sensitised by the amounts below, would be

	Balance sheet 2011 £m	Income statement 2012 £m
Initial assumptions	(225 1)	20 0
Discount rate moves up or down by 0 1%	±43 1	±1 2
Inflation rate moves up or down by 0 1%	±41 2	±3 6
Equity return moves up or down by 0 1%	±0	±1 2
Total life expectancy changes by half a year up or down	±31 6	±2 4
Real salaries move up or down by 0 25%	±32 9	±3 7

27 Reconciliation of operating profit to cash generated from operations

	2011 £m	2010 £m
Cash flows from operating activities		
Operating profit before exceptional items	178 2	148 1
Exceptional items	(20 7)	–
Operating profit	157 5	148 1
Depreciation of property, plant and equipment	31 2	22 3
Amortisation of intangible assets	87 3	18 9
Investment income	2 2	–
Equity share-based payments	5 8	2 7
Profit on disposal of subsidiaries	(2 9)	–
Loss/(profit) on disposal of property, plant and equipment	0 4	(0 4)
Loss on disposal of intangible assets	0 2	–
Operating cash flows before movement in working capital	281 7	191 6
Decrease in inventories	3 5	22 7
(Increase)/decrease in receivables	(83 0)	23 6
Increase /(decrease)/ in payables	123 1	(72 4)
(Decrease)/increase in provisions	(16 8)	4 8
Cash generated from operations	308 5	170 3

28 Movement in net debt

	2011 £m	2010 £m
Increase in cash in the year	43 2	22 8
Cash flow from the (increase)/decrease in debt and lease financing	(374 7)	31 9
Change in net funds resulting from cash flows	(331 5)	54 7
Loans and finance leases acquired and disposed of with subsidiaries	(90 3)	–
New finance leases	–	(5 0)
Foreign currency translation differences	(4 9)	(0 5)
Movement in net debt in the year	(426 7)	49 2
Net debt at the beginning of the year	(302 3)	(351 5)
Net debt at the end of the year	(729 0)	(302 3)

29 Changes in net debt

	31 March 2010 £m	Cash flow £m	Acquisitions and disposals £m	New finance leases £m	Exchange movement £m	31 March 2011 £m
Cash and bank balances	189 6	(278 1)	193 8	–	(1 0)	104 3
Bank overdrafts	(160 6)	127 5	–	–	1 5	(31 6)
Cash, cash equivalents and bank overdrafts at end of year	29 0	(150 6)	193 8	–	0 5	72 7
Debt	(325 1)	(387 6)	(79 7)	–	(6 3)	(798 7)
Finance leases	(6 2)	12 9	(10 6)	–	(0 1)	(4 0)
	(331 3)	(374 7)	(90 3)	–	(6 4)	(802 7)
Net debt before derivatives	(302 3)	(525 3)	103 5	–	(5 9)	(730 0)
Net debt derivative	–	–	–	–	1 0	1 0
Net debt including derivatives	(302 3)	(525 3)	103 5	–	(4 9)	(729 0)

Notes to the Group financial statements continued

30 (a) Acquisitions – current year

On 8 July 2010 the acquisition of 100% of the share capital of VT Group plc was completed for a cash and share consideration of £1,471 3 million On 27 September 2010 the acquisition of the assets and trading of Evergreen Unmanned Systems (Evergreen) in the USA was completed for a cash consideration of £8 9 million (US$14 million)

The goodwill arising on the acquisition derives from the experience, knowledge and location of the workforce, the market position of the entities involved and expected synergies

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

	VT Group plc £m	Evergreen £m	Total £m
Cost of acquisition			
Cash paid	665 7	8 9	674.6
129,034,886 shares issued	805 6	–	805 6
Purchase consideration	1,471 3	8 9	1,480 2
Fair value of assets acquired (see below)	405 0	2 2	407 2
Goodwill	1,066 3	6 7	1,073 0

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

	VT Group plc		Evergreen		Total	
	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m	Book value of assets acquired £m	Provisional fair value acquired £m
Goodwill	302 9	–	–	–	302 9	–
Intangible assets	13 3	8.3	–	–	13 3	8 3
Acquired intangibles*	115 9	464 9	–	4 5	115 9	469 4
Property plant and equipment	74 6	59 6	0 9	0 9	75 5	60 5
Investment in and loans to joint ventures	16 0	59 3	–	–	16 0	59 3
Retirement liabilities	(84 8)	(58 1)	–	–	(84 8)	(58 1)
Deferred tax	(11.5)	(86 9)	–	–	(11 5)	(86 9)
Income tax	(1 8)	(1 2)	–	–	(1 8)	(1 2)
Cash, cash equivalents and bank overdraft	193 6	193 6	0 4	0 4	194 0	194 0
Bank loans	(80 9)	(81 5)	–	–	(80 9)	(81 5)
Finance leases	(10 6)	(10 6)	–	–	(10 6)	(10 6)
Inventory	14 7	14 3	–	–	14 7	14 3
Current assets	178 6	165 3	0 2	0 2	178 8	165 5
Current and non-current liabilities	(175 4)	(201 6)	–	–	(175 4)	(201 6)
Provisions	(55 7)	(116 8)	(3 8)	(3 8)	(59 5)	(120 6)
Minority shareholders	(2 9)	(3 6)	–	–	(2 9)	(3 6)
Net assets acquired	486 0	405 0	(2 3)	2 2	483 7	407 2

* Acquired intangibles are customer relationships and order book.

Included within current assets are trade receivables with a fair value of £87 6 million after allowing for uncollectables of £3.8 million

None of the goodwill recognised is expected to be deductable for income tax purposes with the exception of £79 4 million relating to the USA.

30 (a) Acquisitions – current year (continued)

Cash outflow to acquire businesses net of cash acquired

	VT Group plc £m	Evergreen £m	Total £m
Purchase consideration	1,471 3	8 9	1,480 2
Cash, cash equivalents and bank overdrafts	(193 6)	(0 4)	(194 0)
Acquisition costs accrued in prior year	2 0	–	2 0
	1,279 7	8 5	1,288 2
Less issue of shares net of costs	802 0	–	802 0
Cash outflow this period	477 7	8 5	486 2

The revenue and operating profit of acquired businesses since the date of acquisition and as if they had been acquired on 1 April 2010 are

	Since date of acquisition £m	For full year £m
Group revenue		
VT Group plc	758 4	1,035.6
Evergreen	2 7	4.7
	761 1	1,040.3
Total revenue (including share of joint ventures)		
VT Group plc	856 0	1,178 2
Evergreen	2 7	4 7
	858 7	1,182 9
Operating profit (before amortisation of acquired intangibles)		
VT Group plc	90 3	100 2
Evergreen	0 1	0 3
	90 4	100 5
Underlying profit (including investment income and share of joint venture underlying profit)		
VT Group plc	112 2	125 7
Evergreen	0 1	0 3
	112 3	126.0

Notes to the Group financial statements continued

30 (b) Acquisitions – prior year

On 2 November 2009 the Group acquired 100% of the share capital of UKAEA Limited for a consideration of £51 3 million, inclusive of costs. UKAEA operates in nuclear site management, operations and decommissioning and it has a number of established advisory roles

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

Details of the assets acquired and the goodwill are as follows

	UKAEA £m
Cost of acquisition	
Purchase consideration	49 6
Direct costs	1 7
Total purchase consideration and costs	51 3
Fair value of assets acquired (see below)	38 5
Goodwill	12 8

Net assets and liabilities arising from the acquisition are as follows

	UKAEA	
	Book value of assets acquired £m	Fair value acquired £m
Acquired intangibles*	–	27 1
Property, plant and equipment	0 3	0 1
Deferred tax	–	(7 6)
Cash, cash equivalents and bank overdraft	13 4	13 4
Inventory	0 2	0 2
Current assets	12 1	12 2
Current and non-current liabilities	(6 7)	(6 7)
Provisions	–	(0 2)
Net assets acquired	19 3	38 5

* Acquired intangibles are customer relationships and order book.

Cash outflow to acquire businesses net of cash acquired

	UKAEA £m
Total purchase consideration plus costs	51 3
Cash, cash equivalents and bank overdrafts	(13 4)
Cash outflow this period	37 9

The revenue and operating profit of acquired businesses since the date of acquisition in the previous year and as if they had been acquired on 1 April 2009 are

	Since date of acquisition £m	For full year £m
Revenue		
UKAEA	16 6	35 5
Operating profit (before amortisation of acquired intangibles)		
UKAEA	1 5	1 2

31. Disposals

During the year the Group disposed of four small subsidiaries

	Book value £m
Property plant and equipment	2 0
Income tax	(0 5)
Cash, cash equivalents and bank overdrafts	0 2
Bank loans	(1 8)
Current assets	0 2
Current liabilities	(0 5)
Provisions	(0 2)
Non-controlling interests	(0 1)
	(0 7)
Cash received	2 2
Profit on disposal of subsidiaries	2 9

32 Operating lease commitments – minimum lease payments

	2011		2010	
	Property £m	Vehicles plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Commitments under non-cancellable operating leases payable				
Within one year	20 1	8 4	14 0	7 6
Later than one year and less than five years	52 5	6 7	38 6	6 1
After five years	33 9	–	37 1	–
	106 5	15 1	89 7	13 7

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

33 Contingent liabilities

(a) Pursuant to the Rosyth Dockyard privatisation agreement, the MoD will share in the net proceeds of sale or development of the Dockyard following planning enhancement, on terms set out in the asset purchase agreement between the RRDL and the MoD dated 30 January 1997 By way of security for the MoD's rights to such share, the Company has granted a fixed charge (standard security) over the Dockyard in favour of the Authority

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

(c) The Group is involved in disputes and litigation which have arisen in the course of normal trading The Directors do not believe that the outcome of these matters will result in any material adverse change in the Group's financial position

Notes to the Group financial statements continued

34 Capital and other financial commitments

	2011 £m	2010 £m
Contracts placed for future capital expenditure not provided in the financial statements	9 1	0 6

35. Related party transactions

(a) The following related parties either sell to or receive services from the Group Loans to joint ventures are detailed in note 15

	2011 Revenue to £m	2011 Purchases from £m	2011 Year end debtors balance £m	2011 Year end creditor balance £m
Joint ventures				
Debut Services (South West) Limited	129 3	–	0 1	–
Holdfast Training Services Limited	65 8	0.2	13 8	–
Mouchel Babcock Education Services Limited	–	0 7	–	–
First Swietelsky Operation and Maintenance	8 3	–	1 0	0 6
First Swietelsky Joint Venture High Output	0 5	–	–	–
Ascent Management Co Limited	1 0	–	0 3	–
Advanced Jet Training Co Limited	8 9	–	3 1	–
Rear Crew Training Limited	1 0	–	0 1	–
Airtanker Services Limited	15 7	–	0 6	–
Whitefleet Limited	0 3	35 1	0 1	2 2
ALC (Superholdco) Limited	1 9	–	0 3	–
Lewisham Schools for the Future Holdings Limited	–	–	2 2	–
L21 Lewisham PSP Limited	–	–	0 4	–
Lewisham Schools for the Future LEP Limited	1 5	–	0 9	–
Lewisham Schools for the Future SPV Limited	1 3	–	0 4	–
Greenwich BSF SPV Limited	0 3	–	–	–
Career Enterprise (Futures) Limited	0 9	0 2	0 7	–
Related by common directorships				
Finmeccanica UK Group	6 2	–	2 1	–
			26 1	2 8

	2010 Sales to £m	2010 Purchases from £m	2010 Year end debtors balance £m	2010 Year end creditor balance £m
Joint ventures				
Debut Services (South West) Limited	123 6	–	–	–
Holdfast Training Services Limited	61 2	0 5	7 0	0 1
First Swietelsky Operation and Maintenance	5 5	–	0 7	–
First Swietelsky Joint Venture High Output	27 5	–	–	–
			7 7	0 1

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

(b) Defined benefit pension schemes
Please refer to note 26 for transactions with the Group defined benefit pension schemes

36 Post balance sheet events

(a) Dividend

Details on dividends are given in note 10 There are no further material events subsequent to 31 March 2011 that require disclosure

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

We have audited the parent Company financial statements of Babcock International Group PLC for the year ended 31 March 2011 which comprise the Company balance sheet and the related notes The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibility statement on page 63, the Directors are responsible for the preparation of the parent Company financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the parent Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the Annual Report and Accounts 2011 to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion the parent Company financial statements

- give a true and fair view of the state of the Company's affairs as at 31 March 2011,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006, and
- the information given in the Directors' report for the financial year for which the parent Company financial statements are prepared is consistent with the parent Company financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent Company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Other matters

We have reported separately on the Group financial statements of Babcock International Group PLC for the year ended 31 March 2011

Neil Grimes
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

16 May 2011

Neil Grimes

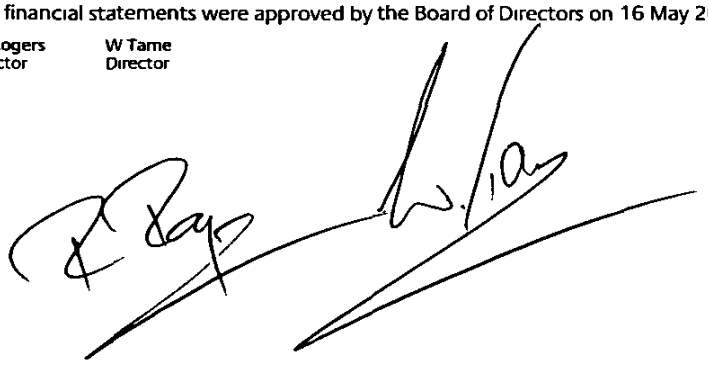
Company balance sheet

As at 31 March 2011	Note	2011 £m	2010 £m
Fixed assets			
Investment in subsidiary undertakings	3	2,004 3	359 1
Tangible fixed assets	4	0 2	0 3
		2,004 5	359 4
Non-current assets			
Debtors – amounts due after more than one year		163 9	–
Current assets			
Debtors	5	544 2	636 6
Other financial assets		1 0	–
Cash at bank and in hand		34 1	12 0
		579 3	648 6
Creditors – amounts due within one year	6	760 6	214 9
Net current (liabilities)/assets		(181 3)	433 7
Total assets less current liabilities		1,987 1	793 1
Creditors – amounts due after one year	6	781.4	325 1
Net assets		1,205 7	468 0
Capital and reserves			
Called up share capital	7	215 3	137 8
Share premium account	8	872 8	148 3
Capital redemption reserve	8	30 6	30 6
Profit and loss account	8	87 0	151 3
Total shareholders' funds		1,205 7	468 0

The accompanying notes are an integral part of this Company balance sheet. Company number 02342138

The financial statements were approved by the Board of Directors on 16 May 2011 and are signed on its behalf by:

P L Rogers Director **W Tame** Director



Notes to the Company financial statements

1. Significant accounting policies

The principal accounting policies adopted by the Company are disclosed below

Basis of accounting

The Company's financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards and in compliance with the Companies Act 2006 The Directors have reviewed the Company's existing accounting policies and consider that they are consistent with last year

Investments

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

Leases

Operating lease payments are recognised as an expense in the income statement on a straight-line basis

Taxation

Current UK corporation tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements

A deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date Deferred tax is measured on a non-discounted basis

Finance costs

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

Employee benefits

(a) Share-based compensation

The Company operates equity-settled, share-based compensation plans The economic cost of awarding shares and share options to employees is recognised as an expense in the income statement equivalent to the fair value of the benefit awarded The fair value is determined by reference to option pricing models The charge is recognised in the income statement over the vesting period of the award and recharged to subsidiaries Full details of the share-based compensation plans are disclosed in note 25 of the Group financial statements

(b) Treasury shares

The shares purchased by the Company's ESOP trusts are recognised as a deduction to equity Refer to the Group financial statements note 24 for further details

(c) Pension arrangement

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

There is no material difference between the FRS 17 (as amended) 'Retirement Benefits' and IAS 19 'Employee Benefits' valuation Refer to the Group financial statements note 26 for further details

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

Notes to the Company financial statements continued

1 Significant accounting policies (continued)

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative is entered into and are subsequently remeasured at their fair value The Company designates certain of the derivative instruments within its portfolio to be hedges of the fair value of recognised assets or liabilities or unrecognised firm commitments

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

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

Financial risk management

All treasury transactions are carried out only with prime rated counterparties as are investments of cash and cash equivalents

Dividends

Dividends are recognised in the Company's financial statements in the period in which they are approved and in the case of interims, when paid

Cash flow statement and related party disclosure

A cash flow statement has not been prepared by the Company under the terms of FRS 1, available to wholly owned subsidiaries of a company whose consolidated financial statements include a consolidated cash flow statement and are publicly available The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are part of the Babcock International Group PLC group

2 Company profit

The Company has taken advantage of the exemption granted by section 408 of the Companies Act 2006 whereby no individual profit and loss account of the Company is disclosed. The Company's loss for the financial year was £24 8 million (2010 profit £23 3 million)

Audit fees and expenses paid to the Company's auditors was £0 2 million (2010 £0 1 million)

3. Investment in subsidiary undertakings

	2011 £m	2010 £m
At 1 April	359 1	359 1
Additions	1,646 3	–
Disposals	(1 1)	–
Investments in shares	2,004 3	359 1

The value of the Company's investments include an impairment in the year of £nil (2010 £nil) The cumulative impairment is £0 2 million (2010· £0 2 million)

4 Tangible fixed assets

	Leasehold property £m
Cost	
At 1 April 2010	0 5
Additions	–
At 31 March 2011	0 5
Accumulated depreciation	
At 1 April 2010	0 2
Charge for the year	0 1
At 31 March 2010	0 3
Net book value at 31 March 2011	0 2
Net book value at 31 March 2010	0 3

5 Debtors

	2011 £m	2010 £m
Trade debtors	–	0 4
Amounts owed by subsidiary undertakings	539 7	629 6
Deferred tax	3 7	4 8
Prepayments and accrued income	0 8	1 8
	544 2	636 6

6 Creditors

	2011 £m	2010 £m
Amounts due within one year		
Bank loans and overdrafts	168 1	110 7
Trade creditors	0 1	0 1
Amounts owed to subsidiary undertakings	588 5	86 3
Derivative financial instruments	–	13 3
Accruals and deferred income	3 9	4 5
	760 6	214 9
Amounts due after one year		
Bank loans	781 4	325 1
Amounts owed to subsidiary undertakings	–	–
	781 4	325 1

The Company has £1,105 5 million (2010: £700 million) of committed bank facilities, of which £782 5 million (2010: £330 million) was drawn at the year end The interest rate applying to bank loans is 2 9% (2010 1 1%) and is linked to LIBOR whilst the interest rate applying to overdrafts is 1 5% (2010 1 5%)

7 Share capital

	Ordinary shares of 60p Number	Total £m
Allotted, issued and fully paid		
At 1 April 2010	229,687,601	137 8
Shares issued	129,150,491	77 5
At 31 March 2011	358,838,092	215 3
At 1 April 2009	229,574,959	137 7
Shares issued	112,642	0 1
At 31 March 2010	229,687,601	137 8

Notes to the Company financial statements continued

8 Reserves

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2010	148 3	30 6	151 3
Shares issue in the period	724 5	–	–
Share-based payments	–	–	5 2
Tax on share-based payments	–	–	0 4
Movement on ESOP	–	–	(2.1)
Acquisition costs	–	–	(2 0)
Fair value adjustments to interest rate hedges (net of tax)	–	–	7.0
Retained profit for the year – loss for the year	–	–	(24 8)
– dividends	–	–	(48 0)
At 31 March 2011	872 8	30 6	87 0
At 1 April 2009	148 2	30 6	160 4
Shares issue in the period	0 1	–	–
Share-based payments	–	–	2 7
Tax on share-based payments	–	–	0 5
Movement on ESOP	–	–	(2 0)
Fair value adjustments to interest rate hedges (net of tax)	–	–	1 2
Retained profit for the year – profit for the year	–	–	23 3
– dividends	–	–	(34 8)
At 31 March 2010	148 3	30 6	151 3

9. Operating lease commitments

The Company has an operating lease commitment for land and buildings as at 31 March 2011 with an annual commitment expiring after more than five years of £2.2 million (2010 £2 2 million)

10 Contingent liabilities

(a) The Company has guaranteed or has joint and several liability for bank facilities of £790 0 million (2010 £334 3 million) provided to certain Group companies

(b) Throughout the Group, guarantees exist in respect of performance bonds and indemnities issued on behalf of Group companies by banks and insurance companies in the ordinary course of business At 31 March 2011 these amounted to £161 0 million (2010 £54.8 million), of which the Company had counter-indemnified £87.6 million (2010 £45 0 million)

(c) The Company has given guarantees on behalf of Group companies in connection with the completion of contracts within specification

11 Post balance sheet events

(a) Dividends

The Directors have proposed a final dividend of 14 20p per 60p ordinary share (2010 second interim dividend 12 80p per 60p ordinary share) and it will be paid on 9 August 2011 to shareholders registered on 8 July 2011 Subject to approval at the Annual General Meeting on 7 July 2011.

Principal subsidiaries, joint ventures and associated undertakings

Marine & Technology

Babcock Design & Technology Limited
Babcock Marine Holdings (UK) Limited
Babcock Marine (Rosyth) Limited
Rosyth Royal Dockyard Limited
Devonport Royal Dockyard Limited
Babcock Marine (Clyde) Limited
LSC Group Limited
Frazer-Nash Consultancy Limited
Appledore Shipbuilders (2004) Limited
Strachan & Henshaw Australia (PTY) Limited (Australia)
Strachan & Henshaw Canada Inc (Canada)
Babcock Integrated Technology Limited
Babcock Communications Limited
VT Flagship Limited
Babcock Fitzroy Limited (70%)(New Zealand)

Defence & Security

Air Power International Limited
Babcock Support Services Limited
Acetech Personnel Limited
Babcock Airports Limited
Babcock Communications Limited
VT Flagship Limited
Babcock Aerospace Limited
Babcock Land Limited
Airwork Limited
Babcock International Support Services Limited

Joint Ventures

FSP (2004) Limited (50%)
Mouchel Babcock Education Services Limited (50%)
Holdfast Training Services Limited (74%)
ALC (Superholdco) Limited (50%)
Airtanker Limited (13 3%)
Airtanker Services Limited (23 3%)
Ascent Flight Training (Holdings) Limited (50%)

Support Services

BNS Nuclear Services Limited
UKAEA Limited
Babcock Airports Limited
Babcock Rail Limited
Babcock Networks Limited
Babcock Communications Limited
VT Flagship Limited
Deva Manufacturing Limited
Babcock Critical Services Limited
Babcock Career Management Limited
Babcock Education & Skills Limited
Babcock Fire Services Limited
Babcock Fire Training (Avonmouth) Limited
Babcock 4S Limited (80 1%)
Babcock Nuclear Limited
Babcock Southern Careers Limited
Babcock Training Limited
Babcock West Sussex Careers Limited (80 1%)

International

Babcock Africa (Pty) Limited (South Africa)
Babcock Africa Services (Pty) Limited (South Africa)
Babcock Ntuthuko Engineering (Pty) Limited (75% owned) (South Africa)
Babcock Eagleton Inc (USA)
VT AEPCO (USA)
VT Griffin Services, Inc (USA)
VT Milcom, Inc (USA)
VT US Inc (USA)
Airwork Limited

Others

Babcock UK Holdings Limited
Babcock Holdings Limited
Babcock International Holdings BV (Netherlands)
Babcock International Limited
Babcock Investments Limited
Babcock Management Limited
Babcock Overseas Investments Limited
Babcock Support Services (Investments) Limited
Chepstow Insurance Limited (Guernsey)
PHG Insurance Limited (Guernsey)
Babcock Southern Holdings Limited
Vosper Thorneycroft (UK) limited
Babcock Group International Limited
Babcock Group Services Limited
Babcock Insurance Services Limited
Babcock Project Investments Limited

Investments

Dounreay Site Restoration Limited
Research Sites Restoration Limited

Due to restrictions on control the above entities are treated as investments

All undertakings are wholly owned unless otherwise stated With the exception of Babcock UK Holdings Limited, which is owned by the Company, all Group undertakings are owned by subsidiary undertakings

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

Shareholder information

Financial calendar

Financial year end	31 March 2011
2010/11 preliminary results announced	17 May 2011
Annual General Meeting	7 July 2011
Final dividend payment date (record date 8 July 2011)*	9 August 2011

* See also 'Results and dividends' on page 57

Registered office and company number

33 Wigmore Street
London W1U 1QX

Registered in England
Company number 2342138

Registrars

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Tel 0871 664 0330
(calls cost 10p per minute plus network extras – lines are open 8 30 am to 5 30 pm Monday to Friday)
Tel (from overseas). +44 20 8639 3399
Email ssd@capitaregistrars com
www babcock-shares com

Shareholder enquiries relating to shareholding, dividend payments, change of address, loss of share certificate etc., should be addressed to Capita Registrars at their address given above

Independent auditors

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

Principal UK bankers

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

The Lloyds Banking Group
Level 7 – Bishopsgate Exchange
155 Bishopsgate
London EC2M 3YB

Investment bankers

JPMorgan Cazenove
10 Aldermanbury
London EC2V 7RF

Stockbrokers

JPMorgan Cazenove
10 Aldermanbury
London EC2V 7RF

RBS Hoare Govett Limited
135 Bishopsgate
London EC2M 3UR

Share dealing services

Capita Share Dealing Services provide Babcock shareholders with a quick and easy way to buy or sell Babcock International Group PLC ordinary shares Commission starts from £20 if you deal online and £25 if you deal by phone

In addition, stamp duty, currently 0.5%, is payable on purchases.

There is no need to open an account in order to deal and you can trade at live market prices during stock market hours You also have the added convenience of placing 'limit' orders which are valid for up to 90 days. This means that you decide the price at which you wish to sell and your shares will only be sold if the price reaches this pre-set limit during the 90-day period

To use the service, either log on to www capitadeal com or call 0871 664 0448 (calls cost 10p per minute plus network extras – lines are open 8 00 am to 4 30 pm Monday to Friday) Please have your share certificate(s) to hand when you log on or call If you are planning to purchase shares, you will need to have your debit card at hand with cleared funds available at your bank

These services are offered on an execution-only basis and are subject to terms and conditions which are available on request or at www capitadeal.com

Capita Share Dealing Services is a trading name of Capita IRG Trustees Limited, which is authorised and regulated by the Financial Services Authority

This is not a recommendation to buy, sell or hold shares in Babcock International Group PLC Shareholders who are unsure of what action to take should obtain independent financial advice Share values may go down as well as up, which may result in a shareholder receiving less than he/she originally invested

Dividend Reinvestment Plan

This is a convenient way to build up your shareholding by using your cash dividends to buy more shares in the Company If you would prefer to receive shares for your next dividend instead of cash, please complete an application form online at www babcock-shares com or call Capita IRG Trustees on 0871 664 0381 (calls cost 10p per minute plus network extras, lines are open 9 00 am to 5 30 pm Monday to Friday) from UK or +44 208 639 3402 from overseas

ShareGift

If you have only a small number of shares which would cost more for you to sell than they are worth, you may wish to consider donating them to the charity ShareGift (Registered Charity 1052686) which specialises in accepting such shares as donations The relevant stock transfer form can be obtained from Capita Registrars There are no implications for Capital Gains Tax purposes (no gain or loss) on gifts of shares to charity and it is also possible to obtain income tax relief Further information about ShareGift may be obtained on 020 7930 3737 or from www ShareGift.org

Five-year financial record

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Revenue	2,755 8	1,895 5	1,901 9	1,555 9	988 3
Operating profit	157 5	148 1	133 1	110 2	62 8
Share of profit/(loss) from joint ventures	6 1	(0 5)	(0 2)	–	0.4
Profit before interest	163 6	147 6	132 9	110 2	63 2
Net interest and similar charges	(48 2)	(18 4)	(26 2)	(25 6)	(6 2)
Profit before taxation	115 4	129 2	106 7	84 6	57 0
Income tax expense	(10 7)	(20 8)	(19 1)	(14 9)	(11 0)
Profit from continuing operations	104 7	108 4	87 6	69 7	46 0
Discontinued operations	–	–	(13 3)	–	(0 8)
Profit for the year	104 7	108 4	74 3	69 7	45 2
Minority interest	(3 6)	(2 4)	(2 3)	(2 4)	(1 8)
Profit attributable to owners of parent	101 1	106 0	72 0	67 3	43 4
Non-current assets	2,436 6	877 4	858 4	836 1	327 2
Net current assets/(liabilities)	(218 5)	(88 9)	(117 3)	(18 6)	(96 0)
Non-current liabilities and provisions	(1,197 5)	(702.7)	(448 3)	(456 7)	(24 0)
Total net assets	1,020 6	85.8	292 8	360 8	207 2
Equity holders of the parent	1,011 7	80.6	288 4	357 2	205 6
Minority interest	8 9	5.2	4 4	3 6	1 6
	1,020 6	85.8	292 8	360 8	207 2
Earnings per share – basic	31 28p	46.29p	37 42p	29 99p	21 10p
Dividend per share (proposed)	19 40p	17.60p	14 40p	11 50p	8 05p

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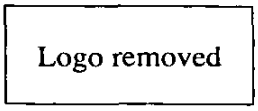

Babcock International Group PLC
33 Wigmore Street
London W1U 1QX
Tel +44(0)20 7355 5300
Fax +44(0)20 7355 5360
www.babcock.co.uk