



# trusted to deliver



## Who we are

Babcock is the UK's leading engineering support services organisation.

Operating in the UK and overseas, we pride ourselves on our long-term customer focused relationships and ultra-reliable engineering excellence. We are trusted to deliver critical support to the defence, energy, emergency services, transport, education and telecommunications sectors.

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For more go to [www.babcock.co.uk](http://www.babcock.co.uk)

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### Directors' report

The Directors present the Annual Report and Accounts for the year ended 31 March 2012. This page and pages 1 to 82, 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 40 to 43 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.

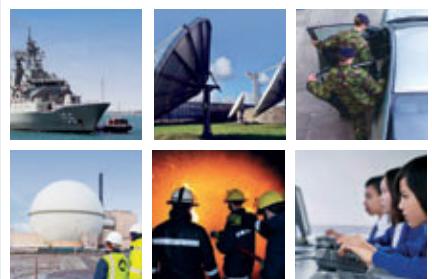
# What's in this report



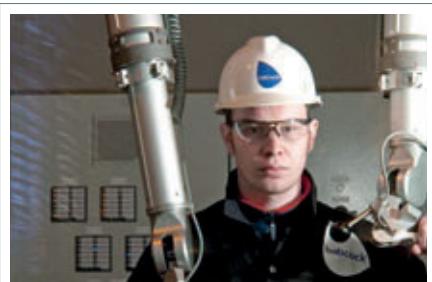
**"This year the growth in our order book and bid pipeline reflects the opportunities we have been able to create by delivering on our strategic objectives."**

Peter Rogers, CEO

Peter Rogers our CEO explains how our strategy has delivered another good set of results this year. **p10**



Key achievements this year. **p04**



Our strategy in action. Here we illustrate what our strategy means in practice when working with our customers. **p12**

## Business review

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# Another successful year

### Continuing revenue

**£3,070.4m**  
**+14%**

2011: £2,703.2m

### Continuing underlying operating profit

**£329.0m**  
**+19%**

2011: £275.4m

### Continuing underlying profit before tax

**£274.1m**  
**+26%**

2011: £216.7m

### Continuing operating profit

**£202.0m**  
**+32%**

2011: £153.2m

### Continuing underlying basic earnings per share

**61.47p**  
**+17%**

2011: 52.50

### Continuing basic earnings per share

**42.93p**  
**+42%**

2011: 30.14

See page 5 for definition of underlying results.

# Chairman's statement

**"2012 has been another year in which Babcock has delivered excellent financial results as well as significantly improving its visibility of future revenues through an increased order book and bid pipeline."**



I am pleased to report that Babcock continues to go from strength to strength, not just as demonstrated in this year's excellent financial results but more importantly in the way our strategy has created a business well positioned in its market sectors and with significant opportunities for future growth. As I discussed last year, the general economic climate and the requirement of our customers to reduce their expenditure at the same time as maintaining, or even improving, their operational efficiency, has created a positive trading environment for the Group and significant opportunities for our future.

## Headline results

Total continuing revenue for the year increased by 14% to £3.1 billion (2011: £2.7 billion). Continuing underlying operating profit increased by 19% to £329.0 million (2011: £275.4 million) and continuing underlying profit before tax by 26% to £274.1 million (2011: £216.7 million).

Continuing basic earnings per share has increased by 17% to 61.47 pence per share (2011: 52.50 pence per share).

## Dividend

The Board is focused on ensuring our shareholders share in the financial success of our business and we have a clear policy of maintaining dividend cover between 2.5 and 3 times. As we continue to strengthen our order book and bid pipeline, the Board remains confident in the long-term future of our business and is therefore recommending a final dividend of 17.0 pence per share. This will give a total dividend for the year of 22.7 pence per share, an increase of 17% (2011: total dividend 19.40 pence per share). The dividend will be paid on 7 August 2012 to shareholders on the register at close of business on 6 July 2012.

## The Board

Throughout this year we have maintained a steady balance of Executive and Non-Executive Directors on the Board with Kate Swann joining us on 1 June 2011.

After 10 years' service, John Rennocks retired as Senior Independent Non-Executive Director on 31 December 2011. I would like to thank John for the significant contribution he made to the Company's progress during that period. Sir David Omand has taken over from John as our Senior Independent Director. On 27 March 2012, we announced that Sir Nigel Essenhough would be retiring from the Board on 31 December 2012. Nigel stepped down from membership of the Audit and Risk and Remuneration Committees from 31 March 2012. Nigel has been a member of the Board for the past nine years and we have benefited from his wealth of knowledge and experience during that period.

To maintain the appropriate balance of Executive and Non-Executive Directors, we are already actively involved in finding a new Non-Executive Director to join the Board and hope to conclude this process before the end of the year. As we face a period when so many new opportunities are opening up for us, we need to ensure we chose someone with the appropriate skills and experience to contribute to the ongoing development of the Group.

## Our people

Babcock is a service company. We pride ourselves on our strong service culture and our trusted to deliver reputation. On behalf of the Board, I would like to thank all our employees for their hard work and dedication, without which we would not have achieved this year's excellent results.

## Outlook

The key markets in which the Group operates remain strong and we believe that the current economic climate will continue to create significant medium and long-term growth opportunities, both in the UK and overseas.

In this environment we believe we are well placed to benefit from the scale of our operations, the breadth of our experience and our track record of delivering operational and financial efficiencies.

The Group continues to benefit from excellent visibility of future revenue streams through its long-term contracts, strong order book and bid pipeline. The Board, therefore looks forward to building on the strong results announced for 2011/12 and making further good progress in 2012/13.

**Mike Turner CBE**  
Chairman

# From strength to strength



### Surface fleet support in Australia

#### Ground breaking contract win

Having built a position in the Australian naval market through our weapons handling systems, we have been awarded a five year support contract for the entire Anzac frigate fleet, our first overseas surface fleet contract win.

### Broadcasting to the world

#### Partnering for 25 years

We have been a trusted partner to the BBC World Service for 15 years. In the first year of a new ten year contract we will co-ordinate 180,335 hours of transmissions to 166 million people worldwide.

### Keeping the military moving

#### Continuation of vehicle support

We have been selected to continue our support of 14,000 MoD vehicles as the white fleet contract ends and the new Phoenix contract comes into place.



### Nuclear excellence

#### Babcock Dounreay Partnership wins £1.6bn contract

In its search for 'world-class management and innovation' the NDA selected our partnership to manage the final demolition, decommissioning and clean-up of the site.

### Training the LFB

#### Biggest modernisation of fire fighter training in over a century

We have been selected to provide training to the London Fire Brigade for the next 25 years, delivering over 200 different courses per year. We will save the LFB an estimated £66m over the course of the contract.

### Top of the class

#### Support to 364 schools across the county

With a proven track record of improving educational standards in Surrey, we were awarded a seven year contract with the Devon County Council to deliver education support and improvement services.

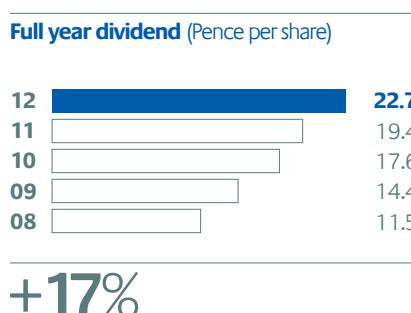
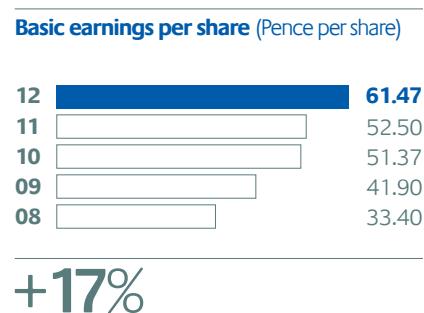
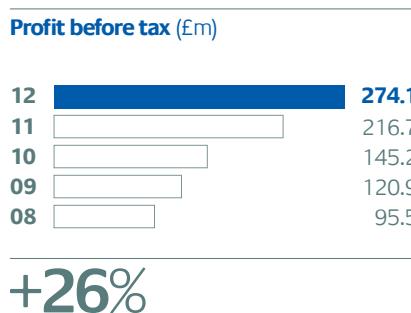
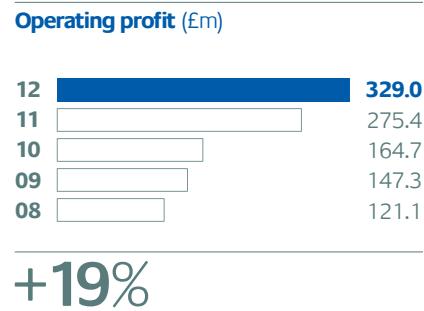
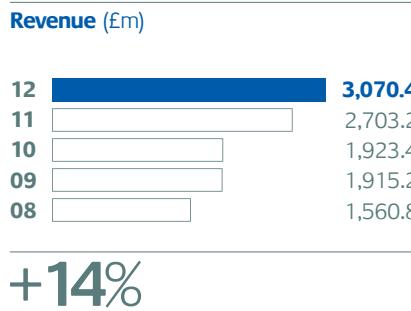
# Our track record

<b>Statutory results</b>	
Revenue	£2,848.4m (2011: £2,564.5m) +11%
Operating profit	£202.0m (2011: £153.2m) +32%
Profit before tax	£173.0m (2011: £111.1m) +56%
Basic earnings per share (continued)	42.93p (2011: 30.14p) +42%

## 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 20.

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



# Our structure

## Marine and Technology



**Employees:**  
9,137

**Divisional Chief Executive:**  
Archie Bethel

### Divisional overview

Marine

### Key activities

- Submarine through-life support, refit and refuelling
- Warship maintenance and refit
- QE class aircraft carrier engineering and assembly
- Naval base management, HMNB Clyde and HMNB Devonport

Technology

- Engineering, design, systems integration and platform management
- Equipment support and training
- Consultancy

### Key customers include

- Royal Navy
- Australian Government
- Canadian Government
- DE&S Equipment Support
- Navantia
- Other international navies

## Defence and Security



**Employees:**  
4,560

**Divisional Chief Executive:**  
John Davies

### Divisional overview

Air

### Key activities

- Future Strategic Tanker Aircraft (FSTA) joint venture
- Military Flying Training Systems (MFTS) joint venture
- Military flight training
- Aircraft engineering and base support

Land and sea

- REME and Royal Armoured Corps training support contract
- RSME training support contract
- Royal Navy Training through Fleet Outsourced Activities Project
- White fleet and construction vehicle fleet management

### Key customers include

- Army
- Royal Air Force
- Royal Navy
- BAE Systems

## Support Services



**Employees:**  
10,057

**Divisional Chief Executive:**  
Kevin Thomas

### Divisional overview

Critical assets

### Key activities

- Airport baggage handling support
- Global broadcast system management
- High-voltage power transmission maintenance and upgrade

Education and training

- Vocational training, including apprenticeships
- School improvement programmes

Infrastructure

- Built asset management
- Facilities management

Mobile assets

- Fleet management for the emergency services and mining and construction

Nuclear

- Decommissioning and waste management
- Power generation support

Rail

- Signalling and track replacement

### Key customers include

- Central government
- Commercial organisations
- Local government and emergency services
- Regulated bodies

## International



**Employees:**  
1,386

**Divisional Chief Executive:**  
Peter Rogers

### Divisional overview

Africa

### Key activities

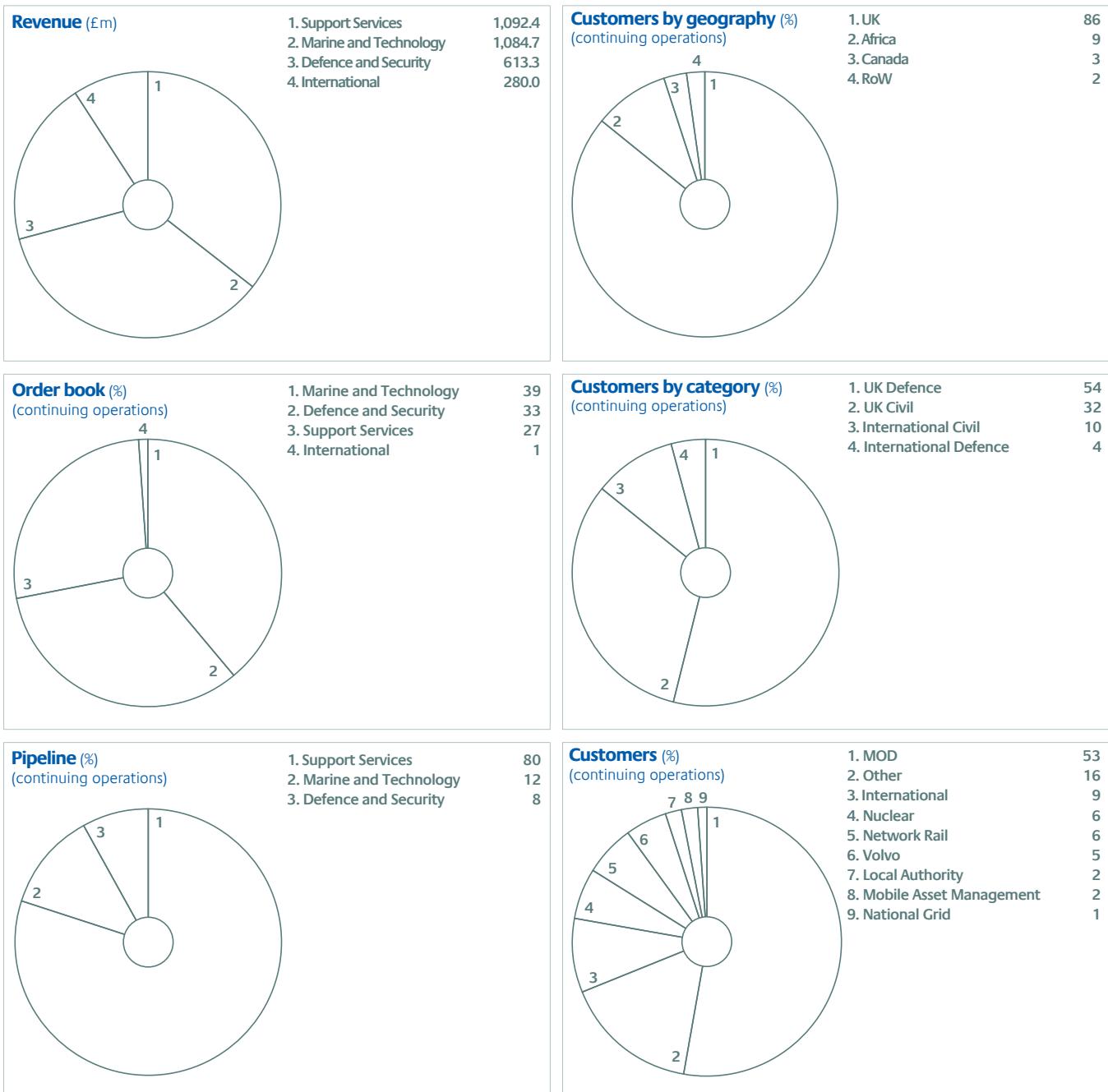
- Engineering support to power stations
- Construction, erection and maintenance of high voltage power lines
- Sole distributor of Volvo and DAF equipment for mining and infrastructure industries

Middle East

- Civilian and military flight training
- Support to Royal Oman Air Force

### Key customers include

- Eskom
- Southern African mining and construction companies
- Volvo

**Our customer profile**

# How we create value

For a number of years we have had a consistent and clearly defined strategy, set out opposite, which outlines our business model. It differentiates us from our competitors and enables us to deliver sustainable long-term value to both our shareholders and customers. It also makes Babcock a rewarding place to work for our employees.

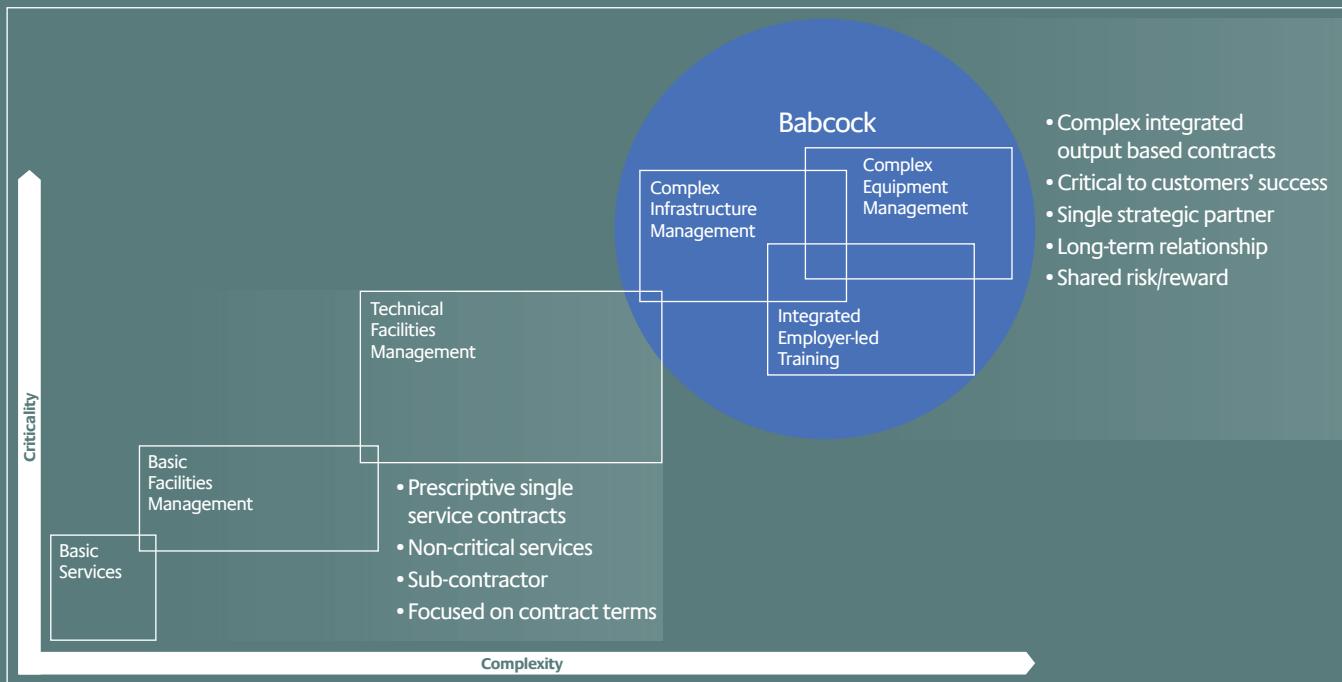
### 1. Our business model

**Babcock is the UK's leading engineering support services company. Our objective is to develop from our position as the UK's leading engineering support services company and grow in both the UK and overseas.**

In today's marketplace, 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 providing distinctive support to complex and critical infrastructures, assets and training programmes.

The depth and breadth of our knowledge and experience as well as the unique infrastructures we own or manage ensure we are able to operate in the higher value sectors of our markets. We seek to add further value by becoming our customers' strategic partner and entering into long-term, integrated output based contracts where both parties share in the risk and reward of its outcome.



Peter Rogers our CEO explains how our strategy has delivered another good set of results this year. **p10**

**Full year dividend**

**+17%**  
to 22.7p

**Continuing basic eps**

**+17%**  
to 61.47p

## 2. Our strategy

### 1 Leading market positions

**Aim:** We expect our businesses to be one of the top three in their market sector. If they are not, they will have clear plans to achieve this goal.

**Progress:** Through a number of major contract wins in the last year we have strengthened our market positions. **\* p12**

### 2 Preferred customer characteristics

**Aim:** We seek to work with customers who own large strategically important assets. These customers tend to be government departments, public bodies or private companies operating in highly regulated markets.

**Progress:** The majority of our revenue is derived from our preferred customer base. This is consistent with previous years. **\* p13**

### 3 Customer focused, long-term relationships

**Aim:** We seek to work collaboratively with our customers to support the long-term nature of our contracts.

**Progress:** We have been awarded a number of contracts where the emphasis is on long-term partnerships rather than on short-term tasks. **\* p14**

### 4 Integrated engineering and technical expertise

**Aim:** We seek to use our skills, integrating engineering and technical expertise to deliver projects and long-term asset management.

**Progress:** The majority of our employees are technically qualified and their skills are used to support our customers' strategically important assets. **\* p15**

### 5 Balancing risk and reward

**Aim:** We seek to enter into contracts that fairly balance the risk and reward with our customers, so we can each share the financial effects of success or failure.

**Progress:** Contracts with new customers, like the fleet management contract with Lafarge, are moving away from cost plus to a pain/gain share basis. **\* p16**

### 6 Excellent health and safety record

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

**Progress:** This year we reduced our overall RIDDOR frequency rate by 7%. At our Rosyth site RIDDOR dropped by 86%. **\* p17**

## 3. Our value chain

Committed to operational excellence

Delivering efficiency and value

Offering more to our customers

Building a strong order book

Generating increased revenue

Delivering shareholder value

# Growing our business – delivering our strategy\*

**"This year the growth in our order book and bid pipeline reflects the opportunities we have been able to create by delivering on our strategic objectives."**



As expected, 2011/12 has been an exciting year for Babcock during which we were able to deliver a further set of excellent results and make considerable progress securing our long-term future.

At the beginning of the year we could see a number of new opportunities ahead of us, both in the UK and overseas. While our financial results reflect the strength of our underlying business, the growth we have reported in our order book and in our bidding pipeline over this year reflect our progress realising the opportunities we have been able to create for ourselves in the UK and overseas, by delivering on our strategy.

Last year we set out that we will seek to achieve growth by:

- growing existing contracts – using current arrangements to deliver additional services.
- growing existing customers – building on existing relationships and using the depth and breadth of skills across the Group to offer a broader range of services.
- growing new customers – transferring existing capabilities to new customers.

After a hiatus in new opportunities coming to market during 2010, driven by our customers' imperative to operate within the constraints imposed by the current economic climate. We understood that our customers would have to look for alternative delivery models if they were to achieve the level of savings and efficiencies required to meet their budgets. Babcock is well positioned to help our customers formulate cost efficient support solutions and benefit from further outsourcing opportunities that will come to market.

During the second half of the year we were successful in winning new contracts and contract extensions with a value of around £2 billion. These contracts bring us new customers as well as reinforce relationships with existing customers, extend and strengthen our market positions and demonstrate our ability to drive both operational and financial efficiencies. The order book for continuing operations

## Trusted to deliver for our customers and our shareholders.

Our strategy sets us apart from others operating in our markets and is the key to our future success.

currently stands at £13 billion (2011: £12 billion) and provides us with excellent visibility of future revenues. We currently have over 70% of anticipated revenue contracted for 2012/13 and over 45% for 2013/14.

The bid pipeline for continuing operations has also increased to £9.5 billion (2011: £7 billion) and consists of opportunities in the UK and overseas as well as in both our civil and defence markets. 69% of the pipeline comprises bids with a value in excess of £100 million, only three of which are rebids where current contracts will not run out until 2014.

In addition to formal competitions currently in the bid pipeline we are tracking and are discussing with customers a number of significant future outsourcing programmes, particularly in the defence training and equipment support markets. All of these opportunities are supported by and build on the key elements of our strategy.

### **Leading market positions**

It is important that we are leaders in our chosen markets. As such we can demonstrate unparalleled depth of knowledge and expertise and our customers can be confident that their operations will benefit from the very best support solutions. We are able to build on these positions in our UK markets to take our expertise into new overseas markets.

**We are the No 1 support provider to the Royal Navy and in 2012 we won our first warship support contract for the Royal Australian Navy.**

### **Preferred customer characteristics**

All our customers own or operate large, strategically important assets, often operating in highly regulated environments. We understand the criticality of what they do and have the technical expertise to support them in the challenging environments in which they operate.

**For over 80 years, we have provided an end-to-end service for the UK's high voltage overhead power network. This year, National Grid extended our support contract for a further five years.**

### **Customer focused, long-term relationships**

We are a service company, the strength of the relationships we develop with our customers are critical to our success. We focus on delivering what they need, meeting or exceeding their expectations not through short-term contracts but by developing long-term partnerships.

**Over the past two years we have won over 85% of contracts we have rebid.**

### **Integrated engineering and technical expertise**

We understand complex engineering and have unrivalled technical expertise in our chosen markets. Unlike individual equipment manufacturers, we can use our knowledge and experience to integrate a range of systems and ensure our customers get the right solution.

**We provide 100% of the deep maintenance work on the UK's nuclear submarine fleet, probably some of the world's most complex machines. In March 2012, as HMS Vigilant leaves Devonport, HMS Vengeance arrives for a three and a half year refuelling and refit programme.**

### **Balance risk and reward**

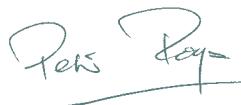
In today's economic environment it is vital that our customers benefit by working with us. We understand their businesses and operational requirements. We can deliver cost saving solutions aligned to service improvements so our contracts are designed so we each share in the success or failure.

**The Metropolitan Police have benefited from increased availability from their vehicle fleet whilst reducing the total number of vehicles and achieving cost savings.**

### **An excellent safety record**

Across the Group, safety is our first priority, we are committed to ensuring everyone who works with us can go home safe and well at the end of every day. We are focused on continual improvement of our health and safety activities working towards our 'zero accident' goal.

Our strategy sets us apart from others operating in our markets and is key to our future success. By remaining focused on our strategy we can continue to build on the underlying strengths of our business and our position as the UK's leading engineering support services company.



**Peter Rogers**  
Chief Executive Officer



## Leading market positions



A member of the Babcock training team leads a workshop at our specially established state-of-the-art facilities in Gosport.

### The UK's largest provider of vocational training

For the past six years, we have delivered a unique three year apprentice training programme for Network Rail, providing technical, academic and vocational qualifications. In the Network Rail Partnership Awards 2011 we won the 'Investing in People' award for excellence and best practice.

Apprentices trained for Network Rail to date

**1,425**

Total number of apprentices trained nationwide by Babcock each year

**22,000**



## Preferred customer characteristics



### Babcock Dounreay Partnership to deliver the UK's first major closure project for the NDA at Dounreay

We set out to work with customers who, like the NDA, own large strategically important assets. At Dounreay, we will use our knowledge and experience of working in highly regulated environments to tackle the difficult technical and programme management challenges at Dounreay and set new standards for decommissioning delivery and safety.

One of our highly trained members of staff using manipulator arms to remotely handle radioactive material at the Dounreay facility.

Anticipated closure costs  
reduced by

>£1bn

Close accelerated by

16 years



## Customer focused, long-term relationships



A Babcock trainer  
delivering one-to-one  
electronics training  
to a member of the  
Royal Marines.

### Long-term training partner for the MoD

As the Navy's training partner for over 15 years, we have established ourselves as the UK's largest provider of military training across the three armed forces. We specialise in the delivery of complex, large scale, cost effective, long-term training contracts.

Servicemen trained pa

**50,000**

Man training days pa

**1.5m**



## Integrated engineering and technical expertise



### Royal Navy's strategic partner for through-life submarine support

Harnessing the engineering and technical expertise of the 2,500 qualified engineers in our Marine and Technology division, we work on all aspects of the UK's submarine fleet, some of the most complex machines in the world. Work has started on HMS Vengeance's 3½ year, long overhaul period (refuel) (LOP(R)).

As part of our commitment to delivering superior asset availability for the Royal Navy a member of staff checks components at our Devonport facility.

One LOP(R)

2.5m<sup>man hrs</sup>

Items required

850,000



## Balancing risk and reward



Managing operations  
on site at Mountsorrel  
quarry in Leicestershire,  
one of Europe's largest  
granite quarries.

### New £150 million fleet management contracts with Lafarge

In North America and the UK we provide fleet management and support to Lafarge's aggregate and cement operations. This allows them to focus on their core activity – delivering world-class materials – and both of us to share in the success of financial efficiencies.

**Lafarge assets managed  
by Babcock**

**948**

**Lafarge sites supported  
by Babcock**

**317**



## Excellent health and safety record



### Home safe every day

Maintaining an excellent health and safety record is a top priority for Babcock. We met the challenge of welcoming hundreds of additional contractors to our Rosyth dockyard for the assembly of the Queen Elizabeth Class aircraft carrier and still saw an 86% year-on-year reduction in the number of reportable accidents during the year.

A health and safety brief at Rosyth. We create a safety-conscious atmosphere wherever we work.

#### RIDDOR reduction at Rosyth

**86%**

#### Increase in workforce at Rosyth

**c 1,600**

# Our KPIs

### The areas we focus on

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

### Financial KPIs

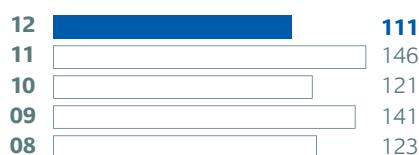
#### Revenue growth (%)



#### Description

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

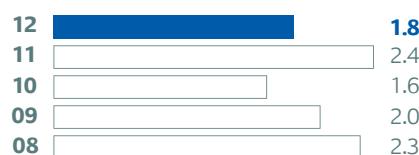
#### Operating Cash Flow (OCF) conversion rates (%)



#### 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).

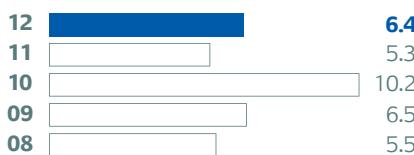
#### Net debt/EBITDA (x)



#### Description

Net debt/EBITDA is calculated as net debt divided by earnings (as based on financial covenants) and excludes share of joint ventures before interest, tax, depreciation and amortisation.

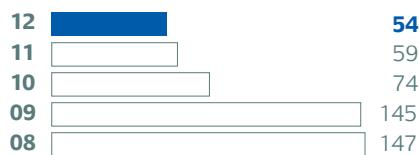
#### EBITDA interest cover (x)



#### Description

Interest cover is profit before interest, tax, depreciation, amortisation, joint ventures and exceptionals divided by net interest payable.

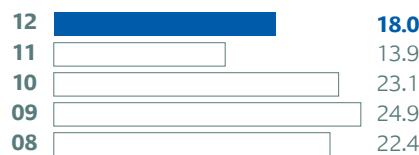
#### Gearing ratio (%)



#### Description

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

#### Return on Invested Capital (ROIC) (% restated)



#### Description

Return on Invested Capital (ROIC) is defined as underlying profit before financing and tax divided by total capital (equity, excluding retirement benefit deficits or surpluses, plus net debt).



### How our strategy drives our performance

The device highlights strategic driver related content in the operating review on pages 26 to 35.

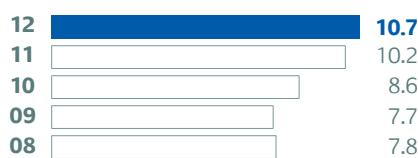
★ See page 09

### Our KPIs are used to measure our performance

The device below highlights KPI related content in the Financial review on pages 20 to 25.

◀ KPI: page 18

#### Operating Return on Revenue (ORR) (%)

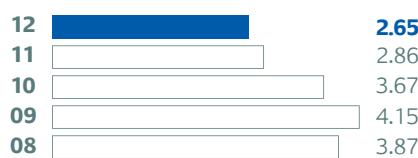


##### Description

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

#### Non-financial statistics and measures

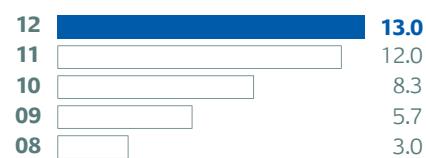
##### Total injuries rate per 100,000 hours worked (KPI)



##### Description

Health and safety is a core value for Babcock. The data includes all injuries reported each year across the entire Group.

##### Order book (£bn)



##### Description

Includes total value of signed contracts and prudent estimate of value of framework contracts only where we are sole supplier.

##### Environmental quality

# 52%

##### Description

Percentage of the Group's operations with environmental management systems ISO 14001 certified.

##### Number of graduates

# 213

##### Description

Number of graduates currently on a graduate programme across the Group.

##### Senior management retention

# 96%

##### Description

Percentage of senior managers at the beginning of the financial year still employed by the Group at the end of the year.

##### Number of apprentices

# 522

##### Description

Number of apprentices currently on apprenticeships across the Group.

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

##### Operating Return on Revenue (ORR)

Operating profit before amortisation of acquired intangibles and exceptional items expressed as a percentage of revenue.

##### Revenue growth

The percentage increase in the division's continuing revenue when compared to that of the previous years.

# Building momentum



**“We have established a strong financial base from which to support an increasing number of significant growth opportunities.”**

## Overview

This review encompasses the first full 12 month period following the acquisition of VT Group plc. During the course of the year we have reported a significant acceleration in activity and growth opportunities in our markets as well as a number of successes in high financial and strategic value contracts across a range of those markets. At the same time we have established a strong financial base from which to support an increasing number of significant growth opportunities; operating cash flow conversion has remained above 100%, net debt has further reduced to £641.1 million, representing 1.8 times EBITDA, on a covenanted basis, and operating margins have improved further to 10.7% of revenue.

At the time of our half year results published in November 2011, we reported organic growth in both revenue and operating profit and this has been sustained for the full year with continuing revenue up 5.6% and operating profit up 15%.

The former VT businesses have been fully integrated and the promised merger benefits of £50 million per annum have been identified and will be delivered slightly ahead of our planning assumptions. We have progressed the business portfolio review and agreement has been reached for the sale of VT Services Inc, subject to regulatory clearance. Consequently the results of VT Services Inc are reported as discontinued and the Group's investment in the business as an asset/liability held for sale pending the completion of the sale. Comparatives have been restated to reflect the reporting of VT Services Inc as discontinued. Underlying results are based on the results from continuing businesses.

## Income statement – continuing operations

### Statutory to underlying reconciliation

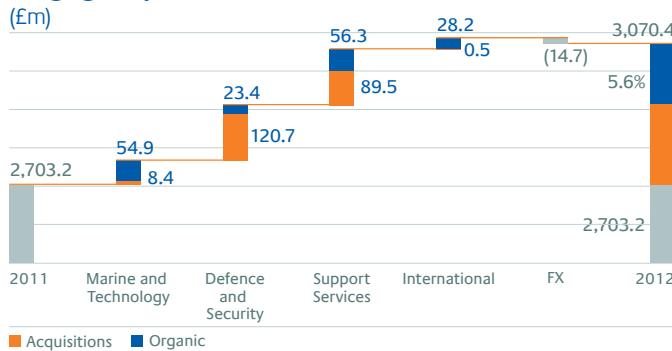
	Continuing operations – statutory £m	Joint ventures and associates						Continuing operations – underlying £m
		Revenue and operating profit £m	Finance costs £m	Tax £m	IFRIC 12 income £m	Amortisation of acquired intangibles £m	Change in UK tax rate £m	
<b>31 March 2012</b>								
Revenue	2,848.4	222.0						3,070.4
Operating profit	202.0	11.0		27.8	77.3		10.9	329.0
Share of profit from jv	4.3	(11.0)	19.4	6.7	(25.6)	6.2		–
Investment income	2.2				(2.2)			–
Net finance costs	(35.5)		(19.4)					(54.9)
Profit before tax	173.0	–	–	6.7	–	83.5	–	10.9
Tax	(15.8)			(6.7)		(21.7)	(3.4)	(2.8)
Profit after tax	157.2	–	–	–	–	61.8	(3.4)	8.1
								223.7
<b>31 March 2011</b>								
Revenue	2,564.5	138.7						2,703.2
Operating profit	153.2	9.3		16.0	76.6		20.3	275.4
Share of profit from jv	6.1	(9.3)	8.3	4.1	(13.8)	4.6		–
Investment income	2.2				(2.2)			–
Net finance costs	(50.4)		(8.3)					(58.7)
Profit before tax	111.1	–	–	4.1	–	81.2	–	20.3
Tax	(10.1)			(4.1)		(22.7)	(2.7)	(3.8)
Profit after tax	101.0	–	–	–	–	58.5	(2.7)	16.5
								173.3

## Revenue

The comparative numbers for 2010/11 include nine months of the financial results from the former VT Group businesses compared to a full 12 months for 2011/12 and consequently headline growth of 14% **◀ KPI: page 18** (2011: 41%) includes the effects of the additional three months' activity from VT. Adjusting for this and movements in foreign exchange rates, yields growth in revenue of 5.6%.

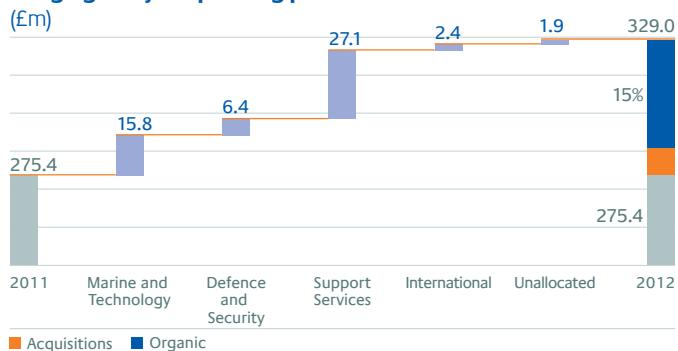
By division, Marine and Technology saw growth of over 6% driven by higher activity levels in the Submarine and Warship support programmes and continued growth overseas in the Technology business unit. New contract wins in Infrastructure, Nuclear and Rail helped to deliver year-on-year growth of 15% in the Support Services Division whilst the achievement of milestones in the FSTA (Future Strategic Tanker Air) programme and the RSME (Royal School of Military Engineering) construction phase contributed significantly to year-on-year growth in Defence and Security of 31%. In International, South Africa remained relatively buoyant with continued growth in the equipment market although offset to some extent by power generation which was relatively weak.

## Bridging analysis revenue



Whilst total revenue growth was a major driver of the increase in underlying operating profit to £329.0 million (2011: £275.4 million), an increase in operating return on revenue **◀ KPI: page 19** to 10.7% (2011: 10.2%) was also a significant contributor. Organic operating profit growth was 15% (2011: 5%). This was derived in part from cost synergy benefits delivered in the year in excess of those achieved last year, leaving an annualised run rate of £40 million at the end of this year – and in part from improved contract margins. Successful completion of the Long Overhaul Period (Refuel) (LOP(R)) contract for HMS Vigilant boosted margins in Marine and Technology whilst stronger performance in Nuclear and Rail took Support Services to 9.8% (2011: 8.4%). As flagged last year, return on revenue in Defence and Security reduced to 13.0% (2011: 15.6%) following completion of the Main Operating Base (MOB) facilities for FSTA and MFTS (Military Flying Training System) in 2010/11. Despite some weakness in its Power business the South African business overall improved as the equipment franchise continued to make progress and consequently the International division return on revenue improved to 6.9% (2011: 6.8%).

## Bridging analysis operating profit



Charges to continuing exceptional items were £10.9 million (2011: £20.3 million) and comprised the following items:

	2011/12	2010/11
VT reorganisation costs	12.8	10.8
Profit on disposal of subsidiaries	(1.9)	(2.9)
Acquisition costs	–	12.4
Total	10.9	20.3

Reorganisation costs represent the costs of delivering the merger synergies and for which the cumulative expenditure at 31 March 2012 was c £24 million out of a projected total of £45 million, as previously reported. The profit on disposal arose on the sale of Babcock Eagleton – see note 32 to the accounts for details of the consideration and net asset values.

**Amortisation of acquired intangibles** of £83.5 million (2011: £81.2 million) represents the amortisation of the value attributed on business acquisitions to customer relationships (both contractual and non-contractual). The value is amortised over the estimated useful life, which does not exceed ten years, by reference to the duration of contracts in hand at the time of acquisition and for non-contractual customer relationships, the risk adjusted value of potential future orders from existing customers with an average estimated duration.

**Net finance costs** of £54.9 million (2011: £58.7 million) including the Group's share of joint venture net interest expense of £19.4 million (2011: £8.3 million) represents a full twelve month period of interest charges on the post-acquisition of VT net debt compared to nine months last year. Joint venture finance costs are primarily related to financing structures on the FSTA and MFTS Private Finance Initiative (PFI) contracts and will increase as the PFI delivers assets into service for the customer. 2011/12 saw the delivery of both the FSTA and MFTS MOBs as well as the first tanker aircraft, with the related non-recourse debt drawn down under the PFI facilities. As further assets are constructed and delivered, this element of net finance costs will increase. During the period following the end of the construction phase and as the PFI debt is repaid over the long-term, finance costs will decline. Finance costs on the Group's own facilities decreased from £50.4 million to £35.5 million in line with the decrease in the amount drawn on the Group's revolving credit facility and improved financing terms.

**Profit before tax** before amortisation of acquired intangibles and exceptional charges increased to £274.1 million (2011: £216.7 million). The associated tax charge including the Group's share of joint venture tax of £8.3 million (2011: £5.4 million) totalled £50.4 million (2011: £43.4 million) representing an effective rate of tax of 19% (2011: 20.5%). The effective tax rate is calculated by reference to the Group's underlying profit before tax and therefore excludes the tax effect of prior year tax adjustments and of amortisation and exceptional charges.

#### Earnings per share

Underlying earnings per share on continuing operations for the year was 61.47 pence (2011: 52.50 pence) an increase of 17% on 2010/11. Continuing basic earnings per share as defined by IAS 33 was 42.93 pence (2011: 30.14 pence) per share.

#### Dividend

The Board is recommending an increase in the total dividend per share of 3.2 pence to 22.7 pence (2011: 19.4 pence) an increase of 17%, representing dividend cover on underlying eps of 2.71 times (2011: 2.71 times). The final dividend per share for 2011/12 would therefore be 17.0 pence per share (2011: 14.2 pence).

#### Discontinued operations

Following a review of our business portfolio post the acquisition of VT Group in 2010, the Board decided that the VT US business did not meet the strategic requirements of the Group. A review was undertaken to establish the most appropriate course of action including the possible divestment of the business. This review was completed during the year and following discussions with a number of parties the Board opted to divest the business. Agreement has now been reached for the sale of VT Services Inc, subject to regulatory clearance, as such, the business has been treated as discontinued.

Within discontinued operations an exceptional impairment of goodwill of £58.5 million is included in respect of VT Services Inc. This has been calculated by reference to the estimated sale value of the business.

#### Cash flow and net debt

	2011/12 £m	2010/11 £m
Cash generated from operations	260.7	308.5
Capital expenditure (net)	(46.0)	(33.2)
Interest paid (net)	(37.1)	(50.0)
Taxation	(28.0)	(19.3)
Free cash flow	149.6	206.0
Acquisitions and disposals net of cash/ debt acquired	4.2	(574.3)
Investments in joint ventures	(2.7)	0.2
Own shares	0.6	(2.2)
Dividend received from joint ventures and associates	6.6	–
Dividends paid	(73.5)	(51.5)
Exchange difference	3.1	(4.9)
Net cash inflow	87.9	(426.7)
Opening net debt	(729.0)	(302.3)
Closing net debt	(641.1)	(729.0)

2011/12 has been another successful year for cash generation and the pay down of debt and at 31 March 2012 net debt had reduced to £641.1 million from £729.0 million at the previous year end. The management of cash is at the core of our financial disciplines and we aim to convert 100% of operating profit to operating cash over the medium term.

**Cash generated from operations** was £260.7 million (2011: £308.5 million) and represents a conversion rate [◀ KPI: page 18](#) of 111%. The increase in working capital in the year was £76.6 million which was primarily as a result of the unwind of prepayments from customers, the acceleration of pension contributions and the increase in contract activity levels.

Following the acquisition of VT in 2010, the Group began a major IT transformation project with a total value of approximately £25 million and a programme of upgrades to dockyard facilities at Devonport and Rosyth. These, together with other minor expenditure principally focused on the South African business, formed part of the total Group capital expenditure in 2011/12 of £46.0 million (2011: £33.2 million). Expenditure on the IT project totalled £14.4 million and cumulatively stood at £18.6 million. Following slight slippage in the programme the balance is now expected to be spent in 2012/13. Dockyard facilities upgrades will also continue into 2012/13.

**Net Cash interest paid** was £37.1 million (2011: £50.0 million) excluding that paid by joint ventures. The positive effect on interest arising from the reduction in drawn debt on the Group banking facility was to some extent offset by the additional three months of post-VT debt funding including the new US Private Placement loan notes issued in early 2011.

After **taxation** payments of £28 million (2011: £19.3 million) free cash flow was £149.6 million (2011: £206.0 million) representing a free cash flow yield on 31 March 2012 of 5%. The disposal of Babcock Eagleton raised £5.7 million after costs. Cash dividends paid out in the year to shareholders totalled £71.4 million (2011: £48.0 million).

Group **net cash inflow** was £87.9 million (2011: outflow £426.7 million) reducing total net debt to £641.1 million (2011: £729.0 million).

#### Return on invested capital (ROIC) [◀ KPI: page 18](#)

We define ROIC as underlying profit before interest and tax divided by shareholders funds (excluding pensions deficits or surpluses) plus debt. For the year 2011/12, ROIC was 18.0%, up from the relatively low level of 13.9% in 2010/11 – a low point following the take-on of significant additional capital for the acquisition of VT Group plc part way through the financial year. Measured against the current weighted average pre-tax cost of capital of 9.7% and the track record of performance, this year's return of 18.0% demonstrates the Group's ability to generate value enhancing rates of return today and in the long term.

### Available financial capital

The Company defines available financial capital as shareholder equity, net debt plus undrawn committed borrowing facilities.

#### Objective

To ensure an appropriate level of available financial capital (AFC) to

- i) provide operational flexibility and meet financial obligations
- ii) fund the Group's organic and acquisitive growth
- iii) maintain sufficient headroom to cover the peaks and troughs in the Group's working capital cycle
- iv) sufficient liquidity to see the Group through any periods of tightened liquidity in the market.

#### Policy

The Board aims to maintain a balance between equity and debt capital which optimises the Group's cost of carry whilst allowing access to both equity and debt capital markets at optimum pricing when appropriate.

The Group, in considering its capital structure and financial capital, views net debt to EBITDA at below two times as being steady state and sustainable in the current market and against the current economic backdrop. This is not to rule out acquisition spikes above two times, as reported following the VT Group plc acquisition, but only if the Group can see a clear path to reducing net debt to EBITDA [◀ KPI: page 18](#) back below two times within a reasonable time frame.

#### Performance

The Group's gearing and debt cover ratios [◀ KPI: page 18](#), used by the Group to evaluate AFC, have improved significantly from last year both in the rapid pay down of debt and through increased profits attributable to shareholders.

	Covenant	2011/12	2010/11
Debt service cover	EBITDA/net interest	>4	6.4x
Debt cover	Net debt/EBITDA	<3.5	1.8x
Gearing	Net debt/shareholders' funds	n/a	54% 59%

Debt ratios are well below covenanted levels and gearing is at a level where the cost of capital is optimal. As such we believe capital markets remain readily accessible when required.

### 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

#### Objective

With debt as a key component of available financial capital, the Group seeks to ensure that there is 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.

#### Policy

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

It remains the Group's policy to ensure the business is prudently funded and that sufficient headroom is maintained on its facilities to fund its future growth.

#### Performance

In last year's Annual Report, the Group reported that it had taken the opportunity to review its capital structure following the acquisition of VT Group plc in 2010, and in line with the above objective, issued US\$650 million of notes with seven and ten year maturities in the US Private Placement market in March 2011. In this financial year, the Group completed the refinancing of its Revolving Credit Facility (RCF) in June 2011, raising £500 million with a term of five years three months. The two aforementioned debt raisings along with the £100 million of loan notes issued in January 2010, provide the Group with total committed banking facilities and loan notes of £1 billion.

For further information see note 22 in the Group accounts.

Interest rates	Currency
Objective	Objective
To manage 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.	To reduce 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.
<b>Policy</b>	<b>Policy – Transactional risk</b>
Interest hedging and the monitoring of the mix between fixed and floating rates is the responsibility of the treasury department, and is subject to the policy and guidelines set by the Board.	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.
<b>Performance</b>	<b>Policy – Translational risk</b>
As at 31 March 2012, the Group had 45% fixed rate debt (March 2011: 41%) and 55% floating rate debt (March 2011: 59%) based on gross debt of £741.3 million (March 2011: £833.3 million).	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.
For further information see note 22 in the Group accounts.	<b>Performance</b>
<b>Liquidity</b>	
<b>Objective</b>	
i) to maintain adequate undrawn committed borrowing facilities.	
ii) to monitor and manage bank credit risk, and credit capacity utilisation.	
iii) to diversify the sources of financing with a range of maturities and interest rates, to reflect the long term nature of the Group's contracts and commitments and its risk profile.	
<b>Policy</b>	
i) All the Group's material borrowings are arranged by the treasury department and funds raised are lent onwards to operating subsidiaries as required.	<b>Pensions</b>
ii) to ensure that the Group has sufficient cash on hand and that its committed RCF is appropriately sized and has sufficient term to meet the Group's general corporate funding requirements. 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 provides a number of defined benefit and defined contribution schemes for its employees. The largest schemes are the Babcock International Group Pension Scheme, the Devonport Royal Dockyard Pension Scheme and the Rosyth Royal Dockyard Pension scheme whose combined assets of £2.4 billion represent 85% of the total assets of all the Group's defined benefit schemes. All the defined benefit schemes are closed to new members except where such provision is mandated for former public sector employees transferring into the Group in relation to specific contracts.
iii) the Group adopts a conservative approach to the investment of its surplus cash. It is deposited with financial institutions only for short durations, and the bank counterparty credit risk is monitored closely on a systematic and ongoing basis. A credit limit is allocated to each institution taking account of its credit rating and market information.	The Group operates a company-wide defined contribution scheme open to all new employees and to current UK employees who are not members of the defined benefit schemes. This scheme will be used to comply with the automatic enrolment legislation from 2013 and plans are well underway to enrol all non-pension scheme members.
<b>Performance</b>	<b>Investment strategy</b>
i) the Group renegotiated and signed a new syndicated RCF of £500 million in June 2011, with a term of five years three months.	The Group works constructively with an investment sub-committee which operates across the three largest schemes to implement a consistent strategy to derisk the schemes as funding levels improve and to systematically purchase derivatives to significantly reduce exposure to interest and inflation rate movements. Approximately 50% of the assets are invested in diversified common growth funds with the balance in a mixture of hedging assets including bonds and derivatives.
ii) the Group had cash and cash equivalents as at 31 March 2012 of £100.3 (31 March 2011: £104.3 million).	
iii) the Group at 31 March 2012 had in place £1bn of committed borrowing facilities available for corporate purposes.	
For further information see note 22 to the Group accounts.	

## Funding valuations

The valuation dates for the three largest schemes are set such that only one scheme is undertaking an actuarial valuation each year in order to spread the impact of market movements in assets and liabilities. The valuation for the Rosyth scheme is due as at 31 March 2012 and the Babcock International scheme as at 31 March 2013 with any consequent cash requirements expected to be implemented from 1 April 2013 and 1 April 2014 respectively.

An actuarial valuation of the Devonport scheme as at 31 March 2011 will be completed in June 2012 based on the market value of assets and assumptions for the valuation of liabilities as agreed with the sponsoring company.

## Cash contributions

£m	11/12
Future service contributions	60.7
Deficit recovery	30.5
Longevity swap	8.0
Pension prepayments (net)	(10.0)
Total cash contributions – employer	84.3

The total cash contributions expected to be paid by the Group into the defined benefit pension schemes in 2012/13 are £93 million. £20 million of this was paid prior to 31 March 2012. £56 million is in respect of the cost of future service accrual of which £27 million, for future service accrual in Marine and Technology, is recovered via contractual terms. Of the balance, £8 million of the contributions are in respect of the three longevity swaps transacted during 2009/10 to mitigate the financial impact of increasing longevity, leaving £36 million to be funded from other Group contracts.

## Mergers

During 2011/12 the Group completed the merger of three former VT schemes into the Babcock scheme as planned. During 2012/13 one further merger is expected to be completed.

## Accounting valuations

The IAS 19 valuation for accounting purposes showed a market value of assets of £2.8 billion in comparison to a valuation of the liabilities based on AA corporate bond yields of £3.0 billion representing 93% funding level.

A summary of the key assumptions used to value the largest schemes is shown below. The most significant assumptions that impact on the results are the discount rate, the rate of future pensionable salary increases and the expected rate of inflation. The impact of the longevity swaps transacted during 2009/10 has helped to mitigate the impact of increasing allowance for longevity.

	Devonport		Babcock		Rosyth	
	11/12	10/11	11/12	10/11	11/12	10/11
Discount rate	4.85%	5.60%	4.85%	5.60%	4.85%	5.60%
Rate of increase in salaries	2.45%	3.05%	2.45%	3.05%	2.45%	3.05%
Rate of increase in pensions in payment	2.15%	2.75%	3.15%	2.50%	3.15%	3.00%
Life expectancy of male currently aged 65	20.9	22.1	22.7	22.6	17.7	17.7

The total accounting deficit, pre-deferred tax, at 31 March 2012, was £265.9 million (2011: £225.1 million) and the expected IAS 19 service cost in 2012/13 is £46.1 million (2011/12: £44.5 million). The net IAS 19 charge to the income statement after allowing for interest on liabilities and expected return on assets for 2012/13 is £15.2 million or c £11.5 million after tax (2011/12: £18.1 million and c £13.8 million). The application of the proposed revisions to IAS 19, which will apply to the year 2013/14, on a pro forma basis to 2012/13 would give a net charge to the income statement of £45 million. Further details on the Group's pension schemes can be found in note 27 to the accounts.

## Governance

Professional and effective pension scheme management is paramount to enable members and sponsors to be confident in the trustees' stewardship of the schemes. The Group and the cross scheme Governance committee have continued to work constructively to improve the effectiveness of the trustee boards of the three largest schemes and their sub-committees as well as enhancing trustees' knowledge through training and decision-making.

# Our marketplace

### **UK defence environment**

Over the past 12 months the UK defence market has generally remained stable. In the current economic environment, the imperative of our major UK defence customer the Ministry of Defence (MoD) to reduce costs whilst maintaining availability and operational efficiency and effectiveness is unchanged and is entirely consistent with our business model in the Marine and Technology and the Defence and Security divisions as well as the Infrastructure business unit within the Support Services division. In total these activities account for 54% of the Group's revenue. The October 2011 MoD statistics confirmed that Babcock had become their second largest supplier in volume terms, behind BAE Systems and ahead of Finmeccanica.

Despite the sudden change of Secretary of State in October 2011, the MoD has not changed the direction of its policy embodied in the 2010 Strategic Defence and Security Review. The MoD's main focus of change has been structural and the Defence Reform Unit's report of June 2011 is being implemented alongside the major changes envisaged to the make-up and character of both the Defence Equipment and Support organisation (DES) and the Defence Infrastructure Organisation (DIO), with options being considered which include a move to an Executive Non-Departmental Public Body or a Government-owned, contractor-operated structure. No decision has yet been reached and we remain closely involved in both these processes.

We believe the structural changes outlined above will be of greater significance to the Group than the MoD's February 2012 Defence (Industrial) White Paper, which will have limited impact on the defence outsourcing debate.

The British Government remains committed to matching the NATO target of spending 2% of GDP on defence, which makes it only one of the few members to do so. The UK is the fourth largest defence spender in the world and while the ongoing search for support – side efficiencies plays naturally to our business model, the ongoing level of defence spending as whole continues to underwrite the capital programmes in which we have a major stake – the Queen Elizabeth class aircraft carriers and the Successors to the current fleet of Trident missile submarines – and ensures that there is critical mass of both equipment for us to maintain and enhance and servicemen and women to train. The MoD's requirement – self-assessed as the need to identify £4 billion of non-front-line savings over the course of the present UK Parliament – is leading to additional opportunities for more outsourcing of their support activities.

### **International defence environment**

Around the world, a number of governments and defence departments are facing the same challenges as the UK MoD. Many are finding their existing arrangements fail to deliver value for money or meet the level of operational availability expected. In addition, some governments are feeling increased pressure to protect their borders and as a result are investing heavily in their defence capabilities.

## Marine and Technology

### Highlights of the year

- Return to service of HMS Vigilant
- Won 1st warship support contract in Australia.
- HMCS Victoria successfully completes weapons system trials
- Successfully designed and delivered weapons launch system equipment for Spain's S-80 submarines.
- HMS Illustrious completes a successful 16 month docking period and returns to the fleet on-time and on-budget.

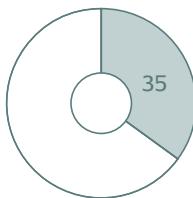
### Revenue growth KPI

**+6%**

### Return on revenue KPI (%)

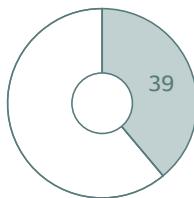
12	12.5
11	11.7
10	12.0

### Revenue (% Group)



● Marine and Technology ○ Rest of Group

### Order book (% Group)



### Building complex naval infrastructure

The Future Nuclear Facilities project at Devonport will provide a capability to dock the new Astute-class submarines and defuel fleet submarines at the end of their lives.

For more case studies go to [babcock.co.uk](http://babcock.co.uk)

**"As the leading support partner to the Royal Navy, we believe the outlook for the Marine and Technology division is extremely secure, with a number of opportunities to deliver further growth in both the UK and overseas."**

### Our market

Our UK market has remained stable over the past 12 months with no significant change expected in the year to come. During the year, progress towards general MoD outsourcing of equipment support was slow, although we believe the changes proposed to the MoD's procurement organisation, Defence Equipment and Support, are likely to create outsourcing opportunities for larger, more complex programmes well suited to the depth and breadth of our capabilities.

In Canada, through the Canada First Defence Strategy and the National Shipbuilding Procurement Strategy, progress is being made towards major naval surface fleet modernisation. With two submarines soon to return to service, recent budget allocations suggest a positive outlook for submarine support and enhancement.

In Australia, the Government has an ambitious programme of investment in future naval programmes, the Rizzo Review and the Coles Review have been set up to review and identify improved support solutions for both surface ship and submarine fleets. Both these reviews create opportunities for our proven, value for money support capabilities.

### Our strategy

In the UK our strategy is to retain and develop our position as the leading support partner to the Royal Navy **strategy**. In support of this we have focused on delivering our commitments under the Terms of Business Agreement (ToBA) as well as seeking to identify opportunities to enhance and expand the services we provide our customer while driving further efficiencies. We have a significant involvement in major UK alliance programmes, the Surface Ship Support Alliance (SSA) and the Submarine Enterprise Performance Programme (SEPP), where we are building on our significant engineering and integration expertise and know-how to broaden and deepen our involvement. Our strategy to provide technology-led services **strategy** across the full programme lifecycle has been supported by our growing role in the design development of the future nuclear deterrent submarine as well as the provision of specialist design support and system proposals for the UK naval ship programme.

We have a clear strategy to grow our international presence in naval support markets building on our UK position. In Australia, we have continued to grow our presence through the provision of technical support on both in-service and new programmes in line with our strategy to become a leading support provider to the Royal Australian Navy. Recent contract wins have demonstrated the value of our commitment to the Australian market **strategy**. In Canada we have established an initial capability for submarine support and we are now seeking to deliver wider services drawing on our UK track record. In other overseas markets we continue to build on our design/build activity on the South Korean and Spanish submarine programmes and are also reviewing the potential for our complete naval asset management support models in other countries where Babcock's track record in delivering cost reduction and improvements in service delivery is recognised.

### Financial review

The division reported revenue of £1,084.7 million (2011: £1,019.5 million) an increase of 6% benefiting from increased revenue on submarine and warship programmes, including the QE class carrier programme as well as continued growth from international revenue. Operating profit increased to £135.1 million (2011: £119.3 million) an increase of 13% which resulted in an operating return on revenue of 12.5% (2011: 11.7%) driven largely by completion of the main part of HMS Vigilant's LOP(R) and the continuing efficiencies which we share with our customers.

### Operational review

Our ToBA with the MoD creates a long-term partnering arrangement that provides us with a predictable, long-term programme of work in submarine and warship deep maintenance as well as continuing our role as the MoD's partner at the naval bases in Devonport and Clyde. During the year we met all of our requirements under the ToBA including the delivery of significant cost reductions in excess of the requirement level.

We retain a strong market position in the through-life support of the UK submarine fleet as sole provider of both deep and in-service maintenance. We are working with the MoD, BAE Systems and Rolls-Royce on SEPP to ensure maximum availability of the UK submarine fleet whilst delivering ongoing reductions in operating costs.

HMS Vigilant successfully completed the main element its LOP(R) which involved 160 capability upgrades, the removal and overhaul of 26,500 components and the defueling and refuelling of the nuclear reactor. As HMS Vigilant returned to HMNB Clyde for sea trials and contract acceptance, HMS Vengeance arrived at Devonport to begin her three and a half year, c £350 million LOP(R).  strategy

We continue to provide specialist systems and services for the Astute-class submarine programme as well as specialist training for submarine crews. HMS Astute is now included in the Babcock led in-service engineering management organisation and is continuing sea-trials before becoming fully operational in 2013. HMS Ambush is expected at Faslane in the summer of 2012 and procurement activities are already underway for the fifth submarine in the class. On the Successor future deterrent submarine programme, activities continue to progress. Babcock has involvement in the long-term technical engineering support and has secured the role as provider of the key tactical weapons launch system and we continue to invest in capability to deliver further elements of the programme.

The MoD is progressing its proposals for the Submarine Dismantling Programme (SDP) and has completed the public consultation process at Devonport and Rosyth, the sites identified for the dismantling phase of the programme. We expect the results of the consultation to be published in the summer of 2012 with the MoD's currently stated preference being for dismantling activities to take place in parallel on both sites.

During the year we have successfully delivered deep maintenance periods for a number of warships as part of the SSSA. The recently signed Phase 2 Agreement brings all of the remaining classes of warship currently in-service into the class management arrangements developed for SSSA. Work is also underway to develop Phase 3 of the SSSA covering future classes of warships providing Babcock with a potentially enhanced support role in future years.

As part of the Aircraft Carrier Alliance, with significant roles in both the design and build of the new vessels, we continue to make excellent progress and the programme remains on schedule with costs remaining in line with forecast. The first superblock is in place in the dock at Rosyth following delivery of lower and upper hull blocks and their assembly using the new Goliath crane.

We have been successfully managing the delivery of services at HMNBs Devonport and Clyde under the Warship Support Modernisation Initiative (WSMI) for the past 10 years. Under the framework of the ToBA, we are in active discussion with the MoD to introduce a replacement contract under the Maritime Support Delivery Framework. This new contract will provide a platform for further development of our role in both naval bases and provide a mechanism for us to deliver scope expansion.

In our broader equipment support operations, where we provide engineering support for a range of key assets as well as procurement and logistics support, we have consistently achieved or exceeded our customer's operational KPIs. During this year, our approach to demand management for a wide range of defence spares has enabled us to win additional, competitively tendered, procurement packages. In addition, we expect the MoD will, over time, transition to substantial outsourcing of equipment management services, roles where we can demonstrate industry leading capabilities.

Our international activities continue to progress well and now account for over 10% of the division's revenue. In Australia we have successfully tested our torpedo launchers and weapons handling systems for the new Hobart class Air Warfare Destroyers. We have also been selected, with our partners UGL, to provide in-service support for the Royal Australian Navy's fleet of eight Anzac class frigates. The contract worth £200 million over the initial five year period, establishes a new model of long-term support arrangements delivering benefits to the customer and industry.  strategy We have also been down-selected to tender for future packages of warship support which are expected to come to market by mid-2013.

With the Australian Government committed to progressive reform of its naval support activities, which has included an in-depth review of its submarine support activities, we believe we are well placed with distinctive capabilities and credentials.

On the Canadian submarine programme, the Navy successfully trialled Babcock systems on HMCS Victoria, their first submarine to come back into service during 2012. We have taken control of HMCS Corner Brook ahead of refit activities and with HMCS Chicoutimi progressing through a refit, we continue to build our capability in Canada for an increasing future workload. The recent budget in Canada confirmed the Government's commitment to the submarine fleet and high level agreements have been put in place for major surface fleet renewal. We expect these programmes to progress in the medium-term and bring a range of growth opportunities for us.

In Spain, significant deliveries of Babcock systems have been made throughout the year in support of the Spanish S-80 submarine programme and these are being integrated into the first of class build programme.

#### Divisional outlook

In the UK, as a result of our ToBA and our position on a number of key programmes we have excellent visibility of future revenues. We are well positioned, with unrivalled depth and breadth of expertise within each of our business units, to assist the MoD and Royal Navy as they seek to achieve maximum availability and increased financial efficiency as well as supporting them as further programmes are outsourced.

In our international markets, we continue to build our presence and are now well positioned as governments seek to achieve better value for money for naval equipment and infrastructure support and improved availability for their submarine and warship fleets.

We believe the outlook for the Marine and Technology division is extremely secure, with a number of opportunities to deliver further growth in both the UK and overseas.

## Defence and Security

### Highlights of the year

- 61,000 military flying hours delivered
- 19,000 military vehicles supported
- 1.5 million training days delivered to 50,000 military students
- £90 million six year training contract secured with Royal Navy
- c £40 million extension to 2014 for training and support contract for REME
- c £400 million vehicle procurement services provider for Project Phoenix, 14,000 vehicles until 2016

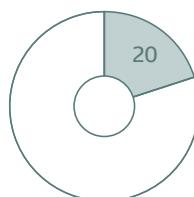
### Revenue growth KPI

+31%

### Return on revenue KPI (%)

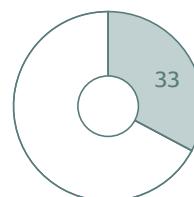
12		13.0
11		15.6
10		11.3

### Revenue (% Group)



● Defence and Security    ○ Rest of Group

### Order book (% Group)



### The UK's leading military training partner

Having successfully delivered training to the Royal Electrical and Mechanical Engineers for over a decade, we were awarded a £40 million, two year extension to our training and support work at Bordon and Aborfield.

For more case studies go to [babcock.co.uk](http://babcock.co.uk)

**“As the leading training and equipment support services provider to the MoD, we are well positioned to support our customer as they face increasing financial and operational challenges over the next few years.”**

## Our markets

The key focus of the Defence and Security division is military training and equipment support primarily for the UK MoD with over £1.5 billion of MoD spend within our core capabilities. Through our 4,500 people in over 70 locations we have extensive experience across all three UK Armed Services in leading the provision of training and equipment support services to operationally critical defence activities. Our success is built on our commitment to a safe working environment for our people, our depth of engineering and technical expertise and the ability to establish long-term partnering relationships with our customers.

In the UK the £38 billion shortfall in the Defence Budget over the next 10 years is being addressed through a comprehensive review of existing and planned programmes and personnel requirements. As a result, radical organisational change is proposed within the MoD together with significant reductions in equipment spending and in uniformed and civilian MoD staff. Within this context we expect the increasing pressure on budgets and manpower will drive greater outsourcing and the short-term potential for the extension of existing contract services in support of MoD legacy assets.

## Our strategy

During the year our key focus has been to secure the rebids and extensions essential to maintaining our business capabilities and to build on our leading market positions  in military training and equipment support to ensure we are well placed for future outsourcing opportunities. In support of these activities we remain focused on ensuring we are able to deliver the most cost efficient solution for our customer on current, as well as potential future, activities.

We have a demonstrable track record of delivery which has been sustained despite the current challenging economic and operational environment. This is recognised by the MoD through our excellent SRT (Supplier Relations Team) scores which reflect our strong relationship and our ongoing commitment to the identification and sharing of efficiency savings.

Overseas, in selected markets where defence operational requirements are similar to those in the UK, we have been reviewing opportunities to exploit our expertise in developing long-term contracting support solutions. We believe our current Group position in the Australian and Middle East markets will provide an attractive growth opportunity.

## Financial review

Revenue for the year including the Group's share of joint ventures for the Defence and Security division increased to £613.3 million (2011: £469.2 million) an increase of 31% mainly resulting from a full year of revenue from former VT operations. Organic growth for the division was 4%. The division's share of revenue from its joint venture projects, including FSTA and MFTS was £167.3 million (2011: £87.3 million). With a long-term commitment and a role as shareholder in both projects, we expect them to continue to contribute significantly to the division's revenue. The securing of the MoD's new Phoenix framework for the management of its white fleet of vehicles will underpin the division's revenue into next year. Both training and equipment support performed well. Operating profit was £79.6 million (2011: £73.2 million) and, as previously indicated, operating return on revenue reduced to 13.0% (2011: 15.6%) following completion of the construction phase of both the joint ventures and the change in mix between new and mature contracts.

## Operational review

Throughout the year our operational performance supporting the RAF has been strong. Following the successful completion of the Main Operations Base and the communications and information systems for the Future Strategic Tanker Aircraft (FSTA) project, our focus has now moved to the through-life service delivery phase for the remaining 23 years of the programme. Under the UK Military Flight Training System (UKMFTS) programme we are now delivering the first training packages in support of RAF Advanced Jet Training at RAF Valley and Rear Crew Training at RAF Barkston Heath and RNAS Culdrose.

Our airfield and operational support contracts have performed well. We delivered 39,000 flying hours on the Light Aircraft Flying Task using our fleet of 119 Grob 115e Tutor aircraft across 15 MoD sites and 17,000 flying hours on 52 aircraft through the Tucano in Service Support Contract at RAF Linton-on-Ouse. We continue to provide engineering manpower support to the Sea King Integrated Operational Support (SKIOS) Search and Rescue service which is expected to continue until the Sea King out-of-service date in 2016.

We continue to deliver our contract for engineering support to the fleet of 67 Hawk T1 aircraft in advanced flying training and engineering support to BAE Systems for the introduction to service of the Hawk T2 at RAF Valley – in aggregate support to 15,000 Hawk flying hours.

In our Land business we have continued to expand our training and equipment support capabilities. During the year we won a four year contract as the service provider for the MoD's new Phoenix framework we have also signed a contract to provide continuity of service and incremental replacement for over 14,000 vehicles (ranging from cars to coaches and articulated trucks) previously provided through the White Fleet contract. We expect the overall Phoenix contract to be worth c £400 million to September 2016. To help the MoD to meet its challenging budget constraints, we have enhanced our service offering by incorporating telematic monitoring and on-line booking systems to improve fleet optimisation. 

Throughout the year, our ALC joint venture contract with Amey has successfully managed and provided the MoD's fleet of 2,000 construction vehicles worldwide has successfully and consistently delivered services in support of Urgent Operational Requirements (UORs). We are working closely with the MoD to identify further savings opportunities through more effective use of this contractual arrangement.

Our fleet management capability is also evidenced through our strong performance as a service provider on the Allenby Connaught programme where we provide maintenance and fleet management services to the MoD Green Fleet and have delivered in excess of 66,000 transport tasks during the year.

We expect the MoD to launch its competition for the Logistics and Commodities Service Transformation programme during 2012 and in preparation for this we have entered into a teaming agreement with DHL to bid, and if successful, operate this programme jointly.

At Bovington, our contract to provide training, maintenance and support services to the Royal Armoured Corps had delivered over 45,000 man training days to 1,900 students and provides us with a further opportunity to extend our role in both training and equipment support solutions until 2016.

We continue to focus on delivering the highest standards of training for both the Army and Royal Navy (RN). Following the cancellation of the Defence Training Rationalisation programme in 2010 the MoD is reviewing its long-term requirements and this will determine the scale and timing of future outsourcing opportunities. In the interim, our successful delivery record in training has enabled us to secure a £40 million, two year contract extension to 2014, for our activities at Bordon and Arborfield for the Royal Electrical and Mechanical Engineers.

At The Royal School of Military Engineering (RSME) we provide technical trade and professional engineering training as well as infrastructure and facilities management services. The construction and refurbishment programme is now 60% complete and 40 new and refurbished training assets have been handed over to the Royal Engineers during the year. New accommodation and specialist training facilities are planned at the Defence Explosives Munitions and Search School at Bicester during 2012 and this will deliver a step change in training capability in counter IED (Improvised Explosive Device) activities. We continue to work with the RSME in the transformation of engineering training and we remain on target to optimise the delivery of all trade courses by 2015.

We have had continued success in the winning and delivery of services to the RN. During the year we were awarded a six year c £90 million contract for the training requirement of the Fleet Outsourced Activities Project. This contract offers the RN significant improvements in efficiency and service delivery through innovative training and support processes and has options for the customer to extend to 15 years. Following a successful transition from the previous Flagship contract service delivery commenced in January 2012.

In support of our services to the RN training establishments we were awarded a contract extension until 2013 for the delivery of soft facilities management services. A competition is underway for the provision of these services from 2013 and we are actively engaged in that process.

In August 2011 we started delivery of training at the Royal Navy Maritime Composite Training System facility at HMS Collingwood where our team enables state-of-the-art training on synthetic training equipment. This £20 million, seven year contract is with BAE Systems who have developed the system in support of the Maritime Synthetic Training programme.

In the Security sector our ten year strategic partnering relationship with a Government Agency for the provision of engineering and procurement services continues to operate successfully and we continue to work with our customer to identify further savings opportunities within their operations as they arise.

#### Divisional outlook

Following our success during the year in securing new vehicle support and training contracts for the Army and Royal Navy, our short-term focus is on service delivery and ensuring we maintain our track record of delivering efficiencies to the MoD.  As these new contracts become operational we continue to seek opportunities to increase the scope of these services and participate in new MoD outsourcing programmes as they arise.

Our fleet availability contracts and engineering support activities leave us well placed to compete for future programmes. We expect that the pace of outsourcing across the MoD will accelerate particularly in relation to:

- the proposed disposal of the Defence Support Group (DSG) which provides routine and depth maintenance on the Army's vehicle fleet
- MoD Logistics Commodities and Service Transformation – the outsourcing of elements of the Joint Supply Chain
- Tri-Service training packages in technical, collective and sponsored reserve training
- support of front line aircraft

Overseas we aim to leverage our UK expertise and capabilities in selected markets where defence operational requirements are similar and opportunities arise to exploit our experience in developing long-term contracting models. 

## Support Services

### Highlights of the year

- Awarded £150m fleet management contract by Lafarge – a global first in this sector
- Extended 15 year relationship with BBC World Service for a further 10 years
- Worked 3 million man hours at Dounreay without a lost time accident
- Responsible for training 45,000 learners for 6,000 employers
- Won £125m contract with Devon County Council for effectiveness services

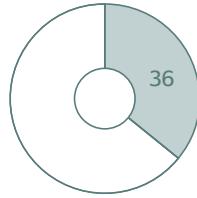
### Revenue growth KPI

+ 15%

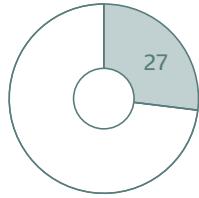
### Return on revenue KPI (%)

12	9.8
11	8.4
10	5.2

### Revenue (% Group)



### Order book (% Group)



● Support Services

○ Rest of Group



### Supporting the UK's power network

Having built a successful partnership with National Grid over the past five years, we have been awarded a £650 million, five year extension to the Electricity Alliance West contract to maintain and upgrade overhead power lines across the UK.

For more case studies go to [babcock.co.uk](http://babcock.co.uk)

**“Our unique combination of market leading positions; technical management and analytical expertise and track record of improving service delivery and reducing costs for our customers, creates a compelling proposition and a strong platform for growth.”**

### Our markets

The Support Services division operates predominantly in a range of UK public sector, MoD, regulated and commercial markets, targeting various elements of the c £200 billion market for outsourced services.

Since the 2010 Comprehensive Spending Review, aggregated customer output and spend has reduced across our markets, however that spend which is addressable to Babcock has, in most cases, grown or remained flat, influenced by a range of factors. These include a transformation in our customers' operating models towards a commissioner of services, and hence increased reliance on private sector partners, such as in our local authority, schools, police and fire and rescue markets.

Equally, the mission critical nature of the engineering assets managed on behalf of our civil nuclear, MoD, power and telecoms customers typically encourages longer-term planning and procurement cycles.

Finally, and in response to the challenging economic climate, as well as the Cabinet Office's push for alternative provision of service delivery, Babcock has been working with customers in our government property, mining and construction and local authority markets on innovative models of asset ownership and finance and service provision that has unlocked spend that might otherwise not be available.

### Our strategy

The division has continued to develop its strategy, in line with the Group's strategic objectives, and is focused on taking responsibility for our customers' complex and critical assets, providing technical expertise and improving service delivery at reduced cost to give our customers the confidence to focus on their core operations and strategic direction. Our business units have developed their strategies to ensure they are in a strong position to compete within their specific markets.

In particular, we have strengthened our approach to account management for our key customers, developing specific propositions that are targeted at delivering additional value and strengthening our relationships. This approach is also providing a bridge between business units, allowing us to develop propositions that combine capabilities across the division.

With growth as our key priority, last year we identified a number of core growth sectors; nuclear, infrastructure, education and training and mobile asset management. Good progress has been made throughout the year with a number of key contract wins and new competitions coming to market demonstrating progress.

The integration of ex-VT businesses has delivered substantial cost synergies arising from revised organisation structures and enhanced procurement activities. Revenue synergies are also being delivered, in particular in the Nuclear and Mobile Assets businesses, where the combination of Babcock and VT skills and capabilities have delivered innovative propositions and further improved our market positioning.

## Financial review

The division's revenue, including the Group's share of joint ventures, increased by 15.4% to £1,092.4 million (2011: £946.6 million) of which c 5% was organic growth. Joint venture revenue was £54.7 million (2011: £51.4 million). All businesses showed revenue growth with Infrastructure and Nuclear benefiting from new contract wins as well as continued organic growth. Operating profit including jvs increased by 34.0% to £106.7 million (2011: £79.6 million) which gave an operating return on revenue of 9.8% (2011: 8.4%) driven by both contract performance and additional cost synergy realisation.

## Operational review

### Nuclear

Our Nuclear business continues to grow its reputation as a major player in the UK market with capabilities in the decommissioning and power generation sectors.

The key success during the year was at Dounreay, where the Nuclear Decommissioning Authority awarded the contract for the decommissioning and clean up of the Dounreay nuclear site to the Babcock Dounreay Partnership (a joint venture between Babcock, CH2M Hill and URS).  **strategy** This is a complex long-term contract to deliver the site to its interim end state by 2025, 16 years earlier than the previous plan. The total contract value is expected to be in the region of £1.6 billion, which represents a reduction of over £1 billion on previous estimates. Dounreay is the first major closure project in the UK and is also the first target cost/incentive fee contract for this type of programme – a clear demonstration of Babcock's ability to create value for its customers.

We have continued to strengthen our position at Sellafield with involvement in a number of significant decommissioning programmes on the site. Core contracts awarded in 2010/11 have performed well and our position has been further reinforced by other major wins during this year; Phase 1 of the Silos Maintenance Facility, a key part of the hazard reduction programme and the Design Services Alliance framework agreement which will provide initial design works for decommissioning related projects on the site.  **strategy** Both these contracts have a potential total value of up to £150 million.

Elsewhere in the UK, Babcock has secured substantial decommissioning work at the Trawsfynydd Magnox site and the decommissioning of the A1 facility at AWE is progressing very well.

We continue to provide specialist fuel route support to EDF on the UK's current fleet of nuclear power stations. Looking forward, although we do not expect any contract awards until at least 2015, we have teamed with a major French contractor and are starting to prepare bids for future activities as part of EDF's new build programme at Hinkley Point and Sizewell.

## Mobile assets

As announced in September 2011, we are now managing and maintaining Lafarge's fleet of heavy mobile equipment in the UK, US and Canada worth a total of £150 million over a ten year period. The team continue to develop the next phases of the process with due diligence on going in further territories, where we expect some negotiations to be concluded in the first half of this financial year.

Our other fleet management contracts for the emergency services continue to perform well and our operations at Heathrow continue to expand as a result of a new contract with BAA to support their airfield operations vehicles at the world's busiest international airport.

We are now looking at a number of opportunities where our proven through-life management model could prove attractive to customers operating complex mixed vehicle fleets.

## Infrastructure

For our Infrastructure business, the current reorganisation of the Defence Infrastructure Organisation (DIO) has created a number of opportunities. Our current regional prime contracts are performing well and have been extended to 2014 as the DIO prepares for the Next Generation Estate Contracts to come to market. Babcock is the only organisation to have pre-qualified for all contracts being let under the first phase of this process; the Scotland and Northern Ireland Prime, the Housing Prime and the National Training Estate Prime contracts. The contract to support the British Forces in Germany is also performing well and will remain proactive and responsive to the Military's needs as operations are wound down in Germany and forces are returned to the UK.

In addition, we are also looking at other opportunities within the DIO, and other public and private sector customers, to help them unlock value within their complex and critical property portfolios.

## Education and training

The training business has continued to perform strongly. We remain the UK's largest provider of vocational training, with c 45,000 learners on a programme at any one time. We work in partnership with over 6,000 employers, drawn from a broad range of industries, predominately in the engineering and services sectors.

During the year our training client base has continued to expand, most notably with a new 25 year contract with the London Fire Brigade (LFB) to support the training of all fire-fighters across London. Our contract will also entail the building of two dedicated fire training facilities in London and the refurbishment of facilities at a number of fire stations. The new contract started on 1 April 2012 following a rapid mobilisation and is performing well.

In addition to new contracts, we also secured rebids with the Army and Network Rail and we hope to secure a rebid for the EDF technical training facility. These contracts along with the LFB success clearly demonstrate our unparalleled position in the technical training sector.

Within the Education business, we have built on our successful partnership with Surrey County Council by winning the £125 million, seven year contract with Devon County Council to deliver education effectiveness services and learning support. This new contract will be delivered through a dedicated team of education professionals, working to create a regional and national centre of excellence to deliver savings and returns to the council of over £10 million over the life of the partnership. Babcock are now the leading provider of support effectiveness services to UK schools.

Outside the core growth areas highlighted above, the division has also had two major successes during the year retaining core contracts and customer relationships.

We retained our position as a trusted partner for the BBC built up over the past 15 years **strategy** with the win of the ten year, £200 million contract to continue providing the BBC World Service with transmission and distribution services for radio and television.

A major contract extension was awarded by National Grid to our Electricity Alliance contract with a further five year framework arrangement agreed to maintain and upgrade high voltage power lines across the UK. This extension also offers the exciting opportunity to proactively support our customer as it moves into the new RIIO regulatory framework being implemented by Ofgem with its focus on performance through incentives, innovation and output.

#### Divisional outlook

The pressure on the UK Government and our private sector customers to deliver services within restricted budgets continues to create substantial growth opportunities for the Support Services division. In addition investment and change is being driven through the UK's infrastructure, including the power transmission, rail and mobile communications networks where we can offer existing and new customers a differentiated engineering solution.

Our unique combination of market leading positions; technical, management and analytical expertise and track record of improving service delivery and reducing costs for our customers, creates a compelling proposition and a strong platform for growth.

## International

### Highlights of the year

- Awarded R50m transmission line orders to link in with the new Eskom Medupi power station
- Currently operating a full maintenance site support agreement for 112 DAF trucks over three years for one of South Africa's largest independent transport operators
- Awarded extension to maintenance support agreement for five Eskom power stations
- Providing training to 63 apprentices
- Supporting 10 underprivileged South African children with bursaries for high school education

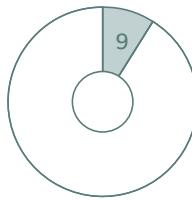
### Revenue growth KPI

+5%

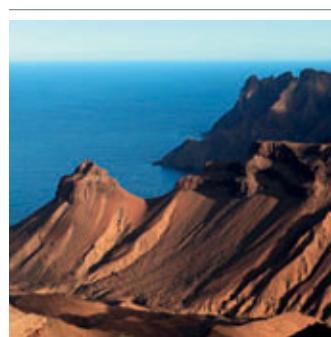
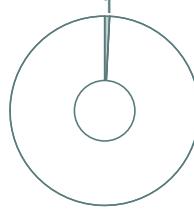
### Return on revenue KPI (%)

12	6.9
11	6.8
10	6.2

### Revenue (% Group)



### Order book (% Group)



### Providing equipment to support the economic development of the island of St Helena

As part of a Basil Read project to upgrade the airport on the island of St Helena, we have been awarded a four-year contract to supply and support construction equipment during the build phase. The contract will see 12 Babcock staff members permanently based on the island.

For more case studies go to [babcock.co.uk](http://babcock.co.uk)

Following agreement being reached for the sale of the US defence business, subject to regulatory approval, which was previously reported with the results of the International division, the division's financial results have been restated to include only continuing operations. These comprise the South African operations and aircraft support contracts in Oman and Kuwait. The US business is reported as discontinued and as held for sale.

### **South Africa** **Our market**

In South Africa, the general economic environment has remained stable during 2011 and economic growth is forecast to continue. Our equipment markets continue to be supported by both the ongoing investment in infrastructure; for which the South African Government announced a c ZAR800 billion programme of investment over the next three years in October 2011, and the increasing global demand for South African commodities, including coal, diamonds and copper. For our power generation support operations, as economies continue to grow across Southern Africa, demand for energy is increasing and is putting pressure on current generating capacity. We expect this to continue for the next 15–20 years.

### **Our strategy**

Throughout the downturn, between 2008–2010, we took the opportunity to review and reshape our business and ensure we were well placed to take full advantage of the recovery which started during 2011. Our key priorities are to drive growth through our well-established equipment dealership networks and plant hire operations and build on our long-term relationship with Eskom in our power generation activities. We will also be seeking to build on Group-wide capabilities and expertise to develop new business streams and will be focusing on opportunities we have identified for automotive training and defence infrastructure and equipment support.

### **Financial overview**

Continuing revenue for the division increased by 5% to £280.0 million (2011: £267.9 million) and operating profit increased by 7% to £19.3 million (2011: £18.1 million) which resulted in an operating return on revenue of 6.9% (2011: 6.8%). The growth in Volvo equipment and in the plant hire business has driven up profits year-on-year.

### **Operational overview**

The equipment market has continued to experience steady growth throughout the year. We have seen good demand for Volvo equipment, benefiting in particular from the introduction of new ranges of trucks, and are planning for this to continue during 2012. Following the launch of the DAF truck franchise in 2010, sales have been steady throughout the first year and with the introduction of new customer finance packages we expect to see increased growth in the coming year.

With increased investment in infrastructure our plant hire operations have experienced strong demand for cranes and power generators. We expect growth in demand to increase significantly and we have increased our capacity to respond to this accordingly as well as creating opportunities to move into new geographies.

Eskom, South Africa's power generation company, continue to fall behind on their planned outage and maintenance activities. However we have experienced good activity levels within our power generation support operations as Eskom meet increased demand for electricity. Powerlines activity has remained stable and although one or two international competitors have withdrawn, competition remains stiff.

### **South African outlook**

In South Africa, the markets in which we operate are expected to remain strong for a number of years supported by significant investment programmes and global commodity requirements. We have restructured our business so we are in a strong position to benefit from these trends.

For our current operations we have a number of opportunities within our existing markets and we have identified opportunities to develop these businesses into new geographies and new markets. In addition, we have identified a number of opportunities in new markets and for additional business streams which we can access by building on expertise elsewhere in the Group.

### **Middle East**

Despite the ongoing political unrest in parts of the Middle East a number of factors support our belief that the area will provide the Group with significant growth opportunities in future. In particular, the drive for economic diversification away from oil and the increased focus on vocational training, in both civil and defence sectors, to support this as well as the rising investment in education and infrastructures across the region.

We have continued to build our presence through our management team in Abu Dhabi and have been actively engaged in dialogue with a number of government departments and private organisations. As anticipated, this process is taking time but we are making steady progress. We have identified a number of areas where we can build on our current contracts in the region and exploit the capabilities across the Group and our successful track record of delivery.

# Supporting growth

In addition to strong operational and financial performance, being a sustainable business requires the proper management of the building blocks that underpin first class performance **five key areas of focus:**



### Strengthening customer relationships



### Ensuring safety



### Developing and sustaining talent



### Managing environmental impact



### Our commitment to governance

### Strengthening customer relationships

Adopting a partnering approach to our relationships with our customers is at the heart of Babcock's business model. We seek to develop and maintain an in-depth understanding of our customer's organisation and major stakeholders, as well as a detailed knowledge of the strategic objectives, business drivers and key issues. This allows us to use the capabilities within Babcock to focus on and address what is really important to our customers and to develop propositions and solutions for them.

We also endeavour to add value, not only in what we do for our customers, but in how we do it. This year, we launched a Group-wide project management business improvement initiative further to enhance our programme and project management skills. This was seen as an opportunity to establish a common competency framework and enable the sharing of best practice amongst our different Divisions to benefit our customers.

Monitoring, evaluating and improving customer satisfaction is part and parcel of the customer-focused service we deliver and we have many examples of comprehensive performance review systems across the Group.

One such example is the Customer Service Excellence Programme that has been taking place within the BBC World Service since 2010. Each year an independent company interviews 50–75 BBC employees to evaluate all aspects of Babcock's delivery. Feedback is captured in a report, which is followed by a workshop attended by key stakeholders to review results and agree actions to continually improve service.

We also have a well-embedded and understood performance review system with the MoD, which has recently seen the eighth review issued. Babcock met its own collective target score for 2011 and our performance put us in the top five of the MoD's 20 key suppliers so measured.

## Ensuring safety

Given the nature of our operations, which often involves working in highly hazardous environments, health and safety is of utmost importance at Babcock: senior management bonuses are at risk if performance is unsatisfactory. Our vision for our employees, contractors and anyone visiting our sites is captured in three simple words: 'Home Safe Everyday'.

We aim to have the best framework which is appropriate to the specific safety environment of any given activity ensuring that everyone understands the role they have to play in practice in ensuring safe working, whilst remaining vigilant to what can be perceived as lesser risks in potentially dangerous environments.

We recently made changes to the governance structure relating to health and safety management in light of the consolidation of Babcock's divisional structure following the acquisition of VT Group. Having set the overall health and safety strategy for the Group, many of the roles performed by our Group Safety Leadership Team have been transferred to the divisional management boards to implement with the help of their respective divisional safety leadership teams and safety steering groups. At Group level, the role and composition of the Corporate Safety Steering Group (CSSG) have been reviewed to strengthen its Group-wide responsibility for reviewing performance and trends, assessing the impact of legislative changes and sharing best practice.

As last year, the focus continues to be on the behavioural and cultural attitudes underlying unsafe acts. Led by the CSSG, work was carried out during the year in consultation with a number of representative groups from the workforce and with the help of external consultants to develop a tool, the 'Safety Lens', designed to provide a framework of common understanding of what 'Home Safe Everyday' means in terms of actions and behaviours. This tool has already proved to be useful in a number of ways in the pilot projects where it has been tested, including better communication between workforce and managers in support of improved health and safety management, and it is showing a positive impact on accident frequency rates. The Safety Lens is now in the process of being rolled out across the Group.

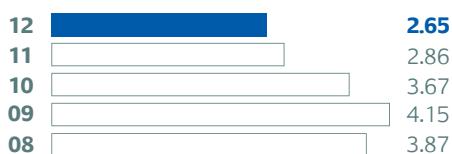
### Performance

During the year, the year-on-year rate at which our total injuries rate and RIDDOR rate has been falling has slowed somewhat. That is why we are focusing on sustaining the momentum of our existing initiatives so that they will translate into lower accident rates. We believe that the Safety Lens will help us in addressing this challenge. In addition, we have adopted an improved analytical and reporting tool across the Group better to understand the trends not only of actual accidents, but also of high potential near-misses. This will allow us to identify more accurately areas of risk and ensure that the proper time and resources are allocated where they are needed. This new tool has been fully operational Group-wide since 1 April 2012 and we expect to see benefits from it within the first year.

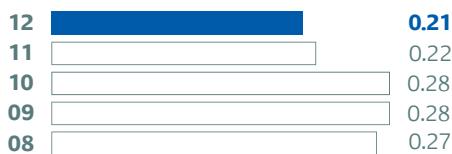
### Performance

	2008/09	2009/10	2010/11	2011/12
Total number of injuries	2,781	2,530	1,967	1,973
Fatalities	1	2	0	0
Major injuries	42	28	21	27
Over-three-day injuries	148	164	130	128
RIDDOR totals	191	194	151	155

### Total injuries rate per 100,000 hours worked (KPI)



### RIDDOR rate per 100,000 hours worked



## Developing and sustaining talent

Babcock needs to ensure that it has the right people to deliver today and tomorrow technically complex, long-term contracts for its customers, as well as support the Group's long-term strategic growth. We aim to achieve this by continually improving our comprehensive talent management system. During the year, work led by our Group Director of Organisation and Development has continued to coordinate this activity across the Group.

With regard to succession planning, in addition to having plans that identify successors to key executive posts within senior management, individual training and development plans for those so identified are put in place. Over 90% of executive positions have identified, immediate replacements.

In addition to the training and development provided at the local level (total expenditure in the year to 31 March 2012 was over £10 million), we have Group-wide management development resources:

- The Babcock Academy, run in conjunction with Strathclyde University since 2005, continues to provide a structured framework for our managers to improve their managerial skills and strategic awareness.
- We reported last year the creation of an Emerging Leaders Development programme for our high flyers. In addition to holding Emerging Leaders workshops, we ensure that key divisional managers are able to identify high flyers and provide them with the development they need to retain their skills within the Group.

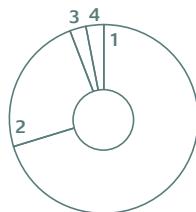
### Graduates and apprentices

Our graduate and apprenticeship schemes are intended to support business requirements with the aim of securing the skills and expertise we need now and in the future and we seek to provide as many opportunities as those requirements justify.

With regard to graduates, we reported last year that we were expecting to recruit 79 graduates for the 2011/12 intake. In the event, business requirements were such that we needed to recruit an additional 18 graduates bringing the total for 2011/12 to 97 (2011: 85). There are currently 213 graduates on the graduate programme, 77% of whom are in engineering disciplines, which is similar to last year. At the date of this report, we expect to recruit 122 graduates for the 2012/13 intake. In addition to our graduate scheme, we recruit many graduates directly to management positions.

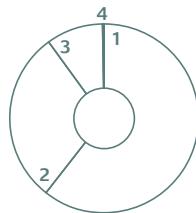
At 31 March 2012, there were 522 apprentices across the Group (2011: 611) of whom 135 were recruited during the year (2011: 89). The drop in numbers since last year is due in the main to a substantial number of apprentices completing their training. Of those completing their training over 94% were appointed into substantive roles.

### Graduate programme



1. Marine and Technology	150
2. Support Services	51
3. Defence and Security	6
4. Group	6
<b>Total</b>	<b>213</b>

### Apprentices



1. Marine and Technology	317
2. Support Services	154
3. International	50
4. Defence and Security	1
<b>Total</b>	<b>522</b>

### Diversity

Diversity awareness is an integral part of our talent management system because it is a business imperative that we ensure access to the widest pool of talent available. Diversity is more than just about avoiding discrimination on the basis of age, race, colour, ethnic origin, gender, marital status, religious beliefs, sexual orientation or disability. It is about embracing the richness of different skills and outlooks and learning from each other to deliver our best to our customers. Our diversity initiative, 'All together different', is championed by a Diversity Management Group, which coordinates the implementation of our equality and diversity policy.

### 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 £272,000 (2011: £236,000).

## Managing environmental impact

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

Based on revenue, 52% of the Group's operations have environmental management systems that are ISO 14001 certified and the breakdown by division can be found below. Where our environmental processes are not certified, we seek to ensure that they are in accordance with customer requirements and, where appropriate, we are also working towards ISO 14001 certification.



Best practice refers to our environmental management controls at sites not yet ISO 14001 certified.

Environmental considerations will play an important role in developing cutting edge solutions for our customers. A recent example is the reconstruction and reconfiguration of the southern taxiway at RAF Marham in Norfolk, using sustainable materials and innovative techniques, which received an 'excellent' rating under the Civil Engineering Environmental Quality Assessment and Award Scheme (CEEQUAL) and delivered a £5 million budget saving.

### The environment and carbon emissions

Babcock holds the Carbon Trust Standard for its UK operations and is committed to continue reducing its carbon footprint in accordance with the Carbon Trust requirements. Over the last two years, our absolute footprint has naturally increased following two significant acquisitions (see table below). However, we expect to see a reduction in this, as we continue our programme aimed at improving the efficiency of the built estate used across the Group. At the date of this report, we are working with the Carbon Trust to renew our certification.

	2008/09	2009/10	2010/11 <sup>1</sup>
Absolute footprint (tCO <sub>2</sub> e)	125,590	126,287	181,608
Relative benchmark (tCO <sub>2</sub> e/£m turnover) <sup>2</sup>	68.4	71.0	65.4

<sup>1</sup> Latest available figures at the date of the report.

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

The Group also participates in the Carbon Reduction Commitment Energy Efficiency Scheme (CRC) and submitted its first report on its energy consumption in July 2011. The CRC published its first Performance League Table in November 2011 and Babcock featured amongst the top 11% of the 2,013 CRC participants with an early action metric score of 72.5% (based on the proportion of non-mandatory CRC electricity and gas supplies measured through voluntary installed 'automatic meter reading' meters in year one of the Scheme and coverage of the Company's operations by the Carbon Trust Standard).

Babcock delivers energy management services to a number of its customers. This year, it expanded its Strategic Energy Management Programme (SEMP) to cover 57 of the key MoD sites, up from 21 last year. SEMP delivered £1.8 million for the MoD.

## Our commitment to governance

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, divisional Chief Executives take responsibility for mitigation steps.

### 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. New employees are made aware of the existence of the hotlines as part of their induction; details of the hotlines are advertised at operating sites.

### Ethical conduct

We have during the year, following the enactment of the Bribery Act 2010, completely refreshed and updated our longstanding Ethical Policy, introducing a new Code of Conduct (which can be viewed on our website at [www.babcock.co.uk/investors/governance](http://www.babcock.co.uk/investors/governance)) making clear our total commitment to not tolerating bribery, corruption or other unethical behaviour on the part of our businesses or those who perform services on our behalf in any part of the world. This policy is backed up with a detailed anti-bribery and corruption policy containing helpful guidelines and procedures designed to underpin our policy. We have also rolled out across the Group an online anti-bribery and corruption training package for employees.

# Principal risks and risk management controls

The risks and uncertainties shown below are those the Board considers to be of most direct relevance and greatest significance to Babcock as it stands today. They have the potential to materially and adversely affect Babcock's business, results of operations, revenue, profit, cash flow, assets and the delivery of its strategy.

For each risk there is a description of the general strategic response by the Company.

The size, complexity and spread of Babcock's businesses and the continually changing environment in which the Group operates

means, however, that the list below cannot be an exhaustive list of all significant risks that could affect the Group.

For example, risks and uncertainties which affect or are likely to affect businesses in general are not set out below but Babcock, in common with other businesses, faces those risks too.

**The Group's risk management and internal control systems can 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.**

## Risk

### Reliance on large contracts with a relatively limited number of major clients, including clients affected by political and public spending decisions

Babcock's customers are mainly large, complex organisations, typically central or local government departments, other public sector bodies or commercially owned entities in sectors subject to specific regulation. Many of them rely, to a greater or lesser extent, on public funding.

Babcock's contracts are typically intended to last for five to seven years, but many for much longer than that.

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

- National and local government policy changes and public spending constraints are potentially material risks for the Company as they could result in delays in placing work, pressure on pricing or margins, withdrawal of projects, early termination of contracts, lower contract spend than anticipated or adoption of less favourable contracting models;
- These customers set demanding criteria for eligibility for contracting with them, the cost of compliance with which can be significant; the failure to obtain or retain the necessary eligible status to contract with such customers could substantially impact entire business areas;
- A loss of reputation for any reason, 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 performance, ethical conduct and contract performance;
- Bid success rate determines how much of a pipeline of opportunities is actually turned into growth;
- Bidding for large and complex contracts is time-consuming (it can take many months or even run into years) and is expensive – as can be mobilising on new contract wins;
- Unsuccessful bids or rebids can involve significant wasted bid costs;
- By their nature, large, longer term contracts are irregular and relatively infrequent in coming to market;
- These factors together mean that lack of success in a new bid can represent a significant missed opportunity for growth, and losing rebids can mean the loss of a significant existing revenue and profit stream.

## Strategic response

- The Company has extensive and regular dialogue with key customers, involving as appropriate, the Chief Executive, Divisional Chief Executives and other members of the senior management team.
- The Company actively monitors actual and potential political and other developments that might affect its customers.
- By these means, the Company seeks to maintain a clear understanding of customer needs, plans and constraints and to be able to respond to them.
- The Company aims to be innovative and responsive in helping customers meet their needs and challenges.

## Risk

### Operations carrying significant health and safety or environmental risks

Many of Babcock's operations, if not properly managed and conducted, entail the risk of significant harm to employees, third parties or the environment. Apart from the adverse impact this could have on reputation and the willingness of customers to deal with Babcock (see above), this could lead to significant financial loss and claims for damages.

## Strategic response

Health, safety and environmental performance are absolute priorities for Babcock and receive close and continuous attention and oversight from the senior management team as well as at the operational level.

## Risk

### Need for experienced management resource and skilled employees, who can sometimes be in short supply

The Group needs, now and in the future, strong, experienced senior executive and management teams familiar with the Babcock culture, business model and customer base and who are capable of delivering its strategic development plans. Also, some of the Group's core engineering, technology and project management businesses are complex and demand skilled, suitably qualified personnel to deliver them operationally. The continuing success of the Group relies on Babcock's ability to attract, train and retain qualified and experienced management and business development executives and other specialist professionals, technicians, engineers and project management staff. The number of suitable candidates is limited and the market for them competitive. This can lead not only to increasing costs of recruitment and retention but also potential problems with resourcing contracts and pursuing bids and new business areas, which could in turn threaten the Company's growth and reputation.

### Strategic response

High priority and significant resources are given to recruiting skilled professionals, apprentice and graduate recruitment programmes, training and development, succession planning and talent management generally.

#### Risk

## IT and cyber-security

Like any business, Babcock depends on having reliable and secure IT systems and cyber-security is an increasing threat for all businesses. However, for Babcock this is also a critical customer concern. Many customer contracts require the Group to operate contract-supporting IT either entirely within secure customer networks or to be able to interface reliably and securely with those systems, and the nature of Babcock's main customers is such that they and their suppliers are a prime target for cyber-security attacks.

The ability of Babcock to be able to deliver secure IT and other information assurance systems is, therefore, a key factor for the customer. If Babcock is unable to demonstrate continuing compliance with customer requirements in this area it could have a substantial impact on major business sectors.

### Strategic response

Babcock has made a major investment – and will need to maintain significant investment – in updated, reliable, more secure and suitably accredited systems, under a centrally run IT management structure. As a part of this investment programme a major project is underway to upgrade and further enhance security and information assurance controls and management.

#### Risk

## The Group has significant defined benefit pension schemes

Defined benefit schemes provide for a specified level of pension benefit to members, the cost of which is met from both 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, such as 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 impact can occur due to differences between the actual and assumed investment returns and changes in the assumption for 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 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. Future accounting, regulatory and legislative changes may also adversely impact on valuations and costs.

### Strategic response

Continuous strategic monitoring and evaluation by Group senior management of both the assets and liabilities of the pension scheme and, as appropriate, the execution of mitigation opportunities. The Company seeks to have a constructive and open relationship with the schemes' trustees with a view to working together to mitigate and manage these long-term risks.

### General risk management and internal controls in Babcock

The Board is ultimately responsible for the Company's risk management and internal control system, which is overseen on its behalf by the Audit and Risk Committee.

The Audit and Risk Committee reviews aspects of the risk management and control system at its meetings and at least once a year formally reviews the system's effectiveness on behalf of the Board: see the effectiveness review statement on page 61.

The Committee receives regular internal audit reports from Ernst & Young LLP which review controls and compliance.

Internal control systems are monitored operationally by senior Group management with Divisional Chief Executives having day-to-day operational responsibility for risk identification and risk management in their businesses.

A Group Risk Manager works with divisional management teams to keep under review and development, and to share best practice in making, the Group's risk assessments and in complying with risk management standards and processes.

Risk assessments made at business unit level are subject to regular review and challenge by Group senior management.

The following pages summarise the main internal control processes that are used in addressing the risks mentioned above and other business risks.

Babcock's risk control system includes the following controls that are directly relevant to managing the principal risks mentioned on pages 40 and 41:

Control	Explanation	Risk
<b>Health, safety and environmental monitoring, reporting and management</b>  See also the Corporate responsibility report on <a href="#">p37</a> .	<p>Governance and management arrangements:</p> <p>Corporate Safety Steering Group and Divisional Safety Leadership Teams at Senior management level (see the Corporate Responsibility report, page 37);</p> <p>Divisional health, safety and environmental professionals;</p> <p>Divisional Boards and the Group Executive Committee receive monthly reports of health, safety and environmental performance;</p> <p>Chief Executive reports regularly to the Board on any significant matters;</p> <p>Board receives detailed half-yearly reports on performance.</p> <p>Education and training programmes.</p> <p>External consultants advise on best practice and help evaluate and design management-led improvement initiatives.</p> <p>Unsatisfactory performance can lead to reduction or cancellation of executive bonuses.</p> <p>Insurance (subject to compensation limits and deductibles).</p> <p>Statutory or customer indemnities in some operations (for example, nuclear engineering businesses).</p>	<ul style="list-style-type: none"> <li>• Harm to employees and others or to the environment.</li> <li>• Damage to reputation.</li> <li>• Substantial civil liabilities and criminal penalties.</li> </ul>
<b>Bid reviews</b>	<p>All material commercial and contractual activities are subject to challenge, oversight and approval by senior Divisional and Group executives;</p> <p>Bids are subject to multiple 'gating' (evaluation) points for approval to proceed to next stage.</p> <p>Group Policies and Procedures set commercial, financial and legal framework for all bids.</p> <p>Internal and external legal support and review.</p>	<ul style="list-style-type: none"> <li>• Poor bid success rate.</li> <li>• Inefficient use of bid resources.</li> <li>• High delivery risks.</li> <li>• Contracting on unacceptable commercial terms.</li> </ul>
<b>Contract reviews</b>	<p>Forward-looking management reviews of contracts in operation to ensure that they operate profitably, required performance is being and will continue to be delivered and that they are being properly accounted for.</p> <p>The financial performance of all significant contracts is regularly reviewed by Group Finance.</p> <p>Customer satisfaction surveys help identify potential threats to customer relationships so that they can be addressed early.</p>	<ul style="list-style-type: none"> <li>• Poor contract performance, leading to breach of contract or financial penalties under KPI regimes.</li> <li>• Damage to customer relationships.</li> <li>• Loss of reputation.</li> <li>• Unprofitable contract performance.</li> <li>• Inappropriate contract accounting.</li> </ul>
<b>Pensions management function</b>	<p>The Group Pensions Manager, reporting to the Group Finance Director, keeps strategic pension matters under close review and reports regularly to the Executive Committee and/or the Board.</p> <p>'Longevity swaps' to reduce exposure to the impact of increasing life expectancy;</p> <p>Long-term investment strategy and risk framework agreed with scheme trustees intended to reduce the impact of the schemes' exposure to changes in inflation and interest rates;</p> <p>Consolidation and effective management of existing risks within all UK pension arrangements and mitigation of additional risks taken on with new long-term contracts.</p>	<ul style="list-style-type: none"> <li>• Large and/or volatile pensions funding liabilities and pensions accounting exposures.</li> </ul>
<b>Succession plans</b> <b>Graduate and apprentice recruitment, training and retention programmes.</b> <b>Talent and management development plans.</b>	<p>The Group Organisation and Development Director reports to the Board and Executive Committee on succession planning, executive management/ talent training and development and graduate recruitment. Management resourcing needs are discussed regularly at Board and Group Executive Committee meetings.</p> <p>See further on this subject in the Corporate Responsibility report. Page 38.</p>	<ul style="list-style-type: none"> <li>• Lack of necessary skilled and experienced employee and management resource now and in the future, hampering contract delivery and the strategic development of the Group.</li> </ul>

**Other internal controls include:****Budget process**

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.

**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 matters of potential strategic significance.

Group senior management receives a monthly narrative operating report from all business units.

**Internal and external audit reports to the Audit and Risk Committee****Clear delegations and limits of authority****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.

**Claims 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 internal legal service.

**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.

**Code of conduct and anti-bribery and corruption policies and procedures**

The Group has a Code of Conduct making clear its commitment to the highest ethical standards and setting out the ethical standards it demands of its employees and those who work for it and with whom it does business.

There is an explicit anti-bribery and corruption governance structure in place and detailed policy and procedures, with supporting training programmes, that the Company believes meet the requirements of 'adequate procedures' under the Bribery Act 2010.

**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, export controls; contracting requirements and guidelines; legal; financial and accounting matters. These are available on the Group intranet and are supplemented at divisional level by further business unit specific policies.

# Directors and Company Secretary

Here you will find short biographies of the Directors in office at the date of this Annual Report. On page 46 a table provides more information about them and their attendance at Board and Committee meetings.



**Mike Turner CBE**  
Chairman of the Board

Mike Turner was appointed Chairman of Babcock in November 2008. Since 3 May 2012 he has also been Chairman of GKN plc, where he was previously senior independent director. He is a former chief executive of BAE Systems plc and a former Chairman of the UK Defence Industries Council (DIC). He is a member of the UK Government's Apprenticeship Ambassadors Network and is a non-executive director of Lazard Limited.



**Peter Rogers CBE**  
Chief Executive

Peter Rogers joined the Board as Chief Operating Officer in June 2002 and became Chief Executive in August 2003. He is a non-executive director of Galliford Try PLC and a former director of Courtaulds PLC and Acordis BV. He has also served as a president of ADS (Aerospace Defence Security).



**Bill Tame**  
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. He is a non-executive director of Carclo PLC.



**Archie Bethel CBE**  
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. He is vice-president and honorary treasurer of the Institution of Mechanical Engineers and is also President of the Society of Maritime Industries.



**Kevin Thomas**  
Chief Executive, Support Services

Kevin Thomas became a Director on 1 May 2010. He joined the Group in June 2002. Before 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.



**Sir David Ormand GCB**  
Senior Independent Director

Sir David joined the Board on 1 April 2009. He is a non-executive director of Finmeccanica UK Limited and is a visiting professor in the department of War Studies, King's College London. He left UK Government service in 2006 having served in various senior roles, including as UK Government Security and Intelligence Coordinator, 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.



**Justin Crookenden**  
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 is a former investment banker, having worked at UBS, Barclays de Zoete Wedd and Credit Suisse First Boston – where he was managing director, UK Investment Banking.



**Ian Duncan**  
Independent Non-Executive Director;  
Chairman of the Audit and Risk Committee

Ian Duncan joined the Board as a Non-Executive Director on 10 November 2010. He is a Chartered Accountant and is a former Group Finance Director of Royal Mail Holdings PLC. He has also been Corporate Finance Director at British Nuclear Fuels plc and Chief Financial Officer and Senior Vice President at Westinghouse Electric Company LLC in Pennsylvania, USA.



**Sir Nigel Essenhain GCB**  
Independent Non-Executive Director

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



**Kate Swann**  
Independent Non-Executive Director

Kate Swann joined the Board as a Non-Executive Director on 1 June 2011. She is currently Group Chief Executive of WH Smith PLC. She is a former Managing Director of Argos, and a former Managing Director of Homebase Ltd.



**Albert Dungate**  
Group Company Secretary and General Counsel

Albert Dungate is a Solicitor. He has been Group Company Secretary and General Counsel since February 2002. He is Secretary to the Board and to the Audit and Risk, Remuneration and Nominations Committees.

## The Board and its committees during the year to 31 March 2012

	Served throughout the year?	Independent	Period of service on the Board	Board attendance (out of maximum possible full Board meetings)	Committee memberships and attendance (out of maximum possible)						
					Remuneration	Audit and Risk	Nominations				
<b>Current Directors</b>											
<b>Chairman</b>											
Mike Turner	Yes	n/a	4 years	12/12	–	–	2/2				
<b>Executive Directors</b>											
Peter Rogers <i>Chief Executive</i>	Yes	No	10 years	12/12	–	–	–				
Bill Tame <i>Group Finance Director</i>	Yes	No	10.5 years	12/12	–	–	–				
Kevin Thomas <i>Chief Executive, Support Services</i>	Yes	No	2 years	12/12	–	–	–				
Archie Bethel <i>Chief Executive, Marine and Technology</i>	Yes	No	2 years	12/12	–	–	–				
<b>Non-Executive Directors</b>											
Sir David Omand <i>Senior Independent Director (since 1 January 2012)</i>	Yes	Yes	3 years	12/12	6/7 <sup>1</sup>	4/4	2/2				
Justin Crookenden <i>Chairman, Remuneration Committee</i>	Yes	Yes	6.5 years	12/12	7/7	4/4	2/2				
Ian Duncan <i>Chairman, Audit and Risk Committee (since 7 July 2011)</i>	Yes	Yes	1.5 years	12/12	7/7	4/4	2/2				
Sir Nigel Essenhagh <i>(Will retire from the Board on 31 December 2012; ceased membership of the Remuneration and Audit and Risk Committees on 31 March 2012)</i>	Yes	Yes	9 years	11/12 <sup>2</sup>	6/7 <sup>2</sup>	4/4	2/2				
Kate Swann	From 1 June 2011	Yes	1 year	10/11 <sup>3</sup>	6/6	3/3	1/1				
<b>Other Directors who served during the year</b>											
John Rennocks <i>Chairman, Audit and Risk Committee from 1 April to 7 July 2011 and Senior Independent Director from 1 April to 31 December 2011</i>	From 1 April 2011 until he retired on 31 December 2011	Yes	9.5 years	9/9	4/4	3/3	1/1				

1. Absence due to delayed meeting start causing clash with prior commitment;

2. Absence due to personal commitment overseas;

3. Absence due to prior business commitment made before appointment to Board.

# Governance statement

## From Mike Turner, Chairman

Your Board is committed to fostering a strong culture of good governance. As Chairman, I recognise my special responsibility, along with Peter Rogers, our Chief Executive, for demonstrating ethical leadership and for promoting and upholding the highest standards of corporate governance, integrity and probity on the part of Babcock and its employees.

In support of this governance commitment, as a Board we have during the past financial year:

- overseen the development and implementation of formal policies and procedures in the light of the coming into force of the Bribery Act 2010;
- followed and discussed the board diversity debate, particularly the subject of gender diversity;
- ensured the smooth implementation of changes to refresh and diversify the Board, which involved the appointment of a new Non-Executive Director, the retirement of a long-standing Non-Executive Director and the appointment of a new Senior Independent Director and a new Chairman of the Audit and Risk Committee;
- taken steps to improve our executive development programme and our senior executive succession planning arrangements;
- engaged extensively with leading shareholders on the subject of Executive Director remuneration;
- reviewed and updated our formal statement of the roles of the Chairman, Chief Executive and Senior Independent Director;
- reviewed and updated the terms of reference of the Board's Committees;
- reviewed and updated the powers delegated by the Board to the executive team;
- undergone an externally conducted evaluation of our performance; and
- had two special meetings focusing solely on strategy.

We talk in more detail about what we are doing on some of these fronts in the following pages.

**Mike Turner CBE**  
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 56 to 62 also form part of our Governance statement.*

## Governance Code compliance

The principal governance rules applying to the Company are contained in The UK Corporate Governance Code ('the Governance Code') issued by the Financial Reporting Council ('the FRC') in June 2010.

Except as noted below under the description of Board balance, the Board considers that the Company complied with the Main Principles of the Governance Code during the year under review.

## 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;
- reviewing the respective roles and responsibilities of the Chairman, Chief Executive and Senior Independent Director;
- business acquisitions and disposals;
- approving significant contracts outside the ordinary course of business;
- setting treasury and borrowing policy; and
- determining ethical, social, health, safety, environmental and governance policy.

Committee terms of reference and other delegated authorities are formalised and reviewed from time to time. Following a recent review the terms of Reference of the main committees have been refreshed and updated as has the statement of the respective roles of the Chairman, Chief Executive and Senior Independent Director. They are available to view on our website: [www.babcock.co.uk/investors/governance](http://www.babcock.co.uk/investors/governance).

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.

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

**Matters considered by the Board in the year to 31 March 2012****(in addition to matters delegated to the Audit and Risk, Remuneration and Nominations Committees) included:**

<b>Health, safety and environmental performance</b>	Babcock senior management is unrelenting in its focus on performance in these areas and keeps the Board apprised of that performance through formal half-yearly reviews and reports at every Board meeting from the Chief Executive and Divisional Chief Executives on current performance and any specific initiatives or issues that are being addressed.
<b>Strategy</b>	Two special Board meetings were held during the year devoted solely to consideration of strategic development plans and their follow up.
<b>Board effectiveness and diversity</b>	The Board considered the Financial Reporting Council's and the ABI's Guidance on Board Effectiveness, the Davies Report on Women on Boards and Government statements on the subject. The Board's statement on diversity is set out on page 49 below.
<b>Succession planning, management resource planning; graduate recruitment, apprentice training and talent development</b>	The Board (itself and through the Nominations Committee) considered and approved: <ul style="list-style-type: none"> <li>• Detailed executive and senior management succession plans;</li> <li>• Proposals for improving significantly the Company's senior executive development programme;</li> <li>• Proposals to improve the Babcock Academy's management training programmes;</li> <li>• The continued development of the Company's extensive graduate recruitment, emerging leaders and apprentice training programmes;</li> <li>• Proposals from Group and divisional management teams to recruit additional business development and bidding resource and expertise.</li> </ul>
<b>Delivery of synergy benefits from the VT acquisition in 2010</b>	The Board received a report at each of its meetings tracking the delivery of the cost synergy benefits foreseen when it decided to acquire VT Group plc.
<b>Budgets</b>	The Board reviewed and approved the budget for 2012/13 and the forecasts for succeeding years.
<b>Operating and financial overview</b>	At each of its meetings the Board receives: monthly management accounts and a report from the Group Finance Director on Group financial performance; a report from the Chief Executive and divisional Chief Executives on operational or other matters of note or of potential strategic significance; copies of divisional management operating and financial reports; and copies of Group Executive and Divisional Management Board minutes.
<b>Business presentations</b>	The Board held one of its meetings at Rosyth Royal Dockyard at which it received a local management presentation on the aircraft carrier build programme and development opportunities for the businesses operating from the yard. The Board received a presentation from the Managing Director of the new Mobile Assets management business on the proposed arrangements with Lafarge.
<b>Order book and pipeline</b>	The Board has monthly reports showing the development of the Group's order book and pipeline.
<b>Corporate development</b>	The Board considered options for the future of the Group's US businesses, both VT US and Babcock Eagleton, including sale.
<b>Investor sentiment and feedback</b>	The Board receives at each meeting a report on investor relations activities that reports on visits or presentations to analysts, meetings with shareholders, investor feedback, proposed investor relations programmes and market expectations as to financial performance. Members also receive copies of analysts reports. The Board also received a presentation on a specially commissioned Shareholder Survey conducted by an external consultancy on its behalf.
<b>Pension schemes</b>	The Board receives reports on the funding position of the Group's defined benefit schemes, their impact on the Group and plans to manage the risks presented by them.
<b>Insurance</b>	The Board received a briefing on the renewal of the Company's insurance programme and the Company's strategic approach to insurance.
<b>IT</b>	The Board received a presentation and written updates on progress with the Group's major IT Transformation programme.
<b>Bribery Act</b>	The Board reviewed and approved a new Code of Conduct and Anti-Bribery and Corruption policy and procedures that addressed the requirements and implications of the Bribery Act 2010.
<b>Board, committee and Director annual evaluation</b>	The Board considered and debated the results of the evaluation reviews.
<b>Tax</b>	The Board received a presentation on the Group's tax position and its approach to tax planning.
<b>Security, cyber-security</b>	The Board discussed the increasing risks to cyber-security and appointed one of its members a Group Security Director to oversee a programme to implement a new security management structure and policies and procedures to mitigate security risks and address developing customer requirements.

## The Board

The current Directors' biographies are on pages 44 and 45. The Board is satisfied that each has the necessary time to devote to the effective discharge of their responsibilities.

### *Its responsibility, effectiveness and skills*

The Board is responsible for the long-term success of the Company.

To this end, it must have, and believes it currently has, a balance of skills, understanding, perspectives and experience relevant to the Group's activities.

It is accepted though that this is a question it must keep under review as it looks forward under its strategic plans to the potential development of business in both existing and new market sectors and with new, and new types of, customers, both in the UK and internationally, and the need to maintain the Board's credibility in its chosen business areas. It will have these considerations in mind when making new appointments.

The recent appointments of Ian Duncan and Kate Swann as Non-Executive Directors were made against this background, bringing as they did senior management expertise, perspectives and experience from different industrial and commercial sectors.

In recruiting new Non-Executive Directors, the Board has a preference for choosing from among candidates with operational experience in running large businesses or other operations. It also considers candidates who may not yet have had main board listed company experience but who serve or have served on substantial private company or public sector boards or who have or have had senior management responsibility below board level, for example in running significant non-listed entities or business divisions within larger organisations.

### *Diversity*

The Board has noted and discussed at some length the public debate around the subject of the benefits of diversity, particularly gender diversity, amongst board members and more generally in executive management teams.

Babcock is fully committed to the view that the potential benefits of diversity – in all its aspects – is something of which companies, and other sectors in society, should be actively conscious and keep in mind in their business operations and plans for development.

The Board is clear as well that its overriding policy should be to appoint the best available candidates. In making that judgement there needs to be an active consideration of the benefits of diversity, including gender diversity, but the Board believes that setting or announcing specific target aspirations, especially by specific dates, is tantamount to imposing a quota and that quotas with deadlines can distort the selection process and conflict with its preferred, diversity-aware 'best for the job' approach.

The Board can unequivocally state that its aspiration and intent is to see an increasing number of women on the Board and in executive management roles just as quickly as can be achieved with this 'best for the job' approach.

It also has to be borne in mind when judging how a company might be performing on broadening gender diversity that companies have very different histories and backgrounds that have led to where they are today. Some, like Babcock, operate principally in sectors that might be regarded as 'traditionally male', such as engineering or working with the armed forces. Inevitably, such companies tend to be starting from a background of relatively low female participation, especially in management positions, which reflects a wider social context.

But things are changing and Babcock now has:

- its first female Director (currently representing 10% of the whole board and 25% of the Independent Non-Executives) and in making future appointments the Board will ensure that the candidate list has actively sought out and includes a number of suitably qualified women;
- a diversity awareness campaign launched and rolled out across the whole Group led by the Chief Executive;
- a Diversity Committee, chaired by the Chief Executive;
- taken the decision to focus its graduate recruitment programme, particularly of engineering graduates, on those universities that have a richer undergraduate gender mix so as to improve the diversity of the pool of talent from which it recruits its engineers and managers of the future – this is already bearing fruit and female graduates now make up close to 20% of the annual intake, with the numbers rising each year;
- and the senior executive management team is also actively considering how to make management roles more attractive and amenable to female candidates so as to increase the numbers interested in applying for them.

### *Balance between independents and non-independents*

The Governance Code recommends 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.

As explained in the Governance report last year, although John Rennocks had from June 2011 been on the Board for nine years – seen by some as indicative of non-independence – as he had by then announced his intention to retire on 31 December 2011, the Board continued to regard him as independent. However, although he continued as a member of the Remuneration and Audit and Risk Committees and to fulfil the role of Senior Independent Director until he retired at the end of December, he stepped down from his position as Chairman of the Audit and Risk Committee in July 2011.

If he were to have been regarded as non-independent, the Board would for the period from June 2011 to December 2011 still have met the balance requirement of the Governance Code, although membership of the Audit and Risk and Remuneration Committees would not for that period have consisted wholly of independent Directors (but the balance on them would have been five independents to one non-independent).

In March 2012, Sir Nigel Essenhight completed nine years of service as a Non-Executive Director and announced his intention to retire from the Board on 31 December 2012, but stood down from membership of the Remuneration and Audit and Risk Committees on 31 March 2012.

Although the Board considers Sir Nigel still to be independent given the relatively short time that will elapse between his having served for nine years on the Board and his announced retirement date, if for the period from 1 April 2012 to 31 December 2012, he is, because of his length of service, regarded as no longer independent and pending the appointment of a new independent Non-Executive Director, the Board would, disregarding the Chairman, have five non-independent Directors and four independent, but the Remuneration and Audit and Risk Committees will consist only of independent Directors as required by the Governance Code.

It is the Board's intention to appoint a new independent Non-Executive during the year.

#### **Refreshing of the Board**

In this and recent years, the following evolutionary changes have been made or announced:

Year	Board changes
2012	Long-serving Non-Executive Director to retire on 31 December 2012 Announced intention to appoint new Non-Executive Director; New Senior Independent Director.
2011	Appointment of new independent Non-Executive Director; Retirement of long-serving Non-Executive Director; New Chairman of the Audit and Risk Committee.
2010	Resignation of Deputy Chairman; Appointment of new independent Non-Executive Director; Appointment of two new Executive Directors.

#### **Chairman, Chief Executive and Senior Independent Director 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. This has been reviewed and updated recently and now includes the role of the Senior Independent Director. A copy of this is available on the Company's website ([www.babcock.co.uk](http://www.babcock.co.uk)).

#### **Senior Independent Director**

From 1 April 2011 until 31 December 2011, John Rennocks was, and since 1 January 2012 Sir David Omand has been, 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 Group Finance Director. The Chairman looks to the Senior Independent Director 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.

#### **Board proceedings**

##### *General*

The Board has at least ten scheduled full board meetings a year plus two meetings devoted solely to strategy.

The Chairman also meets separately with Non-Executive Directors without Executive Directors or other managers present.

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, no Directors expressed dissatisfaction with the timing and quality of information provided to them.

#### **Board appointments – the process**

Appointments to the Board are led by the Chairman working with the Nominations Committee.

It is the Company's normal practice to use the services of independent external search consultants in recruiting new Non-Executive Directors, as was the case with the two most recent appointments of Ian Duncan and Kate Swann.

### ***Annual re-election of Directors***

All Board members now stand for annual re-election.

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 review for the financial year 2011/12 was facilitated externally by Professor Stuart Timperley, a former professor at the London Business School with considerable experience of working on and with boards and as an advisor on growth, transition and capability issues. Professor Timperley has carried out such external reviews on two earlier occasions and has on occasion provided mentoring to a small number of senior executives, but otherwise provides no other services to the Group. He was able to focus his attention and base his questions from a position of having a good understanding of the Company, its challenges and needs and was able to see things in the context of the Company's development and of his earlier reviews.

He conducted a series of one-on-one confidential interviews with Board members, the Company Secretary and selected members of the senior management team. He reported back on his findings to the Chairman and submitted a report to, and made a presentation at, a full Board meeting, at which his observations were discussed.

Noting that, since his last review, there had been a continuation of Babcock's growth, significant acquisition activity, a rebalancing of the portfolio, substantial contract wins and a demonstrable track record in maintaining a stable base whilst undergoing considerable change, he looked at the way in which the Board had identified and addressed the range of issues in this period and how it needed to handle its strategic and governance responsibilities going forward.

The review found no immediate or short-term issues relating to the effectiveness of the Board, its members or its committees that required addressing other than continuing to manage inevitable transitions. It did, however, identify medium and longer term challenges that will require consolidation and planning. These would include:

- The inevitable challenges of overseeing and running a much larger and changing organisation and the ensuing pressures on governance, management resource and structural issues;
- Maintaining the momentum of a growth strategy, in particular the ramifications and demands of any international expansion;
- Ensuring the Board had credibility in relation to any new business areas it might be considering;
- Planning for and managing the impact of succession and changes at the Executive Director level and in the senior management team below that. It was noted that this was a matter that had been identified, had been receiving close attention over several years and its importance was reflected in its regular consideration.

### ***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.

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 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.

Non-Executive Directors are invited to attend the Group's senior management conferences.

### ***Change in Chairman's significant external commitments***

During the year to 31 March 2012 there were no changes to Mike Turner's significant external commitments. On 3 May 2012, he became Chairman of GKN plc, on whose board he was already sitting as a non-executive director. The Board is satisfied that despite this change his external commitments will have no impact on the discharge of his responsibilities to the Company.

### Relations with shareholders

The Board understands the importance of there being a dialogue with shareholders to ensure that it is abreast of and understands shareholders' views and opinions. During the year the Company commissioned Clare Williams Associates to undertake a survey of a number of its major shareholders, as well as some non-holding institutions, as to their perception of the Group, its management, its strategy and future direction. The results were formally presented to the Board in September 2011.

Investor relations activities are designed to ensure that shareholders, potential investors and analysts are regularly updated on current trading, financial results and other developments within the Group's businesses.

This is achieved in a variety of ways:

- the Chief Executive, Group Finance Director and Head of Investor Relations regularly meet institutional shareholders or potential investors either individually or as part of group meetings. In the year to 31 March 2012, there were 130 such meetings with a total of over 150 investors;
- 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; visits and presentations in the year to 31 March 2012 included: a half-day seminar on the Support Services division in London in September 2011 and, in March 2012, a visit to the BMW Academy near Reading and the School of Electrical and Mechanical Engineering at Bordon to understand more about the Education and Training business unit and the Defence and Security division;
- investor relations reports describing investor and analyst opinions are provided regularly to the Board;
- the Chairman is available for meetings with major shareholders and he reports on such 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 2011 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 presentations. Shareholders may register on the website to be sent news releases automatically.

### In the year to 31 March 2012 formal contacts\* with shareholders, potential investors and analysts were as follows:

Contacts with shareholders, investors and analysts	When
Letters from the Group Chairman and Remuneration Committee Chairman to leading shareholders (and follow-up meetings if requested) on proposals for executive remuneration as described in this and last year's Remuneration reports	May/June 2011, November 2011 and March 2012
Meetings with the ABI	January 2012
31 meetings with sell-side analysts (including meetings with brokers' sales teams)	Throughout
130 meetings with shareholders and potential investors	Throughout
Roadshow in Paris	May 2011
Roadshow in the USA	March 2012
Presentations to investors from divisional CEOs and management teams, including broker organised conferences	September 2011 and March 2012
Full-year and half-year results announcements and presentations	May and November 2011
Interim management statements, and pre-close trading statement conference calls with the Group Finance Director (also available as audio casts on the Company's website)	July and September 2011, January and March 2012
Annual General Meeting	July 2011

\* In addition to regular contact on a daily basis with analysts and shareholders responding to questions and requests for information through the Head of Investor Relations.

# Report of the Nominations Committee

## Committee membership

Current membership of the Committee, and its membership during the year to 31 March 2012, is shown in the table on page 46 of this Annual Report. The Company Secretary is Secretary to the Committee.

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 Committee's attention has been focused on discussing Board succession planning and at senior executive level, and on approving proposals for targeted, enhanced executive development programmes to underpin those plans.

## Diversity

The Board as a whole discussed the issues raised by the Davies Report on Women on Boards and related statements and reports on the topic of diversity and board effectiveness. The Board's position on diversity is set out on page 49.

### Mike Turner CBE

Committee Chairman

14 May 2012

# Report of the Audit and Risk Committee

## From Ian Duncan, Committee Chairman

I am pleased to present the first report of the Audit and Risk Committee since I took over from John Rennocks as Committee Chairman in July 2011. I would like to express on behalf of Committee members our sincere thanks for John's excellent chairmanship of the Committee over the nine years that he led it. I took over the chairmanship of a well-functioning and well-supported body that takes its responsibilities very seriously and recognises the essential governance role it has to fulfil.

In addition to this change in Committee chairmanship, Kate Swann joined the Committee as a new member on her appointment as a Non-Executive Director on 1 June 2011. Sir Nigel Essenhight retired from the Committee on 31 March 2012. These changes have also coincided with a change, in accordance with professional rotation requirements, in the audit partner assigned to the Babcock account by PricewaterhouseCoopers, which took effect for the financial year to 31 March 2012.

Within the space of less than two years, therefore, the composition of the Committee has changed significantly ensuring that it maintains its freshness of approach.

**Ian Duncan**  
Committee Chairman

## Committee's role

The table on page 55 describes what the Committee does. Its formal terms of reference – as updated and revised during the past year – are available on the Company's website at [www.babcock.co.uk](http://www.babcock.co.uk).

## Committee membership

Current membership of the Committee, and its membership during the year to 31 March 2012, is shown in the table on page 46 of this Annual Report. The Company Secretary is secretary to the Committee.

### Chairman

John Rennocks acted as Committee Chairman from 1 April 2011 to 7 July 2011 when his role as Chairman was taken over by Ian Duncan.

Ian Duncan is considered by the Board to have the necessary recent and relevant financial experience for the role of Committee Chairman. He 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.

## Who attends Committee meetings?

The Committee invites the Group Chairman, Chief Executive, Group Finance Director and Group Financial Controller to attend its meetings. All Directors not sitting on the Committee are welcome to attend its meetings and now do so on a regular basis.

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 also meets PricewaterhouseCoopers LLP and Ernst & Young LLP in the absence of executive management, and other Committee members have the opportunity to do so. The auditors are also invited to address the Committee without executives present at least once a year.

## 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 and the lead audit partner was changed with effect from the year under review.

Audit fees are re-evaluated periodically.

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 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.

### Matters considered by the Committee in the year to 31 March 2012

Topic	What was considered
<b>Financial results</b>	Full and half year financial statements and related results announcements. Reports and reviews from external auditors. Matters that required the exercise of a significant element of management judgement.
<b>Internal controls</b>	An annual review of the Company's system of internal controls (described on pages 42 and 43) and their effectiveness.
<b>Fraud</b>	Reports to each meeting on fraud risk, covering any suspected incidents of fraud, their investigation and remedial or preventive action. The report of a Group-wide review of fraud risks.
<b>Bribery Act</b>	Policies and procedures to address the requirements of the new Act.
<b>Cyber-security</b>	An assessment of cyber-security maturity in the Group's operations.
<b>Audit plans</b>	Internal and external audit plans for the year or particular audits.
<b>Internal audit</b>	At each meeting, internal audit reports 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 control performance of business units over time and how quickly any matters are addressed. The integration of a review of the Company's new anti-bribery and corruption policies and procedures into the audit plan.
<b>Risk</b>	Regular detailed reports identifying areas of risk at business unit, divisional and Group level assessing and prioritising potential impact, risk mitigation steps in place and the pre- and post-mitigation risk levels.
<b>Whistleblowing</b>	Regular reports of calls to the Group's external independent whistleblowing services and how they have been investigated and dealt with.
<b>Audit fees; fees for non-audit services; auditor independence</b>	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 26 to 35 of this Report.

## Directors

Biographies of the current Directors of the Company are to be found on pages 44 and 45.

The table on page 46 shows the Directors who served in the year to 31 March 2012.

## Reappointment of Directors at the 2012 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.

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 The Grosvenor House Hotel, Park Lane, London W1K 7TN on Thursday, 5 July 2012, at 11 am. The notice of meeting with an explanation of the business to be conducted at it is being sent to shareholders as a separate document (or is available to view online at [www.babcock.co.uk](http://www.babcock.co.uk) for those who have chosen or who are deemed to have chosen simply to receive notices of availability of documents).

## Results and dividends

The profit attributable to the owners of the parent company for the financial year was £100.8 million (2011: £101.1 million). An interim dividend of 5.7p per 60p ordinary share was declared in the year (2011: 5.2p). The Directors are recommending that shareholders approve at the forthcoming Annual General Meeting a final dividend for the year of 17.0p (2011: 14.2p) on each of the ordinary shares of 60p to be paid on 7 August 2012 to those shareholders on the register at the close of business on 6 July 2012.

## Significant shareholdings

As at 10 May 2012, the Company had been notified in accordance with Chapter 5 of the Disclosure and Transparency Rules of the following major interests in voting rights attached to its ordinary shares (which represent interests in 3% or more of its issued ordinary share capital).

Name	Number of 60p ordinary shares	%
Standard Life Investments Limited	21,406,135	5.96
BlackRock, Inc	18,147,899	5.05
Cantillon Capital Management LLC	18,018,048	5.01
FMR LLC	17,700,915	4.93
Ignis Investment Services Limited	14,059,461	3.91
Legal & General Group Plc	11,471,276	3.19
JPMorgan Chase & Co	11,376,214	3.17
Ameriprise Financial Inc	11,330,063	3.15

### Employee share schemes and plans:

The table below summarises share-based plans in existence during the year to 31 March 2012 or at the date of this Report that have outstanding awards (i.e. that have awards yet to vest or vested awards yet to be exercised).

Name of Plan	Who it covers	Performance related?	Summary description	Outstanding number of shares under 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.	4,557,164 (1,324,845 expected to vest in July 2012)	Market purchase or 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.	483,086 (306,536 expected to vest in September 2012)	Market purchase or 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.	279,832 (All vested)	Market purchase or 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.	501,629 (239,908 expected to vest in July 2012)	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.	43,872 (All vested)	Market purchase or fresh issue

**Employee share schemes and plans (continued)**

Name of Plan	Who it covers	Performance related?	Summary description	Outstanding number of shares under 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.	40,592 (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.	0 (Expired in March 2012)	Fresh issue

Further information relating to awards held by Directors under the LTIP, PSP, CSOP, DBP and the 1999 Schemes can be found in the Remuneration report on pages 72 and 73.

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 14 May 2012, the total number of ordinary shares in the trusts was 423,167, which represented 0.12% 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 25 on pages 116 and 117.

**Authority to purchase own shares**

At the Annual General Meeting in July 2011, members authorised the Company to make market purchases of up to 35,903,257 of its own ordinary shares of 60p each. That authority expires at the forthcoming Annual General Meeting in July 2012 when a resolution will be put to renew it so as to allow purchases of up to a maximum of no more than 10% of the Company's issued share capital. No shares in the Company have been purchased by the Company in the period from 7 July 2011 (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 2012, 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 25 on pages 116 and 117.

**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 £272,000 (2011: £236,000) 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 £18,000 in trade creditors at 31 March 2012 (representing 2 creditor days) and £113,000 in trade creditors at 31 March 2011 (representing 31 creditor days).

### 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 2012, 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 former 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.

Although the Group has some contracts that on their own are not significant to the Group, several may be with the same customer. If, upon a change of control, the customer decided to terminate all such agreements, the aggregate impact could be significant.

The following agreements are those individual 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.

#### 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

£500 million facility agreement dated 17 June 2011 between the Company and Australia and New Zealand Banking Group Limited, BoA Netherlands Coöperatief U.A., Barclays Corporate, HSBC Bank plc, J.P. Morgan Limited, Lloyds TSB Bank plc and the Royal Bank of Scotland plc as mandated lead arrangers and the Royal Bank of Scotland plc as facility agent.

The facility provides funds for general corporate and working capital 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 2012, the Company issued to 21 financial institutions (i) US\$ 150 million aggregate principal amount of 4.94% Series A Senior Notes due 17 March 2018 and (ii) US\$ 500 million 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 81. 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.

At the date of this Report 359,146,705 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](http://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 2012 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 42 and 43.

## 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 or she ought to have taken as a Director in order to make him- or herself 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 2012, from pages 1 to 62 of this Annual Report document, has been approved by the Board of Directors on 14 May 2012 and signed on its behalf by:

**Albert Dungate**  
Company Secretary

14 May 2012

### 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 or her knowledge:

- the Group financial statements (set out on pages 84 to 127) 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 43 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.

<b>Mike Turner</b>	Chairman
<b>Peter Rogers</b>	Chief Executive
<b>Bill Tame</b>	Group Finance Director
<b>Archie Bethel</b>	CEO, Marine and Technology
<b>Kevin Thomas</b>	CEO, Support Services
<b>Sir Nigel Essenhain</b>	Non-Executive Director
<b>Justin Crookenden</b>	Non-Executive Director
<b>Sir David Omand</b>	Non-Executive Director
<b>Ian Duncan</b>	Non-Executive Director
<b>Kate Swann</b>	Non-Executive Director

On behalf of the Board

**Mike Turner CBE**  
Chairman

14 May 2012

## Letter from Justin Crookenden, Committee Chairman

On behalf of the Remuneration Committee, I am pleased to present the Directors' Remuneration report for the year to 31 March 2012. In the following pages you will find the formal disclosures we are required to make in the report and additional detail to help our shareholders better understand how we link remuneration to the performance of the Company, its strategic objectives and risk management.

As the Company has grown in recent years we have had to revise our remuneration arrangements to meet new challenges and keep abreast of developments internally and externally. During that time we have had an open and constructive dialogue with our leading shareholders and taken into account their views in formulating and finalising the remuneration arrangements.

## Background and context

Babcock has consistently delivered strong operating and financial performance and good returns for shareholders. Indeed, in the ten years since Peter Rogers and Bill Tame joined the Company (in June and January 2002 respectively) the Company has gone from one capitalised at £157 million on 31 March 2002 with turnover of £423 million (for the year to 31 March 2002), to one with a market capitalisation of £2,860 million on 31 March 2012 with turnover in the financial year just ended of £3.1 billion. Over the same period, the Company's share price has risen from 106.5p on 31 March 2002 to 796.5p on 31 March 2012. Further information about the recent performance of the Company is set out on pages 4 and 5 of this Annual Report.

The success and significant increase in the size and complexity of the business has presented new challenges and opportunities. We have reviewed and amended our executive remuneration arrangements in order to keep up with developments to our business, changes in best practice, good governance and shareholders' views. This has involved introducing or updating a number of new schemes, rather than just raising base pay, which, although simpler, would have been inconsistent with our overall remuneration policy and with views being expressed more widely by shareholders and others.

Our senior executives, along with our wider workforce, have built up a substantial skill and knowledge base that has enabled us to forge strong and stable relationships with key customers and given us a critical understanding of our customers' needs and expectations. It is this which contributes to Babcock's 'trusted to deliver' culture and maintaining it and rewarding it is, in our view, a significant factor in the quality of our service, reputation and, therefore, ultimately, our success. Our remuneration arrangements need to reflect this.

The four key functions the Committee performs are to:

- Set executive remuneration policy and communicate it to management and shareholders;
- Ensure remuneration arrangements are in place consistent with that policy (and capable of delivering it);
- Set levels of executive base pay and performance criteria for variable pay and to measure performance against those criteria; and
- Ensure that the remuneration arrangements are working (i.e. that the outturn is fair to all parties, the arrangements incentivise and focus on the appropriate matters and, if not, to adjust them going forward as necessary).

In doing this, the Committee regularly engages with shareholders and seeks to ensure their views are considered and the remuneration arrangements are aligned with the interests of our shareholders.

## Remuneration policy

Our policy for executives reflects a preference we believe is shared by the majority of our shareholders – to rely more heavily on the value of variable performance-related rewards, rather than on the fixed elements of pay, using them to provide a structure that delivers fair total packages that allows for superior rewards for superior performance (upper quartile pay for upper quartile performance).

The rationale for this is simple – to reward success and not failure.

The focus of our executive remuneration is, therefore, weighted towards performance-related pay (with a significant element on long-term rather than short-term performance) and this has been further emphasised in the changes being proposed this year, details of which are set out later in this letter and in the pages that follow. We believe that, properly structured and with suitable safeguards, these variable rewards are the best way of linking pay to strategy, risk management and shareholders' interests.

As to base pay, we set it at or below market median, but for us this is not a policy of chasing a median. The relevance of market pay and median levels is in assessing whether our overall remuneration policy objectives are being and are likely to continue to be met. It is important that the Committee is aware of market pay rates as not only must we compete in the market for the best executives to ensure Babcock's continuing success, but also because, if elements of the package, including base pay, become too far adrift from prevailing market rates, it is reasonable for executives to ask whether the package is fair and competitive.

### Commentary on our policy

Remuneration arrangements in 2010/11 placed salaries (and the fair value of total remuneration) for our Executive Directors at around lower quartile. As set out in last year's report, having consulted shareholders, we took the first steps last year towards addressing this by increasing base pay for 2011/12 by around 9% and made a modest adjustment to the bonus potential of two Directors (increasing their maximum bonus from 120% to 125%). We also announced that this process, to narrow the gap, would be phased over the next few years through increases in base pay or by enhancing the variable elements of pay. Despite the changes implemented, the Directors' packages remained at or below lower quartile and our policy objective remains in danger of not being met, unless further steps are taken.

The Committee has reviewed and considered this in the current year and also consulted extensively with our leading shareholders on proposals designed to address this issue and meet our shareholder-approved policy objectives. As a result of that review and bearing in mind the long-term contract nature of our business, feedback from shareholders consulted, the current economic situation and investor sentiment, the Committee prefers to increase the competitiveness of total remuneration through the enhancement of long-term variable pay rather than solely through salary increases. Therefore we have made, or are proposing, the following changes, further details of which can be found in the following pages:

- Base pay increases in the order of 3% (which took effect on 1 April 2012, and which are in line with the average pay rise across the Group);
- To introduce a Deferred Bonus Matching Plan (DBMP) that allows for matching share awards of up to 2 for 1 to be made on deferred bonus shares and additional voluntarily invested shares held for three years. Matching shares will be subject to three-year performance targets based on EPS growth, relative TSR and ROCE performance. The new plan, if approved by shareholders at the AGM in July, extends the current period of bonus deferral from two to three years where a matching award is granted and it is the Committee's intention to make awards under the DBMP to the Executive Directors this year;
- To increase the normal annual maximum limit under the Performance Share Plan from 150% to 200% of base pay. Currently, a 200% award can only be made in exceptional circumstances. This change also requires shareholder approval. If approved, our intention this year would be to make an award of 200% for the Chief Executive, Peter Rogers, but to keep the awards at 150% for the other Executive Directors;

As, by the end of the year, none of our Executive Directors remained in the Group's defined benefits pension scheme we also reviewed and standardised arrangements for all Executive Directors regarding cash supplements in lieu of pension benefits whilst ensuring they remain consistent with the approach taken in comparable companies.

If and when these changes are implemented in full, the fair value of the remuneration packages at grant will still be at or below median, with base pay being around the lower quartile. However, the Committee believes that, if fully implemented, the changes should significantly address the issues identified in last year's report and that they should provide sufficient flexibility so that no further changes to the executive remuneration schemes and structure will need to be put to shareholders in the near term. As is evident, a major part of the new arrangements will be tied to the Company's performance over the long term.

I hope that having read this letter and the rest of the report that follows you will understand and support what the Committee is trying to achieve and how it is going about its task.

Much has been achieved by the executive and management team in the last decade. Our remuneration arrangements need to ensure their efforts in the next decade, if they continue to perform, are appropriately rewarded, consistent with our policy and also best practice.

**Justin Crookenden**  
Committee Chairman

## The Committee

### *Members (current and served throughout the year unless shown otherwise)*

Justin Crookenden (Chairman)  
 Sir Nigel Essenhain (retired from the Committee on 31 March 2012)  
 Sir David Omand  
 Ian Duncan  
 Kate Swann (from 1 June 2011)  
 John Rennocks (1 April 2011 to 31 December 2011)

The Group Chairman and the Chief Executive normally 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') was 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. Kepler is a founding member of the Remuneration Consultants Group.

### *How often it met*

In total there were seven meetings in the year to 31 March 2012. Details of each member's attendance at these meetings are set out on the table on page 46. The Committee plans to meet at least six times in the current financial year.

### **Principal areas of focus for the Committee during the year to 31 March 2012**

#### *Executive Director remuneration packages*

As explained last year and in the letter from the Committee Chairman on pages 63 and 64, the principal focus of the Committee during the year has been addressing the potential mismatch between the remuneration policy and the remuneration packages of the Executive Directors. This has involved extensive internal consideration by the Committee and also a major consultation exercise with leading shareholders. More detail is provided elsewhere in this Report on the review and proposals regarding changes to the Group's share plans that will be put to shareholders at the Annual General Meeting in July.

### *Performance measures and targets for annual bonus and long-term incentive schemes*

The Committee considered at length the appropriate financial conditions to attach to annual bonus awards and share awards to ensure they continue to be relevant to our strategic objectives and aligned with shareholders' interests; mindful of risk management; and suitably stretching whilst realistic in prevailing economic conditions. Further details on the measures we propose to use are set out in the following pages of this Report.

### *Other matters*

The Committee also considered other matters during the year, including:

- The Committee's terms of reference;
- The making of share awards under the Company's existing share plans;
- The level of vesting of share awards granted in 2008 and 2009;
- The level of annual bonuses for the year to 31 March 2011;
- Annual pay reviews for Executive Directors and other senior executives for the year to 31 March 2013;
- Supplements in lieu of pension scheme membership for Executive Directors in the context of overall remuneration and market practice;
- The level of take up of all-employee share plans.

### *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. General pay reviews therefore vary across the Group differing from business unit to business unit, but for the year to 31 March 2013 these are expected to average out at around 3%.

## Policy

### *Our approach to remunerating Babcock's Executive Directors*

The Chairman's letter on pages 63 and 64 describes the Committee's remuneration policy, the challenge it has faced in delivering it, and its proposals for 2012/13. The following table is a summary, which should be read with that letter.

Our policy	General
<b>Objective</b>	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.
<b>What it means in practice</b>	A continued and increased weighting towards performance-related short and longer term elements. On a fair value basis and taking account of the changes proposed for 2012/13, around 60% of a Babcock Executive Director's package is performance-related – see charts on page 68 below, which is increased from the weighting (51%–56%) seen in earlier years. The total remuneration package on a fair value basis is around market median* for the Group Chief Executive and Group Finance Director and between lower quartile and median* for the other Executive Directors.
Our policy	Fixed element (base pay)
<b>Objective</b>	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.
<b>What it means in practice</b>	Fixed remuneration should be at or below median* but not so far from median that it is not, in combination with variable performance-related measures, able to deliver total remuneration consistent with the Committee's general policy.
<b>What we did in 2011/12</b>	As announced last year, the Committee made a move towards reducing the disparity of Directors' base pay (which was 15% to 20% below median*), but limited increases to no more than 9% which moved Executive Director salaries (and the fair value of the total remuneration package for all the Executive Directors) to between lower quartile and median.
<b>What we are doing in 2012/13</b>	Whilst salaries remain around 20% below median*, the Committee has taken account of shareholder feedback and market conditions and limited the base pay increases to 3%, preferring to address the issue and meet the policy by enhancing long-term performance related elements of the Directors' packages.
Our policy	Take account of risk and align with strategy
<b>Objective</b>	To ensure that Directors' remuneration arrangements do not reward or encourage inappropriate taking of risk in pursuit of short-term rewards. Also to link remuneration directly to strategic objectives and the Company's focus on health, safety and environmental performance.
<b>What it means in practice</b>	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 the 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.
<b>What we did in 2011/12</b>	The Committee followed this policy. For more detail see page 69.
<b>What are we doing for 2012/13?</b>	The Committee will continue with this approach.

\* When assessing remuneration packages for fairness and relativity, we compare Babcock to a peer group comprising a blend of companies of a similar size to Babcock and companies operating in the same sector selected by the Committee's independent remuneration advisers, Kepler Associates. The Committee is confident that utilising this blend of comparators is the correct approach.

Our policy	Performance-related rewards
<b>Objective</b>	Variable pay should reward long-term sustainable growth and value creation and, when operating with base pay, should be capable of meeting the general policy objective (see above).
<b>What it means in practice</b>	Annual bonus schemes underpin delivery of year-on-year financial performance and the meeting of strategic non-financial objectives, being structured to ensure delivery against targets and to motivate stretching outperformance; share awards reward longer term delivery of sustained superior performance.
<b>What we did in 2011/12</b>	<p>As announced last year, modest adjustments were made to the annual bonus potential for the divisional Chief Executives by increasing potential maximum from 120% of base salary to 125%, with the potential for the Group Chief Executive and Group Finance Director remaining unchanged at 150%.</p> <p>As for share awards, in keeping with the approach in 2010, PSP awards in 2011 were made of 150% of base salary for all Directors, other than Peter Rogers, the Group Chief Executive. As announced last year the award for him was, as it was in 2010, at the maximum exceptionally permitted amount of 200% of base salary given the exceptional nature of the ongoing challenge he faced overseeing the integration of VT Group plc (acquired in mid-2010).</p>
<b>What are we doing for 2012/13?</b>	<p>No changes are proposed to the maximum annual bonus potential for any of the Directors.</p> <p>As regards share awards, the Company is asking shareholders to amend the PSP to allow for normal maximum annual awards of 200% of base pay. If the changes are approved, the Committee's intention in 2012 is only to make an award at this level for Peter Rogers, maintaining awards at the 150% level for the other Directors.</p> <p>The Company is also asking shareholders to approve a deferred bonus share matching plan (DBMP) to allow the Committee to award matching shares (of up to 2:1, based on three-year performance) in respect of deferred bonus shares and any additional voluntary investment. Executive Directors are currently required to defer 40% of bonus earned into shares for a period of two years, with no matching share entitlement. The proposal is to allow participants to make an additional voluntary investment above this mandatory deferral, of up to 40% of salary, regardless of any annual bonus earned. For the Chief Executive and Group Finance Director the maximum investment opportunity would therefore be 100% of salary (assuming maximum bonus payment and full take-up of the voluntary investment opportunity). The annual bonus deferral period would be extended to three years to better align with shareholder value creation over the long term.</p>
Our policy	Alignment with shareholders' interests
<b>Objective</b>	To ensure that a major part of remuneration is performance-related (both standalone and comparative) and deliverable only over the longer term in the form of share awards directly linking the Directors' remuneration to the investment risk faced by shareholders.
<b>What it means in practice</b>	<p>40% of annual bonus is deferred into Company shares exposing the reward for the short-term bonus year to the potential longer term risks inherent in current year decision-making, and making performance-related longer term share awards a substantial element of the Directors' remuneration. Together, these ensure that a substantial part of Directors' rewards is exposed to the longer term performance of Babcock.</p> <p>In order to further 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.</p>
<b>What we did in 2011/12</b>	The Committee applied its normal practice as described above.
<b>What are we doing for 2012/13?</b>	As described above, the Company is seeking shareholder approval to make PSP awards of up to 200% of annual salary in future (although the intent this year would be only to make an award at this level to the Chief Executive) and to make performance-related matching awards under the DBMP (if approved by shareholders at the Annual General Meeting in July 2012), with deferral of bonus and any voluntary investment over three years. These proposals will increase still further the Directors' reliance on share price performance over the long term.

### Summary of the structure of Executive Directors' remuneration

Based on the Committee's policy and having regard to its proposals for the current financial year, 2012/13, the principal elements of the arrangements for Executive Director remuneration in the year to 31 March 2012 were, and (if shareholders approve the changes to the Performance Share Plan and the introduction of a Deferred Bonus Matching Plan at the Annual General Meeting in July) for the year to 31 March 2013 are expected to be 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	2012/13				2011/12		
	Base pay £	Annual bonus potential (% of salary)	Performance share awards (% of salary)	Matching Share opportunity under DBMP <sup>1</sup> (% of salary)	Base pay £	Annual bonus potential (% of salary)	Performance share awards (% of salary)
Peter Rogers	561,350	150%	200%	200% <sup>1</sup>	545,000	150%	200% <sup>2</sup>
Bill Tame	355,350	150%	150%	200%	345,000	150%	150%
Archie Bethel	309,000	125%	150%	180%	300,000	125%	150%
Kevin Thomas	309,000	125%	150%	180%	300,000	125%	150%

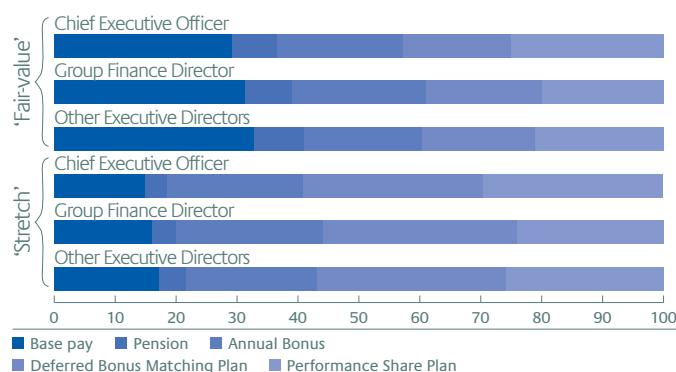
1. Assuming maximum bonus and maximum self-investment and 2 for 1 share match.

2. Made up as to 150% ordinary award and 50% exceptional additional award.

### Balance of remuneration

The chart below shows the relative proportions of each element of the Executive Directors' total remuneration as proposed for the year to 31 March 2013.

#### Pay mix (%)



The chart assumes that PSP awards over shares have a value on grant equal to 150% of the Director's base salary (200% for Peter Rogers). For the 'fair-value' scenario, the chart is based on the following assumptions: annual bonus fair values (including the mandatorily deferred share element) of 71% of salary for Peter Rogers and Bill Tame and 59% of salary for Archie Bethel and Kevin Thomas; maximum self-investment opportunity is taken up under the proposed DBMP, with a fair value of the matching award of 61% of salary for Peter Rogers and Bill Tame and 57% of salary for Archie Bethel and Kevin Thomas; and PSP fair values of 64% of salary for the Directors other than Peter Rogers, and 86% of salary for Peter Rogers. The 'stretch' scenario assumes maximum bonus, the maximum self-investment opportunity is taken up under the proposed DBMP, and full vesting of awards under both the PSP and the DBMP. The fair value of an incentive 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 a share and the performance conditions.

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

The Committee links the remuneration of executives to the long-term interests of shareholders and key strategic and risk management objectives by the performance criteria (both financial and non-financial) it uses in the annual bonus and long-term incentive schemes. Examples include the following:

Strategic Objective (SO)/Risk (R)	Annual bonus scheme metric	Long-term incentive metric
SO/R: Delivering superior and sustainable value for our shareholders, whilst balancing risk and reward.	Financial measures focused on annual delivery of sustainable earnings and/or profits with stretch targets, whilst maintaining strict control of cash.	Incentivising delivery of top quartile shareholder returns and earnings growth over the longer term. Long-term measures and deferral of significant part of annual bonus to guard against short-term steps being taken to maximise annual rewards at the expense of future performance.
SO: Growth.	Setting challenging budgets and stretch targets, as well as non-financial measures specifically aimed at: <ul style="list-style-type: none"> <li>• laying the foundations for sustainable growth in specific geographical and existing and new business markets;</li> <li>• winning key bids and re-bids;</li> <li>• fostering strategically important partnering arrangements.</li> </ul>	
SO: Developing and maintaining leading market positions in the UK and selected overseas markets.	Specific non-financial objectives for: <ul style="list-style-type: none"> <li>• progressing plans for entry into or expansion in targeted domestic and overseas markets;</li> <li>• securing key business development milestones.</li> </ul>	
SO: Building and maintaining customer-focused, long-term relationships with strategically important customers.	Objectives linked to: <ul style="list-style-type: none"> <li>• measurable customer satisfaction indicators;</li> <li>• continuing improvement of management processes;</li> <li>• meeting and planning for existing and future customer expectations on capability and compliance, for example, in the field of security and information assurance.</li> </ul>	
R: Loss of business reputation, poor contract performance.		
SO/R: Ensuring the Group will continue to retain and attract the suitably qualified and experienced people it needs to deliver its growth and strategic plans, maintain and develop its technical and management expertise.	Non-financial objectives linked to talent development and succession planning, and fostering employee engagement. 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.
SO/R: Maintenance of an excellent health, safety and environmental record.	Overriding health, safety and environmental performance criterion in annual bonus schemes.	

### Annual bonus schemes

For our annual bonus schemes in 2012/13 we will continue to use a mix of financial and non-financial measures. The non-financial measures are principally based on the key themes that are of central importance to the continued success of the Company: reputation protection; setting the building blocks for finding and underpinning future growth; executive succession and talent management planning and gaining wider employee engagement in the Company's success. Maintaining a satisfactory health and safety and environmental performance also remains an overriding bonus objective. Although slightly restructured, reintroducing a measure related to profit before tax, the financial measures for the Chief Executive and Group Finance Director continue to be focussed on delivery of budget, cash management and growth in earnings. For the divisional Chief Executives there is also an element for delivering budgeted divisional profits and cash flow.

The tables below set out the annual bonus schemes in place for the Executive Directors and the outturn under them in 2011/12 and show the structure for 2012/13.

#### 2011/12

Bonus element	Peter Rogers		Bill Tame		Archie Bethel		Kevin Thomas	
	Maximum potential % of salary	Outturn						
<b>EPS* performance</b>	105%	105%	105%	105%	75%	75%	75%	75%
Stretching targets established against budget, with a sliding scale between threshold and maximum								
<b>Achieving budgeted Group cash flow</b>	15%	15%	15%	15%	–	–	–	–
<b>Achieving budgeted divisional PBIT*</b>	–	–	–	–	12.5%	12.5%	12.5%	12.5%
<b>Achieving budgeted divisional cash flow</b>	–	–	–	–	12.5%	12.5%	12.5%	12.5%
<b>Non-financial objectives</b>	30%	28.5%	30%	28.5%	25%	25%	25%	25%
<b>Total (maximum potential)</b>	150%	148.5%	150%	148.5%	125%	125%	125%	125%

#### 2012/13

Bonus element	Peter Rogers	Bill Tame	Archie Bethel	Kevin Thomas
	Maximum potential % of salary			
<b>EPS* growth</b>	90%	90%	70%	70%
Stretching targets with a sliding scale between threshold and maximum				
<b>Achieving budgeted Group PBT*</b>	15%	15%	–	–
<b>Achieving budgeted Group cash flow</b>	15%	15%	–	–
<b>Achieving budgeted divisional PBIT*</b>	–	–	15%	15%
<b>Achieving budgeted divisional cash flow</b>	–	–	15%	15%
<b>Non-financial objectives</b>	30%	30%	25%	25%
<b>Total (maximum potential)</b>	150%	150%	125%	125%

\* Before amortisation of acquired intangibles. The treatment of exceptional items is at the discretion of the Committee.

## Annual bonus 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. If shareholders approve the proposal at the Annual General Meeting in July 2012 to establish a Deferred Bonus Matching Plan, the Committee intends to grant performance-related matching awards to Directors on the bonus for 2011/12 deferred into shares and any amount that the Director chooses to self-invest under that scheme (up to an additional 40% of annual salary). However, the deferral period would in that case be extended from two to three years. The proposed performance conditions relating to matching awards are set out on page 75. Bonuses deferred into shares in 2009, 2010 and 2011 do not have any matching share awards.

## 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 2012 or who hold office at the date of this Report in the issued share capital of the Company. The interests were beneficial interests of the Director and/or their spouse.

Director	At 31 March 2012 <sup>1</sup>	At 1 April 2011	Current holding for shareholding guideline purposes <sup>2</sup>
<b>Chairman and Executive Directors</b>			
Mike Turner	40,000	40,000	n/a
Peter Rogers	710,535	710,535	1,140%
Bill Tame	362,927	385,046	897%
Archie Bethel	124,304	108,668	420%
Kevin Thomas	84,149	113,081	309%
<b>Non-Executive Directors</b>			
Nigel Essenhagh	–	–	n/a
John Rennocks (retired 31 December 2011)	28,000 <sup>3</sup>	28,000	n/a
Justin Crookenden	11,647	11,647	n/a
David Omand	–	–	n/a
Ian Duncan	–	–	n/a
Kate Swann (appointed 1 June 2011)	5,000	–	n/a

1. There were no changes in these interests between 31 March 2012 and 14 May 2012.

2. Shown as a % of base salary applying from 1 April 2012. Calculated as at 9 May 2012 at a share price of 816.5p in accordance with our guidelines, these included shares held 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 John Rennocks, the interest in shares shown is the interest in shares on the date he resigned as a Director, 31 December 2011.

## 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.

**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 2012 and 14 May 2012. The Company's mid-market share price at close of business on Friday, 30 March 2012 was 796.50p. The highest and lowest mid-market share prices in the year ended 31 March 2012 were 800.00p and 570.50p, respectively.

During the year to 31 March 2012 the awards made in 2008 under the L-TIP partially vested (on 20 May 2011). On the date that award was made the shares had a market value of 570.50p per share and on the vesting date had a middle market closing price of 679.50p.

Director	Scheme <sup>1</sup> and year of award	Number of shares subject to award at 1 April 2011	Granted during the year	Exercised during the year	Lapsed during the year	Number of shares subject to award at 31 March 2012	Exercise price (pence) <sup>2</sup>	Market value of each share at date of award (pence)	Exercisable from <sup>3</sup>	Expiry date <sup>4</sup>
Peter Rogers	L-TIP 2008	79,080	–	–	(13,484)	65,596	nil	594.33	May 2011	Jun 2018
	PSP 2009	132,053	–	–	–	132,053 <sup>6</sup>	nil	544.67	Jul 2012	Jul 2013
	PSP 2010 <sup>5</sup>	161,334	–	–	–	161,334	nil	619.83	Jul 2013	Jul 2014
	CSOP 2010 <sup>5</sup>	4,840	–	–	–	4,840	619.83	619.83	Jul 2013	Jul 2020
	DBP 2010	45,023	–	–	–	45,023	nil	619.83	Jul 2012	Jul 2013
	PSP 2011	–	157,971	–	–	157,971	nil	690.00	Jun 2014	Jun 2015
	DBP 2011	–	42,609	–	–	42,609	nil	690.00	Jun 2013	Jun 2014
Bill Tame	Approved 2002	21,278	–	(21,278)	–	–	104.33	104.33	Jan 2005	Jan 2012
	L-TIP 2008	51,402	–	(42,637)	(8,765)	–	nil	594.33	May 2011	Jun 2018
	PSP 2009	85,924	–	–	–	85,924 <sup>6</sup>	nil	544.67	Jul 2012	Jul 2013
	PSP 2010 <sup>5</sup>	77,440	–	–	–	77,440	nil	619.83	Jul 2013	Jul 2014
	CSOP 2010 <sup>5</sup>	1,258	–	–	–	1,258	619.83	619.83	Jul 2013	Jul 2020
	DBP 2010	29,598	–	–	–	29,598	nil	619.83	Jul 2012	Jul 2013
	PSP 2011 <sup>5</sup>	–	74,999	–	–	74,999	nil	690.00	Jun 2014	Jun 2015
	CSOP 2011 <sup>5</sup>	–	3,217	–	–	3,217	690.00	690.00	Jun 2014	Jun 2021
	DBP 2011	–	27,270	–	–	27,270	nil	690.00	Jun 2013	Jun 2014
Archie Bethel	L-TIP 2008	40,717	–	(33,774)	(6,943)	–	nil	594.33	May 2011	Jun 2018
	PSP 2009 <sup>5</sup>	68,022	–	–	–	68,022 <sup>6</sup>	nil	544.67	Jul 2012	Jul 2013
	CSOP 2009 <sup>5</sup>	5,507	–	–	–	5,507 <sup>6</sup>	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
	PSP 2011	–	65,217	–	–	65,217	nil	690.00	Jun 2014	Jun 2015
	DBP 2011	–	18,939	–	–	18,939	nil	690.00	Jun 2013	Jun 2014
Kevin Thomas	Approved 2002	16,068	–	(16,068)	–	–	106.33	106.33	Nov 2005	Nov 2012
	L-TIP 2008	38,320	–	–	(6,534)	31,786	nil	594.33	May 2011	Jun 2018
	PSP 2009 <sup>5</sup>	64,030	–	–	–	64,030 <sup>6</sup>	nil	544.67	Jul 2012	Jul 2013
	CSOP 2009 <sup>5</sup>	2,368	–	–	–	2,368 <sup>6</sup>	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
	PSP 2011	–	65,217	–	–	65,217	nil	690.00	Jun 2014	Jun 2015
	DBP 2011	–	18,939	–	–	19,939	nil	690.00	Jun 2013	Jun 2014

## Directors and shares (continued)

- 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 77 and 78 below.
- The PSP, DBP and L-TIP awards are structured as nil priced options. DBP awards represent the amount of the annual bonus mandatorily deferred by the Director converted into shares on the value at the award date.
- Subject to the rules of the scheme concerned, including as to meeting performance targets.
- 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.
- The vesting of the CSOP award is subject to performance measures that 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.
- The PSP awards and CSOP awards made to the Directors in 2009 are expected to vest as to 57.8% based on the performance measures attached to them.

*The table below shows details of awards exercised during the year to 31 March 2012*

Director	Award(s) exercised	Date of exercise	Total number of shares acquired on exercise	Number of shares sold on exercise	Market price on exercise	Total value of shares on exercise (less exercise price if applicable)
Peter Rogers	–	–	–	–	–	–
Bill Tame	Approved 2002	27/05/2011	21,278	3,253	685.06p	£123,567.73
	L-TIP 2008	27/05/2011	42,637	22,250	685.06p	£292,089.03
Archie Bethel	L-TIP 2008	27/05/2011	33,774	17,625	685.06p	£231,372.16
Kevin Thomas	Approved 2002	27/06/2011	16,068	–	685.00p	£92,980.70

Note: The number of shares sold on exercise of the L-TIP awards by the above Directors was in each case just sufficient to cover income tax and employee national insurance charges arising on exercise, and dealing costs. The number of shares sold by Bill Tame on the exercise of the Approved options was sufficient to cover the exercise price and dealing costs.

### Performance-related awards made to Executive Directors in 2011

In June 2011, PSP awards were made to each of the Executive Directors. Bill Tame also received a CSOP award linked, as explained in note 5 above, to his PSP award.

## Directors and shares (continued)

### PSP vesting schedules for 2011 awards

In accordance with past practice, the awards for Directors 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. An additional award of 50% was also made to Peter Rogers as explained below.

The performance targets attached to those 150% awards – split equally between TSR performance relative to the peer group and real EPS growth (see table on page 77 for detail) – are illustrated in the charts below:

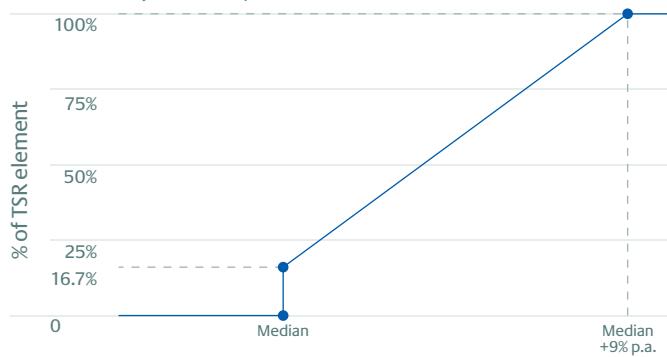
#### EPS element (50% of award)

Babcock's three-year annualised real EPS growth (% p.a.)



#### TSR element (50% of award)

Babcock's three-year TSR out-performance of FTSE 350 Median



Note: real EPS growth is that in excess of the change in the retail prices index.

TSR comparators are companies comprised in the FTSE 350 (excluding investment trusts and financial services companies).

In the case of Peter Rogers, in recognition of the exceptional management challenge he faced following the VT acquisition, and following discussions with leading shareholders, the Committee made him an additional award equivalent in value to 50% of his base salary (taking his total award to 200% of 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 (see chart above). Vesting of the additional 50% award requires TSR performance of between median plus 9% p.a. (no vesting) and 12.5% p.a. (full vesting), with vesting on a straight-line proportionate basis between those points.

#### PSP awards to be made in 2012

It is the Committee's intention to make awards to the Executive Directors in the same amounts as in 2011 (200% of basic salary for Peter Rogers and 150% for the others). It intends to apply to each award the same performance measures as set out in the chart above. The 200% award to Peter Rogers is intended to be made under the proposed amendment to the terms of the PSP that is being put to shareholders at the Annual General Meeting in July 2012, as outlined in the Chairman's letter on page 64.

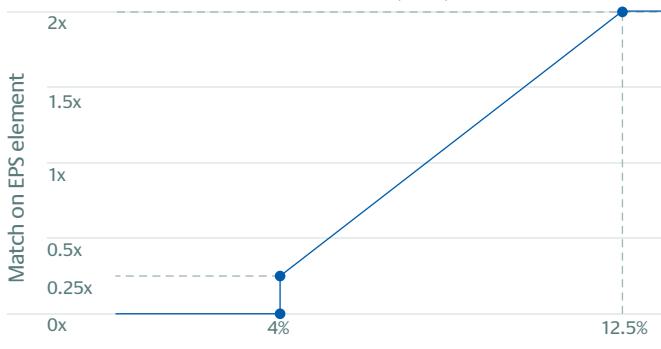
The Committee has decided, despite the prevailing economic climate, to maintain the same targets as we have used generally in 2009, 2010 and 2011. Threshold vesting (16.7% of this element) for the EPS element is set at real growth of 4% per annum and maximum vesting at 12.5% per annum. We believe that these targets in the current climate are effectively more challenging than they have previously been and that real growth of 12.5% would represent exceptional performance. For the comparative TSR element, threshold vesting of that element (16.7% of this element) would be for performance in line with the median of the FTSE 350 (excluding investment trusts and financial companies) and maximum vesting would be for 9% p.a. outperformance of the median, representing upper quartile performance.

## Deferred Bonus Matching Plan awards in 2012

As outlined in the Chairman's letter on page 64, a proposal is to be made to the Annual General Meeting in July 2012 to approve the introduction of a Deferred Bonus Matching Plan (DBMP). The existing deferred bonus plan is purely a mechanism for delaying release of a part of annual bonus and exposing its continuing value to share price performance. The DBMP would allow the Committee to make matching share awards of up to two times the deferred bonus shares (40% of bonus, unchanged) and any additional shares self-invested by the Director (of up to 40% of salary). The matching share award would be performance-related and would only vest to the extent that the performance criteria are met in respect of the three-year performance period. If the plan is approved, the Committee intends to make matching awards to the Executive Directors in 2012 in respect of the amount of 2011/12 annual bonus deferred and any amounts self-invested at the same time. For this first cycle, the performance period would be the period from 1 April 2012 to 31 March 2015, the same as for PSP awards to be made in 2012. The performance measures and targets to be adopted would also be the same as those shown for the PSP awards above, with an additional third measure dependent on average return on capital employed (ROCE) over the period; the target for maximum vesting would be ROCE of 20.5% and for threshold vesting it would be 17.5%. The three measures would each have equal weighting. The maximum match would be 2 for 1 on any shares held under the deferred bonus plan; 0.25 matching shares would be released for each such share at threshold vesting. Therefore for each measure, threshold vesting would be a (0.25/3) for 1 match (4.2% of maximum) and maximum vesting would be a (2/3) for 1 match (33% of maximum). The charts below illustrate the three vesting schedules.

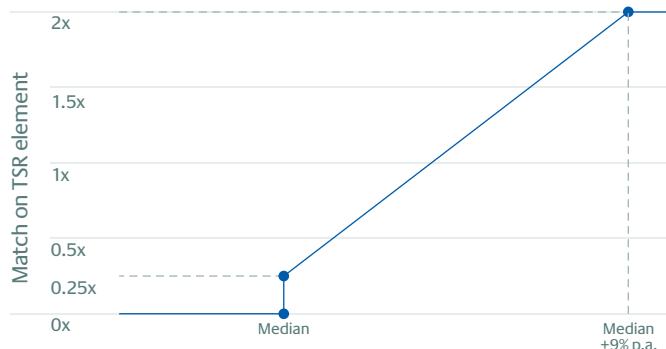
### EPS element (33% of award)

Babcock's three-year annualised real EPS growth (% p.a.)



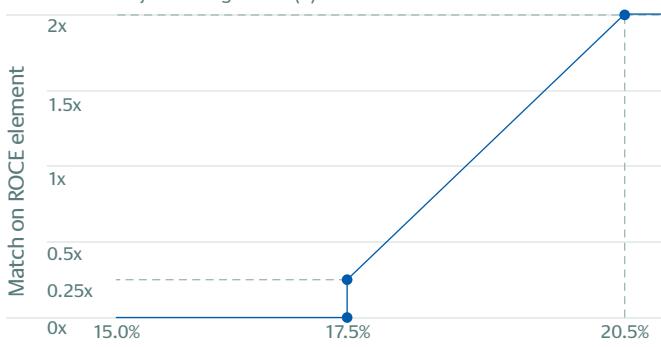
### TSR element (33% of award)

Babcock's three-year TSR performance relative to the FTSE 350 Median



### ROCE element (33% of award)

Babcock's three-year average ROCE (%)



### Performance measure selection for long-term incentives

The Committee believes that TSR and EPS continue to be effective measures of long-term performance for Babcock, providing a good balance between shareholder value creation and line of sight for executives. 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 incentivising 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. We have also decided to maintain the same targets for the TSR and EPS measures as used in the past three years. The Committee believes they are appropriate and challenging in the current climate.

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.

Following the consultation with shareholders during 2012, the Committee has proposed to include an additional measure for DBMP awards and has selected average ROCE (return on capital employed) performance, to be given equal weighting with TSR and EPS. ROCE reinforces the focus on returns for shareholders and encourages capital discipline. It also provides good line of sight for management.

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.

### Sourcing of shares

Shares needed to satisfy share awards for Directors are either fresh issue shares or shares 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. The preferred source selection is finalised on vesting, the choice being based on what is in the best interests of the Company at the time, and what is permissible within available headroom limits.

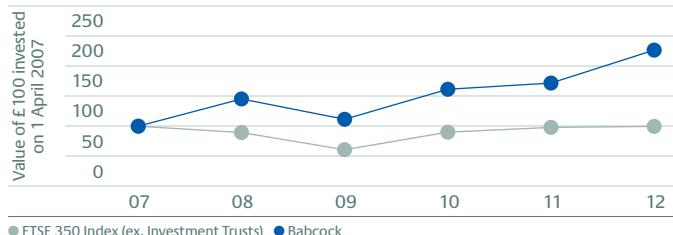
### Performance graphs

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 2007 to 31 March 2012 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 outperformed both indices. An investment of £100 in the Company on 1 April 2007 would have been worth (assuming the dividends were reinvested in further Company shares) £226 at 31 March 2012. This compares to an investment in each of the indices of £100 which, on the same basis and over the same period, would have been worth £122 (FTSE 350 Support Services Index) and £100 (FTSE 350 Index excluding Investment Trusts).

**Babcock International vs. FTSE 350 Support Services Index**



**Babcock International vs. FTSE 350 Index (ex. Investment Trusts)**



## Share awards summaries

The following tables summarise the performance targets (if applicable) and other information about the schemes relevant to *outstanding* share awards (i.e. those awards yet to vest) and those that vested during the year to 31 March 2012 (the awards made in 2008 under the L-TIP) held by Directors (see also the information about share schemes on pages 57 and 58).

Scheme	Performance Share Plan (nil price options) and Company Share Option Plan (market price options) – 2009–2011 awards*			
Performance period	For the 2009 awards: 1 April 2009 to 31 March 2012. (Note: expected to vest in July 2012 as to 57.8%) For the 2010 awards: 1 April 2010 to 31 March 2013. For the 2011 awards: 1 April 2011 to 31 March 2014.			
General Performance target	EPS growth test	Proportion of total award that can vest	Comparative TSR test	Proportion of total award that can vest
	Real compound annual growth of 11% (2009)/12.5% (2010/11) 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 and 2011 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 74 for further details). This will affect the relative proportion of the award vesting in his case.			
TSR comparator group	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	<p>The awards are not subject to re-testing. 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. 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.</p> <p>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.</p> <p>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.</p> <p>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.</p>			

\* 2012 awards are intended to be at the same levels as for the 2011 awards using the same performance tests as were applied in 2011 to the 150% awards, as explained on page 74 (with the performance period being 1 April 2012 to 31 March 2015).

<b>Scheme</b>	<b>Deferred Bonus Plan (nil price options) 2010 and 2011 awards</b>			
<b>Performance period</b>	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.			
<b>Other information</b>	<p>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).</p> <p>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.</p> <p>The shares carry the right to dividends paid in the period of deferral, but payable only when the shares are released.</p> <p>There is no provision for the Company to match these deferred shares on any basis.</p>			
Note: the intention, as explained on page 64, is to seek shareholder approval to introduce a Deferred Bonus Matching Plan to make matching awards from 2012 onwards. The intended performance criteria for matching shares awards under the plan are explained on page 75, the shares representing deferred bonus or self-invested amounts would not be subject to further performance tests and would only be subject to forfeiture or adjustment as described above, but the deferral period would be extended to three years.				
<b>Scheme</b>	<b>2003 Long-Term Incentive Plan (nil price options) – 2008 awards</b>			
<b>Performance period</b>	1 April 2008 to 31 March 2011. (82.95% vested)			
<b>Performance targets</b>	EPS growth test	Proportion of total award that could vest 50%	Comparative TSR test	Proportion of total award that could vest 50%
	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%
<b>TSR comparator group</b>	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.			
<b>Other information</b>	<p>EPS was subject to adjustment at the discretion of the Committee in respect of exceptional items and is pre-acquired intangible amortisation.</p> <p>Real EPS growth is that in excess of the change in the consumer prices index.</p>			

### Directors' emoluments and compensation (audited)

Director	Salary or fee year ending 31 March 2012 £'000	Cash allowances in lieu of pension benefits <sup>2</sup> £'000	Other cash allowances <sup>3</sup> £'000	Annual bonus £'000 <sup>4</sup>	Benefits in kind <sup>5</sup> £'000	Total year ended 31 March 2012 £'000	Total year ended 31 March 2011 £'000
<b>Chairman and Executive Directors</b>							
Mike Turner (Chairman)	255	—	—	—	—	255	255
Peter Rogers (Chief Executive)	545	109	—	809	1	1,464	1,336
Bill Tame (Group Finance Director)	345	49	18	512	22	946 <sup>6</sup>	851
Archie Bethel	300	28	—	375	7	710	593
Kevin Thomas	300	14	—	375	1	690	591
<b>Non-Executive Directors</b>							
Nigel Essenhain	50	—	—	—	—	50	48
Justin Crookenden	58	—	—	—	—	58	55
David Omand	53	—	—	—	—	53	48
Ian Duncan	59	—	—	—	—	59	19 <sup>1</sup>
Kate Swann (appointed 1 June 2011)	42					42	—
John Rennocks (retired 31 December 2011)	48	—	—	—	—	48	73
Alexander Hesketh (resigned 8 November 2010)	—	—	—	—	—	—	36
<b>Total</b>	<b>2,055</b>	<b>200</b>	<b>18</b>	<b>2,071</b>	<b>31</b>	<b>4,375</b>	<b>3,905</b>

#### Notes:

- Emoluments for Archie Bethel, Kevin Thomas and Ian Duncan for the year ended 31 March 2011 were emoluments for only the period from the date of their appointment to the Board. Archie Bethel and Kevin Thomas were appointed on 1 May 2010 and Ian Duncan on 10 November 2010.
- For Peter Rogers, the cash allowance reflects pay in lieu of all pension benefits. As for the other Executive Directors, the allowance for Archie Bethel and Kevin Thomas for the entire year and for Bill Tame for the period from 1 April 2011 to 30 September 2011 was an allowance in lieu of pension benefits on that part of their base salaries as exceeded the applicable earnings cap for the pension scheme. On 1 October 2011, Bill Tame ceased active membership of the pension scheme and his allowance from that date was in lieu of all pension benefits. See further under 'Directors' pensions' below.
- Allowance in respect of expenses connected with accommodation.
- 60% of the amount shown is paid in cash. The balance of 40% is to be deferred into Company shares under the proposed Deferred Bonus Matching Plan if it is approved by shareholders at the Annual General Meeting in July 2012 or under the existing Deferred Bonus Plan otherwise.
- 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, car fuel benefit and accommodation benefits.
- Note that, in comparing total remuneration in this table for Bill Tame to total remuneration the prior year, the change to his supplement in lieu of pension (note 2 above) and his withdrawal during the year from the defined benefit pension scheme needs to be borne in mind. Whilst this table captures the cash supplement in lieu in each year, it does not reflect the value of his pension scheme membership in either year – the whole year for the year to 31 March 2011, but only half the year to 31 March 2012. Pension scheme benefits are dealt with under 'Directors' pensions' and 'Babcock International Group Pension Scheme (the Scheme)' below.

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 page 72.

For the year ended 31 March 2012, the fees payable to John Rennocks reflected his role as Audit and Risk Committee Chairman and Senior independent Director for the period from 1 April 2011 to 31 December 2011; for Ian Duncan they reflected his role as Audit and Risk Committee Chairman since 7 July 2011 and for Sir David Omand his role as Senior Independent Director from 1 January 2012. Justin Crookenden's fees reflected his additional duties as Chairman of the Remuneration Committee throughout the year.

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

### Directors' pensions (audited)

Peter Rogers did not participate in a Group pension scheme or otherwise receive pension benefits from the Group during the year to 31 March 2012. He received a supplement equal to 20% of his base salary in lieu of pension benefits.

During the year, the three other Executive Directors, who were in the scheme, decided to withdraw from active membership of the scheme as regards accrual of pension for future service: Bill Tame, with effect from 30 September 2011, and Archie Bethel and Kevin Thomas from 31 March 2012. Whilst members, in addition to pension benefits accruing under that scheme (as described below), they each received a cash supplement in lieu of pension benefits on that part of their base salary as exceeded the applicable scheme earnings cap. The supplement was at the rate of 15% of the excess, less employer's national insurance costs on the supplement, and had been at this level for many years. As explained in the Remuneration report last year, in 2011 Directors were offered the option of reducing the amount of salary to be taken into account for accrual purposes and taking a revised supplement in lieu of pension benefits *on the excess* of their actual salary over that reduced pensionable amount. This revised supplement was calculated on an individual basis as representing no extra cost to the Company taking account of the cost of pension scheme membership and the former supplement.

Subsequently, as part of its annual review of remuneration arrangements, the Committee considered an appropriate level of salary supplement that should be applied going forward on a standardised basis for both existing and future Directors. As a result of this review, the Committee decided to set a standard supplement at the rate of 25% of basic salary, a rate that is both in line with practice in other companies and that did not materially affect the fair value of the existing Directors' overall remuneration. This rate is now being paid to all the Executive Directors from 1 April 2012.

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 was a member of the senior executive tier of the Scheme until 30 September 2011. Archie Bethel and Kevin Thomas were members of the executive tier of the Scheme until 31 March 2012. All three Directors are no longer active members of the Scheme.

Whilst still members of the Scheme, Bill Tame accrued benefits at the rate of one-thirtieth, and for Archie Bethel and Kevin Thomas at the rate of one-forty-fifth, of pensionable salary for each year of service.

Pension entitlements under the Scheme (defined benefit) for the year to 31 March 2012 are set out in the following table:

Director	Accrued pension at 31 March 2012 £ p.a.	Increase in accrued benefits excluding inflation during the year ended 31 March 2012 £	Change in accrued benefits after allowing for inflation £	Transfer value at 1 April 2011 £	Transfer value at 31 March 2012 £	Transfer value of increase in accrued benefits less Director's contributions £	Increase in transfer value less Director's contribution £
Bill Tame	41,309	3,033	1,119	783,172	1,089,821	21,060	303,409
Archie Bethel	35,501	5,764	4,277	425,049	604,423	62,999	172,343
Kevin Thomas	57,019	6,759	4,246	710,028	932,467	57,060	212,719

1. Transfer values do not represent amounts that a Director is entitled to receive, they are an actuarial calculation of the cost of providing for the potential benefits. Changes in transfer values reflect both additional pension earned and changes in valuation factors such as stock market performance, bond values and discount rates.

2. Inflation has been taken as 2.92% for the purposes of calculating increases in transfer values and pension earned.

3. 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.

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

5. 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.

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

7. 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.

Three Directors also benefit from life assurance cover of four times base salary. The cost of providing that life assurance cover was:

Director	2012 £'000	2011 £'000
Bill Tame	3	2
Archie Bethel	2	1
Kevin Thomas	2	1

### 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 were last reviewed as of 1 April 2011 and are set out in the table below; no changes are being made for 2012/13.

	Year to 31 March 2012 £	From 1 April 2012 £
Annual rate of fees		
Chairman	255,000	255,000
Senior Independent Director	60,000	60,000
Basic Non-Executive Director's fee	50,000	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 within 12 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).

**Chairman and Non-Executive Directors**

Name	Date of appointment as a Director	Date of current appointment letters	Anticipated expiry of present term of appointment (subject to annual re-election)*
Mike Turner (Chairman)	1 June 2008	14 April 2011	AGM for 2014
Nigel Essenhight	4 March 2003	28 March 2012	31 December 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 for 2013
Kate Swann	1 June 2011	18 April 2011	AGM for 2014

\* 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 2012 he received £39,500 by way of fees for that role. He was also a Non-Executive Director (and President) of ADS Group Limited until 31 December 2011, a role for which he received no fees. Bill Tame is a Non-Executive Director of Carlo PLC. During the year to 31 March 2012 his fees in that role were £28,500.

**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 5 July 2012.

This Remuneration report was approved on behalf of the Board by a Committee of the Board on 14 May 2012 and signed on its behalf by:

**Justin Crookenden**

Chairman of the Remuneration Committee

14 May 2012

# 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 2012 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 62, 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 2012 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 2012 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 matters 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; and
- the information given in the Corporate Governance Statement set out on pages 47–52 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 61, in relation to going concern;
- the part of the Governance statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance 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 2012 and on the information in the Directors' remuneration report that is described as having been audited.

### John Baker

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

14 May 2012

# Group income statement

	Note	£m	2012 Total £m	2011 Total (restated) £m
For the year ended 31 March 2012				
<b>Total revenue</b>			3,070.4	2,703.2
Less: joint ventures and associates revenue			222.0	138.7
<b>Group revenue</b>	3		2,848.4	2,564.5
<b>Group</b>				
Operating profit before amortisation of acquired intangibles and exceptional items	3, 4, 5	290.2		250.1
Amortisation of acquired intangibles	6	(77.3)		(76.6)
Exceptional items	6	(10.9)		(20.3)
<b>Group operating profit</b>	3		202.0	153.2
<b>Joint ventures and associates</b>				
Share of operating profit	3	11.0		9.3
Investment income	3	25.6		13.8
Amortisation of acquired intangibles	6	(6.2)		(4.6)
Finance costs		(19.4)		(8.3)
Income tax expense		(6.7)		(4.1)
<b>Share of results of joint ventures and associates</b>			4.3	6.1
<b>Group and joint ventures and associates</b>				
Operating profit before amortisation of acquired intangibles and exceptional items		301.2		259.4
Investment income		27.8		16.0
Underlying operating profit*		329.0		275.4
Amortisation of acquired intangibles		(83.5)		(81.2)
Exceptional items		(10.9)		(20.3)
Group investment income		(2.2)		(2.2)
Joint ventures and associates finance costs		(19.4)		(8.3)
Joint ventures and associates income tax expense		(6.7)		(4.1)
<b>Group operating profit plus share of joint ventures and associates</b>			206.3	159.3
<b>Finance costs</b>				
Investment income	3	2.2		2.2
Finance costs	7	(46.0)		(59.0)
Finance income	7	10.5		8.6
			(33.3)	(48.2)
<b>Profit before tax</b>			173.0	111.1
Income tax expense	9	(15.8)		(10.1)
<b>Profit for the year from continuing operations</b>	5		157.2	101.0
<b>Discontinued operations</b>				
(Loss)/profit for the year from discontinued operations attributable to owners of the parent	10	(53.1)		3.7
<b>Profit for the year</b>	5		104.1	104.7
<b>Attributable to:</b>				
Owners of the parent			100.8	101.1
Non-controlling interest			3.3	3.6
			104.1	104.7
<b>Earnings per share from continuing operations</b>	12			
Basic			42.93p	30.14p
Diluted			42.76p	30.03p
<b>Earnings per share from continuing and discontinued operations</b>	12			
Basic			28.11p	31.28p
Diluted			28.01p	31.17p

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

## Group statement of comprehensive income

	Note	2012 £m	2011 £m
For the year ended 31 March 2012			
Profit for the year		104.1	104.7
<b>Other comprehensive income</b>			
Currency translation differences		(6.2)	(7.7)
Fair value adjustment of interest rate and foreign exchange hedges		4.3	7.3
Tax on fair value adjustment of interest rate and foreign exchange hedges		0.5	(1.5)
Fair value adjustment of joint venture and associates derivatives	16	(65.1)	8.8
Tax on fair value adjustment of joint venture and associates derivatives	16	16.9	(2.4)
Net actuarial gain/(loss) in respect of pensions	27	(106.9)	103.5
Tax on net actuarial (gain)/loss in respect of pensions		27.8	(31.3)
Impact of change in UK tax rates		(5.7)	(2.7)
<b>Other comprehensive income, net of tax</b>		(134.4)	74.0
<b>Total comprehensive (loss)/income</b>		(30.3)	178.7
<b>Attributable to:</b>			
Owners of the parent		(33.3)	175.0
Non-controlling interest		3.0	3.7
<b>Total comprehensive (loss)/income</b>		(30.3)	178.7

## Group statement of changes in equity

	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 interest £m	Total equity £m
For the year ended 31 March 2012									
<b>At 1 April 2010</b>	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 and other	–	–	–	(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
<b>At 31 March 2011</b>	215.3	872.8	30.6	(109.5)	1.5	1.0	1,011.7	8.9	1,020.6
<b>At 1 April 2011</b>	215.3	872.8	30.6	(109.5)	1.5	1.0	1,011.7	8.9	1,020.6
Total comprehensive (loss)/income	–	–	–	16.0	(43.4)	(5.9)	(33.3)	3.0	(30.3)
Shares issued in the financial year	0.2	0.2	–	–	–	–	0.4	–	0.4
Dividends	–	–	–	(71.4)	–	–	(71.4)	(2.1)	(73.5)
Share-based payments	–	–	–	5.0	–	–	5.0	–	5.0
Tax on shared-based payments	–	–	–	(0.6)	–	–	(0.6)	–	(0.6)
Own shares and other	–	–	–	0.2	–	–	0.2	–	0.2
Non-controlling interest acquired	–	–	–	(0.6)	–	–	(0.6)	(1.2)	(1.8)
Net movement in equity	0.2	0.2	–	(51.4)	(43.4)	(5.9)	(100.3)	(0.3)	(100.6)
<b>At 31 March 2012</b>	215.5	873.0	30.6	(160.9)	(41.9)	(4.9)	911.4	8.6	920.0

# Group balance sheet

	Note	2012 £m	2011 (restated) £m
As at 31 March 2012			
<b>Assets</b>			
<b>Non-current assets</b>			
Goodwill	13	1,540.9	1,622.2
Other intangible assets	14	347.2	473.4
Property, plant and equipment	15	213.7	205.8
Investment in joint ventures and associates	16	19.3	64.9
Loan to joint ventures and associates	16	24.9	22.1
Retirement benefits	27	10.2	12.2
Trade and other receivables	19	1.8	1.9
IFRIC 12 financial assets		23.1	38.2
Other financial assets	23	20.1	1.0
Deferred tax	17	31.3	3.3
		2,232.5	2,445.0
<b>Current assets</b>			
Inventories	18	81.6	96.6
Trade and other receivables	19	476.9	540.3
Income tax recoverable		–	2.7
Other financial assets	23	3.3	0.8
Cash and cash equivalents	20	100.3	104.3
		662.1	744.7
Assets held for sale	32	103.0	–
<b>Total assets</b>		2,997.6	3,189.7
<b>Equity and liabilities</b>			
<b>Equity attributable to owners of the parent</b>			
Share capital	25	215.5	215.3
Share premium		873.0	872.8
Capital redemption and other reserves		(16.2)	33.1
Retained earnings		(160.9)	(109.5)
		911.4	1,011.7
Non-controlling interest		8.6	8.9
<b>Total equity</b>		920.0	1,020.6
<b>Non-current liabilities</b>			
Bank and other borrowings	22	757.3	799.0
Trade and other payables	21	8.9	13.6
Deferred tax	17	–	20.6
Retirement liabilities	27	276.1	237.3
Provisions for other liabilities	24	117.2	134.4
		1,159.5	1,204.9
<b>Current liabilities</b>			
Bank and other borrowings	22	4.2	35.3
Trade and other payables	21	819.5	877.8
Income tax payable		10.0	17.3
Other financial liabilities	23	8.2	4.1
Provisions for other liabilities	24	27.8	29.7
		869.7	964.2
Liabilities held for sale	32	48.4	–
<b>Total liabilities</b>		2,077.6	2,169.1
<b>Total equity and liabilities</b>		2,997.6	3,189.7

The notes on pages 88 to 127 are an integral part of the consolidated financial statements. The Group financial statements were approved by the Board of Directors on 14 May 2012 and are signed on its behalf by:

**P L Rogers**  
Director

**W Tame**  
Director

# Group cash flow statement

	Note	2012 £m	2011 £m
For the year ended 31 March 2012			
<b>Cash flows from operating activities</b>			
Cash generated from operations	28	260.7	308.5
Income tax paid		(28.0)	(19.3)
Interest paid		(47.4)	(58.6)
Interest received		10.3	8.6
<b>Net cash flows from operating activities</b>		<b>195.6</b>	<b>239.2</b>
<b>Cash flows from investing activities</b>			
Disposal of subsidiaries and joint ventures and associates	32	5.7	2.2
Dividends received from joint ventures and associates		6.6	–
Proceeds on disposal of property, plant and equipment		2.7	1.0
Proceeds on disposal of intangible assets		–	0.2
Purchases of property, plant and equipment		(42.7)	(30.2)
Purchases of intangible assets		(6.0)	(4.2)
Investment in, loans to and interest received from joint ventures and associates		(2.7)	0.2
Acquisition of non-controlling interest		(1.7)	–
Acquisition of subsidiaries net of cash acquired	31	0.2	(486.2)
<b>Net cash flows from investing activities</b>		<b>(37.9)</b>	<b>(517.0)</b>
<b>Cash flows from financing activities</b>			
Dividends paid	11	(71.4)	(48.0)
Finance lease principal payments		(2.0)	(12.9)
Loans repaid		(305.6)	(457.5)
Loans raised		251.0	845.1
Dividends paid to non-controlling interest		(2.1)	(3.5)
Net proceeds on issue of shares		0.4	–
Movement on own shares		0.2	(2.2)
<b>Net cash flows from financing activities</b>		<b>(129.5)</b>	<b>321.0</b>
<b>Net increase in cash, cash equivalents and bank overdrafts</b>		<b>28.2</b>	<b>43.2</b>
<b>Cash, cash equivalents and bank overdrafts at beginning of year</b>		<b>72.7</b>	<b>29.0</b>
Effects of exchange rate fluctuations		(2.5)	0.5
<b>Cash, cash equivalents and bank overdrafts at end of year</b>	30	<b>98.4</b>	<b>72.7</b>

# Notes to the Group financial statements

## 1. Basis of preparation and significant accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as adopted by the European Union and with those parts of the Companies Act 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 and on a going concern basis. 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 and associates*

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. As can be seen from note 3 this represents approximately 10% of the business.

##### *(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. In a limited number of contracts where performance and revenue are measured annually the revenue and costs are similarly recognised over the course of the year.

##### *(c) Long-term service contracts*

Revenue from long-term service contracts is recognised by reference to the stage of completion of the contract in accordance with IAS18 'Revenue' and IAS11 'Construction contracts'. 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.

The profit element of the revenue attributable to a contract is recognised if the final outcome can be reliably assessed. In order to assess the likely outcome of a contract a full estimated cost of completion is produced which will assess risks and opportunities including cost rates, time, volume and performance for the contract and apply a probability to these being realised. As time elapses these risks and opportunities will become more predictable. Risks and opportunities will vary dependent on the terms of each contract and the commercial environment of each market. Certain contracts will have pain/gain share arrangements whereby target cost under/over spends are shared with the customer. These sharing arrangements are included in assessing the overall contract outturn and the expected profit.

Any 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 interest*

The Group policy is to treat transactions with non-controlling interest as transactions with owners of the parent and therefore result in movements in reserves.

### *Provisions*

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and the amount has been reliably estimated. If the effect is material, provisions are determined by discounting the expected future cash flows at an appropriate discount rate.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been publicly announced. Future operating costs are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

Provisions for losses on contracts are recorded when it becomes probable that total estimated contract costs will exceed total contract revenues. Such provisions are recorded as write downs of work-in-progress for that portion of the work which has already been completed, and as liability provisions for the remainder. Losses are determined on the basis of estimated results on completion of contracts and are updated regularly.

### *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.

Annual impairment reviews are performed as outlined in note 13.

#### *(b) Acquired intangibles*

Acquired intangibles are the estimated fair value of customer relationships which are in part contractual, represented by the value of the acquired order book, and in part non-contractual, represented by the risk adjusted value of future orders expected to arise from the relationships.

The carrying value of the contracted element is amortised straight line over the remaining period of the orders that are in process or the future period in which the orders will be fulfilled, as the case may be. The amortisation periods, reflecting the lengths of the various contracts, are mainly in the range one year to five years, with a minority of contracts and hence amortisation periods, up to ten years.

The carrying value of the non-contracted element is amortised over the period in which it is estimated that the relationships are likely to bring economic benefit via future orders. The method of amortisation is tailored to the expectations of the timing of the receipt of specific future orders and therefore the charge to the income statement matches the timing of value likely to be generated in those years.

Relationships are valued on a contract by contract and customer by customer basis and the pattern of amortisation reflects the expected pattern of benefit in each case. The amortisation profile is determined on a case-by-case basis and in all cases results in a front-loaded profile, reflecting the greater certainty of future orders in the near term compared with the longer term. The amortisation period is in the range one year to ten years.

#### *(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.

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

### *Property, Plant and Equipment (PPE)*

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

Freehold 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 whose objective is to fair value hedge the underlying debt. This will include swaps of the currency of the debt into the functional currency and interest rate basis of the company carrying the debt and fair value hedges.

### *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 balances*

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.

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

### Foreign currencies

#### (a) Functional and presentation currency

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

#### (b) Transactions and balances

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

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

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

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

### 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.

### Discontinued and held for sale

A significant business stream sold during the year or being actively marketed with an expectation of being sold within a year will be treated as discontinued within the income statement. The prior year comparatives will be restated. If such a business has not been sold at year-end the relevant assets and liabilities will be shown as held for sale within the balance sheet.

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

### *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.

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. Interim dividends are recognised when paid.

### *Critical accounting estimates and judgements*

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key areas of estimates and judgements for the Group are contract accounting (see above), the accounting for defined benefit pension schemes (see note 27), impairment of goodwill (see note 13) and income tax recognition.

Fair value adjustments on acquisitions are by nature subject to critical judgements. The size of recent acquisitions make them significant in Group terms (see note 31).

Assets and liabilities held for sale are judgemental and reflects management's best estimate of sale proceeds less costs to sell.

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.

### *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 2011 or later periods but which the Group has not early adopted.

(a) Standards, amendments and interpretations effective in 2011 with minimal or no impact on the Group:

- IAS 24 (revised), 'Related party disclosures'.
- IFRS 1 (amendment), 'First time adoption' on financial instrument disclosures.
- IFRIC 14 (amendment), 'Prepayment of a minimum funding requirement'.
- IFRIC 19, 'Extinguishing financial liabilities with equity instruments'.
- 2010 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 12 (amendment), 'Income taxes', effective 1 January 2012.
- IFRS 7 (amendment), 'Financial instruments; disclosures', effective 1 July 2011
- 2011 Annual improvements, effective from 1 January 2011.

(c) Interpretations to existing standards that are not yet effective, have not been endorsed by the EU and the impact on the Group's operations is currently being assessed but is not expected to be significant with the exception of IAS 19 (amendment):

- IFRS 1 (amendment), 'First time adoption' on hyperinflation and fixed dates.
- IFRS 9, 'Financial instruments' effective 1 January 2015
- IFRS 10, 'Consolidated financial statements', effective 1 January 2013.
- IFRS 11, 'Joint arrangements', effective 1 January 2013.
- IFRS 12, 'Disclosure of interests in other entities', effective 1 January 2013.
- IFRS 13, 'Fair value measurement', effective 1 January 2013.
- IAS 19 (amendment), 'Employee benefits', effective 1 January 2013. This would have an after tax detrimental effect on the income statement of approximately £29 million for 2011/12.
- IAS 27 'Consolidated and separate financial statements', effective 1 January 2013.
- IAS 28 'Investments in associates and joint ventures', effective 1 January 2013.

## 2. Financial risk management

The Group's treasury and capital 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.

### *Capital availability*

The Company defines capital as shareholder equity plus net debt but in addition considers available financial capital which adds committed undrawn facilities to capital as a measure.

**Objective on available financial capital** To ensure an appropriate level of capital and available financial capital to maintain operational flexibility and meet financial obligations whilst funding the Group's organic and acquisitive growth. The Group seeks to maintain the necessary headroom to cover the peaks and troughs in its working capital cycle, and sufficient liquidity to see it through any periods of tightened liquidity in the market.

**Policy** The Board aims to maintain a balance between equity and debt capital which optimises the Group's cost of carry whilst allowing access to both equity and debt capital markets at optimum pricing when appropriate. The Group, in considering its capital structure and financial capital, views net debt to EBITDA at below two times as being steady state and sustainable in the current market and against the current economic backdrop. This is not to rule out acquisition spikes above two times, as reported following the VT Group plc acquisition, but only if the Group can see a clear path to reducing net debt to EBITDA back below two times within a reasonable time frame.

**Performance** The Group's gearing and debt cover ratios, used by the Group to evaluate capital, have improved significantly from last year both in the rapid pay down of debt and through increased profits attributable to shareholders.

		Covenant	2012	2011
Debt service cover	EBITDA/net interest	>4	6.4x	5.3x
Debt cover	Net debt/EBITDA	<3.5	1.8x	2.4x
Gearing	Net debt/shareholders' funds	n/a	54%	59%

Debt ratios are well below covenanted levels and gearing is at a level where the cost of capital is enhanced. As such we believe capital markets remain readily accessible when required.

## 2. Financial risk management (continued)

### *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.

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.

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.

### *Management of capital*

The Group's capital structure is derived from equity and net debt and is overseen by the Board through the Group Finance Committee.

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

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 exceptional items divided by net interest payable). These ratios are discussed under the business review.

Through the monitoring of these metrics it remains the Group's intention to ensure the business is prudently funded, balancing risk and price on the capital markets and to retain sufficient flexibility to fund future organic and acquisitive growth.

### *Foreign exchange risk*

The functional and presentational currency of Babcock International group PLC and its UK subsidiaries is pounds Sterling. The Group has two main areas of currency exposure; firstly, the US\$650 million 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.

<b>Objective</b>	To reduce 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.
<b>Policy – Transactional risk</b>	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.
<b>Policy – Translational risk</b>	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.
<b>Performance</b>	There have been no material unhedged foreign exchange losses in the year.

A key principle 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 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 £12.2 million Sterling to Euro (2011: Sterling to Euro £6.4 million).

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 £1.5 million (2011: £1.0 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.

### 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 interest rate-sensitive instruments and associated debt to a hypothetical parallel shift of the forward interest rate curves of ±50bp (2011: ±50bp), with pre-tax effect annualised and an additional shift in variable rates for the floating rate element of the gross debt. All other variables are held constant. The Group believes ±50bp is an appropriate measure of volatility at this time.

		2012	2011
	£m	£m	£m
	+50bp	-50bp	+50bp
Net results for the year	(2.1)	2.1	(2.1)
Equity	14.3	(14.3)	15.8
			(15.8)

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.

Objective	To manage 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.
Policy	Interest hedging and the monitoring of the mix between fixed and floating rates is the responsibility of the treasury department, and is subject to the policy and guidelines set by the Board.
Performance	As at 31 March 2012, the Group had 45 % fixed rate debt (March 2011: 41%) and 55% floating rate debt (March 2011: 59%) based on gross debt including derivatives of £741.3 million (March 2011: £833.3 million). For further information see note 22 to the Group accounts.

### Liquidity risk

The key objectives are to ensure that the Group has 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.

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 (see note 22).

The Group's committed Revolving Credit Facility (RCF) of £500 million has an expiry date of September 2016, and is available to meet general corporate funding requirements. At 31 March 2012, £225 million was drawn on this facility.

The Group has US Private Placements with a value of circa £500 million maturing between six and nine years.

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.

Objective	With debt as a key component of Available Capital, the Group seeks to ensure that there is 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.
Policy	All the Group's material borrowings are arranged by the treasury department, and funds raised are lent onward to operating subsidiaries as required. It remains the Group's policy to ensure the business is prudently funded and that sufficient headroom is maintained on its facilities to fund its future growth.
Performance	In last year's Annual Report, the Group reported that it had taken the opportunity to review its capital structure following the acquisition of VT Group plc in 2010, and in line with the above objective, issued US\$650 million of notes with seven and ten year maturities in the US Private Placement market in March 2011. In this financial year, the Group completed the refinancing of its Revolving Credit Facility (RCF) in June 2011, raising £500 million with a term of five years three months. The two afore mentioned debt raisings along with the £100 million of loan notes issued in January 2010, provide the Group with total committed banking facilities and loan notes of £1 billion. For further information see note 22 to the Group accounts.

## 2. Financial risk management (continued)

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
<b>At 31 March 2012</b>				
Bank and other borrowings	31.7	29.7	370.4	552.2
Derivative financial instruments	1.1	0.3	0.2	(16.8)
Trade and other payables*	803.9	1.5	4.2	4.6
<b>At 31 March 2011</b>				
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

\* 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
<b>At 31 March 2012</b>				
Forward derivative contracts – cash flow hedges:				
– outflow	25.7	17.5	48.0	400.0
– inflow	25.1	17.6	48.7	420.1
Forward derivative contracts – held for trading:				
– outflow	9.4	–	–	–
– inflow	9.4	–	–	–
<b>At 31 March 2011</b>				
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	–	–

## 3. Segmental information

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, Critical Assets and Mobile Assets. International includes the South African and Middle East businesses. The US defence business formerly included in International is now under Discontinued operations. See note 10.

### 3. Segmental information (continued)

	Marine and Technology £m	Defence and Security £m	Support Services £m	International £m	Unallocated £m	Continuing operations		Discontinued operations	Total Group Total £m
						Total continuing operations £m	International £m	International £m	
2012									
Total revenue	1,084.7	613.3	1,092.4	280.0	–	3,070.4	202.1	3,272.5	
Joint ventures and associates revenue	–	167.3	54.7	–	–	222.0	–	222.0	
<b>Group revenue</b>	<b>1,084.7</b>	<b>446.0</b>	<b>1,037.7</b>	<b>280.0</b>	<b>–</b>	<b>2,848.4</b>	<b>202.1</b>	<b>3,050.5</b>	
Operating profit* – Group	135.1	50.3	97.2	19.3	(11.7)	290.2	14.7	304.9	
IFRIC 12 investment income – Group	–	1.4	0.8	–	–	2.2	–	2.2	
Share of operating profit – joint ventures and associates	–	9.5	1.5	–	–	11.0	–	11.0	
Share of IFRIC 12 investment income – joint ventures and associates	–	18.4	7.2	–	–	25.6	–	25.6	
<b>Underlying operating profit</b>	<b>135.1</b>	<b>79.6</b>	<b>106.7</b>	<b>19.3</b>	<b>(11.7)</b>	<b>329.0</b>	<b>14.7</b>	<b>343.7</b>	
Share of finance costs – joint ventures and associates	–	(12.3)	(7.1)	–	–	(19.4)	–	(19.4)	
Share of tax – joint ventures and associates	–	(6.5)	(0.2)	–	–	(6.7)	–	(6.7)	
Acquired intangible amortisation – Group	(13.0)	(12.6)	(51.7)	–	–	(77.3)	(7.9)	(85.2)	
Share of acquired intangible amortisation – joint ventures and associates	–	(5.8)	(0.4)	–	–	(6.2)	–	(6.2)	
Net finance costs – Group	–	–	–	–	(35.5)	(35.5)	–	(35.5)	
Exceptional items – Group	–	–	–	–	(10.9)	(10.9)	(58.6)	(69.5)	
<b>Group profit before tax</b>	<b>122.1</b>	<b>42.4</b>	<b>47.3</b>	<b>19.3</b>	<b>(58.1)</b>	<b>173.0</b>	<b>(51.8)</b>	<b>121.2</b>	

\* Before amortisation of acquired intangibles and exceptional items

	Marine and Technology £m	Defence and Security £m	Support Services £m	International (restated) £m	Unallocated (restated) £m	Continuing operations		Discontinued operations	Total Group Total £m
						Total continuing operations £m	International (restated) £m	International (restated) £m	
2011									
Total revenue	1,019.5	469.2	946.6	267.9	–	2,703.2	191.3	2,894.5	
Joint ventures and associates revenue	–	87.3	51.4	–	–	138.7	–	138.7	
<b>Group revenue</b>	<b>1,019.5</b>	<b>381.9</b>	<b>895.2</b>	<b>267.9</b>	<b>–</b>	<b>2,564.5</b>	<b>191.3</b>	<b>2,755.8</b>	
Operating profit* – Group	119.3	52.8	74.7	18.1	(14.8)	250.1	11.5	261.6	
IFRIC 12 investment income – Group	–	1.6	0.6	–	–	2.2	–	2.2	
Share of operating profit – joint ventures and associates	–	8.5	0.8	–	–	9.3	–	9.3	
Share of IFRIC 12 investment income – joint ventures and associates	–	10.3	3.5	–	–	13.8	–	13.8	
<b>Underlying operating profit</b>	<b>119.3</b>	<b>73.2</b>	<b>79.6</b>	<b>18.1</b>	<b>(14.8)</b>	<b>275.4</b>	<b>11.5</b>	<b>286.9</b>	
Share of finance costs – joint ventures and associates	–	(4.7)	(3.6)	–	–	(8.3)	–	(8.3)	
Share of tax – joint ventures and associates	–	(4.0)	(0.1)	–	–	(4.1)	–	(4.1)	
Acquired intangible amortisation – Group	(10.1)	(13.9)	(52.6)	–	–	(76.6)	(6.8)	(83.4)	
Share of acquired intangible amortisation – joint ventures and associates	–	(4.3)	(0.3)	–	–	(4.6)	–	(4.6)	
Net finance costs – Group	–	–	–	–	(50.4)	(50.4)	–	(50.4)	
Exceptional items – Group	–	–	–	–	(20.3)	(20.3)	(0.4)	(20.7)	
<b>Group profit before tax</b>	<b>109.2</b>	<b>46.3</b>	<b>23.0</b>	<b>18.1</b>	<b>(85.5)</b>	<b>111.1</b>	<b>4.3</b>	<b>115.4</b>	

\* Before amortisation of acquired intangibles and exceptional items

Inter divisional revenue is immaterial.

Revenues of approximately £2.0 billion (2011: £1.6 billion) are derived from a single external customer. These revenues are attributable to the Marine and Technology, Defence and Security, and Support Services segments.

### 3. Segmental information (continued)

The segment assets and liabilities at 31 March 2012 and 31 March 2011 and capital expenditure for the years then ended are as follows:

	Assets		Liabilities		Capital expenditure	
	2012 £m	2011 (restated) £m	2012 £m	2011 (restated) £m	2012 £m	2011 £m
Marine and Technology	710.7	724.6	535.2	522.2	24.5	17.4
Defence and Security	765.1	905.1	193.1	170.9	0.5	0.7
Support Services	1,023.9	1,075.9	338.9	314.5	4.5	5.9
International	166.1	327.9	87.3	150.0	8.1	6.7
Unallocated	331.8	156.2	923.1	1,011.5	11.1	3.7
<b>Group total</b>	<b>2,997.6</b>	<b>3,189.7</b>	<b>2,077.6</b>	<b>2,169.1</b>	<b>48.7</b>	<b>34.4</b>

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

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

The segmental depreciation on tangible assets and amortisation of intangible assets for the years ended 31 March 2012 and 31 March 2011 are as follows:

	Depreciation		Amortisation of intangible assets	
	2012 £m	2011 (restated) £m	2012 £m	2011 (restated) £m
Marine and Technology	17.2	15.8	14.2	11.4
Defence and Security	4.2	2.0	14.7	14.1
Support Services	6.1	7.2	52.7	54.2
International	3.6	3.8	0.3	0.3
Unallocated	1.5	1.7	0.3	0.2
<b>Total continuing operations</b>	<b>32.6</b>	<b>30.5</b>	<b>82.2</b>	<b>80.2</b>
Discontinued operations	1.0	0.7	8.2	7.1
<b>Group total</b>	<b>33.6</b>	<b>31.2</b>	<b>90.4</b>	<b>87.3</b>

Geographic analysis	Revenue		Assets		Capital expenditure	
	2012 £m	2011 (restated) £m	2012 £m	2011 (restated) £m	2012 £m	2011 £m
United Kingdom	2,423.2	2,210.4	2,502.0	2,660.5	38.6	26.8
Africa	264.1	250.6	159.3	174.0	6.9	6.1
North America	93.7	67.4	289.7	327.8	1.7	0.6
Rest of World	67.4	36.1	46.6	27.4	1.5	0.9
<b>Group total</b>	<b>2,848.4</b>	<b>2,564.5</b>	<b>2,997.6</b>	<b>3,189.7</b>	<b>48.7</b>	<b>34.4</b>

	Continuing operations		Discontinued operations		Group total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Sales of goods	295.2	307.6	–	–	295.2	307.6
Sales of services	2,550.0	2,254.8	202.1	191.3	2,752.1	2,446.1
Rental income	3.2	2.1	–	–	3.2	2.1
	<b>2,848.4</b>	<b>2,564.5</b>	<b>202.1</b>	<b>191.3</b>	<b>3,050.5</b>	<b>2,755.8</b>

#### 4. Operating expenses

	Continuing operations		Discontinued operations		Group total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Cost of sales	2,507.4	2,258.0	184.3	175.3	2,691.7	2,433.3
Distribution expenses	9.3	10.2	–	–	9.3	10.2
Administration expenses	129.7	143.1	69.6	11.7	199.3	154.8
	2,646.4	2,411.3	253.9	187.0	2,900.3	2,598.3

#### 5. Operating profit for the year

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

	Continuing operations		Discontinued operations		Group total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Employee costs (note 8)	986.0	876.6	89.7	77.9	1,075.7	954.5
Inventories						
– cost of inventories recognised as an expense	290.8	299.8	0.6	0.2	291.4	300.0
– increase in inventory provisions	1.5	5.1	–	–	1.5	5.1
Depreciation of Property, Plant and Equipment (PPE)						
– owned assets	31.8	29.0	0.9	0.7	32.7	29.7
– under finance leases	0.9	1.5	–	–	0.9	1.5
	32.7	30.5	0.9	0.7	33.6	31.2
Amortisation of intangible assets						
– acquired intangibles	77.3	76.6	7.9	6.8	85.2	83.4
– other	4.9	3.7	0.2	0.2	5.1	3.9
	82.2	80.3	8.1	7.0	90.3	87.3
(Profit)/loss on disposal of PPE	(0.3)	0.4	(0.5)	–	(0.8)	0.4
Loss on disposal of intangibles	0.2	0.2	–	–	0.2	0.2
Operating lease rentals payable						
– property	19.5	17.3	1.6	1.1	21.1	18.4
– vehicles, plant and equipment	12.3	11.0	0.3	0.2	12.6	11.2
Research and development	1.9	2.0	–	–	1.9	2.0
Trade receivables impairment/(release)	0.9	2.1	(1.0)	–	(0.1)	2.1
Net foreign exchange losses	0.8	0.9	–	–	0.8	0.9

#### 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	
	2012 £m	2011 £m
<b>Audit fees:</b>		
Fees payable to the Group's auditor for the audit of the parent entity and the consolidated financial statements	0.8	0.9
<b>Fees for other services:</b>		
The auditing of financial statements of subsidiaries of the Company pursuant to legislation (including that of countries and territories outside Great Britain)	0.8	0.8
Taxation services	0.1	0.2
All other services	0.2	0.6
<b>Total fees paid to the Group's auditor and network firms</b>	<b>1.9</b>	<b>2.5</b>

Other services include £0.2 million for work on non statutory audits whilst in 2011 it included £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 and associates		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
<b>Continuing operations</b>						
Profit on disposal of subsidiaries (note 32)	(1.9)	(2.9)	–	–	(1.9)	(2.9)
Reorganisation cost	12.8	10.8	–	–	12.8	10.8
Acquisition costs	–	12.4	–	–	–	12.4
<b>Exceptional items</b>	<b>10.9</b>	<b>20.3</b>	–	–	<b>10.9</b>	<b>20.3</b>
Acquired intangible amortisation	77.3	76.6	6.2	4.6	83.5	81.2
<b>Continuing total</b>	<b>88.2</b>	<b>96.9</b>	<b>6.2</b>	<b>4.6</b>	<b>94.4</b>	<b>101.5</b>
<b>Discontinued operations</b>						
Reorganisation costs	0.1	0.4	–	–	0.1	0.4
Impairment of US defence goodwill	58.5	–	–	–	58.5	–
<b>Exceptional items</b>	<b>58.6</b>	<b>0.4</b>	–	–	<b>58.6</b>	<b>0.4</b>
Acquired intangible amortisation	7.9	6.8	–	–	7.9	6.8
<b>Discontinued total</b>	<b>66.5</b>	<b>7.2</b>	–	–	<b>66.5</b>	<b>7.2</b>

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

Following the exchange of conditional contracts for the sale of the US defence business acquired with the VT Group plc there is an impairment to goodwill reflecting the current sales value expected.

Acquisition costs in 2011 relate to the acquisition of VT Group plc (see note 31). Reorganisation costs relate to the integration of Babcock International Group PLC and VT Group plc.

## 7. Net finance costs

	2012 £m	2011 £m
<b>Finance costs</b>		
Loans, overdrafts and associated interest rate hedges*	43.7	47.5
Finance leases	0.2	0.4
Amortisation of issue costs of bank loan	1.0	8.9
Other	1.1	2.2
<b>Total finance costs</b>	<b>46.0</b>	<b>59.0</b>
<b>Finance income</b>		
Bank deposits and loans	10.5	8.6
<b>Total finance income</b>	<b>10.5</b>	<b>8.6</b>
<b>Net finance costs</b>	<b>35.5</b>	<b>50.4</b>

\* Interest rate hedges included above is £2.8 million income (2011: £13.8 million cost).

## 8. Employee costs

	Continuing operations		Discontinued operations		Group total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
Wages and salaries	852.5	751.4	81.3	71.7	933.8	823.1
Social security costs	80.6	67.0	5.9	4.6	86.5	71.6
Share-based payments (note 26)	4.8	5.7	0.2	0.1	5.0	5.8
Pension costs – defined contribution plans (note 27)	30.0	23.5	2.3	1.5	32.3	25.0
Pension charges – defined benefit plans (note 27)	18.1	29.0	–	–	18.1	29.0
	986.0	876.6	89.7	77.9	1,075.7	954.5

## 8. Employee costs (continued)

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

	Continuing operations		Discontinued operations		Group total	
	2012 Number	2011 Number	2012 Number	2011 Number	2012 Number	2011 Number
Operations	21,855	21,491	1,838	2,243	23,693	23,734
Administration and management	3,470	3,734	114	120	3,584	3,854
	25,325	25,225	1,952	2,363	27,277	27,588

Emoluments of the 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.

		2012 £m	2011 £m
Salaries		7.3	7.3
Post-employment benefits		0.4	0.2
Share-based payments		1.9	2.2
		9.6	9.7

## 9. Income tax expense

	Continuing operations		Discontinued operations		Group total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
<b>Analysis of tax charge in the year</b>						
Current tax						
– UK current year charge	32.8	35.7	–	–	32.8	35.7
– Overseas current year charge	10.4	7.8	4.4	3.4	14.8	11.2
– UK prior year charge	3.0	2.8	–	–	3.0	2.8
	46.2	46.3	4.4	3.4	50.6	49.7
Deferred tax						
– UK current year credit	(24.8)	(30.4)	–	–	(24.8)	(30.4)
– Adjustment in respect of prior year	(3.0)	–	–	–	(3.0)	–
– Overseas current year (credit)/charge	0.8	(0.3)	(3.1)	(2.8)	(2.3)	(3.1)
– Overseas prior year credit	–	(2.8)	–	–	–	(2.8)
– Impact of change in UK tax rate	(3.4)	(2.7)	–	–	(3.4)	(2.7)
	(30.4)	(36.2)	(3.1)	(2.8)	(33.5)	(39.0)
<b>Total income tax expense</b>	<b>15.8</b>	<b>10.1</b>	<b>1.3</b>	<b>0.6</b>	<b>17.1</b>	<b>10.7</b>

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

	2012 £m	2011 £m
<b>Profit before tax</b>	<b>173.0</b>	<b>111.1</b>
Profit on ordinary activities multiplied by rate of corporation tax in the UK of 26% (2011: 28%)	45.0	31.1
Effects of:		
Expenses not deductible for tax purposes	2.2	4.5
Adjustments in respect of foreign tax rates	(9.9)	(12.2)
Re-measurement of deferred tax re change in UK tax rate	(3.4)	(2.7)
Difference in respect of joint venture results	(1.1)	(3.6)
Other	(17.0)	(7.0)
<b>Total income tax expense</b>	<b>15.8</b>	<b>10.1</b>

## 9. Income tax expense (continued)

As a result of the change in the UK corporate tax rate from 26% to 24% for the 2012/13 financial year, a credit of £3.4 million (2011: £2.7 million) has been taken to the income statement in respect of the re-measurement of the year end deferred tax balances, and a charge of £5.7 million (2011: £2.7 million) has been taken to reserves.

## 10. Discontinued operations

Agreement has now been reached for the sale of the US defence business, subject to regulatory clearance. Consequently it has been treated as a discontinued operation within these financial statements. The business has been impaired to its fair value less costs to sell and is included as assets and liabilities held for sale. (See note 32).

	2012 £m	2011 £m
<b>Financial performance of discontinued operations</b>		
Revenue	202.1	191.3
Operating profit before amortisation of acquired intangibles	14.7	11.5
Amortisation of acquired intangibles	(7.9)	(6.8)
<b>Profit before tax and exceptional items</b>	6.8	4.7
Taxation	(1.3)	(0.7)
<b>Profit after taxation and before exceptional items</b>	5.5	4.0
<b>Exceptional items:</b>		
Impairment	(58.5)	-
Reorganisation costs	(0.1)	(0.4)
	(58.6)	(0.4)
Taxation	-	0.1
<b>Exceptional loss</b>	(58.6)	(0.3)
<b>(Loss)/profit after taxation from discontinued operations</b>	(53.1)	3.7
<b>Cash flows from discontinued operations</b>		
Net cash flows from operating activities	7.9	12.7
Net cash flows from investing activities	(0.4)	(0.4)
Net cash flows from financing activities	(2.8)	(0.4)
	4.7	11.9

## 11. Dividends

	2012 £m	2011 £m
Final dividend for the year ended 31 March 2011 of 14.20p (2011: 12.80p) per 60p share	50.9	29.4
Interim dividend for the year ended 31 March 2012 of 5.70p (2011: 5.20p) per 60p share	20.5	18.6
	71.4	48.0

In addition, the Directors are proposing a final dividend in respect of the financial year ended 31 March 2012 of 17.0p (2011: 14.2p) per share which will absorb an estimated £61.0 million (2011: £50.8 million) of shareholders' equity. It will be paid on 7 August 2012 to shareholders who are on the register of members on 6 July 2012. These financial statements do not reflect this dividend payable. Subject to approval at the Annual General Meeting on 5 July 2012.

## 12. Earnings per share

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

### Number of shares

	2012 Number	2011 Number
Weighted average number of ordinary shares for the purpose of basic EPS	358,568,556	323,193,144
Effect of dilutive potential ordinary shares: share options	1,312,457	1,144,410
Weighted average number of ordinary shares for the purpose of diluted EPS	359,881,013	324,337,554

### Earnings

	2012 Earnings £m	2012 Basic per share Pence	2012 Diluted per share Pence	2011 Earnings £m	2011 Basic per share Pence	2011 Diluted per share Pence
<b>Continuing operations</b>						
Earnings from continuing operations	153.9	42.93	42.76	97.4	30.14	30.03
Add back:						
Amortisation of acquired intangible assets, net of tax	61.8	17.23	17.17	58.5	18.09	18.02
Exceptional items, net of tax	8.1	2.26	2.25	16.5	5.11	5.09
Impact of change in UK tax rate	(3.4)	(0.95)	(0.94)	(2.7)	(0.84)	(0.83)
<b>Earnings before discontinued operations, amortisation, exceptional items and other</b>	<b>220.4</b>	<b>61.47</b>	<b>61.24</b>	<b>169.7</b>	<b>52.50</b>	<b>52.31</b>
<b>Discontinued operations</b>						
Earnings from discontinued operations	(53.1)	(14.82)	(14.75)	3.7	1.14	1.14
Add back:						
Amortisation of acquired intangible assets, net of tax	4.8	1.35	1.34	4.1	1.30	1.30
Exceptional items, net of tax	58.6	16.33	16.26	0.3	0.09	0.09
<b>Earnings from discontinued operations before amortisation, exceptional items and other</b>	<b>10.3</b>	<b>2.86</b>	<b>2.85</b>	<b>8.1</b>	<b>2.53</b>	<b>2.53</b>
<b>Continuing and discontinued operations</b>						
Earnings from continuing and discontinued operations	100.8	28.11	28.01	101.1	31.28	31.17
Add back:						
Amortisation of acquired intangible assets, net of tax	66.6	18.58	18.51	62.6	19.39	19.32
Exceptional items, net of tax	66.7	18.59	18.51	16.8	5.20	5.18
Impact of change in UK tax rate	(3.4)	(0.95)	(0.94)	(2.7)	(0.84)	(0.83)
<b>Earnings before amortisation, exceptional items and other</b>	<b>230.7</b>	<b>64.33</b>	<b>64.09</b>	<b>177.8</b>	<b>55.03</b>	<b>54.84</b>

### 13. Goodwill

	2012 £m	2011 (restated) £m
<b>Cost</b>		
<b>At 1 April</b>	1,627.0	553.1
On acquisition of subsidiaries (note 31)	–	1,080.4
On disposal of subsidiary (note 32)	(1.2)	–
Reclassified as assets held for sale	(81.7)	–
Exchange adjustments	1.6	(6.5)
<b>At 31 March</b>	1,545.7	1,627.0
<b>Accumulated impairment</b>		
<b>At 1 April</b>	4.8	4.8
Impairment charge	58.5	–
Reclassified as assets held for sale	(58.3)	–
Exchange adjustments	(0.2)	–
<b>At 31 March</b>	4.8	4.8
<b>Net book value at 31 March</b>	1,540.9	1,622.2

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 10.0% to 11.5% 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 7.5% to 8.5% (2011: 8% to 9%). The above impairment relates to the discontinued US defence business and reflects the expected proceeds less costs of sale (note 10).

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:

	2012 £m	2011 (restated) £m
Marine and Technology	387.1	387.2
Defence and Security	591.4	591.4
Support Services	551.7	551.7
International – Africa	0.1	0.1
International – North America	–	81.2
International – Middle East	10.6	10.6
<b>United Kingdom</b>	1,540.9	1,622.2
Africa	0.1	0.1
North America	2.4	83.7
Middle East	10.6	10.6
<b>Net book value at 31 March</b>	1,540.9	1,622.2

## 14. Other intangible assets

	Acquired intangibles £m	IFRIC 12 intangibles £m	Software £m	Development costs £m	Total £m
<b>Cost</b>					
<b>At 1 April 2011</b>	602.6	5.9	25.4	3.2	637.1
Additions	–	–	6.0	–	6.0
Disposals	–	–	(1.1)	(3.2)	(4.3)
Reclassified as assets held for sale (note 32)	(58.7)	–	(0.3)	–	(59.0)
Exchange adjustments	–	–	(0.2)	–	(0.2)
<b>At 31 March 2012</b>	543.9	5.9	29.8	–	579.6
<b>Accumulated amortisation and impairment</b>					
<b>At 1 April 2011</b>	146.9	0.3	13.3	3.2	163.7
Amortisation charge	85.2	2.1	3.0	–	90.3
Disposals	–	–	(0.9)	(3.2)	(4.1)
Reclassified as assets held for sale (note 32)	(17.2)	–	(0.1)	–	(17.3)
Exchange adjustments	(0.1)	–	(0.1)	–	(0.2)
<b>At 31 March 2012</b>	214.8	2.4	15.2	–	232.4
<b>Net book value at 31 March 2012</b>	329.1	3.5	14.6	–	347.2
<b>Cost</b>					
At 1 April 2010	134.3	–	19.4	3.2	156.9
On acquisition of subsidiaries (note 31)	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)
<b>At 31 March 2011</b>	602.6	5.9	25.4	3.2	637.1
<b>Accumulated amortisation and impairment</b>					
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)
<b>At 31 March 2011</b>	146.9	0.3	13.3	3.2	163.7
<b>Net book value at 31 March 2011</b>	455.7	5.6	12.1	–	473.4

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

Acquired intangibles are the estimated fair value of customer relationships which are in part contractual, represented by the value of the acquired order book, and in part non-contractual, represented by the risk adjusted value of future orders expected to arise from the relationships.

The carrying value of the contracted element is amortised straight line over the remaining period of the orders that are in process or the future period in which the orders will be fulfilled, as the case may be. The amortisation periods, reflecting the lengths of the various contracts, are mainly in the range one year to five years, with a minority of contracts and hence amortisation periods, up to ten years.

The carrying value of the non-contracted element is amortised over the period in which it is estimated that the relationships are likely to bring economic benefit via future orders. The method of amortisation is tailored to the expectations of the timing of the receipt of specific future orders and therefore the charge to the income statement matches the timing of value likely to be generated in those years.

Relationships are valued on a contract by contract and customer by customer basis and the pattern of amortisation reflects the expected pattern of benefit in each case. The amortisation profile is determined on a case by case basis and in all cases results in a front-loaded profile, reflecting the greater certainty of future orders in the near term compared with the longer term. The amortisation period is in the range one year to ten years.

## 15. Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Total £m
<b>Cost</b>				
At 1 April 2011	69.4	5.9	255.4	330.7
Exchange adjustments	–	(0.1)	(4.7)	(4.8)
On disposal of subsidiaries (note 32)	–	–	(1.2)	(1.2)
Additions	0.8	0.6	41.0	42.4
Capitalised borrowing costs	–	–	0.3	0.3
Reclassified – see note below	–	–	10.2	10.2
Reclassified as assets held for sale (note 32)	(2.9)	(0.6)	(2.6)	(6.1)
Disposals	(0.6)	(0.4)	(5.9)	(6.9)
<b>At 31 March 2012</b>	<b>66.7</b>	<b>5.4</b>	<b>292.5</b>	<b>364.6</b>
<b>Accumulated depreciation</b>				
At 1 April 2011	25.1	1.1	98.7	124.9
Exchange adjustments	(0.1)	(0.1)	(1.7)	(1.9)
On disposal of subsidiaries (note 32)	–	–	(0.6)	(0.6)
Charge for the year	4.5	1.0	28.1	33.6
Reclassified as assets held for sale (note 32)	(0.1)	–	–	(0.1)
Disposals	(0.2)	–	(4.8)	(5.0)
<b>At 31 March 2012</b>	<b>29.2</b>	<b>2.0</b>	<b>119.7</b>	<b>150.9</b>
<b>Net book value at 31 March 2012</b>	<b>37.5</b>	<b>3.4</b>	<b>172.8</b>	<b>213.7</b>
<b>Cost</b>				
At 1 April 2010	56.7	4.7	188.1	249.5
Exchange adjustments	–	–	0.7	0.7
On acquisition of subsidiaries (note 31)	11.4	0.9	48.2	60.5
On disposal of subsidiaries (note 32)	–	–	(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)
<b>At 31 March 2011</b>	<b>69.4</b>	<b>5.9</b>	<b>255.4</b>	<b>330.7</b>
<b>Accumulated depreciation</b>				
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)
<b>At 31 March 2011</b>	<b>25.1</b>	<b>1.1</b>	<b>98.7</b>	<b>124.9</b>
<b>Net book value at 31 March 2011</b>	<b>44.3</b>	<b>4.8</b>	<b>156.7</b>	<b>205.8</b>

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

During the year two contracts were renewed on different terms resulting in a reclassification from other financial assets of £11.2 million and to inventory of £1.0 million.

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

	2012 £m	2011 £m
Cost	10.1	10.8
Aggregate depreciation	(5.4)	(5.4)
<b>Net book value</b>	<b>4.7</b>	<b>5.4</b>

## 16. Investment in and loans to joint ventures and associates

	Investment in joint ventures and associates		Loans to joint ventures and associates		Total	
	2012 £m	2011 £m	2012 £m	2011 £m	2012 £m	2011 £m
<b>At 1 April</b>						
– Net assets excluding goodwill	63.7	(0.2)	–	–	63.7	(0.2)
– Goodwill	1.2	1.2	–	–	1.2	1.2
– Loans to joint ventures and associates	–	–	22.1	13.3	22.1	13.3
	64.9	1.0	22.1	13.3	87.0	14.3
Acquisition of joint ventures and associates (note 31)	–	51.2	–	8.1	–	59.3
Joint venture becoming a subsidiary (note 31)	4.0	–	–	–	4.0	–
Loans to/(repayments from) joint ventures and associates	–	–	3.2	(0.4)	3.2	(0.4)
Investment in joint ventures and associates	0.9	0.2	–	–	0.9	0.2
Share of profits	4.3	6.1	–	–	4.3	6.1
Interest accrued	–	–	1.1	1.1	1.1	1.1
Interest received	–	–	(1.5)	–	(1.5)	–
Dividend received	(6.6)	–	–	–	(6.6)	–
Fair value adjustment of derivatives	(65.1)	8.8	–	–	(65.1)	8.8
Tax on fair value adjustment of derivatives	16.9	(2.4)	–	–	16.9	(2.4)
<b>At 31 March</b>						
– Net assets excluding goodwill	18.1	63.7	–	–	18.1	63.7
– Goodwill	1.2	1.2	–	–	1.2	1.2
– Loans to joint ventures and associates	–	–	24.9	22.1	24.9	22.1
	19.3	64.9	24.9	22.1	44.2	87.0

Included within joint ventures and associates are:

Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
<b>2012</b>						
Holdfast Training Services Limited	United Kingdom	50.6	(36.6)	42.9	1.1	(0.1)
ALC (Superholdco) Limited	United Kingdom	58.4	(43.7)	20.5	5.1	4.1
Airtanker Limited	United Kingdom	269.5	(274.7)	86.4	3.1	0.5
Airtanker Services Limited	United Kingdom	31.3	(11.0)	3.4	0.2	0.1
Ascent Flight Training (Holdings) Limited	United Kingdom	48.7	(43.7)	14.1	–	(2.9)
Greenwich BSF SPV Limited	United Kingdom	52.7	(55.9)	8.1	0.2	–
Other		84.9	(86.3)	46.6	1.3	2.6
	596.1	(551.9)	222.0	11.0	4.3	

Country of incorporation	Assets £m	Liabilities £m	Revenue £m	Operating profit £m	Retained profit £m	% interest held
<b>2011</b>						
Holdfast Training Services Limited	United Kingdom	40.4	(41.0)	25.9	0.9	(0.2)
ALC (Superholdco) Limited	United Kingdom	59.0	(54.9)	24.5	6.2	4.2
Airtanker Limited	United Kingdom	198.5	(189.4)	31.0	1.2	0.2
Airtanker Services Limited	United Kingdom	12.4	(11.8)	–	0.1	0.1
Ascent Flight Training (Holdings) Limited	United Kingdom	40.9	(38.3)	9.3	–	1.0
Greenwich BSF SPV Limited	United Kingdom	49.1	(47.4)	21.0	0.2	0.1
Other		133.7	(64.2)	27.0	0.7	0.7
	534.0	(447.0)	138.7	9.3	6.1	

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

## 17. Deferred tax

	2012 £m	2011 (restated) £m
Deferred tax asset	31.3	3.3
Deferred tax liability	–	(20.6)
	31.3	(17.3)

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	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
<b>At 1 April 2011</b>	(10.5)	58.5	4.1	(69.4)	(17.3)
Income statement credit	–	4.7	–	22.4	27.1
Tax credit to equity	–	27.8	–	(0.1)	27.7
Prior year adjustment	0.5	–	2.5	–	3.0
Transfer to corporation tax	–	(21.9)	(5.8)	0.1	(27.6)
Acquisition of subsidiaries (note 31)	–	–	–	0.3	0.3
Effect of change in UK tax rate					
– Income statement	0.8	–	–	2.6	3.4
– Equity	–	(5.3)	–	(0.4)	(5.7)
Reclassified as asset held for sale (note 32)	–	–	–	20.4	20.4
<b>At 31 March 2012</b>	(9.2)	63.8	0.8	(24.1)	31.3
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 31)	(12.4)	16.3	–	(88.2)	(84.3)
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	–	–	–	–	–
<b>At 31 March 2011</b>	(10.5)	58.5	4.1	(69.4)	(17.3)

The deferred tax in respect of 'other' includes an asset of £4.4 million (2011: £3.3 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:

	2012 £m	2011 £m
Deferred tax asset	(63.8)	(62.6)
Deferred tax liability	37.7	85.8
	(26.1)	23.2

Deferred tax expected to be recovered within 12 months:

	2012 £m	2011 £m
Deferred tax asset	–	–
Deferred tax liability	(17.0)	(22.4)
	(17.0)	(22.4)

## 17. 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 (2011: £42.8 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £nil million (2011: £13.4 million) of such losses, which may be carried forward. No deferred tax has been recognised in respect of the remaining £42.8 million (2011: £29.4 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 £158.4 million (2011: £109.0 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 2012 Budget Statement. Legislation to reduce the main rate of corporation tax from 26% to 24% from 1 April 2012 is expected to be included in the Finance Act 2012. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2013. These further changes had not been substantively enacted at the balance sheet date and, therefore the impact is not included in these financial statements.

The effect of the changes expected to be enacted in the Finance Act 2012 would be to reduce the deferred tax asset provided at the balance sheet date by £1.2 million. This £1.2 million decrease in the deferred tax asset would increase profit by £1.7 million and decrease equity by £2.9 million. This decrease in deferred tax asset is due to the reduction in the corporation tax rate from 24% to 23% with effect from 1 April 2013.

The proposed reductions of the main rate of corporation tax by 1% per year to 22% by 1 April 2014 are expected to be enacted separately each year. The overall effect of the further changes from 24% to 22%, if these applied to the deferred tax balance at the balance sheet date, would be to further reduce the deferred tax asset by an additional £2.3 million (being £1.2 million recognised in 2013 and £1.1 million recognised in 2014).

## 18. Inventories

	2012 £m	2011 £m
Raw materials	11.7	17.7
Work in progress and long-term contracts	17.3	20.0
Finished goods and goods for resale	52.6	58.9
<b>Total</b>	<b>81.6</b>	<b>96.6</b>

## 19. Trade and other receivables

	2012 £m	2011 £m
<b>Current assets</b>		
Trade receivables	183.9	233.8
Less: provision for impairment of receivables	(6.4)	(9.9)
Trade receivables – net	177.5	223.9
Amounts due from customers for contract work	195.5	205.5
Retentions	6.3	6.8
Amounts owed by related parties (note 36)	21.0	26.1
Other debtors	45.0	35.7
Prepayments and accrued income	31.6	42.3
	<b>476.9</b>	<b>540.3</b>
<b>Non-current assets</b>		
Other debtors	1.8	1.9

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

As of 31 March 2012, trade receivables of £6.8 million (2011: £9.9 million) were impaired. Impairment arises in the main, through contract disputes rather than credit defaults. The amount of the provision was £6.4 million (2011: £9.9 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.

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

The ageing of the net impaired receivables is as follows:

	2012 £m	2011 £m
Less than three months	0.4	–
Three to six months	–	–
Over six months	–	–
	0.4	–

As of 31 March 2012, trade receivables of £19.8 million (2011: £36.4 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:

	2012 £m	2011 £m
Less than three months	16.6	21.0
Three to six months	2.8	9.4
Over six months	0.4	6.0
	19.8	36.4

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:

	2012 £m	2011 £m
<b>Balance at 1 April</b>	(9.9)	(4.2)
Acquisition of subsidiaries (note 31)	–	(3.8)
Provision for receivables impairment	(2.1)	(2.7)
Receivables written off during the year as uncollectable	0.6	0.4
Unused amounts reversed	2.2	0.6
Reclassified as assets held for sale	2.3	–
Exchange differences	0.5	(0.2)
<b>Balance at 31 March</b>	(6.4)	(9.9)

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

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

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

## 20. Cash and cash equivalents

	2012 £m	2011 £m
Cash at bank and in hand	88.0	100.7
Short-term bank deposits (overnight)	12.3	3.6
	100.3	104.3

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

Currency	2012		2011	
	Total £m	Floating rate £m	Total £m	Floating rate £m
Sterling	48.0	48.0	31.2	31.2
Euro	5.3	5.3	5.7	5.7
US Dollar	17.8	17.8	23.2	23.2
South African Rand	19.4	19.4	30.5	30.5
Canadian Dollar	6.2	6.2	6.2	6.2
Omani Rial	2.5	2.5	3.2	3.2
Australian Dollar	0.5	0.5	1.8	1.8
Other currencies	0.6	0.6	2.5	2.5
	100.3	100.3	104.3	104.3

The above balances are invested at short-term, floating rates linked to LIBOR in the case of Sterling, the prime rate in the case of South African Rand and the local prime rate for other currencies.

## 21. Trade and other payables

	2012 £m	2011 £m
<b>Current liabilities</b>		
Contract cost accruals	166.8	162.4
Amounts due to customers for contract work	159.3	173.4
Trade creditors	154.7	191.7
Amounts owed to related parties (note 36)	2.4	2.8
Other creditors	33.5	51.6
Other taxes and social security	34.7	41.1
Accruals and deferred income	268.1	254.8
	819.5	877.8
<b>Non-current liabilities</b>		
Other creditors	8.9	13.6

## 22. Bank and other borrowings

	2012 £m	2011 £m
<b>Current liabilities</b>		
Bank loans and overdrafts due within one year or on demand		
Secured	2.3	1.5
Unsecured	0.6	31.6
	2.9	33.1
Finance lease obligations*	1.3	2.2
	4.2	35.3
<b>Non-current liabilities</b>		
Bank and other loans		
Secured	14.5	15.8
Unsecured	742.3	781.4
	756.8	797.2
Finance lease obligations*	0.5	1.8
	757.3	799.0

\* 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 swaps, details of which are included in note 23.

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

Currency	2012		
	Total £m	Floating rate £m	Fixed rate £m
Sterling	342.4	225.0	117.4
Euro	–	–	–
South African Rand	1.6	1.6	–
US Dollar*	416.0	–	416.0
Other	1.5	1.5	–
	761.5	228.1	533.4

Currency	2011		
	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

\* US Dollars 650 million have been swapped into Sterling and US Dollars 300 million into floating rates.

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:

	1 year £m	1–5 years £m	>5 years £m	Total £m
Total borrowings				
As at 31 March 2012	442.4	60.0	259.1	761.5
As at 31 March 2011	515.1	0.9	318.3	834.3

## 22. Bank and other borrowings (continued)

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

	2012 %	2011 %
UK bank overdraft	1.5	1.5
UK bank borrowings	3.0	2.9
US private placement – fixed	5.7	5.6
US private placement – floating	3.1	3.1
Other borrowings	2.0–7.8	9.0–10.0
Finance leases	5.0–11.0	5.0–11.0

### Repayment details

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

	2012 Loans and overdrafts £m	2012 Finance lease obligations £m	2011 Loans and overdrafts £m	2011 Finance lease obligations £m
Within one year	2.9	1.3	33.1	2.2
Between one and two years	1.7	0.5	278.6	1.4
Between two and five years	287.9	–	4.7	0.4
Greater than five years	467.2	–	513.9	–
	759.7	1.8	830.3	4.0

### Borrowing facilities

The Group had the following undrawn committed borrowing facilities available at 31 March in respect of which all conditions precedent had been met at that date.

	2012 £m	2011 £m
Expiring in less than one year	108.3	63.0
Expiring in more than one year but not more than five years	275.0	323.0
	383.3	386.0

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

	2012 £m	2011 £m
Not later than one year	1.4	2.4
Later than one year but not more than five years	0.5	2.1
More than five years	–	–
	1.9	4.5
Future finance charges on finance leases	(0.1)	(0.5)
Present value of finance lease liabilities	1.8	4.0

## 23. Financial instruments

### Other financial assets and liabilities

	Assets		Fair value	
	2012 £m	2011 (restated) £m	2012 £m	2011 £m
<b>Non-current</b>				
US private placement – currency and interest rate swaps	20.1	1.0	–	–
Total non-current other financial assets and liabilities	20.1	1.0	–	–
<b>Current</b>				
Interest rate hedges	–	–	5.1	1.6
Other currency hedges	3.3	0.8	3.1	2.5
Total current other financial assets and liabilities	3.3	0.8	8.2	4.1

The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales, purchases, deposits and borrowings denominated in foreign currencies, as the transactions occur.

The Group enters into interest rate hedges against 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).

The US private placement has been reclassified as a non-current asset and the 2011 numbers have been restated accordingly.

#### Interest rate hedges

The notional principal amount of outstanding interest rate swap contracts at 31 March 2012 included £17.4 million of UK interest rate swaps and interest rate swaps in relation to the US\$650 million US\$ to GBP cross currency swap.

The Group held the following interest rate hedges at 31 March 2012:

	Amount £m	Fixed payable %	Floating receivable %	Maturity
<b>Hedged</b>				
Interest rate swap	1.1	5.45	1.23	31/3/2015
Interest rate swap	10.2	5.45	1.23	31/3/2019
Interest rate swap	6.1	4.745	1.23	31/3/2029
<b>Total interest rate swaps</b>	<b>17.4</b>			

	Amount US\$m	Amount at swapped rates £m	Swap %	Maturity
<b>Hedged</b>				
Cross currency and interest rate swap	150.0	92.1	Fixed 4.94% US\$ to fixed 5.4% GBP	19/3/2018
Cross currency and interest rate swap	200.0	122.9	Fixed 5.64% US\$ to fixed 5.95% GBP	17/3/2021
Cross currency and interest rate swap	300.0	184.3	Fixed 5.64% US\$ to floating 3 month LIBOR +margin GBP	17/3/2021
<b>Total cross currency and interest rate swap</b>	<b>650.0</b>	<b>399.3</b>		

## 23. 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

	Book value £m	2012 Fair value £m	2011 Book value £m	2011 Fair value £m
<b>Fair value of non-current borrowings and loans</b>				
Long-term borrowings		(757.3)	(756.7)	(799.0)
Loan to joint venture		24.9	24.9	22.1
		(732.4)	(731.8)	(776.9)
				(775.2)
<b>Fair value of other financial assets and financial liabilities</b>				
Short-term borrowings		(4.2)	(4.2)	(35.3)
Trade and other payables*		(812.9)	(811.6)	(878.8)
Trade and other receivables		478.7	478.7	542.2
Other financial assets – IFRIC 12		23.1	23.1	38.2
Short-term deposits		12.3	12.3	3.6
Cash at bank and in hand		88.0	88.0	100.7
Income tax payable		(10.0)	(10.0)	(17.3)
Income tax receivable		–	–	2.7
Other financial assets and liabilities		15.2	15.2	(2.3)
		(209.8)	(208.5)	(246.3)
				(244.5)

\* 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% to 5% (2011: 4.0% to 5.0%).

## 24. Provisions for other liabilities

	Insurance provisions (a) £m	Contract/ warranty (b) £m	Reorganisation costs (c) £m	Property and other (restated) (d) £m	Total provisions (restated) £m
<b>At 1 April 2011</b>	8.6	51.4	–	104.1	164.1
On acquisition of subsidiaries (note 31)	–	–	–	3.7	3.7
Charged/(released) to income statement	(0.4)	(3.5)	(4.2)	0.4	(7.7)
Utilised in year	(1.2)	(1.8)	(2.0)	(3.3)	(8.3)
Reclassifications		2.9	23.9	(26.8)	–
Reclassified as liability held for sale	(2.6)	(1.5)	(1.7)	(1.0)	(6.8)
<b>At 31 March 2012</b>	4.4	47.5	16.0	77.1	145.0

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

	2012 £m	2011 £m
Current	27.8	29.7
Non-current	117.2	134.4
	145.0	164.1

(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) The reorganisation costs arise mainly in relation to acquired businesses personnel related costs.

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

Included within property and other provisions is £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 ten years. Other than these provisions the Group's non-current provisions are expected to be utilised within two to five years.

## 25. Share capital

	Ordinary shares of 60p Number	Total £m
<b>Allotted, issued and fully paid</b>		
<b>At 1 April 2011</b>	<b>358,838,092</b>	<b>215.3</b>
Shares issued	308,613	0.2
<b>At 31 March 2012</b>	<b>359,146,705</b>	<b>215.5</b>
At 1 April 2010	229,687,601	137.8
Shares issued	129,150,491	77.5
<b>At 31 March 2011</b>	<b>358,838,092</b>	<b>215.3</b>

### Potential issues of ordinary shares

The table below shows options existing over the Company's shares as at 31 March 2012. They represent outstanding options granted under all the Company's Executive Share Option Schemes. Of the total number of shares shown, 28,539 are in respect of options granted by the trustee of the Babcock Employee Share Trust and 31,118 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 24,807 shares is in respect of options granted by the Company to subscribe for newly issued shares. In addition, under the Company's other executive share plans, there are awards over 279,832 shares (2011: 571,320) vested at nil price. These awards will be satisfied with new issue shares or shares purchased in the market.

Grant date	Exercise price Pence	Exercise period	2012 Number	2011 Number
25 June 2001	99.33	25/06/2004 – 24/06/2011	–	931
31 January 2002	104.33	31/01/2005 – 30/01/2012	–	21,278
24 June 2002	124.50	24/06/2005 – 23/06/2012	–	142,681
27 November 2002	106.33	27/11/2005 – 26/11/2012	7,346	23,414
30 June 2003	115.60	30/06/2006 – 29/06/2013	28,539	139,109
06 July 2004	126.00	06/07/2007 – 05/07/2014	48,579	197,277
			84,464	524,690

Options granted to Directors are summarised in the Remuneration report on pages 63 to 82 and are included in the outstanding options set out above.

A reconciliation of option movements is shown below:

	2012 Number '000	2012 Weighted average exercise price	2011 Number '000	2011 Weighted average exercise price
<b>Outstanding at 1 April</b>	524	£1.21	640	£1.21
Forfeited/lapsed	–	–	–	–
Exercised	(440)	£1.21	(116)	£1.19
<b>Outstanding at 31 March</b>	84	£1.21	524	£1.21
<b>Exercisable at 31 March</b>	84	£1.21	524	£1.21

Weighted average share price for options exercised during the year was 683.58p per share (2011: 579.83p per share).

During the year no ordinary shares (2011: 412,000) 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 2012 352,386 shares (2011: no shares) were disposed by the Trusts resulting from options exercised. At 31 March 2012, the Trusts held between them a total of 423,167 (2011: 776,053) ordinary shares at a total market value of £3,370,525 (2011: £4,819,289) representing 0.12% (2011: 0.22%) 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.

## 25. Share capital (continued)

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.

## 26. Share-based payments

The charge to the income statement has been based on the assumptions below and is based on the binomial model as adjusted, allowing for a closed form numerical-integrated solution, which makes it analogous to the Monte Carlo simulations, including performance conditions. The detailed description of the plans below is included within the Remuneration report.

During the year the total charge relating to employee share-based payment plans was £5.0 million (2011: £5.8 million) all of which related to equity-settled share-based payment transactions.

After tax, the income statement charge was £3.7 million (2011: £4.2 million).

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

### CSOP and PSP

Grant or modification date	CSOP			PSP Main			PSP Funding		
	2011 14/6/11	2010 13/7/10	2009 11/9/09	2011 14/6/11	2010 13/7/10	2009 11/9/09	2011 14/6/11	2010 13/7/10	2009 11/9/09
Share price at grant or modification date (pence)	701.0	635.0	560.5	701.0	635.0	560.5	701.0	635.0	560.5
Vesting period (years)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Expected volatility	25.9%	27.8%	26.0%	25.9%	27.8%	26.0%	25.9%	27.8%	26.0%
Option life (years)	4.0	4.0	4.0	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	3.0	3.0	3.0
Expected dividends expressed as dividend yield	2.0%	2.8%	2.8%	Holders receive dividends					
Expectations of meeting performance criteria – EPS	40%	40%	99%	40%	40%	99%	40%	40%	99%
Fair value per option (pence) – TSR	92.0	81.0	62.0	433.0	369.0	268.0	339.0	285.0	204.0
Fair value per option (pence) – EPS	116.0	107.0	94.0	701.0	635.0	560.5	582.0	525.0	465.0
Correlation	46%	46%	45%	46%	46%	45%	46%	46%	45%

The number of PSP and CSOPs awarded in 2011 were 1,622,534 and 80,703 respectively and in 2010 were 1,564,465 and 130,455 respectively and in 2009 were 1,093,492 and 336,358 respectively.

The expected volatility is based on historical volatility over the last one to three years. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon government bonds of a term consistent with the assumed option life.

## 27. 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:

	2012 £m	2011 £m
Defined contribution schemes	32.3	25.0

### Defined benefit schemes

Balance sheet assets and liabilities recognised are as follows:

	2012 £m	2011 £m
Retirement benefits – funds in surplus	10.2	12.2
Retirement benefits – funds in deficit	(276.1)	(237.3)
	(265.9)	(225.1)

The Group operates four principal defined benefit schemes for employees in the United Kingdom: the Devonport Royal Dockyard Pension Scheme, the Babcock International Group Pension Scheme (which now includes the VT Group section of the Shipbuilding Industries Pension Scheme (SIPS), following the merger of these two schemes on 1 November 2011), the Rosyth Royal Dockyard Pension Scheme and the Babcock Rail Ltd (formerly First Engineering) Shared Cost Section of the Railways Pensions Scheme. All four schemes are funded by payments to separate trustee-administered funds and the level of the Group's contributions to the schemes is assessed in accordance with the advice of independent, qualified actuaries. The details of the latest formal actuarial valuations of these four schemes are as follows:

	Devonport Royal Dockyard Scheme	Pre-merger section	Former VT Group Section of SIPS	Babcock International Group Scheme	Rosyth Royal Dockland Scheme	Babcock Rail Ltd Section of the Railways Pension Scheme
Date of last formal completed actuarial valuation	31/03/08	01/04/10	31/3/10	31/03/09	31/12/07	
Number of active members at above date	4,114	909	1,348	1,036	705	
Actuarial valuation method	Projected unit	Projected unit	Projected unit	Projected unit	Projected unit	Projected unit
<b>Results of formal actuarial valuation:</b>						
Value of assets	£850.0m	£502.9m	£319.4	£335.6m	£185.2m	
Level of funding	95%	92%	78%	90%	102%	
<b>Principal valuation assumptions:</b>						
Excess of investment returns over earnings increases	2.0%	2.4%	c. 1.4%	3.5%	2.0%	
Excess of investment returns over pension increases	3.0%	1.3%–2.5%	c. 1.4%	2.5%	2.5%	

The merger of the VT Group Section of SIPS into the Babcock International Group Pension Scheme does not affect the amount of contributions that the Group pays, which were determined based on the results of the 2010 actuarial valuations. The Group's future service contribution rate for members of the Babcock International Group Pension Schemes depends upon the section of the Scheme, but will be 33.1% of pensionable pay for former members of the VT Group Section of SIPS and 20% of pensionable pay for the majority of other members. The Group will also pay the following amounts – deficit contributions starting at £16.28 million for the year to 31 March 2013, £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 £7.65 million per annum (rising in line with RPI) 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 Babcock Rail Ltd Section of the Railways Pension Scheme is 17.1% of pensionable pay.

Where salary sacrifice arrangements are in place the Group effectively meet the members contributions in addition.

## 27. Retirement benefits and liabilities (continued)

The Group cash contributions forecast for next year are: £12 million to the Devonport Royal Dockyard Pension Scheme (after taking account of £20 million of advance contributions paid in the current year); £37.5 million to the Babcock International Group Pension Scheme; £14.8 million to the Rosyth Royal Dockyard Pension Scheme; £2.4 million to the Babcock Rail Ltd Section of the Railways Pension Scheme. Other scheme contributions of £6.6 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:

	2012 (weighted average) %	2011 (weighted average) %
Rate of increase in pensionable salaries	2.4	3.1
Rate of increase in pensions	2.7	2.9
Discount rate	4.8	5.6
Inflation rate	2.7	3.1
Expected return on plan assets	6.6	7.2
Total life expectancy – future pensioners (years)	86.7	86.6

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:

	Expected rate of return %	2012		2011	
		Fair value £m		Fair value £m	
Equities	8.4	1,159.9		8.7	1,206.4
Property	7.7	158.6		8.0	140.9
Bonds – corporate	4.85	1,168.7		5.6	387.8
Bonds – government	3.15	347.5		4.4	150.6
Liability matching bonds	–	–		5.6	664.1
Cash plus infrastructure	7.7	17.4		8.0	17.4
Funds awaiting investment	6.25	54.7		7.1	134.3
Active position of longevity swap		(124.1)		(121.6)	
Fair value of assets		2,782.7		2,579.9	
Present value of funded obligations		(3,039.9)		(2,794.6)	
Funded status		(257.2)		(214.7)	
Present value of unfunded obligations		(0.1)		–	
IFRIC 14 adjustment		(8.6)		(10.4)	
Net liabilities recognised in the balance sheet		(265.9)		(225.1)	

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

	2012 £m	2011 £m
Current service cost	(44.5)	(46.0)
Interest on obligation	(145.7)	(135.6)
Expected return on plan assets	172.1	152.6
Total included within operating profit	(18.1)	(29.0)

**27. Retirement benefits and liabilities (continued)***Amounts recorded in the Group statement of comprehensive income*

	2012 £m	2011 £m
Actual return less expected return on pension scheme assets	70.1	7.8
Experience gain/(losses) arising on scheme liabilities	(23.8)	17.0
Change in assumptions relating to present value of scheme liabilities	(152.5)	46.3
Reimbursement right	(2.5)	36.1
IFRIC 14 adjustments	1.8	(3.2)
Exchange differences	–	(0.5)
<b>At 31 March</b>	<b>(106.9)</b>	<b>103.5</b>
<b>Cumulative other comprehensive income at 31 March</b>	<b>(493.4)</b>	<b>(386.5)</b>

*Analysis of movement in the Group balance sheet*

	2012 £m	2011 £m
<b>Fair value of plan assets</b>		
At 1 April	2,579.9	1,979.8
Acquisitions	–	432.5
Expected return	172.1	152.6
Actuarial gains	70.1	7.8
Reimbursement rights (longevity swaps)	(2.5)	36.1
Employer contributions	84.3	82.5
Employee contributions	7.3	7.1
Benefits paid	(128.5)	(118.1)
Exchange differences	–	(0.4)
<b>At 31 March</b>	<b>2,782.7</b>	<b>2,579.9</b>
<b>Present value of benefit obligations</b>		
At 1 April	2,794.6	2,303.8
Acquisitions	–	483.6
Service cost	44.5	46.0
Interest cost	145.7	135.6
Employee contributions	7.3	7.1
Actuarial (gain)/losses	176.3	(63.3)
Benefits paid	(128.5)	(118.1)
Exchange differences	–	(0.1)
<b>At 31 March</b>	<b>3,039.9</b>	<b>2,794.6</b>
Present value of unfunded obligations	(0.1)	–
IFRIC 14 adjustment	(8.6)	(10.4)
<b>Net deficit at 31 March</b>	<b>(265.9)</b>	<b>(225.1)</b>
<b>Actual return on plan assets</b>		
<b>Year ending 31 March</b>	<b>242.2</b>	<b>160.4</b>

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.

## 27. Retirement benefits and liabilities (continued)

(Deficits)/surpluses in the plans

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of plan assets	2,782.7	2,579.9	1,979.8	1,702.9	1,983.8
Present value of benefit obligations	(3,039.9)	(2,794.6)	(2,303.8)	(1,652.2)	(1,841.6)
Present value of unfunded obligations	(0.1)	–	–	–	–
IFRIC 14 adjustment	(8.6)	(10.4)	–	–	–
(Deficits)/surpluses at 31 March	(265.9)	(225.1)	(324.0)	50.7	142.2

### History of experience gains and losses

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Difference between the expected and actual return on scheme assets	70.1	7.8	375.5	(383.0)	(158.0)
Percentage of scheme assets at 31 March	3%	0%	19%	(22%)	(8%)
Experience gains/(losses) of scheme liabilities	(23.8)	17.0	(41.6)	6.1	(15.7)
Percentage of present value of scheme liabilities at 31 March	1%	(1%)	2%	0%	1%
Total amount recognised in the Group statement of comprehensive income	(106.9)	103.5	(403.5)	(145.6)	43.0
Percentage of present value of scheme liabilities at 31 March	(4%)	4%	(18%)	(9%)	2%

The changes to the Group balance sheet at March 2012 and the charges to the Group income statement for the year to March 2013, if the assumptions were sensitised by the amounts below, would be:

	Balance sheet 2012 £m	Income statement 2013 £m
Initial assumptions	(265.9)	15.2
Discount rate moves up or down by 0.1%	±47.5	±0.5
Inflation rate moves up or down by 0.1%	±33.8	±2.1
Equity return moves up or down by 0.1%	±0	±1.0
Total life expectancy changes by half a year up or down	±35.6	±2.3
Real salaries move up or down by 0.25%	±35.3	±3.0

## 28. Reconciliation of operating profit to cash generated from operations

	2012 £m	2011 £m
<b>Cash flows from operating activities</b>		
Operating profit before amortisation of acquired intangible and exceptional items	290.2	250.1
Amortisation of acquired intangible and exceptional items	(88.2)	(96.9)
(Loss)/profit from discontinued operations	(53.1)	3.7
Tax on (loss)/profit from discontinued operations	1.3	0.6
<b>Operating profit</b>	150.2	157.5
Depreciation of property, plant and equipment	33.6	31.2
Amortisation of intangible assets	90.3	87.3
Investment income	2.2	2.2
Equity share-based payments	5.0	5.8
Profit on disposal of subsidiaries	(1.9)	(2.9)
Impairment of goodwill	58.5	–
(Profit)/loss on disposal of property, plant and equipment	(0.8)	0.4
Loss on disposal of intangible assets	0.2	0.2
<b>Operating cash flows before movement in working capital</b>	337.3	281.7
Decrease in inventories	8.6	3.5
Decrease/(increase) in receivables	23.3	(83.0)
(Decrease)/increase in payables	(26.4)	176.5
(Decrease)/increase in provisions	(16.0)	(16.8)
Retirement benefit payments in excess of income statement	(66.1)	(53.4)
<b>Cash generated from operations</b>	260.7	308.5

## 29. Movement in net debt

	2012 £m	2011 £m
Increase in cash in the year	28.2	43.2
Cash flow from the (increase)/decrease in debt and lease financing	56.6	(374.7)
Change in net funds resulting from cash flows	84.8	(331.5)
Loans and finance leases acquired and disposed of with subsidiaries	–	(90.3)
Foreign currency translation differences	3.1	(4.9)
Movement in net debt in the year	87.9	(426.7)
Net debt at the beginning of the year	(729.0)	(302.3)
Net debt at the end of the year	(641.1)	(729.0)

## 30. Changes in net debt

	31 March 2011 £m	Cash flow £m	Acquisitions and disposals £m	Exchange/ other movement £m	31 March 2012 £m
Cash and bank balances	104.3	(1.8)	0.2	(2.4)	100.3
Bank overdrafts	(31.6)	29.8	–	(0.1)	(1.9)
<b>Cash, cash equivalents and bank overdrafts</b>	<b>72.7</b>	<b>28.0</b>	<b>0.2</b>	<b>(2.5)</b>	<b>98.4</b>
Debt	(798.7)	54.6	–	(13.7)	(757.8)
Finance leases	(4.0)	2.0	–	0.2	(1.8)
	(802.7)	56.6	–	(13.5)	(759.6)
Net debt before derivatives	(730.0)	84.6	0.2	(16.0)	(661.2)
Net debt derivative	1.0	–	–	19.1	20.1
<b>Net debt including derivatives</b>	<b>(729.0)</b>	<b>84.6</b>	<b>0.2</b>	<b>3.1</b>	<b>(641.1)</b>

### 31 (a). Acquisitions – current year

On 6 October 2011 the Group acquired a controlling interest in Careers Enterprises (Futures) Limited for a cost of £nil. Prior to this the Group had an investment in the company and accounted for it as a joint venture. The net assets acquired were £nil after allowing for the negative value of the joint venture brought forward and a provision of £3.7 million.

### 31 (b). Acquisitions – prior 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 final goodwill are as follows:

	VT Group plc (final) £m	Evergreen £m	Total (final) £m
<b>Cost of acquisition</b>			
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)	397.6	2.2	399.8
<b>Goodwill</b>	<b>1,073.7</b>	<b>6.7</b>	<b>1,080.4</b>

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

	VT Group plc Book value of assets acquired £m	Final fair value acquired £m	Evergreen Book value of assets acquired £m	Final fair value acquired £m	VT Group plc Book value of assets acquired £m	Final 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 and associates	16.0	59.3	–	–	16.0	59.3
Retirement liabilities	(84.8)	(58.1)	–	–	(84.8)	(58.1)
Deferred tax	(11.5)	(84.3)	–	–	(11.5)	(84.3)
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)	(126.8)	(3.8)	(3.8)	(59.5)	(130.6)
Non-controlling interest	(2.9)	(3.6)	–	–	(2.9)	(3.6)
<b>Net assets acquired</b>	<b>486.0</b>	<b>397.6</b>	<b>(2.3)</b>	<b>2.2</b>	<b>483.7</b>	<b>399.8</b>

\* Acquired intangibles are: customer relationships, both contracted and non-contracted.

**31 (b). Acquisitions – prior year (continued)**

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 arising on acquisition is expected to be deductible for income tax purposes with the exception of £79.1 million relating to the USA.

Last year's financial statements reported fair value adjustments for VT Group plc and Evergreen as provisional. The final fair value adjustments reflect the nature of long term contracts, the estimation of which benefits from the effluxion of time. The balance sheet categories affected were provisions and their related tax benefits:

	Provisional fair value £m	Final fair value £m	Movement £m
Deferred tax	(86.9)	(84.3)	2.6
Provisions	(120.6)	(130.6)	(10.0)
<b>Net assets acquired</b>	<b>407.2</b>	<b>399.8</b>	<b>(7.4)</b>

Cash outflow in 2011 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
<b>Cash outflow prior period</b>	<b>477.7</b>	<b>8.5</b>	<b>486.2</b>

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
<b>Group revenue</b>		
VT Group plc	758.4	1,035.6
Evergreen	2.7	4.7
	761.1	1,040.3
<b>Total revenue (including share of joint ventures)</b>		
VT Group plc	856.0	1,178.2
Evergreen	2.7	4.7
	858.7	1,182.9
<b>Operating profit (before amortisation of acquired intangibles)</b>		
VT Group plc	90.3	100.2
Evergreen	0.1	0.3
	90.4	100.5
<b>Underlying profit (including investment income and share of joint venture underlying profit)</b>		
VT Group plc	112.2	125.7
Evergreen	0.1	0.3
	112.3	126.0

### 32. Disposals and held for sale

During the year the Group disposed of its holding in Babcock Eagleton Inc. At the year end the Group was actively marketing its holding in VT Services Inc. (the US defence business) and has therefore transferred its assets and liabilities to held for sale.

In 2011 four small subsidiaries were disposed of.

	Babcock Eagleton Inc. £m	Held for sale £m	Total £m	Book value £m
Goodwill	1.2	23.4	24.6	–
Intangible assets	–	41.7	41.7	–
Property plant and equipment	0.6	6.0	6.6	2.0
Cash, cash equivalents and bank overdrafts	–	–	–	0.2
Bank loans	–	–	–	(1.8)
Taxation	–	(20.4)	(20.4)	(0.5)
Current and non-current assets	3.4	31.7	35.1	0.2
Inventories	–	0.2	0.2	–
Current and non-current liabilities	(1.4)	(21.2)	(22.6)	(0.5)
Provisions	–	(6.8)	(6.8)	(0.2)
Non-controlling interest	–	–	–	(0.1)
Net assets disposed/held for sale	3.8	54.6	58.4	(0.7)
Profit on disposal of subsidiary	1.9	–	1.9	2.9
Net assets held for sale	–	(54.6)	(54.6)	–
<b>Net cash flow</b>	<b>5.7</b>	<b>–</b>	<b>5.7</b>	<b>2.2</b>

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

	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
<b>Commitments under non-cancellable operating leases payable:</b>				
Within one year	20.5	10.2	20.1	8.4
Later than one year and less than five years	49.9	14.2	52.5	6.7
After five years	24.6	–	33.9	–
	<b>95.0</b>	<b>24.4</b>	<b>106.5</b>	<b>15.1</b>

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases plant and machinery under non-cancellable operating leases.

### 34. Contingent liabilities

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

### 35. Capital and other financial commitments

	2012 £m	2011 £m
Contracts placed for future capital expenditure not provided in the financial statements	4.2	9.1

**36. Related party transactions**

(a) The following related parties either sell to or receive services from the Group. Loans to joint ventures and associates are detailed in note 16.

	2012 Revenue to £m	2012 Purchases from £m	2012 Year end debtors' balance £m	2012 Year end creditor balance £m
<b>Joint ventures and associates</b>				
Debut Services (South West) Limited	122.5	1.2	–	–
Holdfast Training Services Limited	69.2	0.2	11.9	–
First Swietelsky Operation and Maintenance	9.7	–	1.2	–
Ascent Management Company (Weybridge) Limited	0.5	–	–	–
Ascent Flight Training (Management) Company Limited	1.2	–	0.2	–
Advanced Jet Training Limited	2.3	–	0.3	–
Rear Crew Training Limited	0.8	–	0.1	–
Airtanker Services Limited	36.1	–	2.9	–
Whitefleet Limited	2.2	56.2	0.1	2.3
ALC (FMC) Limited	3.7	–	0.1	–
Lewisham Schools for the Future LEP Limited	0.3	–	–	–
Lewisham Schools for the Future SPV Limited	1.9	0.1	0.3	–
Lewisham Schools for the Future SPV2 Limited	0.5	–	0.1	–
Greenwich BSF SPV Limited	0.3	–	–	–
Cura Classis (UK) Limited	4.1	–	0.1	–
Surrey County Council	14.8	0.8	1.3	0.1
ACTUS	3.2	–	0.2	–
Bechtel Babcock Nuclear Solutions	3.9	–	–	–
Babcock Balfour Beatty JV	0.9	–	0.4	–
<b>Related by common directorships</b>				
Finmeccanica UK Group	10.0	0.2	1.8	–
Northrop Grumman Sperry Marine Limited	–	0.1	–	–
	288.1	58.8	21.0	2.4

### 36. Related party transactions (continued)

	2011 Sales to £m	2011 Purchases from £m	2011 Year end debtors' balance £m	2011 Year end creditor balance £m
<b>Joint ventures and associates</b>				
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 Company (Weybridge) Limited	1.0	–	0.3	–
Advanced Jet Training 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	–
<b>Related by common directorships</b>				
Finmeccanica UK Group	6.2	–	2.1	–
	242.9	36.2	26.1	2.8

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

**(b) Defined benefit pension schemes**

Please refer to note 27 for transactions with the Group defined benefit pension schemes.

**(c) Key management compensation is shown in note 8.**

### 37. Post balance sheet events

**(a) Dividend**

Details on dividends are given in note 11. There are no further material events subsequent to 31 March 2012 that require disclosure.

**(b) Disposal of US defence business**

Subsequent to the year end the Group entered into a conditional contract for the sale of the US defence business for \$98.75 million (£61.0 million), a price consistent with the impairment to goodwill reflected in the Annual Report and Accounts.

# 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 2012 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 62, 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 2012 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 2012;
- 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 matter

We have reported separately on the Group financial statements of Babcock International Group PLC for the year ended 31 March 2012.

**John Baker**

Senior Statutory Auditor

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

London, United Kingdom

14 May 2012

# Company balance sheet

As at 31 March 2012	Note	2012 £m	2011 £m
<b>Fixed assets</b>			
Investment in subsidiary undertakings	3	1,600.8	2,004.3
Tangible fixed assets	4	0.1	0.2
		1,600.9	2,004.5
<b>Non-current assets</b>			
Debtors – amounts due after more than one year	5	583.2	163.9
<b>Current assets</b>			
Debtors	5	612.2	544.2
Other financial assets		–	1.0
Cash at bank and in hand		–	34.1
		612.2	579.3
Creditors – amounts due within one year	6	806.9	760.6
<b>Net current liabilities</b>			
Total assets less current liabilities		1,989.4	1,987.1
Creditors – amounts due after one year	6	738.8	781.4
<b>Net assets</b>			
Capital and reserves		1,250.6	1,205.7
Called up share capital	7	215.5	215.3
Share premium account	8	873.0	872.8
Capital redemption reserve	8	30.6	30.6
Profit and loss account	8	131.5	87.0
<b>Total shareholders' funds</b>		1,250.6	1,205.7

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 14 May 2012 and are signed on its behalf by:

**P L Rogers** **W Tame**  
Director 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 as modified by the revaluation of certain financial instruments and in accordance with applicable United Kingdom Accounting Standards and in compliance with the Companies Act 2006 and on a going concern basis. 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 26 of the Group financial statements.

#### *(b) Treasury shares*

The shares purchased by the Company's ESOP trusts are recognised as a deduction to equity. Refer to the Group financial statements note 25 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 27 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 (see note 27 of the Group financial statements).

## 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 profit and loss account 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 profit for the financial year was £106.0 million (2011: loss £24.8 million).

Audit fees and expenses paid to the Company's auditors was £0.1 million (2011: £0.2 million).

## 3. Investment in subsidiary undertakings

	2012 £m	2011 £m
At 1 April	2,004.3	359.1
Additions	1,067.8	1,646.3
Disposals	(1,471.3)	(1.1)
Investments in shares	1,600.8	2,004.3

On 14 June 2011 the Company sold its investment in Babcock Southern Holdings Limited to Babcock Overseas Investments Limited for a profit of £3.7 million. On the same day the Company acquired shares in Babcock (UK) Holdings Limited for £1,067.8 million.

## 4. Tangible fixed assets

	Leasehold property £m
Cost	
At 1 April 2011	0.5
Additions	-
At 31 March 2012	0.5
Accumulated depreciation	
At 1 April 2011	0.3
Charge for the year	0.1
At 31 March 2012	0.4
Net book value at 31 March 2012	0.1
Net book value at 31 March 2011	0.2

## 5. Debtors

	2012 £m	2011 £m
<b>Non-current debtors</b>		
Amounts owed by subsidiary undertakings	163.9	163.9
Preference shares in a subsidiary undertaking	419.3	–
	583.2	163.9
<b>Current debtors</b>		
Trade debtors	–	–
Amounts owed by subsidiary undertakings	608.0	539.7
Deferred tax	3.4	3.7
Prepayments and accrued income	0.8	0.8
	612.2	544.2

Of the preference shares in a subsidiary undertaking, the A preference shares of US\$150 million mature on 19 March 2018 and carry interest at 4.94%. The B preference shares of US\$500 million mature on 17 March 2021 and carry interest at 5.64%. The non-current amounts owed by subsidiary undertakings is repayable on demand and carries interest at LIBOR + 4%.

## 6. Creditors

	2012 £m	2011 £m
<b>Amounts due within one year</b>		
Bank loans and overdrafts	86.7	168.1
Trade creditors	–	0.1
Amounts owed to subsidiary undertakings	715.5	588.5
Accruals and deferred income	4.7	3.9
	806.9	760.6
<b>Amounts due after one year</b>		
Bank loans	738.8	781.4
	738.8	781.4

The Company has £1,006.8 million (2011: £1,105.5 million) of committed borrowing facilities, of which £731.8 million (2011: £782.5 million) was drawn at the year end. The interest rate applying to bank loans is 1.66% (2011: 2.9%) and is linked to LIBOR whilst the interest rate applying to overdrafts is 1.5% (2011: 1.5%).

## 7. Share capital

	Ordinary shares of 60p Number	Total £m
<b>Allotted, issued and fully paid</b>		
<b>At 1 April 2011</b>	358,838,092	215.3
Shares issued	308,613	0.2
<b>At 31 March 2012</b>	359,146,705	215.5
<b>At 1 April 2010</b>	229,687,601	137.8
Shares issued	129,150,491	77.5
<b>At 31 March 2011</b>	358,838,092	215.3

## 8. Reserves

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
<b>At 1 April 2011</b>	872.8	30.6	87.0
Shares issue in the period	0.2	–	–
Share-based payments	–	–	5.0
Tax on share-based payments	–	–	(0.6)
Fair value adjustments to interest rate hedges (net of tax)	–	–	5.5
Retained profit for the year – profit for the year	–	–	106.0
– dividends	–	–	(71.4)
<b>At 31 March 2012</b>	873.0	30.6	131.5
<b>At 1 April 2010</b>	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)
<b>At 31 March 2011</b>	872.8	30.6	87.0

## 9. Operating lease commitments

The Company has an operating lease commitment for land and buildings as at 31 March 2012 with an annual commitment expiring after more than five years of £2.2 million (2011: £2.2 million).

## 10. Contingent liabilities

- (a) The Company has guaranteed or has joint and several liability for bank facilities of £731.8 million (2011: £790.0 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 2012 these amounted to £168.4 million (2011: £161.0 million), of which the Company had counter-indemnified £114.1 million (2011: £87.6 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 17.0p per 60p ordinary share (2011 second interim dividend: 14.2p per 60p ordinary share) and it will be paid on 7 August 2012 to shareholders registered on 6 July 2012. Subject to approval at the Annual General Meeting on 5 July 2012.

# 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%)
Cura Classis (UK) 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%)
Babcock Dounreay Partnership 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 Services Limited
Babcock Critical Services Limited
Babcock Careers 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)
Airwork Limited

## Discontinued

VT AEPCO (USA)
VT Griffin Services, Inc. (USA)
VT Milcom, Inc. (USA)
VT Services Inc. (USA)

## 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 2012
2011/12 preliminary results announced	15 May 2012
Annual General Meeting	5 July 2012
Final dividend payment date (record date 6 July 2012)*	7 August 2012

\* See also 'Results and dividends' on page 56.

### 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](mailto:ssd@capitaregistrars.com)  
[www.babcock-shares.com](http://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

Barclays Bank PLC  
Level 27  
1 Churchill Place  
London E14 5HP

### Investment bankers

JPMorgan Cazenove  
10 Aldermanbury  
London EC2V 7RF

### Stockbrokers

JPMorgan Cazenove  
10 Aldermanbury  
London EC2V 7RF  
Jefferies Hoare Govett  
Vintners Place  
68 Upper Thames Street  
London EC4V 3BJ

### 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  
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to [www.capitadeal.com](http://www.capitadeal.com) or call  
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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-  
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conditions which are available on request  
or at [www.capitadeal.com](http://www.capitadeal.com)

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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](http://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](http://www.ShareGift.org)

## Five-year financial record

	2012 £m	2011 (restated) £m	2010 £m	2009 £m	2008 £m
<b>Continuing revenue</b>	2,848.4	2,564.5	1,895.5	1,901.9	1,555.9
Operating profit from continuing operations	202.0	153.2	148.1	133.1	110.2
Share of profit/(loss) from joint ventures	4.3	6.1	(0.5)	(0.2)	–
Profit before interest from continuing operations	206.3	159.3	147.6	132.9	110.2
Net interest and similar charges	(33.3)	(48.2)	(18.4)	(26.2)	(25.6)
Profit before taxation from continuing operations	173.0	111.1	129.2	106.7	84.6
Income tax expense	(15.8)	(10.1)	(20.8)	(19.1)	(14.9)
Profit from continuing operations	157.2	101.0	108.4	87.6	69.7
Discontinued operations	(53.1)	3.7	–	(13.3)	–
Profit for the year	104.1	104.7	108.4	74.3	69.7
Non-controlling interest	(3.3)	(3.6)	(2.4)	(2.3)	(2.4)
<b>Profit attributable to owners of parent</b>	100.8	101.1	106.0	72.0	67.3
Non-current assets	2,232.5	2,447.6	877.4	858.4	836.1
Net current assets/(liabilities)	(153.0)	(219.5)	(88.9)	(117.3)	(18.6)
Non-current liabilities and provisions	(1,159.5)	(1,207.5)	(702.7)	(448.3)	(456.7)
<b>Total net assets</b>	920.0	1,020.6	85.8	292.8	360.8
Equity holders of the parent	911.4	1,011.7	80.6	288.4	357.2
Non-controlling interest	8.6	8.9	5.2	4.4	3.6
<b>Total equity</b>	920.0	1,020.6	85.8	292.8	360.8
Total earnings per share – basic	28.11	31.28p	46.29p	37.42p	29.99p
Dividend per share (proposed)	22.7p	19.40p	17.60p	14.40p	11.50p

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