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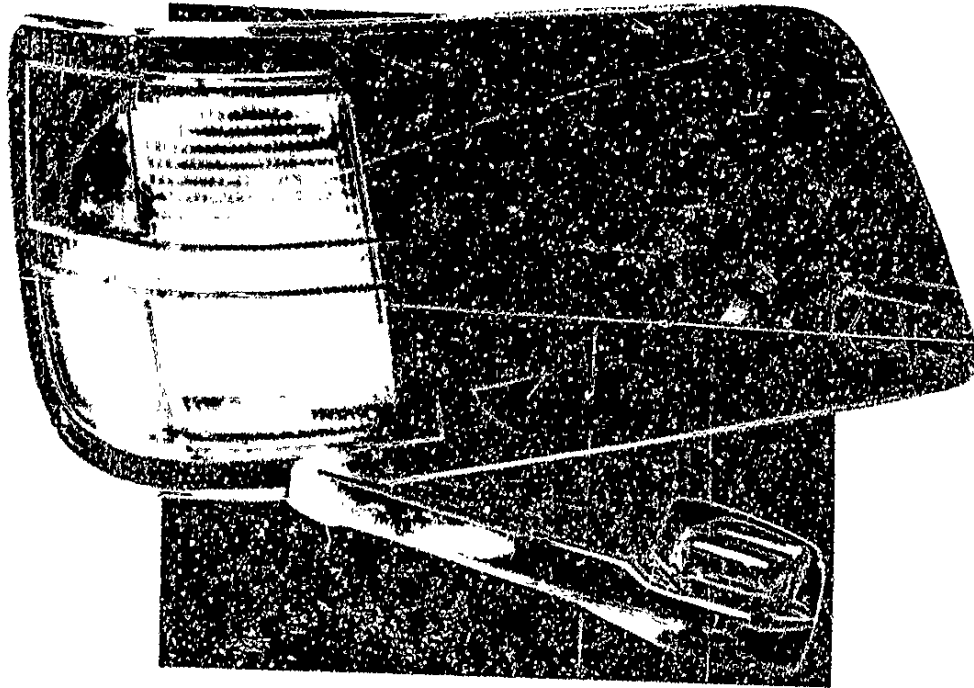
INVESTOR IN PEOPLE

CHPM 4 (07/02)

Babcock

International plc

ANNUAL REPORT 1986



*Automobile front traffic light assembly
and door handle manufactured
by the Brass Company*

*By 1960, the company was manufacturing the first coated steel and
aluminum parts for the production of large equipment for the oil and gas
industry. In 1965, the company followed in the trucking industry,
manufacturing the first truck door handle and door latch.*

Babcock

Babcock is a major group of companies involved in engineering contracting, product manufacturing and the provision of engineering services throughout the world. Historically, Babcock started in the energy business, and with continuing investment remains pre-eminent in this field. More recently Babcock has moved into other high-technology high-growth activities such as factory automation, food processing and packaging and engine testing systems. Babcock employs 24,000 people worldwide and has subsidiary and associated companies in the United Kingdom, United States of America, Australia, Brazil, Canada, Denmark, Finland, France, Holland, Hong Kong, India, Italy, Mexico, New Zealand, South Africa, Spain, Sweden and West Germany.

Activities are organised into six main operating groups: Energy, Contracting, Industrial and Electrical Products, Overseas, North American and FATA European.

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THE YEAR IN BRIEF

	1986 £000	1985 £000
TURNOVER	1,217,648	1,098,926
PROFIT BEFORE TAXATION	37,086	34,549
SHARE CAPITAL AND RESERVES	196,906	181,262
NET DEBT	68,432	87,027
<hr/>		
PER 25p ORDINARY SHARE:		
net assets	145p	134p*
earnings - before tax	27.5p	25.3p*
earnings - after tax	16.3p	17.9p*
dividends	8.7p	7.6p*
<hr/>		
AVERAGE NUMBER OF EMPLOYEES:		
United Kingdom	13,314	13,774
Overseas	12,492	12,811
Total	25,806	26,585
<hr/>		
TURNOVER PER EMPLOYEE BASED ON THE ABOVE AVERAGE	£47,165	£41,336

*Adjusted to reflect the capitalisation issue in 1986

FINANCIAL CALENDAR 1987

ANNUAL GENERAL MEETING
22nd May 1987

RESULTS

1986 Final results - announced 25th March 1987
1987 Interim results - to be announced 3rd September 1987

ORDINARY SHARE DIVIDENDS

1986 Recommended final - announced 25th March 1987, payable 26th May 1987
1987 Interim - to be announced 3rd September 1987, payable 12th October 1987

PREFERENCE STOCK DIVIDENDS

Payable half-yearly on 1st July 1987 and 2nd January 1988

7% CONVERTIBLE GUARANTEED BONDS 1992 OF BABCOCK NEDERLAND BV
Interest payable on 15th October 1987

BOARD OF DIRECTORS

THE RT HON LORD KING OF WARTNABY
Chairman

M. R. HOFFMAN
BSc(Eng) Hons, CEng, FIMechE, FIMrodE
Managing Director

B. J. KNIGHTLEY
FCA
Assistant Managing Director

R. H. CAMPBELL
OBE, BSc(Eng), FEng, FIEE, FRSA
Executive Director

A. T. HARVEY
CEng, FIEE
Executive Director

C. S. TAYLOR
MA, MBA
Finance Director

THE RT HON SIR FRANK COOPER
GCH, CMG
Deputy Chairman, Non-Executive Director

SIR GEORGE JEFFERSON
CBE, HonBSc(London), FEng, HonFIMechE, FRAeS, FRSA, FCGI
Non-Executive Director

THE RT HON C. E. PARKINSON, MP
Non-Executive Director

G. S. STONE
FCA
Non-Executive Director

SECRETARY
J. H. Dodd
LLM

REGISTERED OFFICE
Cleveland House
St James's Square
London SW1Y 4LN

AUDITORS
Coopers & Lybrand

REGISTRARS AND TRANSFER OFFICE
Ravensbourne Registration Services Limited
Bourne House
34 Beckenham Road
Beckenham
Kent BR3 4TU



CHAIRMAN'S STATEMENT

LORD KING

1986 was a year of considerable achievement for Babcock International.

Profit before tax went up by 7.5 per cent to £37.1 million, an improvement however of 21.6 per cent when the net pension fund benefit in 1985 is excluded.

The improved performance in the year has meant that some accumulated tax losses, principally in the United States, have been completely absorbed, resulting in the Group's average taxation charge increasing to 40 per cent. As a consequence earnings per share fell marginally compared with 1985.

The Group's turnover of £1,218 million in 1986 has increased by 10.8 per cent over 1985. Some 60 per cent of the Group's business was conducted by its overseas companies. Exports from the United Kingdom amounted to £182 million. Overall, 75 per cent of the Group's business lay with customers resident outside the United Kingdom. This is much as last year.

Net interest payable increased to £8.1 million from £5.3 million in 1985. This reflects the higher average level of borrowings during the year, caused by the acquisitions made in 1985 and a marginally increased level of interest rates.

The Group's balance sheet improved markedly. Capital and reserves increased to £197 million from £181 million. The net level of indebtedness to bankers and other lending institutions dropped by £19 million to £68 million, following a strong cash inflow in the last quarter of the year. There was an improvement in debt equity ratio which at the year end

was 35 per cent compared with 48 per cent at the end of 1985.

An interim dividend of 4 pence per share was paid in October 1986 on your Company's ordinary shares. Your Board now recommends a dividend of 4.7 pence per ordinary share. If this recommendation is accepted, the total dividend of 8.7 pence per share for 1986 will represent an increase of 13.9 per cent over the 1985 distribution, adjusting for the 1 for 10 scrip issue.

The mid-1980s has been a period of change for your Company. To many people, including I suspect a number of shareholders, the Group is synonymous with the power generation industry and the manufacture of large boilers for fossil-fired power stations. The Company has continued to invest and maintain a competitive capability to undertake such work, but now, the Group's profitability comes principally from its newer businesses located in North America and Europe which have no real connection with power generation. These businesses are winning profitable orders world-wide. The Group's British-based companies exported 38 per cent of their turnover, often in conjunction with other Babcock companies located outside Britain. Indeed, one of the Group's principal strengths is the ability to combine resources, from different businesses, in different countries, to tackle increasingly competitive global markets. We continue to invest in technology and people to remain competitive in international markets.

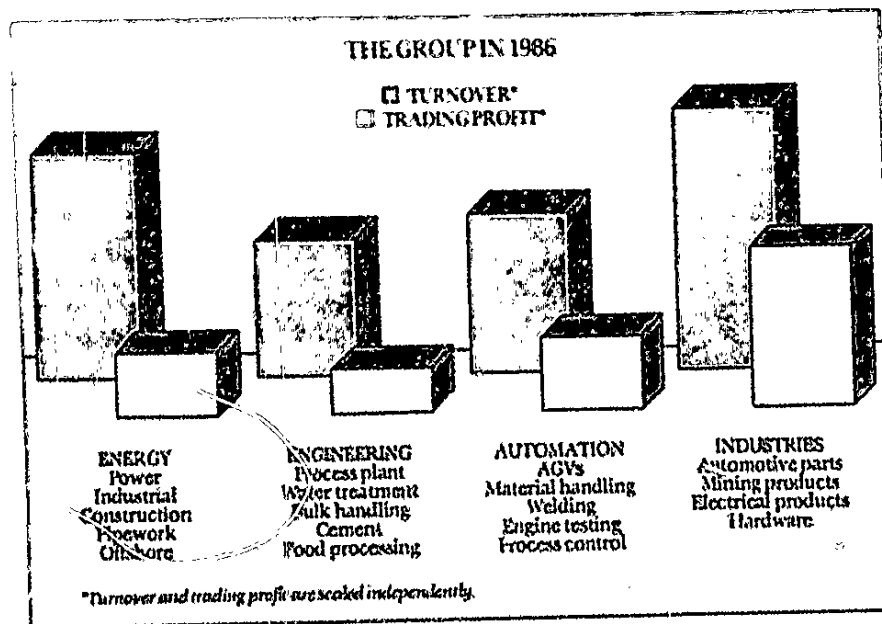
Technology transfer is important between a number of our companies and we have been able to achieve our goals without bureaucratic co-ordinating processes or committees.

The Group now participates in four major business sectors. These are: (i) Energy, which includes the utility boiler business; (ii) Engineering, which includes process plant contracting and the newer activities from the Italian group in food processing and packaging contracting; (iii) Automation, which is a growing business and includes the material handling activities in Italy and the USA, the Froude engine-testing business and process control activities in the United Kingdom and North America; (iv) Product-based activities, including automotive components and hardware in North America and mining and electrical distribution equipment in the United Kingdom.

Many of the businesses that the Group now manages were not present or developed ten years ago. Management responsibility is in line with these sectors, except in Automation, where the worldwide activities are directed by the Managing Director.

The relative turnover and trading profit contributions of the four sectors are set out opposite, together with their main activities.

The Group's resources have for many years been invested principally in the United Kingdom and North America,



markets for which its engineering skills are well-suited. More recently, the Company's Italian and other European operations have begun to grow and widen the international and product base still further. The USA economy has great underlying strength in the long term and the Company is looking to invest further in that country. However we do not see ourselves limited to this area and will invest wherever there are profitable opportunities for our engineering skills.

Our operations in the United Kingdom mostly supply the capital engineering areas where demand is currently flat. An improvement is expected when the next phase of power generation equipment is ordered. While I have stressed that the United Kingdom public sector power generation is no longer the dominant activity of Babcock, power generation is a major source of long term opportunity. Now that the Government has announced that the Sizewell pressurised water reactor nuclear power station will go ahead, we hope that the Central Electricity Generating Board's ordering programme, for both nuclear and fossil-fired power stations, will get under way. Power generation equipment orders have never followed a regular pattern such as that enjoyed, for example, by our major competitors in Japan. It is interesting to note that in the period from 1960 to 1975 some 60,000 megawatts were ordered in the United Kingdom, so that those companies in the industry during that period were working at full capacity. However, in the last 12 years less than 5,000 megawatts have been ordered.

In order to support our expectation of a resumption in power generation orders, we have continued with substantial capital investment at Renfrew. This

investment programme when complete, at the end of 1987, will have amounted to nearly £45 million since 1980 to produce one of the most modern facilities in Europe. We have won some power station orders overseas against fierce competition. Also we have become a skilled defence contractor for which the precision engineering capability at Renfrew is well suited.

A full review of operations in 1986 is contained in Mike Hoffman's review which follows. However, I should like to mention the sale of the Company's holding in Babcock-Hitachi in March of this year and the contract won to manage the Rosyth naval dockyard.

You will have read in the press very recently that the Group's twenty per cent holding in Babcock-Hitachi, a Japanese boiler and industrial company, has been sold for approximately £35 million to our partner Hitachi. The sale makes considerable sense for both parties. Babcock has played a decreasing role in the development of Babcock-Hitachi over recent years, and while it has been very successful, the dividend flow from the company has been low. Unlocking this resource strengthens the Group's balance sheet, which will enable the Company to be more aggressive in its investment programme for developing new products and the purchase of new businesses.

I mentioned in my statement last year that we have joined with THORN-EMI to form a joint company, Babcock THORN, to tender for the contract to run the naval dockyard at Rosyth in Scotland. As has been widely reported in the press, the Government awarded the contract to the joint company on 27th January. This is a major vote of confidence in THORN-EMI's and Babcock's ability to manage a large undertaking where people, and

high and diverse standards of technical skills, are of paramount importance. The management contract is for seven years. Although no one pretends that our task will be easy, we see the contract as being a significant one for Babcock if we can extend the scope of the dockyard's work and effect improvements in efficiency and commercial approach, which the Government is seeking.

THE BOARD

In November of last year we strengthened the executive team by appointing Mr Brian Knightley as Assistant Managing Director. Mr Knightley had been Finance Director for twelve years. Mr Christopher Taylor joins us from Tarmac plc where he has been Assistant Finance Director and he has been appointed Finance Director.

ACKNOWLEDGEMENT TO EMPLOYEES

Your Company's improved results are due in large part to the hard work and loyalty of its managers and employees throughout the world. My personal thanks go to them for their effort and dedication in meeting the challenges of the marketplace, whether in their home markets, or in far off places, such as China, the Middle East or South America.

King

KING



REVIEW OF OPERATIONS BY THE MANAGING DIRECTOR

M. R. HOFFMAN

Most of the Group's businesses round the world improved in 1986 and the trend established in the first half of the year was maintained.

Management has concentrated on product and service development in the four major business sectors as well as continuing to reduce the cost of our operations. Ageing products have been a problem for Babcock, but nearly all business groups have launched successful new products in the last twenty-four months.

Of particular note is the performance of the Italian based FATA EUROPEAN GROUP. Its results were disappointing in 1985, but much of the dedicated development work and organisational changes introduced in the last three years bore fruit in 1986. The group generated a trading profit of £4.1 million, together with a strong positive cash flow. The group's products and its technical expertise are well recognised as demonstrated by an order backlog of nearly £160 million.

The FATA Automation Division has made considerable progress on both automated guided vehicles (AGVs) and traditional material handling processes. The major contracts for General Motors, at their Linden and Wilmington plants in the USA, are operational and two more contracts at their Fairfax and Doraville plants have been awarded. On completion of these contracts, over 500 AGVs will have been delivered to General Motors for a value in excess of

\$50 million. This achievement has been accomplished in close co-operation with the Systems Division of the North American Group.

The group won a number of important contracts in the Soviet Union, during the year, in both automation and packaging contracting. A protocol for the first ever joint venture agreement with the Soviet Union, since the new Soviet trade laws came into force in January 1987, has been signed by FATA. The deal is with the Soviet Ministry of Machine Building for Light and Food Industry, to set up a company for the manufacture of food refrigeration and deep-freezing equipment. The manufacturing programme will cover industrial refrigeration rooms and cabinets, deep-freezing equipment, evaporators and other items dealing with food refrigeration.

The business and assets of the Hunter Engineering Company Inc in the USA were acquired in January 1987. Hunter is a world leader in the design and construction of aluminium sheet and rolling equipment. The acquisition enables the Italian group to integrate its existing expertise in conversion of thin aluminium foil into flexible packaging, allowing a range of packaging materials to be offered to the drug and food industries.

The food processing technology, built up by FATA through its own in-house research and development activity, and the experience gained from a contract to implement an ultra high temperature (long life) milk processing and packaging plant in the Soviet Union, puts the group in the unique position of being one of the few companies in the world that can offer a complete and integrated package of technology and equipment to the food industry.

There was considerable progress in the Froude Group of companies which were acquired in 1985. Almost all of the unprofitable contracts underway at the time of the acquisition have been completed to the clients' satisfaction. This has enabled confidence in the group to be maintained and improved across a wide market area. The company is profitable and its new order intake is proceeding well.

The business and assets of Go-Power (in the USA) were acquired late in the year. This move will considerably enhance the volume dynamometer business for the group worldwide, and complements the existing product ranges.

In the INDUSTRIAL AND ELECTRICAL PRODUCTS GROUP, the mining equipment companies achieved a major improvement to break even after a heavy

loss in 1985. These companies are expected to return to profit in 1987.

The Parsons Chem company improved profitability following some rationalisation of the manufacturing process. After their reorganisation at the beginning of the year, the Huwood companies became profitable in the second half. Service to British Coal remains a major feature of the business but diversification at home and abroad is progressively widening the customer base.

Both Babcock Sweepers and Gloucester Railway Carriage & Wagon Company have been sold. The process control and instrumentation activities, which were part of this group, were combined with the Process Control Division in North America. It will now concentrate on digital rather than analog products and remain a major force in the power station control engineering markets.

Other members of the group have reported significantly increased profits with the exception of Babcock Wire Equipment, Ashford, where several export contracts were underestimated at the initial design stage.

The ENERGY GROUP was re-formed in 1986 into five main operating businesses:-

Babcock Power is responsible for utility boiler, nuclear and defence activities.

Babcock Construction continues to compete for major erection and refurbishment contracts on power station and nuclear installations.

Babcock Industrial Boilers focuses on the Babcock Robey business in Lincoln and is responsible for all of the small boiler activities.

Babcock PED is completing major pipework installations at Rihand in India and on the Heysham and Torness advanced gas-cooled reactor installations. It will benefit from the Sizewell PWR order.

Babcock Offshore provides services to the oil industry.

The main challenge faced by the Energy Group is the very low order intake in utility boilers, and the consequent pressure on profitability. The order backlog reduced further in 1986, and substantial redundancies were declared at Renfrew and London.

Trading profit of the Energy Group fell marginally in 1986 compared with 1985, reflecting the reduction in workload associated with large power station orders. The trading profit was struck after the cost of redundancies had been taken into account.

The sale by Babcock of its holding in Babcock-Hitachi to Hitachi Limited for some £35 million will not affect the close technical association between the companies in the Energy Group and Babcock-Hitachi. In particular, Babcock will continue as Hitachi's licensee for environmental control systems which include DESOX and DENOx capabilities, and Babcock-Hitachi will continue with the Babcock Power boiler licence.

The trading profit of the CONTRACTING GROUP increased marginally in the year on £85 million of turnover. The principal profit earner in the group continued to be Babcock Woodall-Duckham, where a number of major projects were commissioned during the year, including the Acominas coke oven project in Brazil, and the landfill gas gathering scheme for Blue Circle at Swanscombe in Kent.

Responsibility for the Claudius Peters Group of companies headquartered in Germany was assigned to the Contracting Group during 1986 but its results are included in the Overseas Group.

In the OVERSEAS GROUP a sound performance from Babcock Africa was offset by poor performance in Claudius Peters and in the Australian Group. The market sectors served by Claudius Peters are in severe decline and there has been need for a further expensive manpower reduction beyond that of 1984. The Australian company is approaching the end of several contracts. It is now concentrating on industrial boiler activities and the performance and expansion of the water reticulation business that was acquired in 1985.

Trading conditions in the NORTH AMERICAN GROUP in 1986 were similar to those in 1985. Trading profit increased from £22.6 million on a turnover of £411 million to £22.9 million on a turnover of £436 million.

Considerable effort is being expended on new product development by both the Acco and Keeler automotive component companies. The hardware businesses were separated in 1986 into two units, decorative hardware and engineered products, to improve market focus. Both operations turned in a strong profit performance. The Chain Products Group was severely hit by market weakness and incurred a loss. The Material Handling Group benefited from a major profit improvement in the Systems Division's activities, but the Products Division was only able to reduce its rate of loss. There was a major improvement in the USA element of the Process Control Group in 1986, which reversed the very severe decline over the past five years. Babcock is now a worldwide competitor in the process control field.

Capital expenditure in Babcock continued at a significant level. The capital cost of new plant and facilities installed by the Group in 1986, or in course of construction at the end of the year, totalled £24.2 million. This includes £1.2 million which was subject to leasing arrangements. Of this total amount £11.2 million related to assets in the United Kingdom. Capital expenditure is planned to continue at current levels, for at least the next three years, to ensure the operating capability of our companies remains competitive.

Considerable emphasis has been placed on new product development and all companies have detailed product plans. Expenditure on research and development in 1986 by the operating groups amounted to £10.2 million. This included work with universities and external research centres who play an important role in our research activities.

The Group is now organised for marketing and strategic purposes into the four major business sectors outlined in the Chairman's Statement. It has aggressive plans for profit improvement by organic growth and acquisition.

M. R. Hoffman

M. R. HOFFMAN

ENERGY GROUP

Babcock Energy comprises five major units following an organisational change in 1986 designed to give greater autonomy and focus on specific activities. The group serves market sectors and industries such as power generation, defence, steel, process, offshore, oil and marine and licenses boiler technology to other Babcock operations together with a number of third party companies.

TURNOVER (£000)	
TRADING PROFIT (£000)	
1985	1986
282,462	287,699
5,017	4,188

Babcock Power is responsible for the utility boiler, nuclear and defence businesses.

The policy of concentrating on high technology work at Renfrew continues. However the workforce both at Renfrew and in London has had to be reduced to match the 1987 workload, but without impairing the capability to design and build the nuclear and coal-fired plant which will need to be ordered steadily to the end of the century and beyond.

The CEEGB has released the work on the major contracts at Sizewell for steam generators and high integrity pipework and there are many other contracts to be placed for Babcock products.

The design and development work has proceeded well for the new range of coal-fired stations which the CEEGB intends to order and which will be built in parallel with the nuclear stations. These are of larger output and are designed to reduce significantly the level of emission of oxides of sulphur and nitrogen. An important competitive factor is the computer-aided design and production techniques being developed as part of the general upgrading of the facilities.

The final stages of modernisation of the Renfrew works will be complete with the commissioning of the heavy vessel shop at the beginning of 1988. This will be suitable for the manufacture of the large PWR vessels, steam drums for coal-fired stations, vessels for the offshore and chemical industry and submarine components. Manufacture in this new facility will be much more efficient than in the old shops which it replaces.

Construction and commissioning of the large units at Castle Peak has continued well and the 'B' station was officially opened by HRH The Duke of Edinburgh in October. Other Babcock companies supplied ship to boiler coal handling plant, ash handling plant and boiler and turbine controls. Both the 220 megawatt units at Hwange power station in Zimbabwe are commissioned and operating well. These sales, together with the completion of other overseas contracts, have helped Babcock Energy to gain its second Queen's Award for Export. In the United Kingdom, successful commissioning of industrial fluidised bed units has taken place at ICI Huddersfield and Reeds Aylesford, and of a stoker-fired combined heat and power plant at Unilever. British Sugar has ordered a further fluidised bed hot gas generator. This will be the fourth unit to be installed by the group for this customer.

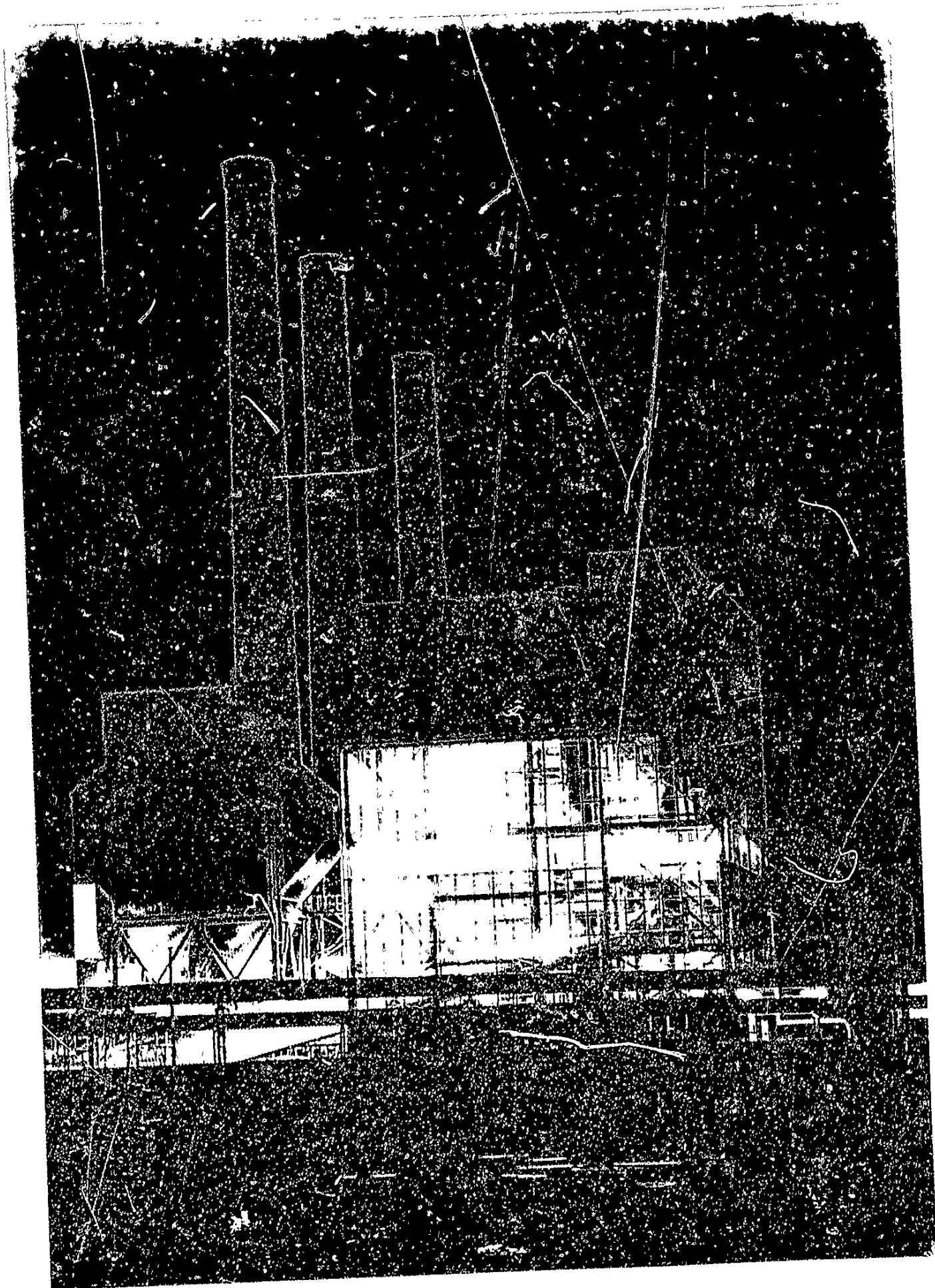
Babcock Construction continues to gain contracts in power station refurbishment. It is also using its skills in new market sectors and has secured orders from BNFL.

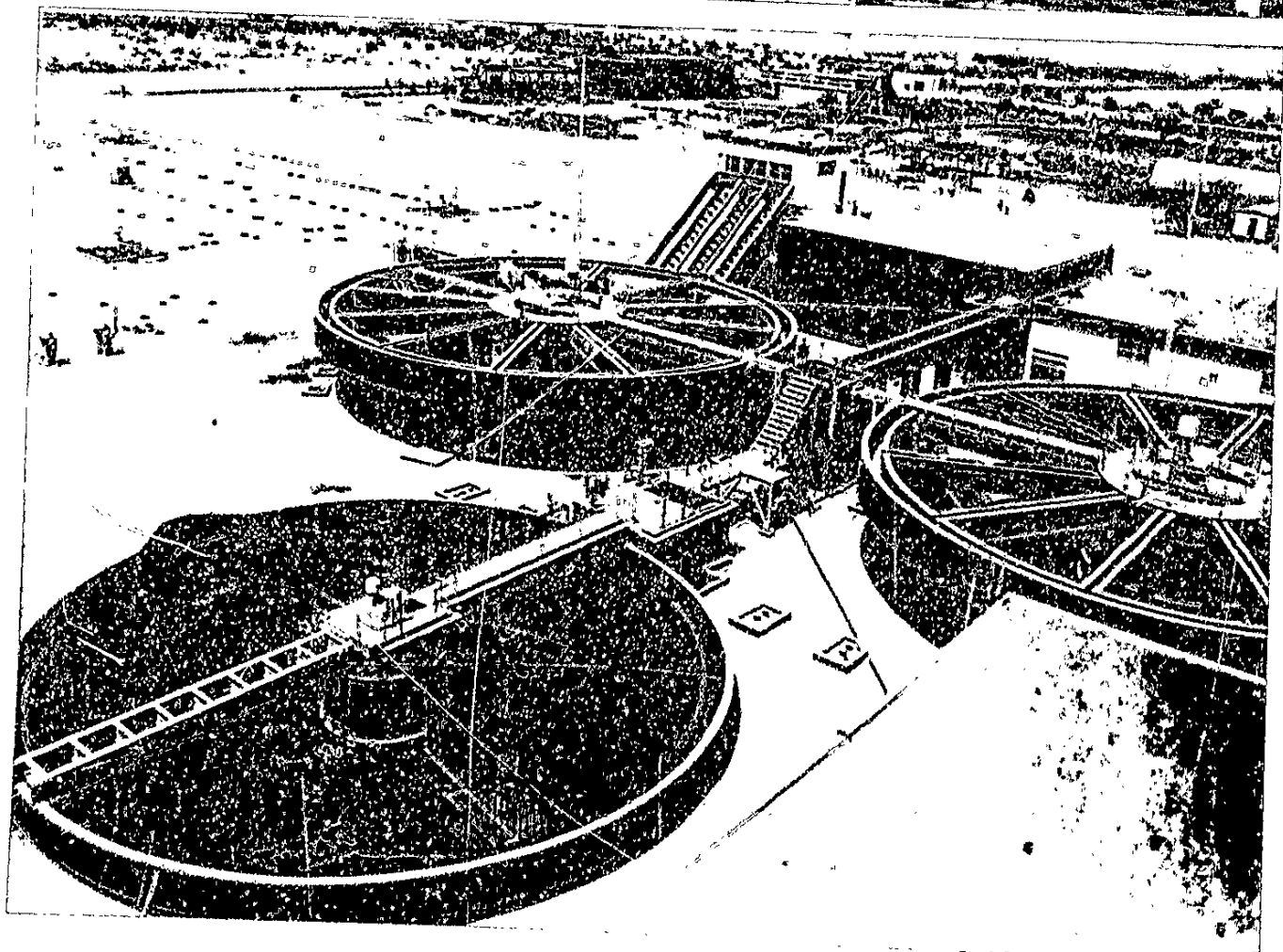
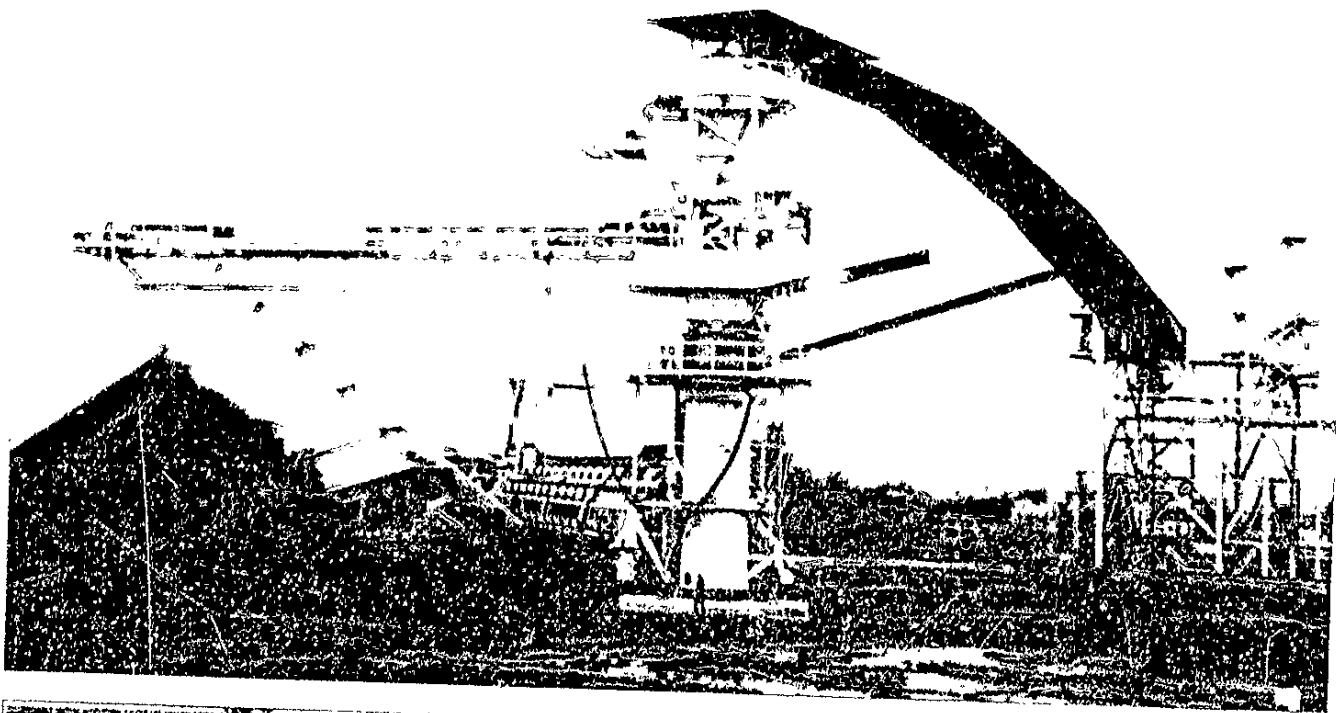
Babcock Industrial Boilers includes Babcock Robey, Babcock Worsley and Babcock Towler. Orders have been difficult to obtain in 1986 as oil price levels have not encouraged conversion to coal. However, oil-fired boilers have not been ordered, due to lack of confidence in the oil price remaining low. At Babcock Jenkins further restructuring became necessary because of the decline in the mining equipment market.

Babcock PEI is in the final stages of the United Kingdom AGR contracts at Heysham and Torness, and the Rihand contract in India. Significant improvements have been made in the manufacturing process and contract management has been strengthened. The company will benefit from the Sizewell pipework order.

Babcock Offshore continues to grow, providing services to the oil industry. It is examining a number of new ventures associated with the North Sea market.

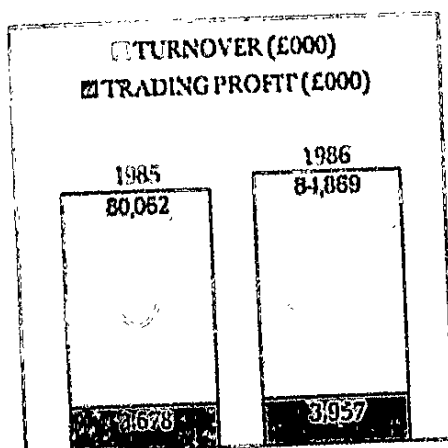
Picture: The new boiler extension at Unilever's Merseyside power station. The project was awarded to Babcock Power division and involved a management contract and supply of a 105 tonne per hour coal fired boiler.





CONTRACTING GROUP

The companies are involved in process plant contracting, for example gas production, glass and glass fibre production and minerals processing - principally Babcock Woodall-Duckham; water engineering - Ames Crosta Babcock and Spaans Babcock; bulk material handling - Babcock-Moxey and Babcock Hydro-Pneumatics; and electric power distribution - Babcock Electrical Projects.



The group made good progress in 1986 and Babcock Woodall-Duckham had another successful year with a record level of activity.

During the year the final phase of the Acominas coke oven project in Brazil was commissioned smoothly, as well as the landfill gas gathering, transmission and utilisation scheme for Blue Circle at Swanscombe, Kent. Two of the four streams of the town gas plant for the Hong Kong and China Gas Company have been completed prior to commissioning.

The major engineering design work for BNFL on the THORP project continues. Comprehensive construction management services are being provided for the radioactive liquid effluent treatment plant for AWRE at Aldermaston, following completion of the detailed engineering phase. A further order has been received from SCM Chemicals for a titanium dioxide plant at Bunbury, Western Australia, which follows closely on the successful completion of a similar facility on Humberide. To meet increasing opportunities for small to medium sized projects in the United Kingdom, Babcock Woodall-Duckham opened a projects and engineering office in the Manchester area. The new venture has won orders from BP Research, British Coal and the Ford Motor Company.

Ames Crosta Babcock continues to expand its share of the United Kingdom water and sewage equipment market. Of significance were the awards of the turnkey contract for the sewage treatment works at Flag Fen, Peterborough, for the Anglian Water Authority, and the contract to supply specialist equipment for water and sewage treatment at New Holland, Northern Ireland. Overseas, it was gratifying to secure repeat business despite the general down-turn in the Middle East. The business of supplying reverse osmosis equipment for marine use maintained steady progress and the award of a contract for the land-based plant at Lanzarote, using this technology, represented the major order placed worldwide in this sector. The EEC quality standards relating to water and effluent, that have been established recently, present increasing opportunities for the company. Spaans Babcock, in addition to achieving improved sales in its traditional screw pump business, was successful in applying this technology to mechanical silos and a large coal silo installation was successfully completed in Denmark.

Babcock-Moxey worked hard throughout the year to clear acceptance trials on their three major developments - the continuous ship unloaders at Castle Peak Hong Kong, and at British Steel Corporation Port Talbot, and the blending system for British Coal at Hem Heath. Good progress was made, though at considerable cost. These units are now all in client proving periods and will provide excellent reference plant for future business. In mid-1986 a new order by British Coal at Harworth for a coal preparation plant was placed. It is one of the largest coal preparation projects and of an innovative modular design of plant. A major contract was also won to extend the surface coal handling plant at British Coal's Gascoigne Wood mine at Selby. The Rihand project for National Thermal Power Corporation, India, progressed and repeat business to the same exacting standards is in prospect.

Further Indian business has been obtained for the Raj Mahal coal handling plant in Bihar State.

Babcock Hydro-Pneumatics had a good work-load throughout the year on ash and dust plants, both in the United Kingdom and overseas. The last unit for the Drax power station was completed and the first unit for Ilwange stage II, Zimbabwe, was successfully run. The order for ash and dust plant associated with the Northern Ireland Electricity Services, Kilroot, coal-firing conversion was secured against fierce competition. In conjunction with Claudius Peters of the Overseas Group the contract for the recuperator 'G' cooler at the Blue Circle Dunbar plant was completed.

Babcock Electrical Projects has made progress on its rural electrification contract for Benue State, Nigeria, and expects to deliver the majority of the equipment and commence erection during 1987. The enlarged contract for Amran and Bajil in North Yemen is well under way with erection to be undertaken in 1987. A new contract for mechanical and electrical equipment for pumping stations in Benghazi, Libya, is nearing satisfactory completion.

Top picture: Stacking and reclaiming homogenising system designed and installed by Babcock-Moxey for the British Coal colliery at Hem Heath.

Bottom picture: Water re-use plant at Jeddah constructed by Ames Crosta Babcock under a turnkey contract. This plant is capable of treating 30,000 cubic metres per day of sewage works effluent, to produce water of a potable standard for general use such as irrigation.

INDUSTRIAL AND ELECTRICAL PRODUCTS GROUP

This group comprises the electrical distribution and general products division and the mining equipment division.

TURNOVER (£000)
TRADING PROFIT (£000)

1985	1986
86,546	89,456

(2,343)

1,567

The electrical distribution companies increased turnover and profit despite difficult market conditions. Whipp & Bourne received major orders for 70 switchgear from Australia, Turkey and the United States, with the main order being phase 2 of the Singapore mass transit system, at a value of £2.5 million. Circuit-breaker orders were received from the Ministry of Defence for Trafalgar-class and Trident-class submarines. Postponement of order placement for the second Trident submarine switchgear resulted in a reduction in the Whipp & Bourne closing order book position.

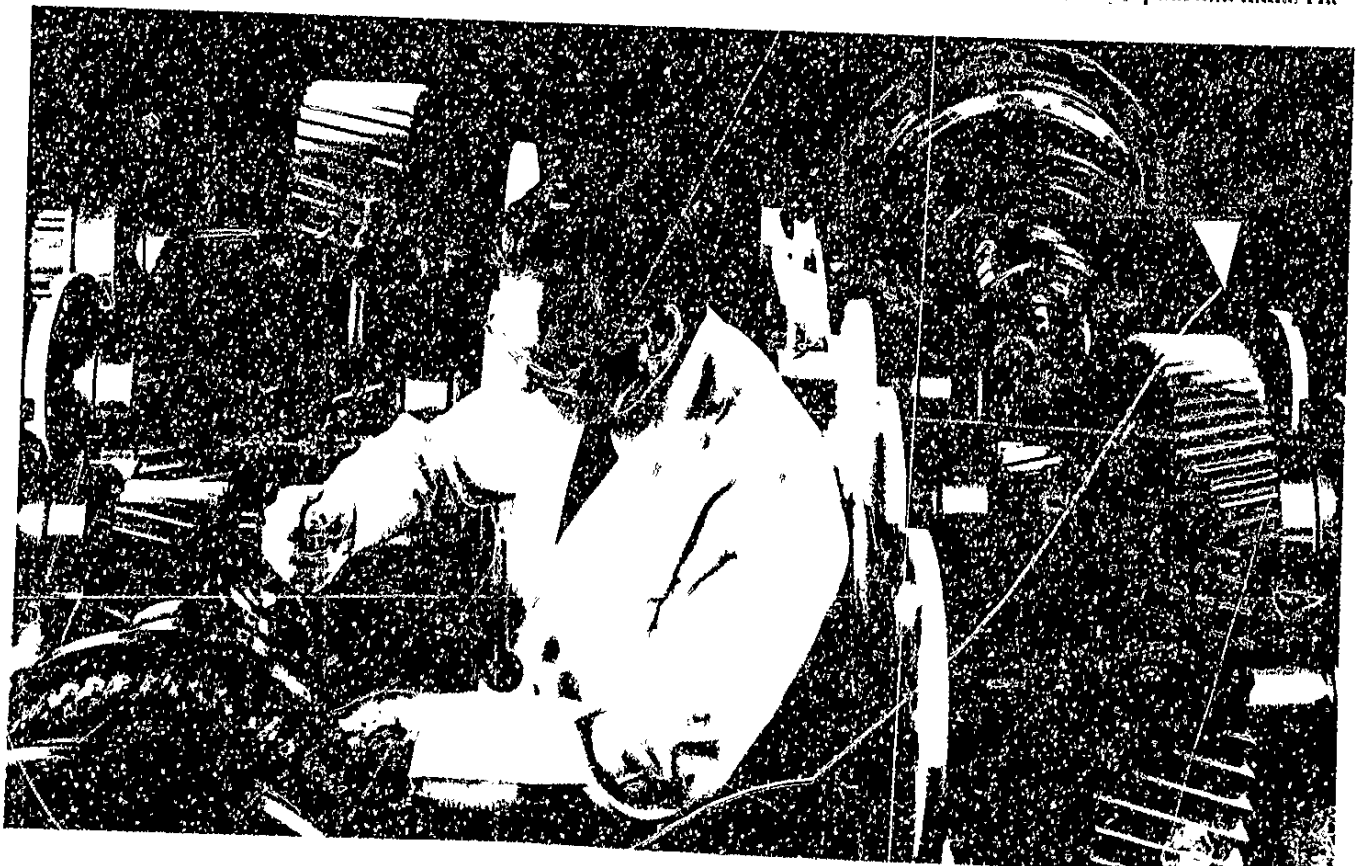
Babcock Transformers had a successful year. Export orders, mainly from the Middle East, represented 60 per cent of order intake, though the fall in oil revenue continues to restrict expenditure in many countries. The company expanded its activities in power supplies and the latest designs of

emergency lighting systems have been introduced to the market with an excellent response. The development work on control systems for defence applications, which commenced in 1985, resulted in orders from major defence contractors.

In General Products, Babcock Wire Equipment, Bolton, did well with increased profits on reduced turnover. Four orders to a value of £1.7 million were received for a new design of rigid strand incorporating automatic handling facilities. A major wire drawing plant was successfully commissioned in Venezuela.

The trading results of Babcock Wire Equipment, Ashford, were adversely affected by cost overruns on contracts taken in 1984 and commissioned in 1986. Interest in Conform equipment resulted in major orders from the United States, Japan, Korea, Italy, Spain and India. The

*Picture: Babcock Gears, Millip announced
face conveyor gearbox manufactured for
Babcock Mining.*



first Conform line to clad fibre optic cable with an aluminium sheath has been developed and manufactured for a customer in Korea.

Both Rockwell Hardness Testers and Babcock Gears showed improved results in 1986.

The Mining Division had a much better year in 1986. Benefits from the restructuring which took place early in the year showed in second half performance where a trading profit was recorded. This improvement combined with more stable home market conditions, enables the 1987 prospects to be viewed with more optimism than the last two years. The demand for heavier duty, more efficient and reliable underground machinery, with the associated electric and electronic control equipment, is expected to be maintained into the 1990s. The group is well placed to service these markets.

Parsons Chain achieved its improvement in profitability from a very modest growth in turnover by more efficient plant operation. Despite success in the annual chain contract, sales to British Coal fell during 1986, reflecting the longer term reduction in demand from that sector. This situation was offset by an improved export performance with

the company re-establishing its "Trawlex" products in the important European fishing markets. New chain designs were developed for mining use in the United States and new markets were established for conventional mining chain in the Soviet Union, Czechoslovakia and Hungary.

At Huwood, operating costs are now in line with sales volume and product development is providing a more competitive edge. An underground belt conveyor system for British Coal's prestigious Selby mining complex was completed and further orders are expected. A new range of heavy duty armoured face conveyors was developed and orders from British Coal and the USA confirmed the company's technological advance in this area.

Huwood supplied two specialist mining support systems during the year and also produced several new powered support designs.

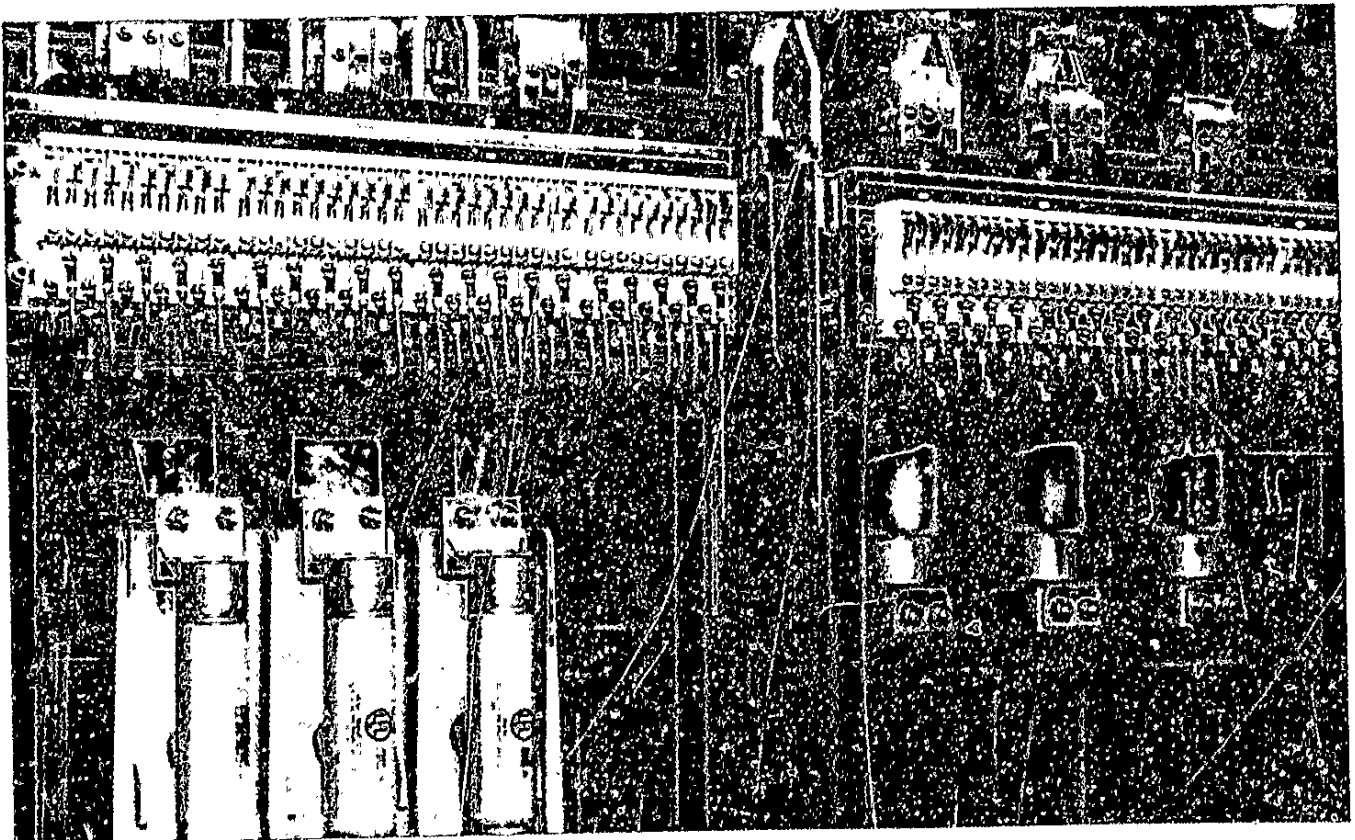
Huwood Electric continues to improve in its sector of the mining market. A number of new products were launched successfully during 1986. In particular Sentries Mimos remote control systems represent a significant contribution to mine monitoring, data transmission and communications. Applications for

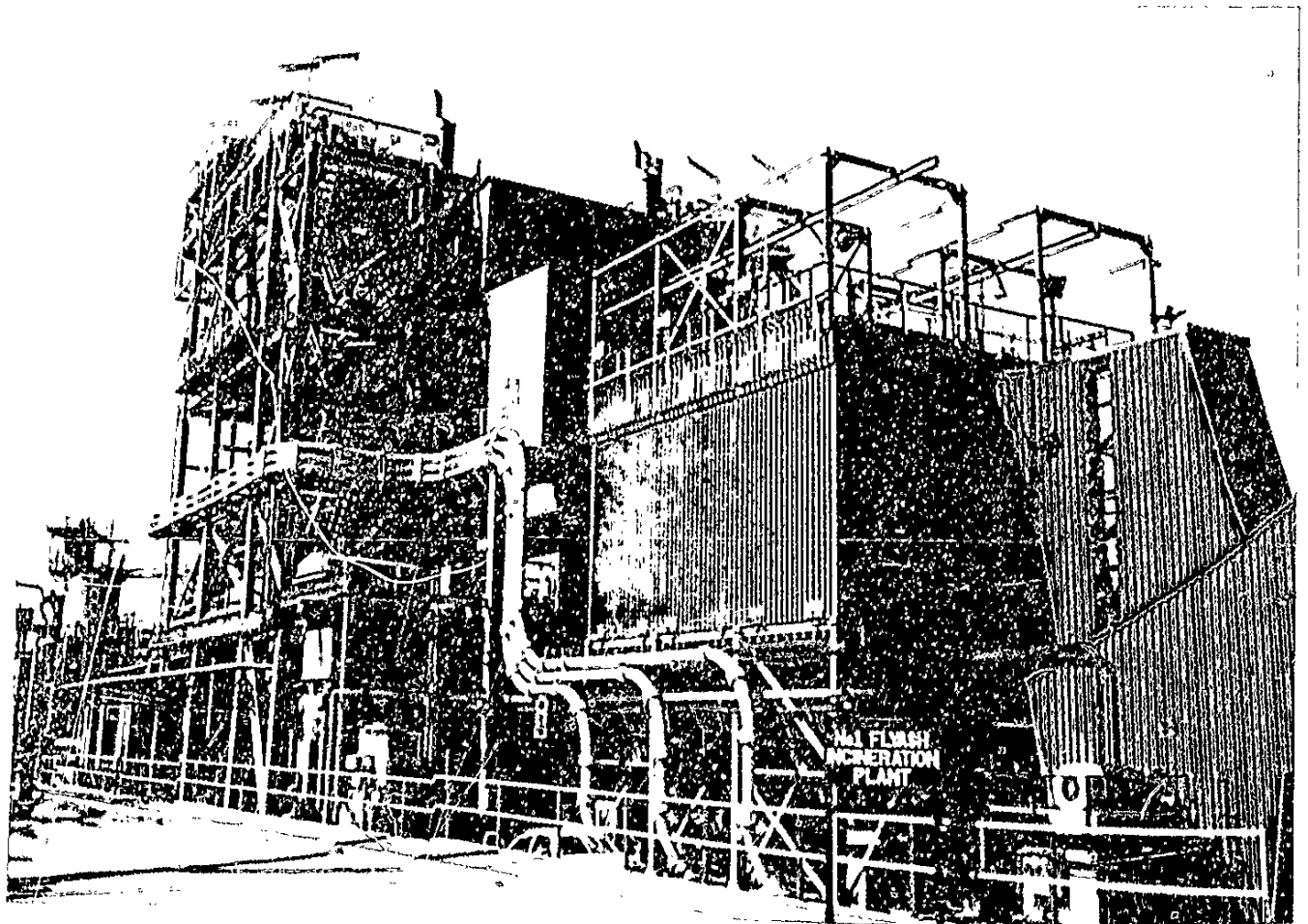
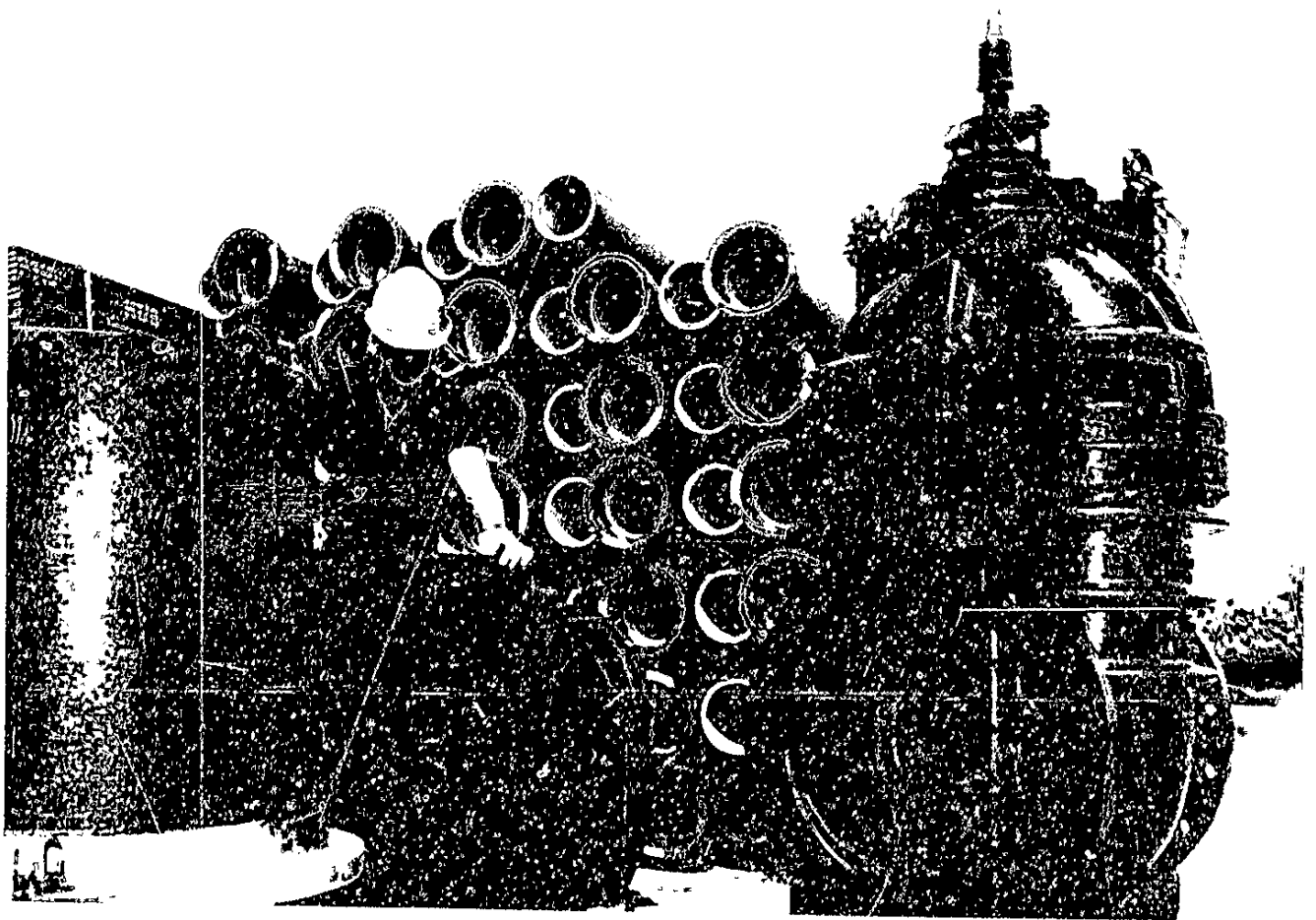
electronics and electronics in underground and other hazardous areas are accelerating and strong growth is predicted for this sector.

In the USA at Huwood Irwin the manufacture and sale of mining cars has been discontinued but the sales of mining chain, conveyors and face equipment will continue to be handled by Acco Mining Sales and Huwood U.S.A. Inc.

Throughout the mining division, marketing, engineering development and quality standards have involved considerable resource and effort. Service to British Coal remains a major feature of the business and diversification of products and markets at home and abroad is progressively widening the customer base.

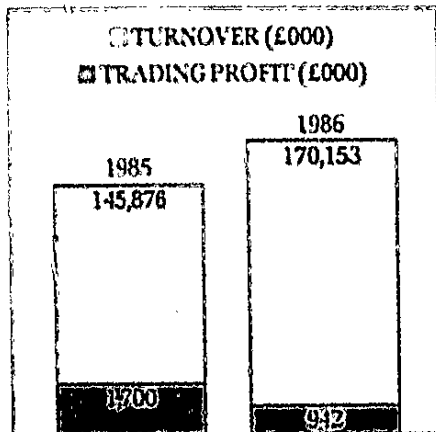
Picture: Typical switchgear units manufactured by Whipp's become for use in a variety of industrial locations. These units are capable of delivering 350 amps at voltages up to 16kV.





OVERSEAS GROUP

The Overseas Group incorporates activities in Africa, Australia and the Claudius Peters Group which is based in West Germany.



The Babcock Africa Group performed well in 1986 measured in terms of local currency. Most of its profit was earned from orders received prior to the recession which has gripped Southern Africa for the past three years. Order intake during this period has been low and it has been necessary for the Africa Group to broaden the base of its operations to earn income from new activities to offset reduction in profit which will occur as existing orders move towards completion.

The first two 600 megawatt boilers at Lethabo power station have been accepted by ESCOM and are performing well. The third and fourth units will be completed during 1987. The group's non-boiler activities earned a small profit but management and organisational changes should improve performance in 1987. The trading activities of Triplejay had to contend with the continuing poor trading conditions in Southern Africa's depressed economy. It cut back its

activities even further in 1986. The on-going operations broke-even but losses were incurred in disengaging from the unprofitable activities.

The Australian Group reported a loss for the year as a result of reduced activity and margins across the full range of products and services. The outlook for engineering contracting orders in Australia and New Zealand remains depressed and further manpower reductions have taken place. Prospects for industrial boilers in South East Asia are still being explored.

The water reticulation business was adversely affected by the Australian economy in 1986 but a number of strategic moves in the year have placed the group's operation on a strong footing and they should perform more profitably in 1987.

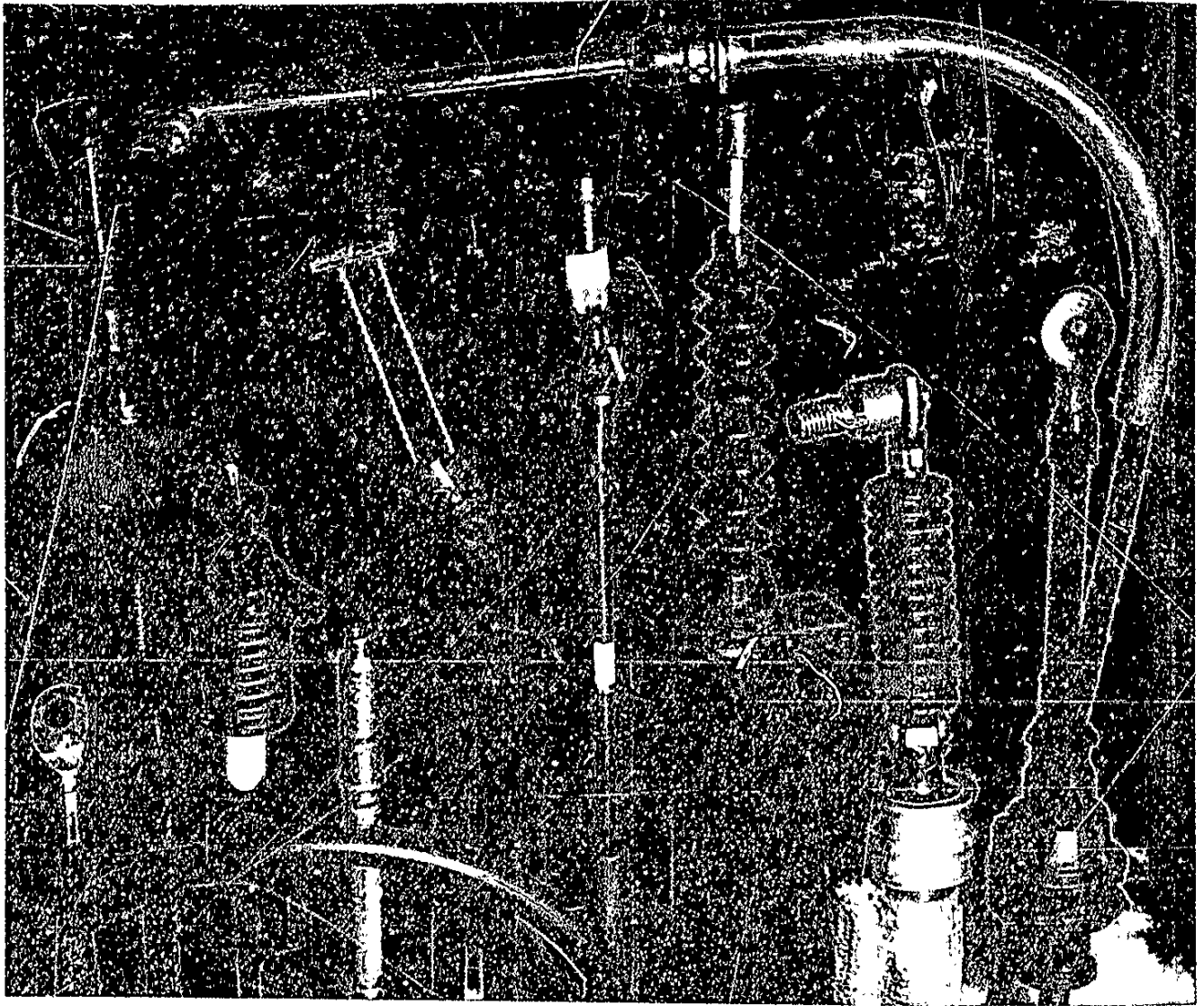
The Claudius Peters Group in West Germany suffered from low order intake in the contracting business and, with the impact of redundancy payments in 1986, operated at a loss. The contracting business was mainly influenced by major delays in the receipt of orders for gypsum and other building material plants from the Soviet Union. The depression in the cement industry continued and the shortage of orders could not be fully balanced by work from the utilities sector. Shortfalls in the contracting business also had a depressing influence on manufacturing, but this sector, due to economics initiated in previous years, did achieve a positive result. The overseas units in France, Spain and Italy performed well, although market conditions were not favourable.

Top left picture: Flanged tee, slant valve and ductile iron pipes, typical of the package of items sold by the six branches of Associated Water Equipment for sewage projects and water reticulation in Australia.

Bottom left picture: Turkey fluted bed boiler installation designed and constructed by Babcock Energy Babcock Engineering Contractors for A.P.C. Modderfontein, including shrouded fuel dewatering and gas cleanup bag filter. The fuel is flyash waste.



Picture: Cement silos designed and commissioned by Claudius Peters for the Lauffen cement works in West Germany.



NORTH AMERICAN GROUP

Babcock's operations in North America are managed through the North American headquarters in Fairfield, Connecticut. They are divided into seven independent operating groups: automotive hardware, cable controls, chain and forged products, engineered hardware, decorative hardware, material handling and process control.

TURNOVER (£000)
TRADING PROFIT (£000)

	1986
470,305	436,110

22,585

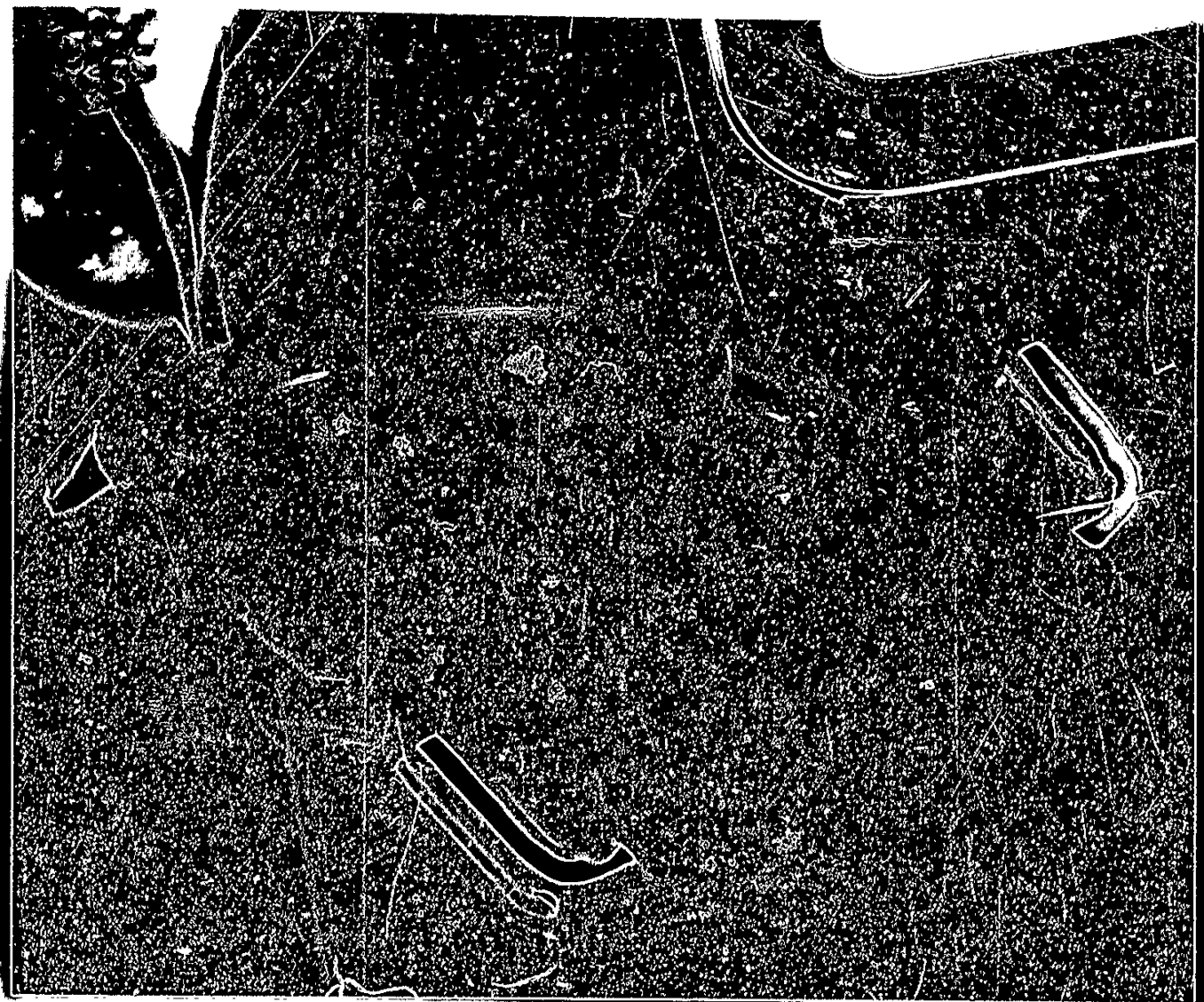
22,942

The North American trading environment in 1986 was very similar to 1985. Consumer demand was stronger than the industrial side of the economy, which benefited from the high activity at the end of 1985. Record automotive build by initiated Babcock's operations.

A significant factor in 1986 was the reorganisation of the Landless-Caster Corporation and Keener Brass Company into three separate groups to provide a greater focus on their separate products. The Engineered Hardware Group, which handles all the engineering and design work, is now a separate group.

The Engineered Hardware Group combines the castors and chain controls of Landless-Caster with the hinges and control mechanisms of Weber Knapp. The third group is Automotive Hardware.

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The Executive Hardware Group was a significant contributor to trading and had the best results in the North Atlantic area group with regard to contribution sales. The group has now established itself as the major North American originator hardware in the USA.

The Engineering Hardware Group had a strong year. Engineering systems control hardware strengthened its position in industrial markets, mainly as a result of highlights against foreign competitors. The cost saving measures taken in operations resulted in a strong year with a contribution margin improvement in most areas. The total contribution investment in the manufacturing sector was clear control.

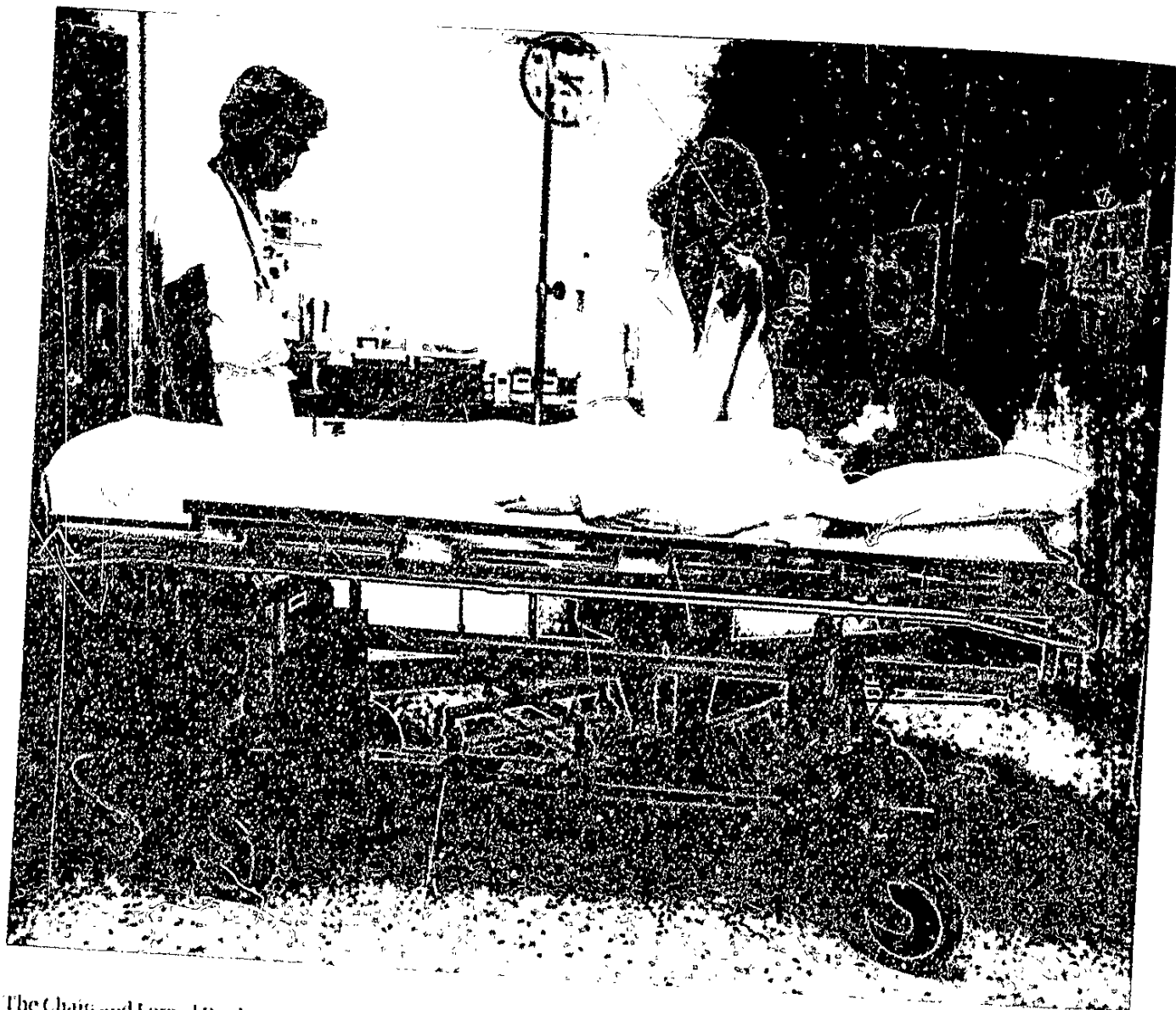
The Automotive Hardware Group, which supplies hardware for the automotive parts, the major volume of the group, continued to grow with the introduction of new products. As a result of past years' cost reduction measures, the group has been able to achieve a steady increase in its contribution margin. The group has also been able to maintain its position in the automotive hardware market.

fighting for automobile manufacturers has combined with Robert Bosch of West Germany to form a new venture. The new venture will combine the latest European technology with American marketing and manufacturing experience.

As reported last year, the Machine Handling Group had a good year. The group's main venture with the EMEA group is the penetration of the USA market with automated guided vehicles. At the end of the year, the group had a total of 100 units in operation. The group is also working on a new venture with the EMEA group to develop a new line of automated guided vehicles. The group is also working on a new venture with the EMEA group to develop a new line of automated guided vehicles. The group is also working on a new venture with the EMEA group to develop a new line of automated guided vehicles.

The United Kingdom and North American interests in process control were combined in a new year. The UK group has derived most of its turnover and profit from control equipment for boilers in power stations. The combined operations will be able to exploit the new digital products developed in the USA in wider markets but will retain the contracting capability for future power station orders.

In the USA, the process control business and power plant automation to reduce costs levels to ensure a strong future. This activity continues to be a powerful force especially in the water engineering and distribution, so-called distribution markets.

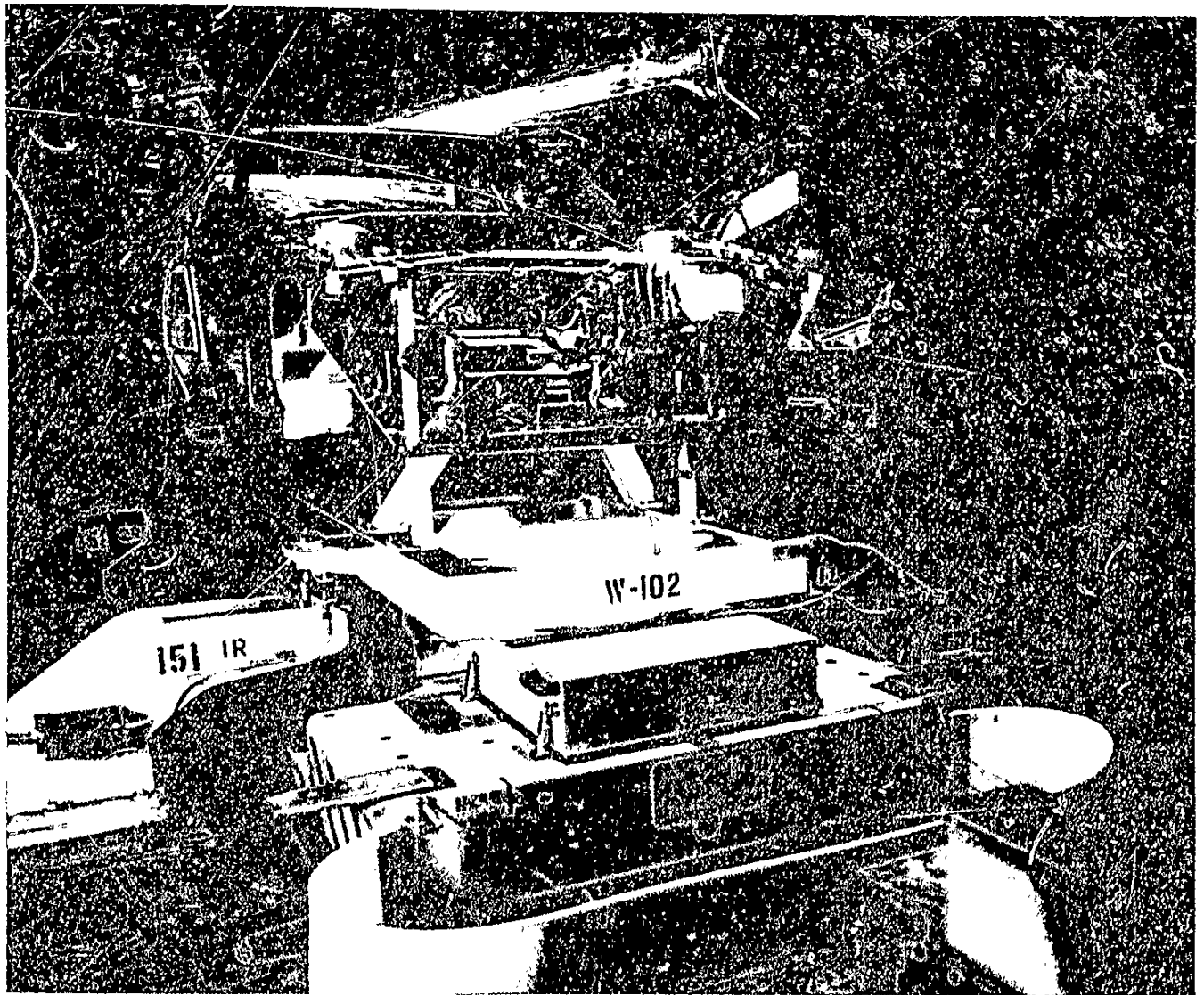


The Chain and Forged Products Group operated at a loss in 1986. The chain industries suffered from excess capacity and severe price competition. Management has taken steps in 1986 to reduce the cost of operations still further and has planned new market innovations to improve market share.

1986 was a record year for the automotive build in North America, but the industrial products part of the Cable Controls Group in North America suffered from margin erosion, which reduced the profitability of the group.

During 1986, the USA and Canadian cable control activities were combined and costs reduced. Considerable product development is required to stay competitive and expenditure levels have been increased. The international operations of the Cable Controls Group made a good contribution to the overall performance. International strength has been enhanced by the acquisition of the cable controls business of Bendix in France in 1987.

Picture shows the manufacturing section supplied by the best casters from the group's investment.



FATA EUROPEAN GROUP

The FATA European Group of companies is based in Italy with operations in the United Kingdom and the USA. The companies operate in three areas; automation, engineering and food processing.

TURNOVER (£000)
TRADING PROFIT (£000)

1986
149,361

1987
94,626

4,393

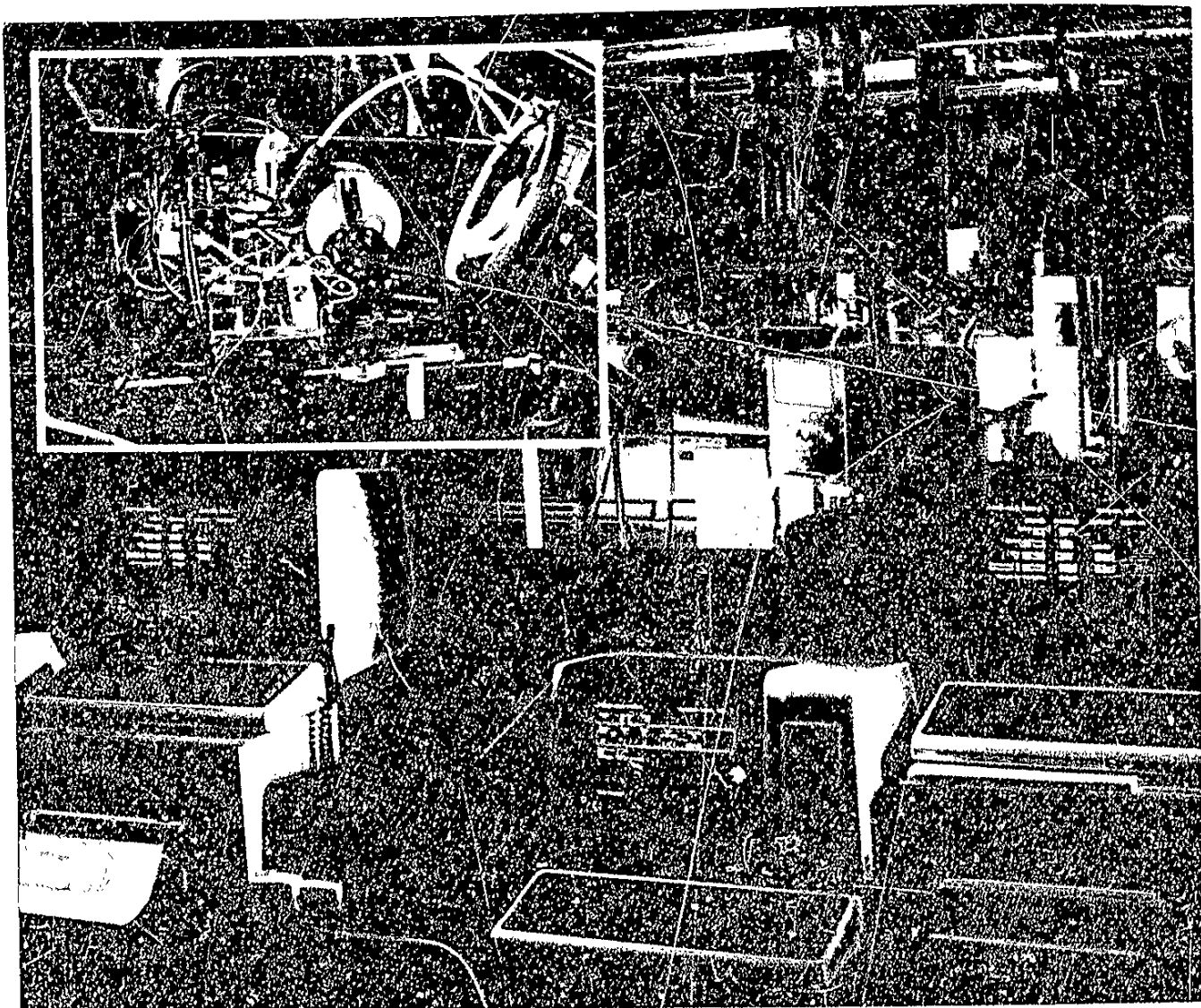
1988
134,421

During 1986 the Italian group was reorganised into two divisions: Automation and Engineering so as to capitalise on the new products strategy developed in previous years.

The Automation Division is based upon the traditional automation material handling expertise of FATA Industrie which now includes AGVs suitable for many different applications and Engineering whose business includes the design and manufacture of the same category of equipment but for the automotive industry. For example, in 1987 FATA Industrie delivered 1000 units of the AGV-1000 to the Ford Motor Co. in the USA.

Wilmington plants of General Motors in the USA. Other AGV contracts have been won in Europe and North America and the company is now a leader in the design and supply of AGV systems from its manufacturing facilities in Turin.

For more information on FATA products and services, please contact: FATA EUROPE, 100, The Quadrant, London W1A 0AA, UK. Tel: 01-494 4444. Fax: 01-494 4445. Telex: 320421 FATA I.



As part of its on going engineering research programme, Fataaluminum has developed advanced gravity casting equipment. This product incorporates the sophisticated features now needed to fulfill the increasingly complex and tight dimensional requirements imposed by the automotive industry. The company has been successful in 1986 in the Soviet Union and, in the United States, has a contract for the supply of 15 automated casting cells for the new Teksid plant in Tennessee which are to produce cylinder heads and manifolds.

The Engineering division includes New Hunter and management of turnkey engineering projects, such as the spare parts and tools factories project in Ethiopia. In 1986, New Hunter secured a number of major orders including two significant contracts in the Soviet Union, a \$50 million order for equipment to produce a wide range of food packaging material at Khabarovsk and a \$4 million contract for food separation plant in

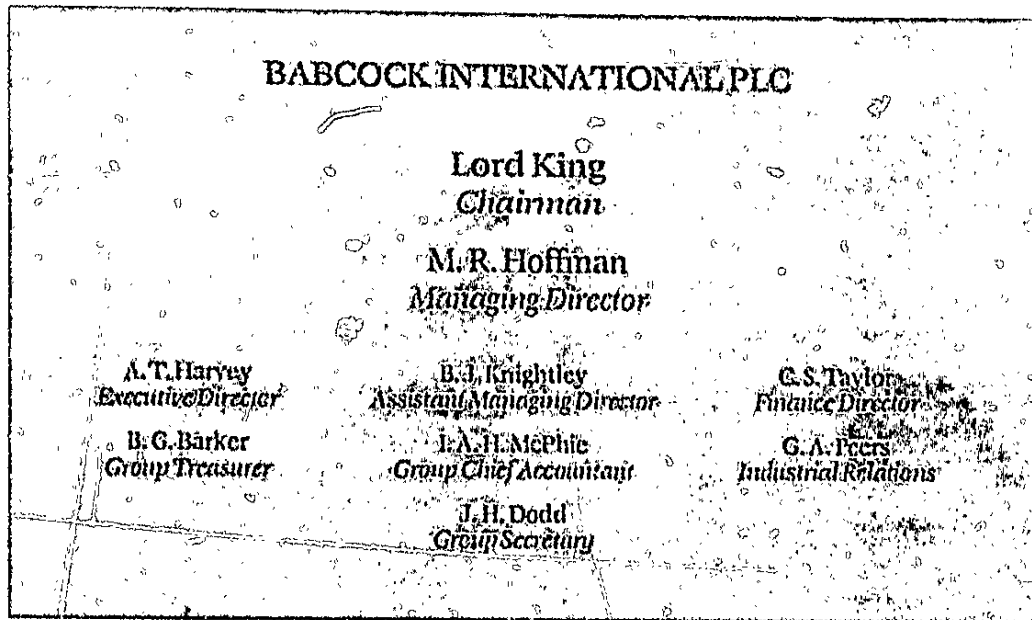
product plant in Russia. The acquisition, early in 1987, of the Hunter business in North America makes FATA a major international force in aluminum and food processing technology. The Ethiopian contract is proceeding on schedule for completion in 1988.

Froude Consulting has merged its technology with that of FATA very successfully as demonstrated by the delivery in 1986 of two large engine testing systems for airports in the United States. The systems use FATA ATAS to deliver engines and combine on test stands. Froude Consulting directed digital control technology leads the world in engine and vehicle system testing and during 1986, systems were commissioned at many of the prime power stations and engine test laboratories throughout Europe. Orders for control and test systems for engine control systems at FTA, Froude Consulting delivered a total of 100 test stands for supply systems to test the engine test systems and

Froude Engineering has continued to expand its business in North America. Contracts completed include systems for Cadillac, Oldsmobile, Volvo, White and GM Technical Center. The business has avoided total dependence upon the automobile sector with orders from the aircraft industry which have been a major source of profit for Allison Gas Turbines. The product base of the Froude group was expanded further by the acquisition of the Geo Power business.

The FATA Group and Group showed a considerable increase in profitability in 1986 over 1985 and all parts of the group contributed to the positive change.

GROUP EXECUTIVE



Energy Group

R. H. Campbell
Managing Director

P. R. McAinsh
Deputy Managing Director

J. H. Lace
Managing Director - Power

Industrial and Electrical Products Group

A. T. Harvey
Managing Director - Mining

A. P. C. Thomson
Managing Director - Industrial and Electrical Products

North American Group

D. F. Flint
Executive Vice-President

W. B. Pipp
President - Material Handling

D. E. Hess
President - Chain and Forged Products

W. F. Wheeler III
President - Cable Controls

A. S. Neiny
President - Automotive Hardware

E. R. Draheim
President - Engineered Hardware

J. W. Withers
President - Decorative Hardware

J. R. Jones
President - Process Control

Contracting Group

G. R. Goyan
Managing Director

Overseas Group

R. A. Arthur
Deputy Chairman - Babcock Africa

H. E. Weir
Managing Director - Babcock Australia

J. Heilenkötter
Managing Director - Claudius Peters

FATA European Group

G. Di Rosa
President - FATA

R. C. White
Managing Director - Froude Consine

REPORT OF THE DIRECTORS

The directors submit their report and the audited accounts for the financial year ended 28th December 1986.

PROFITS AND DIVIDENDS

The profit attributable to members, before extraordinary items, is from which has to be deducted: extraordinary items

leaving a profit of from which has to be deducted: preference dividends interim ordinary dividend of 4.0p per share paid on 13th October 1986

the directors recommend: a final dividend of 4.7p per share

leaving a balance to be transferred to reserves of

£000

£000

21,934

3,149

18,485

66

5,358

5,124

13,061

6,296

6,765

the business and undertaking of its subsidiary, Go-Power Corporation, a leading designer and manufacturer of dynamometers. The cash consideration amounted to \$1,058,000 of which \$106,000 is payable in 1987.

La Société Des Câbles Du Mans
On 1st January 1987 La Télédynamique SA acquired from Bendix France the whole of the issued share capital of La Société Des Câbles Du Mans for a consideration of FF 22.5 million. The principal activity of La Société Des Câbles Du Mans is the manufacture of heavy duty cables for the motor industry, complementing the light duty cables produced by La Télédynamique SA.

Hunter Engineering Company Incorporated
On 16th January 1987 the Company, through its USA subsidiary Babcock International Inc, purchased from Hunter Engineering Company Inc its business in the design and construction of machinery and plants for the production and coating of aluminium sheet and foil. The acquisition involved the transfer of full title to the name "Hunter", all intellectual property rights and certain tangible assets, together with all of the key personnel engaged in the business. The total consideration, payable in cash, part of which is deferred, was agreed in the amount of \$6,311,206. The business is now operated from Riverside, California, by a new subsidiary of Babcock International Inc named Hunter Engineering Co Inc, within the management structure of the FATA European Group.

Babcock-Hitachi KK

By an agreement dated 17th February 1987 Hitachi Limited undertook to purchase the whole of the Company's investment of 1.2 million shares in Babcock-Hitachi KK, representing 20 per cent of its issued share capital, for a consideration of ¥8,520 million. Half the total consideration will be paid with the transfer of 600,000 shares on 1st April 1987 and the balance with the transfer of 600,000 shares on 30th September 1987. At 28th December 1986 the net book value of the investment was £26.3 million. The share of its profit before tax, brought into account for that year, amounted to £5,085,000 on which the provision for Japanese taxation was £2,966,000. It is anticipated that for taxation purposes the profit arising on disposal will be fully relieved by available capital losses. Babcock-Hitachi KK will cease to qualify as an associated company from 1st April 1987.

PRINCIPAL ACTIVITIES

The principal activities of the Group are in contracting and the manufacture and supply of engineering products and equipment to manufacturers and users of capital goods. The statements by the Chairman and Managing Director on pages 4 to 7 include a review of the business and financial performance of the Group in 1986 and the review of operations on pages 8 to 20 contains references to the performance of individual operating groups.

ACQUISITIONS AND DISPOSALS

Babcock Sweepers Limited

On 9th April 1986 Babcock Industrial & Electrical Products Limited sold to Johnson Engineering Limited the whole of the issued share capital of Babcock Sweepers Limited for a consideration of £636,000.

Gloucester Railway Carriage & Wagon Company Limited

On 16th August 1986 Babcock Industrial & Electrical Products Limited sold to Powell Duffryn plc the whole of the issued share capital of Gloucester Railway Carriage & Wagon Company Limited for a consideration of £329,000.

Montpelier Foundry Pty Limited

On 5th September 1986 Babcock Australia Holdings Limited acquired through a subsidiary company the whole of the issued share capital of Montpelier Foundry Pty Limited, Tasmania. The total cost, including the discharge of borrowings, amounted to A\$1.8 million. This acquisition enhances the business of Babcock Water Industries in the manufacture of castings and fittings for water reticulation systems in Australia.

Go-Power Corporation

Under an agreement dated 30th September 1986, Froude Engineering Inc acquired from Buck Engineering Company Inc

DIRECTORS

The names of the directors are set out on page 3. Mr D. Parvin also served as a director during the year until his resignation on 11th February 1986.

Mr C. S. Taylor, who was appointed to the Board on 11th November 1986, will retire under the provisions of Article 96 and, being eligible, will offer himself for re-election at the annual general meeting. Mr Taylor is an executive director of the Company and his employment is subject to termination by one year's prior written notice, given by either party.

The directors retiring by rotation are Lord King, Mr G. S. Stone and Mr A. T. Harvey who, being eligible, offer themselves for re-election.

Lord King is an executive director of the Company and has a service contract of three years expiring on 31st December 1988.

Mr G. S. Stone is a non-executive director of the Company and, as such, does not have a service contract. Special notice has been given of the intention to propose his re-election.

Mr A. T. Harvey is an executive director of the Company and has a service contract, subject to termination by two calendar years' prior written notice, given by either party.

DIRECTORS' INTERESTS

None of the directors was materially interested at any time during the year, or at the year-end, in any contract with the Company or any of its subsidiaries which was significant in relation to the Group's business.

The interests, all of which were beneficial, of the directors and their families in the share capital of the Company at 29th December 1985, or subsequent date of appointment, and 28th December 1986 were as follows:

	Ordinary shares of 25p 28th December 1986	29th December 1985
Lord King	1,269,875	1,153,900
Sir Frank Cooper	1,815	1,650
M. R. Hoffman	2,310	2,100
R. H. Campbell	16,940	15,400
A. T. Harvey	1,100	1,000
Sir George Jefferson	2,420	2,200
B. J. Knightley	60,500	55,000
The Rt Hon G. E. Parkinson	2,750	2,500
G. S. Stone	24,200	22,000
G. S. Taylor	5,000	5,000
(appointed 11th November 1986)		

Options, all of which were beneficial, were held by the directors given below over ordinary shares of 25p of the Company as follows:

	28th December 1986	29th December 1985
Lord King	200,000	-
M. R. Hoffman	222,543	200,000
R. H. Campbell	114,675	104,250
A. T. Harvey	91,300	-
B. J. Knightley	119,625	108,750

On 2nd June 1986, all shareholdings and options held by the directors (excluding Lord King's option which was granted on 22nd September 1985) were adjusted upon the Company's capitalisation issue.

There have been no changes in the directors' interests since 28th December 1986.

RESEARCH AND DEVELOPMENT

The Group's management recognises the emphasis which needs to be placed on research and development activities to enhance, or simply to maintain, the competitive position of the Group's products and processes in their respective market places. For this reason, research and development projects feature as an integral part of the Group's business planning procedures.

FIXED ASSETS

The Group's properties were purchased at various dates over a number of years and some have since been revalued. Their aggregate present value is considered by the directors to be in excess of their book values at 28th December 1986.

The movement in fixed assets during the year and information on property revaluations are shown in notes 54 to 16 on pages 35 to 27.

DONATIONS

Donations made by the Group during the year for charitable purposes in the United Kingdom amounted to £28,142. A donation of £10,000 to the City and Industrial Liaison Council may be considered to have been given for political purposes, as defined by the Companies Act 1985.

EMPLOYMENT OF DISABLED PERSONS

The policy and practice of the Group is to seek to encourage and assist the employment of disabled persons, subject to their ability to perform the duties of the job without exposing themselves or other employees to abnormal risk. The training, career development and promotion of disabled persons is similarly encouraged and assisted. Arrangements are made, wherever possible, for retraining employees who become disabled to enable them to perform work identified as appropriate to their aptitudes and abilities.

REPORT OF THE DIRECTORS CONTINUED

EMPLOYEE INVOLVEMENT

The directors believe that it is essential to enlist the constructive participation of employees in promoting the productivity, competitiveness and prosperity of the Group, as employee involvement promotes industrial efficiency and good industrial relations.

Babcock employees are informed of the Group's progress through the Company newspaper 'Babcock World', which is issued quarterly, and the 'Employees' Review of the Annual Report'.

Within operating groups, employees are kept informed of the financial and economic factors affecting the performance of their company and their views are sought on matters which affect them as employees. The means by which this is achieved varies throughout the Group, but usually includes the issue of company newsletters and periodic meetings between the management and employees and where appropriate their trade union representatives. Employees are consulted through joint working parties, productivity committees, quality circles and joint consultative committees, on ways of improving the productivity of their operating group.

In addition to economic and financial factors, employees are consulted on matters relating to their working environment and to employee benefits generally through local staff consultative committees and the Group Pensions Advisory Committee.

All employees are encouraged to join the Company's Savings Related Share Option Scheme and, following the issue of a second invitation in 1986, the current number of participants is 1,307 which represents 10.6% of UK employees.

Copies of the report lodged with the Department of Trade and Industry under the new Code of Conduct for companies with interests in South Africa are available upon request from the Secretary at Cleveland House.

SUBSTANTIAL SHAREHOLDINGS

The following have notified the Company that their holdings are 5% or more of the undermentioned classes of ordinary and preference capital carrying unrestricted voting rights:

Ordinary share capital (issued 133,964,863)	No of shares	Percentage held
Prudential Corporation group of companies	7,745,000	5.8
5% cumulative second preference stock (issued £183,056)		
Mr G. G. De Vine	10,000	5.5
Guardian Royal Exchange plc	38,000	20.8
The Investment Company plc	39,500	21.6
Natwest Nominees Ltd	24,875	13.6
Wesleyan and General Assurance Society	21,900	12.0
6% cumulative preference stock (issued £100,000)		
The Investment Company plc	45,000	45.0
Guardian Royal Exchange plc	20,000	20.0
Mrs B. K. Whitehouse	5,000	5.0

ANALYSIS OF ORDINARY SHAREHOLDERS
AND SHAREHOLDINGS

As at 28th December 1986 the ordinary shareholdings were analysed as follows:

Category	Number	%	Holdings	%
Individuals	9,293	90.4	22,834,213	17.1
Banks and nominee holdings	557	5.4	30,835,135	23.0
Insurance companies	137	1.3	20,651,571	15.4
Other corporate	90	0.9	18,131,220	13.6
Investment trusts	101	1.0	22,830,651	17.0
Pension funds	42	0.4	15,073,820	11.3
Others	61	0.6	3,608,253	2.7
	<u>10,281</u>	<u>100.0</u>	<u>133,964,863</u>	<u>100.0</u>

Size of holding	Number	%	Holdings	%
1 - 700	2,650	25.8	956,608	0.7
701 - 1,400	2,685	26.1	2,812,336	2.1
1,401 - 2,500	2,359	22.9	4,582,070	3.4
2,501 - 100,000	2,398	23.3	20,269,000	15.1
100,001 - 1,000,000	163	1.6	49,796,904	37.2
over 1,000,000	26	0.3	55,547,945	41.5
	<u>10,281</u>	<u>100.0</u>	<u>133,964,863</u>	<u>100.0</u>

ANNUAL GENERAL MEETING EXPLANATION OF SPECIAL BUSINESS

The first item of special business is concerned with the annual renewal of the directors' power to issue for cash, other than to existing shareholders,

i) such shares as may be necessary in connection with a rights issue to deal with fractional entitlements and difficulties arising from overseas shareholders and

ii) shares up to a total nominal amount of £2,150,000, representing 5% of the issued ordinary share capital and the £9,500,000 unissued ordinary shares available to directors to issue generally.

The Stock Exchange has recently relaxed its rules on issues of equity for cash other than *pro rata* to existing shareholders so as no longer to require prior approval from shareholders for actual issues when they arise, or for the terms on which such issues are to be made, provided that the requisite general authority from shareholders is obtained.

The directors have the shareholders' authority to allot generally securities of the Company up to and including 23rd May 1991.

The other item of special business concerns the amendment to the Rules of the Babcock Savings Related Share Option Scheme (1984). Under the present rules, participants who leave the Group, upon the sale of their Group company or business, can exercise their option within 6 months of their departure, provided the option has been held for over 3 years. A resolution is to be proposed to authorise the directors to amend Rule 5(b)(v) by removing the 3 year restriction. The alteration to the legislation making this possible was introduced by the Finance Act 1986 and, if approved, the amendment will bring the Scheme's rules into line with the rules of the Company's Executive Share Option Schemes.

TAXATION

The Company is not, and has not been, a close company within the meaning of the Income and Corporation Taxes Act 1970 (as amended).

For the purpose of capital gains tax, the market values of the Company's share capital at 6th April 1965 and 31st March 1982, adjusted for subsequent issues, were:

	6th April 1965	31st March 1982
Ordinary shares	25.03p	83.47p
6% cumulative preference stock	84p	33.5p
5% cumulative second preference stock	71p	28.5p
4% cumulative redeemable preference stock	55p	33.5p

AUDITORS

A resolution to reappoint the auditors, Coopers & Lybrand, will be proposed at the annual general meeting.

By order of the Board
J. H. Dodd
Secretary

24th March 1987

CONSOLIDATED PROFIT AND LOSS ACCOUNT

FOR THE FINANCIAL YEAR ENDED 28TH DECEMBER 1985

	Note	1986 £000	1985 £000
TURNOVER	1 and 2	1,217,648	1,098,926
TRADING PROFIT	3 and 4	37,836	33,616
Income from investments	7	470	863
Interest payable (net)	8	38,306 (8,103)	34,479 (5,349)
Share of profits less losses of associated companies	9	30,203 2,883	29,130 5,419
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	1	35,086	34,549
Tax on profit on ordinary activities	10	(14,969)	(10,416)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION		22,117	24,133
Profit attributable to minority interests		(183)	(179)
PROFIT BEFORE EXTRAORDINARY ITEMS		21,934	23,954
Extraordinary items	11	(3,449)	(392)
PROFIT FOR THE FINANCIAL YEAR		18,485	23,562
PREFERENCE DIVIDENDS		(66)	(66)
ORDINARY DIVIDENDS	12	(11,654)	(10,213)
RETAINED PROFIT FOR THE YEAR		6,765	13,283
Earnings per ordinary share	13	163p	179p
STATEMENT OF RETAINED EARNINGS	25		
Opening balance		124,539	134,284
Currency adjustments		11,392	(21,911)
Goodwill written off		(2,877)	(1,112)
Retained profit for the year		6,765	13,283
Closing balance		139,819	124,539

The accounting policies are set out on page 30.
The notes to the accounts are set out on pages 31-43.
The auditors' report is set out on page 43.

CONSOLIDATED BALANCE SHEET

AT 28TH DECEMBER 1986

	Note	1986 £000	1985 £000
FIXED ASSETS			
Tangible assets	14	155,569	151,867
Investments	16	33,335	35,336
		<u>188,904</u>	<u>180,203</u>
CURRENT ASSETS			
Stocks	17	213,319	226,194
Debtors	18	249,595	230,067
Deposits and marketable securities	22	102,110	10,595
Cash at bank and in hand		71,608	45,625
		<u>636,630</u>	<u>512,481</u>
CREDITORS - amounts falling due within one year	19	<u>496,472</u>	<u>370,285</u>
NET CURRENT ASSETS		<u>140,158</u>	<u>142,196</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>329,062</u>	<u>322,399</u>
less:			
CREDITORS - amounts falling due after more than one year	20	122,118	129,872
PROVISIONS FOR LIABILITIES AND CHARGES	23	<u>9,418</u>	<u>10,958</u>
		<u>131,536</u>	<u>140,830</u>
TOTAL NET ASSETS		<u>197,526</u>	<u>181,569</u>
CAPITAL AND RESERVES			
Called up share capital	24	35,774	32,684
Share premium account	25	9,360	12,191
Revaluation reserve	25	11,953	11,848
Profit and loss account	25	139,819	124,589
		<u>196,906</u>	<u>181,262</u>
MINORITY INTERESTS		<u>620</u>	<u>307</u>
TOTAL CAPITAL EMPLOYED		<u>197,526</u>	<u>181,569</u>

Approved by the Board of Directors on 24th March 1987

KING

M. R. HOFFMAN

Directors

K
M R Hoffman

The accounting policies are set out on page 30.
The notes to the accounts are set out on pages 31-43.
The auditors' report is set out on page 43.

BALANCE SHEET

AT 28TH DECEMBER 1986

Co No 65805

	Note	1986 £000	1985 £000
FIXED ASSETS			
Tangible assets	14	610	713
Investments - group companies	15	137,146	144,572
- other	16	5,170	1,682
		<u>142,926</u>	<u>146,967</u>
CURRENT ASSETS			
Debtors	18	78,110	79,512
Deposits		3	38
Cash at bank and in hand		<u>4,757</u>	<u>1,511</u>
		82,870	81,061
CREDITORS - amounts falling due within one year	19	<u>60,567</u>	<u>56,136</u>
NET CURRENT ASSETS		<u>22,303</u>	<u>24,925</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>165,229</u>	<u>171,892</u>
less:			
CREDITORS - amounts falling due after more than one year	20	<u>26,982</u>	<u>31,411</u>
TOTAL NET ASSETS		<u>138,247</u>	<u>140,481</u>
CAPITAL AND RESERVES			
Called up share capital	24	35,774	32,684
Share premium account	25	9,360	12,191
Profit and loss account	25	<u>93,113</u>	<u>95,606</u>
TOTAL CAPITAL EMPLOYED		<u>138,247</u>	<u>140,481</u>

Approved by the Board of Directors on 24th March 1987

KING

M. R. HOFFMAN

Directors

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M. R. Hoffman

The accounting policies are set out on page 30.
The notes to the accounts are set out on pages 31-43.
The auditors' report is set out on page 43.

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

FOR THE FINANCIAL YEAR ENDED 28TH DECEMBER 1986

	1986 £000	1985 £000
FUNDS FROM OPERATIONS		
Profit for the financial year	18,485	23,562
Adjustments for items not involving the movement of funds:		
Retained profits of associated companies	(1,821)	(458)
Minority interests	347	88
Deferred taxation	(2,000)	(1,704)
Decrease/(increase) in working capital	8,712	(2,074)
Movement in tangible fixed assets:		
Expenditure	(23,045)	(36,980)
Disposals	3,042	3,956
Depreciation	21,820	23,115
	1,817	91
SURPLUS/(DEFICIT) FROM OPERATIONS	25,540	(1,545)
DIVIDENDS PAID	(10,774)	(10,154)
OTHER MOVEMENTS:		
Issue of ordinary shares	259	124
Purchase of investments (net)	(989)	(231)
Acquisitions and disposals of subsidiaries (net)	(176)	(32,979)
	(906)	(33,086)
INCREASE/(DECREASE) IN LIQUIDITY	13,860	(44,785)
Reflected by:		
Increase/(decrease) in net liquid funds	6,449	(28,405)
Decrease/(increase) in loans	7,411	(16,380)
	13,860	(44,785)

RECONCILIATION OF MAJOR BALANCE SHEET MOVEMENTS

	Actual difference £000	Balance sheet movements Currency translation effect £000	At constant exchange rates £000	Net effect of acquisitions/ disposals of subsidiaries £000	Movements in funds £000
Tangible fixed assets	702	(2,065)	(1,363)	(454)	(1,817)
Investments	7,999	(5,189)	2,810	-	2,810
	8,701	(7,254)	1,447	(454)	993
Working capital:					
Stocks	(12,875)	(4,956)	(17,831)	(454)	(18,285)
Debtors	19,528	(12,071)	7,457	(184)	7,273
Creditors - current	(20,337)	16,565	(3,772)	2,601	(1,171)
- non current	2,023	1,448	3,471	-	3,471
	(11,661)	986	(10,675)	1,963	(8,712)
Net liquid funds:					
Deposits and marketable securities	91,515	(664)	90,851	-	90,851
Cash at bank and in hand	25,981	(7,210)	18,771	(55)	18,716
Bank overdrafts and loans (current)	(104,904)	1,705	(103,199)	81	(103,118)
	12,592	(6,169)	6,423	26	6,449
Loans	6,003	242	6,245	1,166	7,411
	18,595	(5,927)	12,668	1,192	13,860
Increase/(decrease) in liquidity					
Goodwill				(2,877)	
Cash paid (net)				(176)	

ACCOUNTING POLICIES

BASIS OF ACCOUNTING

The accounts have been prepared under the historical cost convention, modified to include the revaluation of land and buildings.

As permitted by the Companies Act 1985, no profit and loss account is presented for the Company.

BASIS OF CONSOLIDATION

The Group accounts comprise consolidation of the accounts of the Company and its subsidiaries at 28th December 1986. The principal subsidiaries are listed on pages 44 and 45. The profits and losses of subsidiaries acquired or disposed of during the year are consolidated from or to their respective dates of acquisition or disposal.

The difference between the net assets at date of acquisition and cost of shares in subsidiaries, being either goodwill or acquisition reserve, is taken to retained earnings in the year of acquisition.

In accordance with SSAP 1, the Group accounts include the appropriate proportion of the results of the principal associated companies.

FOREIGN CURRENCIES

Foreign currency values in the profit and loss accounts and balance sheets of subsidiary and associated companies are translated into sterling at the rates of exchange ruling at the Group's accounting date.

Differences on the retranslation of foreign currency assets and liabilities, including differences on net assets of overseas subsidiary and associated companies, arising from exchange fluctuations between the beginning and the end of the financial year are dealt with separately in the statement of retained earnings at the foot of the consolidated profit and loss account.

Exchange differences relating to trading transactions during the year are included in profit on ordinary activities before taxation.

TURNOVER

Turnover, which excludes sales between Group companies and value added and similar taxes, comprises:

- i) contract work - the sales value of work done and services rendered, calculated by reference to the total sales value of each contract;
- ii) sales (other than contract sales) of goods and services - at invoiced value;
- iii) fees for technical aid and other services rendered.

CONTRACT RESULTS

A major part of the activity of the Group comprises long term contracts, many of which by their nature involve advanced engineering techniques. Such contracts are subject to regular detailed financial and technical reviews to determine the estimated costs to completion, including provisions for contingencies. A proportion of profits earned on contracts is credited in the accounts on a prudent basis as work progresses, according to the stage of completion. Full provisions are made in respect of foreseeable losses on uncompleted contracts.

INVESTMENT INCOME

Income is included on the basis of dividends receivable during the year.

RESEARCH AND DEVELOPMENT

Expenditure is charged against profit as incurred.

TAXATION

The charge for United Kingdom taxation represents the liability which it is estimated will materialise as a payment of corporation tax on the profits of the year or as advance corporation tax on dividends declared for the year. Overseas taxation is based on profits of overseas subsidiaries and on other overseas income.

Provision is made for deferred taxation on all timing differences where it is considered that a liability may arise in the foreseeable future.

FIXED ASSETS

Freehold and leasehold properties, plant, machinery and equipment are stated at cost or at valuation less depreciation written off. The term 'cost' in this context represents original cost when first purchased by a Group company, less, where appropriate, the amount of United Kingdom investment and regional development grants received or receivable.

Depreciation is charged on cost or valuation on a straight line basis at rates appropriate to the expected useful lives of the assets concerned. In the case of fixed assets acquired for specific contracts, depreciation is charged direct to the contract.

The principal rates of depreciation used are:

Freehold land	Not depreciated
Freehold buildings	2%
Long leasehold land	Over period of lease
Long leasehold buildings	2%
Short leasehold properties	Over period of lease
Plant and machinery - heavy production	6 1/2%
- other	10%
Motor vehicles	20%
Office equipment and furniture	10%

LEASED ASSETS

Assets purchased under hire-purchase agreements are capitalised and depreciated using the rates shown above. Rental and finance charges relating to leased assets, including those held on finance leases, are written off as they fall due.

STOCKS AND WORK IN PROGRESS

Stocks are valued at the lower of cost and net realisable value.

Work in progress is valued at cost, plus a proportion of profits earned on contracts, less any provisions necessary to reduce to net realisable value.

Cost comprises direct materials and, in the case of work in progress, direct labour and works overheads, including depreciation, but excludes selling and administration costs.

Amounts invoiced on account of contracts are deducted from work in progress. Such amounts which have been received and exceed work in progress are included in creditors. Contract provisions in excess of work in progress are similarly treated.

NOTES TO THE ACCOUNTS

1 ANALYSIS OF TURNOVER AND PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	1986 Turnover £000	1985 Turnover £000	1986 Profit/(loss) £000	1985 Profit/(loss) £000
Energy Group	287,699	282,482	4,183	5,017
Contracting Group	84,869	80,062	3,957	3,678
Industrial and Electrical Products Group	89,456	86,395	1,667	(3,343)
Overseas Group	170,153	145,876	942	1,700
North American Group	436,110	410,585	22,942	22,585
FiTA European Group	149,361	93,546	4,393	(992)
Group miscellaneous (expenditure), Income*			(248)	4,971
	<u>1,217,648</u>	<u>1,098,926</u>	<u>37,836</u>	<u>33,616</u>
Income from investments			470	863
Interest payable (net)			(8,103)	(5,349)
Share of profits less losses of associated companies			6,883	5,419
			<u>37,086</u>	<u>34,549</u>

*In 1985, Group miscellaneous income included a credit in respect of pension contributions amounting to £6,016,000. This arose as a consequence of the employers' contribution to the Babcock Group Staff Pension Scheme being excused for one year, following an actuarial valuation of the Scheme.

The subsidiary companies whose results are included above are listed on pages 44 and 45.

2 GEOGRAPHICAL ANALYSIS OF TURNOVER

A geographical analysis of the Group turnover by area of destination is as follows:

	1986 £000	1985 £000
United Kingdom	310,526	302,312
North America	451,734	399,690
Europe	158,194	109,684
Africa	123,951	130,934
Asia	120,534	101,632
Australasia	26,365	20,062
Middle East	15,815	25,552
Other areas	10,529	9,060
	<u>1,217,648</u>	<u>1,098,926</u>

Exports from the United Kingdom during the year amounted to £182,375,000 (1985: £185,754,000).

3 TRADING RESULTS

	1986 £000	1985 £000
Turnover	1,217,648	1,098,926
Cost of sales	<u>1,065,768</u>	<u>961,528</u>
Gross profit	151,880	137,398
less:		
Distribution costs	14,279	12,772
Administrative expenses	<u>99,765</u>	<u>91,010</u>
Trading profit	<u>37,836</u>	<u>33,616</u>

NOTES TO THE ACCOUNTS CONTINUED

4 TRADING PROFIT

	1986 £000	1985 £000
Trading profit is shown after charging:		
Depreciation of tangible fixed assets	21,820	23,115
Redundancy costs	7,158	4,835
Auditors' remuneration (Company £74,000) (1985 £71,000)	1,175	1,145
Hire of plant and machinery:		
Under operating leases	4,104	3,818
Other	3,009	2,399
Other operating lease rentals	2,661	2,542
Emoluments of the directors of the Company:		
Fees	83	98
Managerial services including pension scheme contributions	417	684
Performance related incentive payments*	71	90
Pension to former director	2	2
and after crediting:	573	874
Net surplus on disposal of properties	1,144	581

*The performance related incentive payments to executive directors (including the chairman and highest paid director) were determined by the application of the scheme adopted by the Board in 1985. The 1985 comparative figures above and in note 5 have been re-stated to include payments in 1986, relating to 1985, which were not determinable at the time the Board approved the 1985 accounts. The 1986 amounts have been determined and are shown above.

5 DIRECTORS' EMOLUMENTS

The emoluments (excluding pension scheme contributions) of the chairman and the highest paid director resident in the United Kingdom were as follows:

	1986 £	1985 £
Chairman	106,530	107,419
Highest paid director	129,552	113,709

The emoluments (excluding pension scheme contributions) of the other directors resident in the United Kingdom were within the ranges:

	1986 Number	1985 Number
Not more than £5,000	-	1
£5,001 to £10,000	3	3
£10,001 to £15,000	2	-
£15,001 to £20,000	1	2
£20,001 to £25,000	-	1
£25,001 to £30,000	-	1
£30,001 to £35,000	1	-
£35,001 to £40,000	1	2
£40,001 to £45,000	1	1

6 EMPLOYEE INFORMATION

i) The average number of persons (including executive directors) employed in each of the principal businesses of the Group during the year was as follows:

	1986 Number	1985 Number
Energy Group	8,415	8,448
Contracting Group	1,409	1,303
Industrial and Electrical Products Group	2,375	2,859
Overseas Group	3,404	3,751
North American Group	3,497	8,548
FATA European Group	1,618	1,289
Central	68	29
	25,806	26,185

ii) The aggregate employment costs of these persons amounted to:

	1986 £000	1985 £000
Wages and salaries	333,600	310,229
Social security costs	30,994	26,452
Other pension costs	13,824	12,088
	<u>378,418</u>	<u>348,769</u>

iii) The number of employees in the United Kingdom (excluding directors) having emoluments within the following ranges was:

	1986 Number	1985 Number
£30,001 to £35,000	15	25
£35,001 to £40,000	16	8
£40,001 to £45,000	5	4
£45,001 to £50,000	3	1
£50,001 to £55,000	1	2
£55,001 to £60,000	2	1
£60,001 to £65,000	1	-
£65,001 to £70,000	-	1

7 INCOME FROM INVESTMENTS

	1986 £000	1985 £000
Dividends:		
Listed investments	52	35
Unlisted investments	306	467
Profit on sale of investments	112	361
	<u>470</u>	<u>863</u>

8 INTEREST PAYABLE (NET)

	1986 £000	1985 £000
Interest payable on bank loans, overdrafts and other loans:		
Repayable within five years - by instalment	937	758
- not by instalment	18,089	11,716
Other	1,838	1,652
	<u>20,864</u>	<u>14,166</u>
Less:		
Interest receivable on deposits	12,165	7,550
Interest relief grants	596	1,267
	<u>8,103</u>	<u>5,349</u>

9 ASSOCIATED COMPANIES

The principal associated companies (all unlisted) in which the Group has an interest of 20 per cent or more of the equity are included in this list of principal Group companies on pages 44 and 45.

	1986 £000	1985 £000
The Group's share of profits less losses of such companies was:	6,883	5,419
Taxation	3,599	3,747
	<u>3,284</u>	<u>1,672</u>
Receivable in dividends	1,163	1,214
Retained by associated companies	1,821	458

The Group's share of the results of associated companies is based upon accounts drawn up to dates varying from 30th September 1986 to 31st December 1986. Where audited accounts were not available, unaudited management accounts were used. The directors are of the opinion that such unaudited accounts are reliable.

NOTES TO THE ACCOUNTS CONTINUED

10 TAX ON PROFIT ON ORDINARY ACTIVITIES

	1986 £000	1985 £000
United Kingdom taxation:		
Corporation tax	2,590	2,079
Double taxation relief	(3,315)	(1,955)
Deferred taxation	(4,193)	(795)
Advance corporation tax written off	7,115	2,863
	<u>2,197</u>	<u>1,192</u>
Overseas taxation (including deferred taxation)	<u>9,173</u>	<u>5,477</u>
	<u>11,370</u>	<u>6,669</u>
Associated companies:		
United Kingdom corporation tax	376	376
Overseas taxation	<u>3,223</u>	<u>3,371</u>
	<u>14,969</u>	<u>10,416</u>

United Kingdom corporation tax has been provided at the composite rate of 36.25 per cent (1985: 41.25 per cent).

The charge for United Kingdom taxation has been reduced in respect of overprovisions in previous years of £1,931,000 (1985: £176,000) for corporation tax and increased by £216,000 (1985: reduced by £735,000) for deferred taxation.

The Group's share of the undistributed profits of overseas subsidiary and associated companies would be liable to United Kingdom and overseas taxation if distributed as dividends.

There are accumulated taxation losses, estimated at £12,721,000 (1985: £11,582,000), for United Kingdom companies and £6,476,000 (1985: £8,000,000) in respect of overseas companies in the United States, West Germany and Holland, which are available for relief of taxation on future profits of those companies.

11 EXTRAORDINARY ITEMS

	1986 £000	1985 £000
Losses arising on closure and disposal of businesses and subsidiary companies, net of tax credit of £514,000	<u>3,449</u>	<u>392</u>

12 ORDINARY DIVIDENDS

	1986 p per share	1985 p per share	1986 £000	1985 £000
Final dividend for 1984 paid on ordinary shares issued between 27th March and 26th April 1985	-	-	-	1
Interim dividend 1986	4.0	4.0	5,358	4,863
Proposed final dividend for 1986	4.7	4.4	6,296	5,350
Total	<u>8.7</u>	<u>8.4</u>	<u>11,654</u>	<u>10,213</u>

13 EARNINGS PER ORDINARY SHARE

Earnings per ordinary share are calculated on the 'net' basis on attributable profits of £21,868,000 (1985: £23,888,000) after deducting preference dividends but before taking account of extraordinary items, and on 133,872,213 (1985: 133,707,407) ordinary shares, being the average number of shares in issue during the year. The average numbers of shares in 1986 and 1985 have been adjusted for the capitalisation issue in 1985. On the 'nil distribution' basis earnings per ordinary share would be 21.6 pence (1985: 20.0 pence).

14. TANGIBLE FIXED ASSETS

	Freehold properties £000	Long £000	Leasehold Short £000	Plant machinery and equipment £000	Total £000
COMPANY					
Cost:					
Balances at 30th December 1985	419	76	3	727	1,225
Additions	200	-	-	209	409
Disposals	(227)	(76)	-	(222)	(525)
Balances at 28th December 1986	392	-	3	714	1,109
Depreciation:					
Balances at 30th December 1985	86	28	1	397	512
Charge for year	8	-	-	122	135
Disposals	-	(28)	-	(120)	(148)
Balances at 28th December 1986	94	-	1	404	499
Net book value at 28th December 1986	298	-	2	310	610
GROUP					
Cost or valuation:					
Balances at 30th December 1985	90,237	3,669	1,990	219,729	315,625
Currency adjustments	1,995	-	(14)	2,659	4,640
Acquisition of subsidiaries net of disposals	146	-	-	(23)	123
Additions	4,030	54	165	18,796	23,045
Disposals and reclassifications	(5,352)	(57)	(67)	(6,644)	(12,120)
Balances at 28th December 1986	91,055	3,666	2,074	234,517	331,313
Depreciation:					
Balances at 30th December 1985	10,766	556	866	141,644	161,832
Currency adjustments	696	-	(9)	1,062	2,549
Acquisition of subsidiaries net of disposals	(32)	-	-	(299)	(331)
Charges for year	3,299	39	56	18,426	21,820
Disposals and reclassifications	(3,137)	(18)	(67)	(5,796)	(9,018)
Balances at 28th December 1986	19,592	577	846	155,837	176,852
Net book value at 28th December 1986	71,464	3,089	1,228	78,680	154,461
Patents, trading rights, loose tools and equipment at cost, less amounts written off (1985: 1,074)					1,108
					155,569
Fixed assets which originally cost £68.4 million (1985: £62.9 million) were still in use at 28th December 1986 and retained in these accounts, although fully depreciated.					
The gross book values of Group properties comprise the following:	Freehold properties £000	Long £000	Leasehold Short £000	1986 £000	1985 £000
At professional valuation - in 1980	-	-	750	750	750
in 1982	15,245	-	-	15,245	14,992
At cost	75,811	3,666	1,324	80,801	80,154
	91,056	3,666	2,074	96,796	95,896
If properties had not been revalued, the book values would have been:					
Cost relative to the above gross book values	79,929	3,666	1,324	84,919	84,127
Depreciation	18,923	577	750	20,250	19,582
	61,006	3,089	574	64,669	64,545

NOTES TO THE ACCOUNTS CONTINUED

15 INVESTMENT IN GROUP COMPANIES

	Shares in Group companies £000	Loans to Group companies £000	Total £000
Cost:			
Balances at 30th December 1985	60,735	90,275	151,010
Currency adjustments	-	(13)	(13)
Disposals/repayments	(10)	(4,599)	(4,609)
Balances at 28th December 1986	60,695	85,663	146,358
Less provisions:			
Balances at 30th December 1985	2,373	4,065	6,438
Amounts provided in year	2,775	(1)	2,774
Balances at 28th December 1986	5,148	4,064	9,212
Net book value at 28th December 1986	55,547	81,599	137,146

Particulars of principal subsidiaries are shown on pages 44 and 45.

16 OTHER INVESTMENTS

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
The net book value of other investments includes:				
Shares in associated companies	2,597	-	29,672	22,661
Loans to associated companies	1,200	1,200	1,449	1,412
Other investments and loans	1,373	482	2,214	1,263
	5,170	1,682	33,335	25,336

Information relevant to these investments is as follows:

SHARES IN ASSOCIATED COMPANIES (all unlisted)

Cost or valuation:

	Company £000	Group £000
Balances at 30th December 1985	1,976	22,661
Currency adjustments	-	5,149
Additions	2,597	41
Share of retained profits less losses	-	1,821
Balances at 28th December 1986	4,573	29,672

Amounts written off:

Balances at 30th December 1985 and 28th December 1986	1,976	-
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Net book value at 28th December 1986

Group investments in associated companies are shown at cost, £6,002,000 (1985: £5,965,000), plus the Group's share of post acquisition retained profits, less amounts written off. The Group's share of attributable net assets of associated companies amounted to £32,813,000.

LOANS TO ASSOCIATED COMPANIES

Cost and net book value:

	Company £000	Group £000
Balances at 30th December 1985	1,200	1,412
Currency adjustments	-	37
Balances at 28th December 1986	1,200	1,449

OTHER INVESTMENTS AND LOANS

	Other investments £000	Company Loans £000	Other investments £000	Group Loans £000
Cost:				
Balances at 30th December 1985	20,021	2,449	20,802	2,449
Currency adjustments	-	-	3	-
Additions	901	-	1,100	-
Disposals	(10)	-	(152)	-
Balances at 28th December 1986	20,912	2,449	21,753	2,449
Amounts written off:				
Balances at 30th December 1985 and 28th December 1986	19,539	2,449	19,539	2,449
Net book value at 28th December 1986	1,373	-	2,214	-
	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000

The total cost and market value of investments listed on
The Stock Exchange and included above are:

Cost	1,368	467	1,368	467
Market value	1,297	555	1,297	555

The total cost and market value of investments listed on other
stock exchanges and included above are:

Cost	-	-	1	16
Market value	-	-	51	53

The market values of investments listed overseas are based on the prices in foreign currencies of the respective shares as quoted on the relevant stock exchanges at the end of each year, translated into sterling at the official rates of exchange in accordance with the Group's accounting policies.

The principal associated companies and trade investments are included in the list on pages 44 and 45.

17 STOCKS

	1986 £000	1985 £000
Long term contract work in progress	448,257	352,308
less: progress payments	369,518	272,407
	78,739	79,901
Other stocks and work in progress:		
Raw materials and consumables	40,014	47,860
Work in progress	79,499	91,431
Finished goods and goods for resale	27,770	22,943
	147,283	162,240
less: progress payments	12,703	15,947
	134,580	146,293
Total stocks	213,319	226,194

Long term contract work in progress includes:

- amounts for contracts where title in the goods does not pass until final acceptance;
- an element of profit in compliance with SSAP 9. After taking into account the effect of progress payments the net amount of profit added to the cost of work in progress is not material.

NOTES TO THE ACCOUNTS CONTINUED

18 DEBTORS

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Amounts falling due within one year:				
Trade debtors	-	-	189,215	178,365
Amounts owed by Group companies	66,087	62,103	-	-
Amounts owed by associated companies	-	-	6	4
Other debtors	144	636	22,153	10,337
Prepayments and accrued income	3,401	5,970	12,057	13,345
	<u>69,632</u>	<u>68,709</u>	<u>224,236</u>	<u>210,071</u>
Amounts falling due after more than one year:				
Trade debtors	-	-	10,511	11,272
Other debtors	8,478	9,214	14,119	6,792
Prepayments and accrued income	-	1,504	729	1,932
	<u>8,478</u>	<u>10,718</u>	<u>25,359</u>	<u>19,996</u>
Total debtors	<u>78,110</u>	<u>79,512</u>	<u>249,595</u>	<u>230,067</u>

19 CREDITORS - amounts falling due within one year

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Bank loans and overdrafts	47,007	44,915	147,476	43,921
Other loans	-	-	2,117	768
	<u>47,007</u>	<u>44,915</u>	<u>149,593</u>	<u>44,689</u>
Other creditors:				
Payments received on account	-	-	42,446	45,782
Trade creditors	-	-	138,739	132,454
Bills payable	-	-	2,794	2,709
Amounts owed to Group companies	21	29	-	-
Amounts owed to associated companies	-	-	14	24
Taxation	4,308	3,945	16,980	12,380
Social security	23	18	7,255	4,991
Other creditors	2,112	1,879	132,355	121,906
Proposed final ordinary dividend	6,296	5,350	6,296	5,350
	<u>60,567</u>	<u>56,136</u>	<u>496,472</u>	<u>370,285</u>

20 CREDITORS - amounts falling due after more than one year

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Bank loans:				
repayable between 1 and 2 years	586	2,040	2,854	80,657
repayable between 2 and 5 years	490	536	73,655	1,967
repayable after 5 years - by instalment	-	-	1,254	1,115
Other loans:				
repayable between 1 and 2 years	-	-	824	1,085
repayable between 2 and 5 years	-	-	2,546	2,407
repayable after 5 years - by instalment	-	-	4,834	5,552
- otherwise than by instalment	-	-	4,588	4,995
	<u>1,076</u>	<u>3,376</u>	<u>92,555</u>	<u>90,558</u>
Other creditors:				
Trade creditors	-	-	1,278	2,118
Amounts owed to Group companies	25,891	26,031	-	-
Taxation	15	4	1,199	1,263
Other creditors	-	-	27,086	27,931
	<u>26,962</u>	<u>31,411</u>	<u>123,118</u>	<u>129,872</u>
Total borrowings repayable by instalment, a part of which falls due after 5 years:				
Bank loans	-	-	2,421	1,703
Other loans	-	-	7,504	8,801

21 LOANS

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Debentures:				
Babcock Industrial & Electrical Products Limited 7% debenture stock 1985-90 (i)	-	-	194	199
Other loans:				
Babcock International Finance Corporation Commercial paper notes (ii)	-	-	69,863	77,023
Babcock Nederland BV 7% convertible guaranteed bonds 1992 (iii)	-	-	191	194
Babcock Industries Inc. Mortgages and loans (iv)	-	-	10,728	11,113
Other Group companies Mortgages and loans (v)	-	-	3,796	4,092
Bank loans (vi)	3,380	4,829	13,114	9,226
Bank overdrafts (vii) (viii)	45,503	43,462	144,262	41,351
	48,883	48,291	242,140	143,247
Less current portion	47,807	44,915	149,593	44,689
	1,076	3,376	92,555	98,558

- i) The 7% debenture stock 1985-90 of Babcock Industrial & Electrical Products Limited is secured by a floating charge over the assets of that company.
- ii) The commercial paper notes are issued in New York and are supported by a letter of credit issued by the leader of a consortium of banks. The same credit agreement provides Babcock International Finance Corporation with a revolving credit facility. The credit agreement expires in 1989. Various rates of interest are payable according to the market rate for commercial paper at the time of issue.
- iii) The 7% convertible guaranteed bonds due 1992 of Babcock Nederland BV are guaranteed as to payment of principal, premium (if any) and interest by the Company. The bonds are in bearer form in the denomination of US\$1,000 each. Unless previously redeemed or purchased, the bonds are convertible up to and including 15th September 1992 into fully paid ordinary shares of Babcock International plc at a conversion price, subject to amendment in certain events, of 103p per share with a fixed rate of exchange applicable upon conversion of US\$1,7432 = £1. The bonds may be redeemed in certain defined circumstances. Unless previously converted, redeemed or purchased the bonds will be redeemed at par on 15th October 1992. During 1986, in accordance with the above terms, bonds to a face value of US\$nil (1985: US\$20,000) were converted into ordinary shares of the Company.
- iv) Mortgages and loans of Babcock Industries Inc. bearing interest at rates varying from 2 to 9½ per cent, are redeemable at par at varying dates up to 2015. £10,691,000 (1985: £11,067,000) is secured by charges on assets.
- v) Mortgages and loans of other Group companies, bearing interest at rates varying from 5 to 16 per cent, are redeemable at par at various dates up to 1996. £3,146,000 (1985: £3,245,000) is secured by fixed and floating charges on the assets of those companies.
- vi) Bank loans are denominated chiefly in foreign currencies and bear interest at rates varying from 4 to 15.5 per cent and £570,000 (1985: £632,000) of the Group loans are secured.
- vii) The Group total includes £87.6 million (1985: £7.2 million) of currency borrowings which are matched by short term deposits and marketable securities (note 22). These borrowings, mostly in US dollars, were effected in Italy to cover forward exchange risks on future contract receipts denominated in the currencies concerned.
- viii) The directors believe that the facilities relating to bank overdrafts maturing in less than one year will be renewed.

22 DEPOSITS AND MARKETABLE SECURITIES

	1986 £000	1985 £000
Deposits	6,868	3,154
Marketable securities	93,242	7,441
	102,110	10,595

Marketable securities are held in Italy and represent the proceeds of currency borrowings, described in note 21 (vii), effected to cover forward exchange risks on contracts.

NOTES TO THE ACCOUNTS CONTINUED

2. PROVISIONS FOR LIABILITIES AND CHARGES

	1986 £000	1985 £000
Pensions and similar obligations	6,634	6,906
Deferred taxation	2,704	4,052
	<u>9,418</u>	<u>10,958</u>

PENSIONS AND SIMILAR OBLIGATIONS

The movement in the provision was as follows:

	1986 £000
Opening balance	6,906
Currency adjustments	345
Movement in the year	(617)
Closing balance	<u>6,634</u>

Occupational pension schemes are provided for employees in most countries in which the Group has operations. In particular, significant schemes or plans are operated in the United Kingdom, USA, Canada, Australia and South Africa. With the exception of West Germany and certain provisions in the USA in respect of unfunded prior service benefits in old plans and relating to discontinued operations, the funds of all schemes and plans are maintained separately from those of the Group. Contributions are met, or provided for, as they arise.

In the case of the principal USA plans there are sufficient total assets to meet the total actuarial present value of accumulated plan benefits. However, the asset shortfall for some individual plans is being funded as a supplement to the annual contributions for up to thirty future years in accordance with normal USA accounting standards.

A small deficiency in one of the Canadian schemes is being amortised by annual instalments over fifteen years, ending in 2000.

In West Germany, a small number of the most senior executives have pension contracts whereby the German subsidiary company has undertaken to provide pensions and widows' pensions. In accordance with practice in Germany, provisions are made in the accounts each year on the basis of actuarial advice. Supplementary insurance cover is maintained to meet the cost of widows' benefits, in the event of death in service, to the extent that the relative provision is inadequate for the purpose. Premiums are paid to a central fund to cover unfunded liabilities in the event of the insolvency of the employing company.

In the United Kingdom, contributory schemes are administered for all employees. Both the Staff and Works schemes are managed by separate corporate trustees, the directors of which are nominated and appointed from management and employees. All costs of administration are borne by the Company. Triennial actuarial valuations are undertaken in respect of each of these schemes.

All schemes provided by the Group are valued by actuaries from time to time and have, as at the latest valuations, been declared solvent on a discontinuance basis.

DEFERRED TAXATION

Provision for deferred taxation comprises £636,000 (1985: £1,172,000) in respect of United Kingdom companies and £2,148,000 (1985: £2,860,000) in respect of overseas companies. The movement in the provision was as follows:

	1986 £000
Opening balance	4,052
Currency adjustments	156
Reclassifications	3,960
Credit for the year	(5,284)
Closing balance	<u>2,704</u>

Reclassifications comprise advance corporation tax no longer offset against the provision for United Kingdom deferred taxation. If revalued assets in the United Kingdom were to be sold, it is estimated that any chargeable gains would be fully relieved by capital losses currently available.

The amounts provided for deferred taxation and the full potential liability, in respect of the United Kingdom companies, calculated on the liability method at 35%, are set out below:

	amount provided £000	potential liability £000	amount provided £000	potential liability £000
Capital allowances	9	9,044	10,351	10,350
Future benefit of tax losses		(620)	(613)	(613)
Other timing differences		(720)	(1,531)	(1,531)
	<u>3,711</u>	<u>7,704</u>	<u>8,207</u>	<u>8,207</u>
Advance corporation tax	(3,075)	(6,383)	(2,033)	(2,033)
	<u>636</u>	<u>1,321</u>	<u>1,172</u>	<u>1,172</u>

Total advance corporation tax recoverable against future corporation tax liabilities of the Group, including an amount of £2,270,000 (1985: £2,292,000) in debtors, is £15,321,000 (1985: £12,168,000).

24 CALLED UP SHARE CAPITAL

	Authorised £000	1986 Issued £000	Authorised £000	1985 Issued £000
6% cumulative preference stock	100	100	100	100
5% cumulative second preference stock and shares	200	183	200	183
4% cumulative redeemable preference stock and shares	3,000	2,000	3,000	2,000
	<u>3,300</u>	<u>2,283</u>	<u>3,300</u>	<u>2,283</u>
Ordinary shares of 25p (133,961,863 issued and fully paid) (1985: 121,602,377)	46,700	33,491	36,700	30,401
	<u>50,000</u>	<u>35,774</u>	<u>40,000</u>	<u>32,684</u>

By an ordinary resolution dated 23rd May 1986 the authorised capital of the Company was increased by 40,000,000 ordinary shares. During the year, 12,362,486 ordinary shares of 25p (nominal value: £3,090,621) were allotted as follows:

	Consideration	Number of Shares
One for ten capitalisation issue	-	12,161,099
Exercise of options	£259,700	201,387

Since 28th December 1986, a further 42,783 shares (nominal value £10,696) were allotted upon the exercise of options for a total consideration of £57,169.

At 28th December 1986 there were US\$279,000 (1985: US\$279,000) 7% convertible guaranteed bonds of Babcock Nederland BV outstanding which, after the capitalisation adjustment, would require, upon conversion, the allotment of 155,389 shares (1985: 141,637 shares). See also note 21 (iii).

During the year, further options were granted under the Babcock Executive Share Option Scheme (1984) and the Babcock Savings Related Share Option Scheme (1984). All options held under the Company's share option schemes were adjusted as a consequence of the capitalisation issue.

At 28th December 1986, the following options were outstanding:

Scheme	Number of shares subject to option	Price per share	Exercisable between
Babcock & Wilcox Share Option Scheme	633,821	120-140p	May 1986-May 1990
Babcock Executive Share Option Scheme (1984)	2,326,775*	141p	January 1988-January 1995
	812,350	171p	April 1989-April 1996
	200,000	166p	September 1989-September 1996
Babcock Savings Related Share Option Scheme (1984)	1,670,119	130p	June 1990-December 1992
	415,411	145p	June 1991-December 1993
	<u>6,058,476</u>	(1985: 4,966,540 shares)	

*This figure has been reduced by 611,133 shares, which are the subject of parallel options linked to existing options under the Babcock & Wilcox Share Option Scheme. Holders of options under both schemes may exercise one or the other in whole or in part. Upon the exercise of either option, in whole or in part, the other will lapse *pro tanto*.

The Company has the option of redeeming by drawings, all or part of, the issued 4% cumulative redeemable preference stock at par at any time by giving three months' notice. No final redemption date has been fixed.

NOTES TO THE ACCOUNTS CONTINUED

25 RESERVES

	Company 1986 £000	Group 1986 £000
Share premium account:		
Opening balance	12,191	12,191
Movement in the year	209	209
Amount applied for capitalisation issue	(3,040)	(3,040)
Closing balance	9,360	9,360
Revaluation:		
Opening balance	-	11,848
Currency adjustments	-	105
Closing balance	-	11,953
Profit and loss account:		
Opening balance	95,606	124,539
Currency adjustments (i)	-	11,392
Goodwill written off (ii)	-	(2,877)
Movement in the year	(2,493)	6,765
Closing balance	93,113	139,819

i) Increase on retranslation of the net assets of overseas subsidiaries and investment in overseas associates.

ii) Includes A\$1,384,000 in respect of goodwill arising on the acquisition of the Montpellier Foundry in Australia. Also included is goodwill that has arisen principally as a result of a reappraisal of certain contracts and net assets acquired during 1985 at Froude Consine Limited and Froude Engineering Inc., \$1,700,000 and Faultless Caster Corporation, US\$764,000.

iii) Group reserves include £23,670,000 (1985: £16,696,000) of retained profits and reserves of associated companies.

26 LEASE COMMITMENTS

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Finance leases:				
At 28th December 1986 the Group had the following net obligations under finance leases, none of which has been capitalised:				
Obligations payable				
within 1 year	-	-	3,171	3,103
in 2 to 5 years	-	-	7,131	7,907
after 5 years	-	-	3,693	3,659
less finance charges relating to future periods	-	-	13,995	14,680
Net obligations	-	-	3,349	2,899
At 28th December 1986 the Group had entered into commitments, whose inception occurs after that date, amounting to	-	-	48	543
Operating leases:				
At 28th December 1986 the Group had the following annual commitments under non-cancellable operating leases:				
Leases of land and buildings				
Commitments which expire				
within 1 year	-	-	675	281
in 2 to 5 years	325	291	1,987	2,432
after 5 years	-	96	539	1,109
	325	387	3,651	3,822
Leases of other assets				
Commitments which expire				
within 1 year	-	-	836	564
in 2 to 5 years	30	25	1,745	1,438
after 5 years	-	-	80	56
	30	25	2,661	2,058
Total	355	414	6,312	5,978

The majority of leases of land and buildings are subject to rent reviews.

27 CAPITAL COMMITMENTS

	1986 £000	Company 1985 £000	1986 £000	Group 1985 £000
Capital expenditure sanctioned by the Board and outstanding at 28th December 1986	120	100	50,088	49,747
Contracts placed against these sanctions and not provided for in the accounts			8,248	4,969

The above figures for Group capital expenditure sanctions include £2,707,000 (1985: £1,666,000) for which leasing agreements are contemplated in 1987.

28 CONTINGENT LIABILITIES

- i) There are contingent liabilities amounting to £76,510,000 for the Company (1985: £86,233,000) and £9,480,000 for the Group (1985: £8,510,000), representing in the main guarantees given and bills discounted, on which no losses are anticipated.
- ii) In addition, there are contingent liabilities in the ordinary course of business in connection with the completion of contracts within specification, including responsibility for maintenance.
- iii) Certain subsidiaries are engaged in litigation in connection with claims on contracts. Based on legal advice, provisions for these claims have been made in these accounts to the extent considered necessary by the directors.
- iv) The Liquidator of IBI has instituted proceedings, in the Federal Republic of West Germany, against Babcock International Holdings Ltd and Babcock International plc for payment of DM40 million plus interest in connection with the sale of Babcock Construction Equipment Limited to an associate of IBI in 1982. The directors feel that there is little merit in these proceedings and intend to contest the claim vigorously.

29 POST-BALANCE SHEET EVENTS

Details of the acquisitions of La Société Des Câbles Du Mans and Hunter Engineering Company Incorporated together with details of the disposal of the Group's investment in Babcock-Hitachi KK are given in the Directors' Report.

REPORT OF THE AUDITORS

TO THE MEMBERS OF BABCOCK INTERNATIONAL PLC

We have audited the accounts on pages 26 to 43 in accordance with approved Auditing Standards.

In our opinion the accounts give a true and fair view of the state of affairs of the Company and the Group at 28th December 1986 and of the profit and source and application of funds of the Group for the year then ended and comply with the Companies Act 1985.

Coopers & Lybrand
Coopers & Lybrand
Chartered accountants

London
24th March 1987