

Financial review

Results The results for the year reflect the strategic initiatives being pursued by the Group that have continued to generate improvements in operating margins. They also reflect a full year's contribution from the successful restructuring of the Group's portfolio of businesses completed last year.

Group operating profits have increased by 77.4% to £22.2 million on turnover of £496.3 million. Group operating profits, before goodwill amortisation, from continuing operations have increased by 26.8% to £19.8 million on turnover of £495 million. The overall operating margin, excluding goodwill amortisation, from continuing operations has increased to 4.0% from 2.9% in 1998.

Both Divisions contributed to the increase in Group operating profits, before goodwill amortisation, from continuing operations. In BES these grew by 27.8% to £13.3 million and in BMH by 17.4% to £8.4 million. Operating margins, excluding goodwill amortisation, from continuing operations also increased in both divisions. In BES they grew to 4.8% from 3.4% in 1998, and in BMH they grew to 3.9% from 3.2%.

Turnover by destination in the year shown on page 40 reflects an increasing share from Europe and North America and a decline in the Rest of the World as a result of a weakness in certain Asian markets.

A profit of £6.1 million arising in the year from the disposal of the Group's water engineering interests in Babcock Water Engineering Limited and Babcock Water Engineering LP is shown in exceptional items.

The strong increase in net interest income to £2.5 million (1998: £0.2 million) reflected the very healthy level of net cash resources throughout the year.

Taxation The Group's effective tax rate, excluding exceptional items and goodwill, was at a similar level to the previous year at 22.8% (1998: 23.4%). This is lower than the standard UK rate of 31% due to the utilisation of tax losses and surplus Advance Corporation Tax. At 31 March 1999 the Group

had trading losses carried forward for tax purposes exceeding £70 million. These tax losses exist predominantly in the USA, Germany and South Africa.

Earnings per share and dividends

Basic earnings per share were 15.07p (1998: loss 5.12p). Earnings per share excluding exceptional items and goodwill amortisation were 10.22p (1998: 4.78p).

The Board is recommending an increased final dividend of 1.40p bringing the total dividend for the year to 2.20p (1998: 1.80p) which is an increase of 22%.

Cash flow Improved profitability during the year and tighter working capital control have resulted in a very strong cash inflow from operations of £56.1 million (1998: £10.1 million).

The Group's free cash flow in the year was a healthy £49.8 million (1998: £0.9 million). In addition to the strong cash inflow from operations this also benefited from lower taxation payments of £0.8 million (1998: £1.5 million) and lower net capital expenditure of £5.5 million (1998: £7.7 million).

Balance sheet and financing Equity shareholders' funds increased by £21.1 million in the year to £126.8 million. The increase reflects the retained profits of £21.8 million less foreign exchange losses of £0.7 million (1998: £2.1 million) arising on the translation of the net assets and results of overseas subsidiaries into sterling.

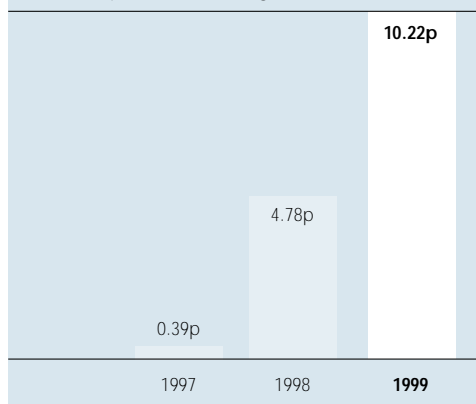
The Group remains ungeared with net cash balances of £82.1 million (1998: £21.1 million) and a further £6.6 million (1998: £nil) of current asset investments classified as liquid resources.

During the year all of the Group's financing requirements were met from its existing cash resources and the strong cash generation referred to above.

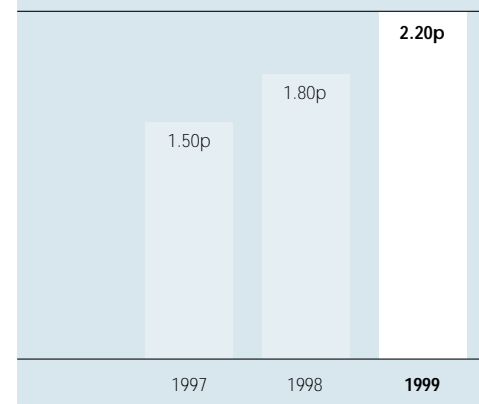
Acquisitions and disposals The net cash inflow from acquisitions and disposals in the year was £16.9 million (1998: outflow £2.4 million).

Basic earnings per share

(before exceptional items and goodwill amortisation)



Dividends per share



During the year the Group acquired AKI Dryer Manufacturers, Inc. in the USA for a cash consideration of \$5.0 million with up to a further \$2.5 million payable over the next three years depending upon that company's trading performance. The Group also made two small acquisitions in the USA and South Africa for a total consideration of £0.6 million. In addition it disposed of its water engineering businesses comprising a 50% joint venture interest in Babcock Water Engineering Limited in the UK and its wholly owned US subsidiary Babcock Water Engineering LP for a total consideration of £13.25 million. The Group also received £7.5 million of deferred consideration relating to the disposal in 1995 of the Group's former Energy division.

Further details can be found in notes 30 and 31 to the Financial Statements.

Pension schemes The Group operates a number of different pension arrangements throughout the world, according to the local requirements of each country. The total pension cost charged against the operating profits of the Group for the year was £6.2 million (1998: £5.8 million). Surpluses of £75.3 million (1998: £72.5 million) relating to the Group's principal pension schemes are carried in the balance sheet as prepayments. These prepayments are charged with the regular pension costs of the scheme members. The interest effect of these surpluses has been to reduce the gross pension charge for the year by £3.6 million (1998: £3.3 million).

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

Financial instruments The Group's financial instruments, other than derivatives, comprise cash and liquid resources, some short term borrowings and various items such as trade debtors and trade creditors etc. that arise directly from its operations.

The main purpose of these financial instruments is to finance the Group's operations.

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

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

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

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

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

If the 1999 results of foreign subsidiaries had been translated into sterling using the same average exchange rates as 1998, the Group turnover would have been £10.6 million higher and the Group operating profit £0.4 million higher.

Liquidity risk The Group invests its surplus funds in financial instruments with maturity profiles necessary to ensure the availability of those funds as required. The Group also maintains committed bank facilities available as a standby in the UK and certain overseas countries. The amount of undrawn committed facilities at 31 March 1999 is set out in note 22 to the Financial Statements.

Interest rate risk The Group is exposed to interest rate risk on its short term borrowings, deposits, and other liquid financial instruments. These short term borrowings and investments are at both fixed and floating rates as set out in note 22 to the Financial Statements. The current Group policy, which has applied throughout the year, is to hedge the interest rate risk on these financial instruments as appropriate.

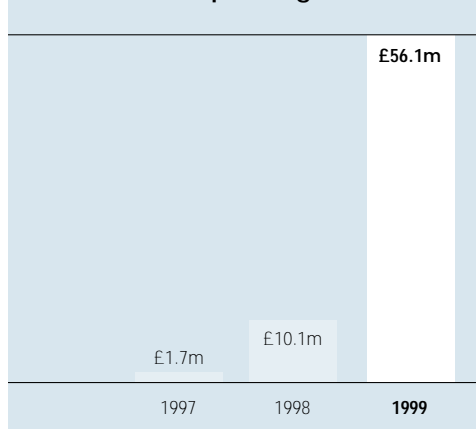
Credit risk The Group controls credit risk by entering into financial instruments only with highly credit-rated and authorised counterparties. Counterparty authorisations and positions are monitored on a regular basis.

Share price performance During the past financial year the Company's share price has fluctuated between 48p and 97.5p. At market close on 15 June 1999 it stood at 114.5p which represents a market capitalisation of £194 million. The accompanying graph compares the Company's share price performance with that of the FT Engineering sector since 31 March 1997. After underperforming in earlier years the Company's share price performance has more recently exceeded that of the engineering sector as a whole.

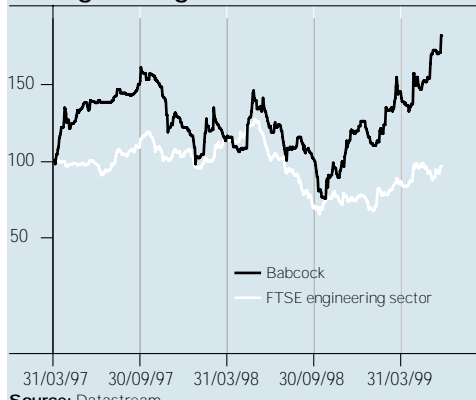


N R Young Group Finance Director
15 June 1999

Cash flow from operating activities



Share price relative to FT engineering sector



	Average rate to £ 1999	Average rate to £ 1998	Year end rate to £ 1999	Year end rate to £ 1998
US Dollars	1.65	1.65	1.62	1.68
German Deutschmark	2.88	2.93	2.95	3.08
Finnish Markka	8.82	8.81	8.97	9.33
Swedish Krone	13.20	12.86	13.50	13.26
South African Rand	9.69	7.78	10.11	8.37