COSTAIN

>relationship
>value
>achievement

Costain Group PLC Annual Report 2002

Costain is an international engineering and construction company seen as an automatic choice for projects requiring imagination, initiative and high levels of technical and managerial skill.

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>Turnover up 17%: £543.4m (2001: £462.9m)

>Profit before tax up 30%: £11.3m (2001: £8.7m)

>Earnings per share up 12%: 2.8p (2001: 2.5p)

>Net cash balances increased to £71.3m

>Return to UK operating profitability

>relationship
>value
>achievement

Statement by David Jefferies Chairman

I am pleased to report that our new strategy has brought clarity to the Costain business. We are now using tough benchmark targets against which we measure our delivery and I am delighted to report that, on every level, we are significantly better than plan. The dual achievements of 2002 were recovery of the Group's trading performance and the re-establishment of its reputation as a major name in the industry.

30%
Increase in profit on ordinary activities before taxation

17%
Increase in turnover

>

Overview

For many decades, the infrastructure of the UK, which is essential for our continuing social and economic success, has been underfunded. This fact has at last been recognised by the Government who are setting tough targets for major improvements in the Health Sector, Schools, Roads, Railways, Water and the Environment.

Despite the current economic downturn, the Government remains committed to driving forward a programme of improvements. It is actively seeking to work with the private sector in those areas where it can be demonstrated that the Industry can offer expertise and value for money in delivering its objectives. Costain is very well positioned to assist in this major task.

Results and finance

The Group made a profit on ordinary activities before taxation of £11.3 million (2001: £8.7m) which is a 30% increase on last year's profit.

The turnover of £543.4 million (2001: £462.9m) is up by 17% on the previous year.

Earnings per share were 2.8p (2001: 2.5p) which is an increase of 12% on last year.

No dividend has been recommended for payment whilst the Group rebuilds its financial resource. This matter is being kept under review.

The Group has no significant borrowings and net cash balances at the end of the year totalled £71.3 million (2001: £67.8m), including the Group's share of cash held by joint arrangements (construction joint ventures) of £27.6 million (2001: £38.0m). This represented a cash inflow during the year of £3.5 million (2001: £25.1m inflow) which was ahead of forecast.

Strategy

Following a comprehensive review of the Group's businesses a year ago, we began the task of implementing a new strategy for growth. The success of turning the strategy into reality is measured against the benchmark targets, which have been put in place. These targets include growth in turnover for the Group of 15% per annum coupled with a continuous improvement in profitability to 3% profit before tax for our Group operations over the five years of the plan. We are ahead of our targets.

Our strategy and the resulting success have also been recognised by the London Stock Exchange. In 2002, the Costain share price increased by 83% from 13.25p to 24.25p in a twelve-month period. This was at a faster growing rate than any other publicly quoted UK construction company. Whilst we are not complacent, I believe this demonstrates that we have acquired a new following and fresh belief in the Company's ability to succeed.

In a number of areas, our position is strong. We have 15% of the water utilities capital programme with the amount of work in that sector increasing rapidly. We are at the forefront of the UK Government's move to improve health and transport. We have linked successfully overseas with our major shareholder Kharafi, we have produced several outstanding operational performances during 2002 to confirm our status as a high-quality contractor and, most importantly, we have substantially de-risked the business. Our joint venture with Banesto Bank at Alcaidesa in Spain has made very significant progress during the year.

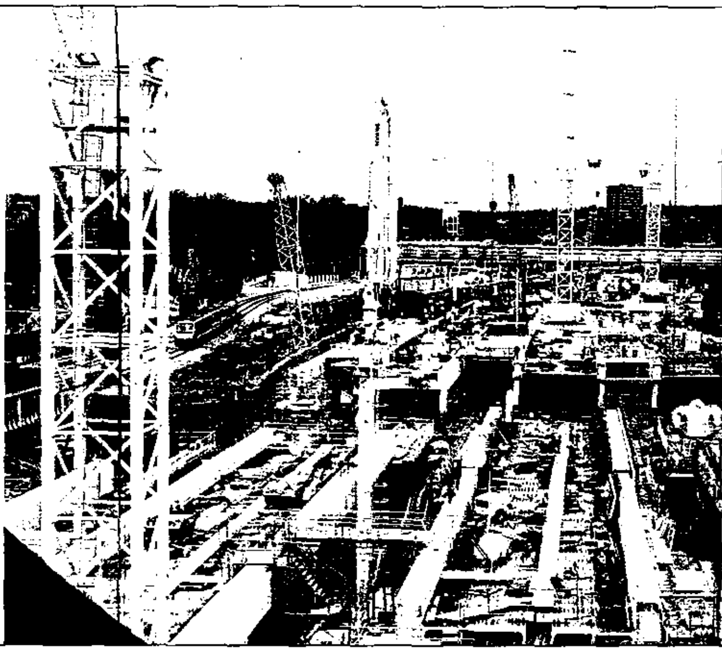
With the Group performing well, the Board has been able to spend some time looking at a range of options beyond the immediate priorities, which of course remain our primary focus. It is clear that Costain has regained a leading position in the construction and contracting sector and now has the potential to take advantage of the current market opportunities. Accordingly, we are examining our financial structure and also future opportunities to expand into additional related activities where we can exploit our core competencies.

Board and Corporate Governance

The Board is delighted to report that although our Chief Executive, Mr Stuart Doughty, attains the age of 60 years in September 2003, the normal retiring age for executive directors, he has agreed to continue as Chief Executive to ensure the delivery of the targets which he helped to set for the Company.

In 2002, Charles McCole was appointed to the Board as Finance Director and John Bryant and Abdul Wahid Omar joined the Board as non-executive directors. Mr Omar was appointed Deputy Chairman on 22 March 2002. I reported this in last year's Annual Report as all three Board members joined the Company early in the year. Save for that, the Board remained stable in 2002 and the only departure was Basil Vasiliou, who resigned as a non-executive

St Pancras Station
> Left
Rick Randall (left), Costain Project Manager, pictured with Tim Smart, URN Client Manager.
> Right
Contract 105 at St Pancras Station in London - part of the Channel Tunnel Rail Link project which features Costain as one of the main contractors.



director on 24 May 2002. The Company is indebted to Mr Vasiliou for his help and guidance during his time with the Company.

As you will probably be aware, two reports have recently been published which broadly fall under the banner of Corporate Governance.

First, the "Review of the role and effectiveness of non-executive directors" by Derek Higgs, published in January 2003 (the "Higgs report") and, secondly, the report by the committee set up by the Financial Reporting Council under the chairmanship of Sir Robert Smith, which looked at audit committees (the "Smith report") and was published on 20 January 2003.

I am pleased to say the Company already complies with many of the recommendations of the Smith report. Some of the recommendations of the Higgs report have proved controversial, particularly the proposal to enhance the role of the senior independent non-executive director, which many look upon as being potentially divisive and damaging to board unity. This Company does not appoint a senior independent non-executive director for the reasons set out in the Report of the Directors. The Company already follows some of the other recommendations in the Higgs report but, upon the adoption of these reports into the Combined Code, we will, as a Company, review the amendments and make such adjustments as the Board considers appropriate.

Share incentive schemes

You will recollect that at the Annual General Meeting last year the members of the Company approved the adoption of a Save As You Earn Share Option Scheme (the "Scheme") and a Long Term Incentive Plan (the "Plan"). All employees are entitled to participate in the Scheme so long as they have been employed by the Company for twelve months at the time the invitation is issued. A total of 1,256 employees were entitled to participate in the Scheme. The take-up by employees was higher than is usually the case with 494 employees expressing the wish to take part in the Scheme which represents some 39.33% of those invited to participate. The average saving of each employee is £106.00 per month, which I understand is double the usual saving for this type of scheme. Total number of shares, subject to the option, is 13,420,225 ordinary shares which is equivalent to 3.98% of the current issued share capital of the Company. We are delighted with the confidence that the employees have shown in the Company.

The Plan was designed as an incentive and reward to executive directors and senior management for meeting the objectives of the Group's business plan and thus enhancing profitability. It also aligns the interest of the executive directors and senior management with those of shareholders. There are twelve participants in the Plan and the number of shares subject to an option under the Plan is 2,047,833 which is equivalent to 0.607% of the current issued share capital of the Company. Details of the performance target is set out in the Directors' remuneration report.

Staff

During 2002, the decision was taken to move the headquarters of those divisions within Costain Limited which were not based in Maidenhead into the Maidenhead office. The intention was to create greater cohesion between the various divisions of Costain Limited and with Costain International Limited and to achieve economies and improve the efficiency within the business. I am pleased to say that the move has been successfully completed and is bedding down well.

The financial results that the Company has achieved is entirely down to the hard work, competence and commitment of the Costain staff and, on behalf of the Board, I would like to express our thanks for the great effort that they have made on behalf of the Company.

Outlook

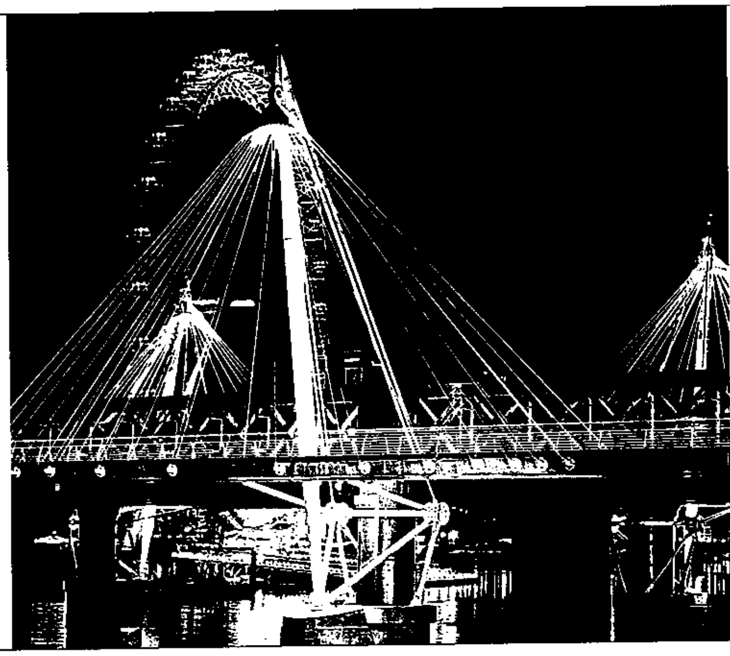
We are encouraged that central Government is now delivering on its commitment to investing in major improvements in the Transport, Ministry of Defence and Healthcare sectors, in all of which the Group has significant involvement.

Despite the downturn in commercial and industrial sectors, Government expenditure levels are now way above the high of 1992 with construction output running in excess of 7% of GDP.

It would be inappropriate not to recognise the current economic climate, however, I remain convinced that the need to improve UK infrastructure is so pressing that programmes will continue as originally planned.

David G Jefferies
Chairman
25 March 2003

Hungerford Bridge
> Right
Hungerford Bridge, one of London's landmarks, which was completed in 2002 by Costain in joint venture.



>Key management appointments

>Management systems and controls strengthened

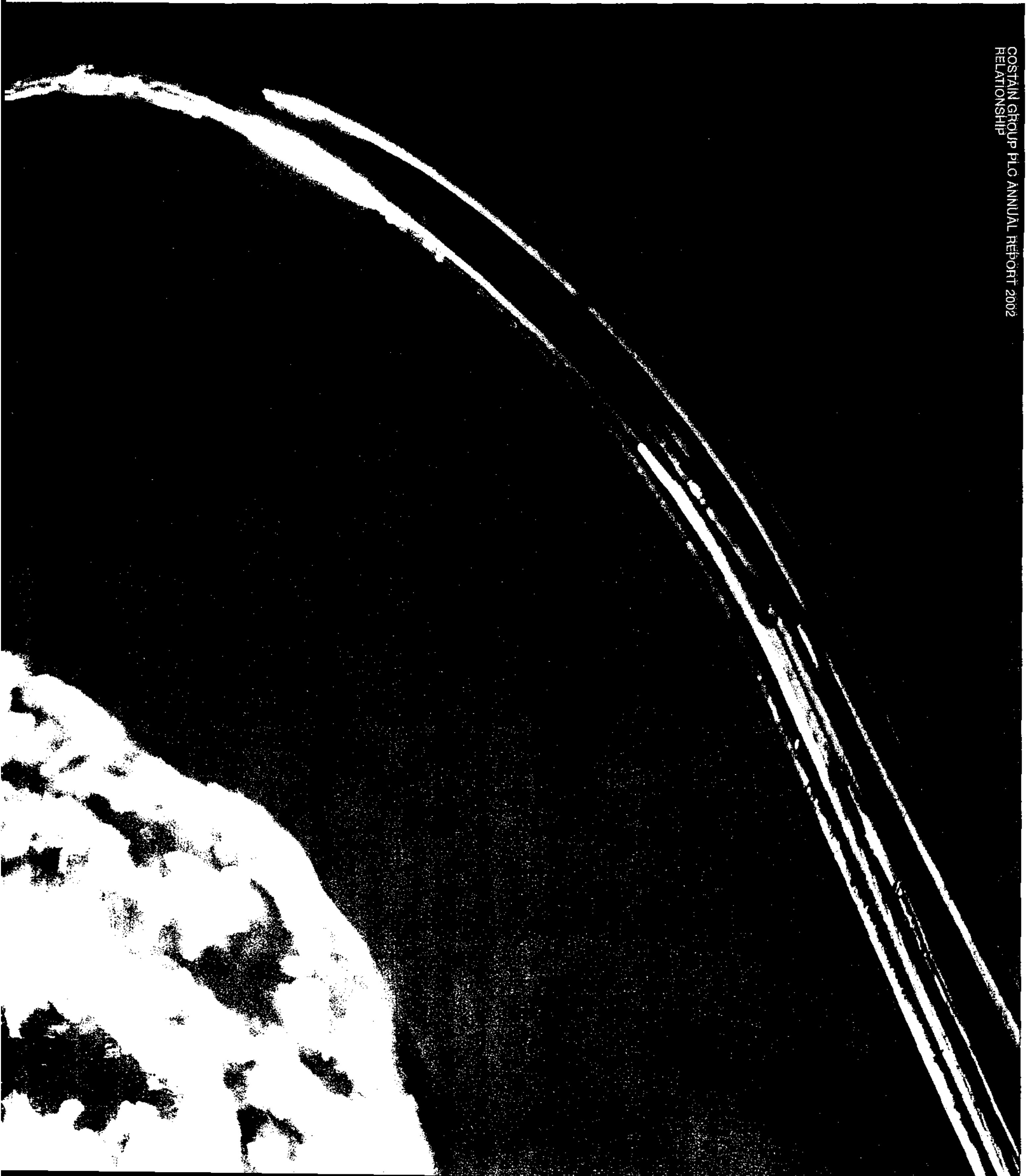
>Business "de-risked": 85% of forward order book consisting of partnering/framework contracts

>Asset management/ contracting proportion ahead of target

>relationship

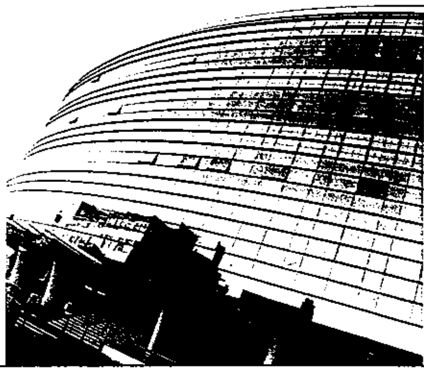
Graham Keegan, General Manager Asset Delivery, United Utilities said: ‘Costain has demonstrated an open, honest approach in working with United Utilities in this Partnership’.


Lostock WTW
> Left
Costain's Northern Regional Director, Chris Tyerman (right), pictured with United Utilities' General Manager Asset Delivery, Graham Keegan.
> Right
United Utilities, Lostock Water Treatment Works, Bolton.



>value

King's College Hospital Golden Jubilee Wing completed ahead of schedule and David Pokora, Chief Executive of HpC King's College Hospital Limited, said: 'The onsite team's whole approach was perfect'.



King's College Hospital
> Left
David Pokora, Chief Executive of HpC King's College Hospital, pictured with Jean Wright, Costain's Healthcare Director.
> Right
King's College Hospital's new Golden Jubilee Wing, a PFI project built by Costain in joint venture.

>achievement

Transport Minister John Spellar praised the work that went into the A43 project and said: 'The positive comments we have received from the industry and the public are richly deserved'.

A43

> Left
Highways Agency Project Manager Operation Division, Graham Wright, pictured with Alan Kay, Costain Project Manager (left).

> Right
The A43 road project completed August 2002.

Business review by Stuart Doughty Chief Executive

83%
Increase in share price over the year

12%
Increase in earnings per share

The Group took decisive steps in 2002 to reinforce and further implement the Costain strategy, which for the past 18 months has provided the platform and direction for future growth. The results, showing improvements in profit and turnover whilst sustaining the same high level of cash, have given us the opportunity to look at the Group's longer-term strategic direction and I deal with this in more detail later. First, a look at the environment in which we are operating and the exciting opportunities we believe it affords to the Group going forward.

2002: A year of achievement

The UK construction industry has a total annual turnover of £65 billion. It comprises a large variety of work in terms of size and nature, ranging from small local challenges through to massive national infrastructure schemes which impact on a nation's shape. Whilst the opportunities are numerous, speed of delivery is becoming an increasingly important issue in the Government's procurement process, with a far more mature approach being adopted in looking for best out-turn value rather than lowest tender cost. A disciplined approach to service delivery rather than contractual protection is at the heart of the new philosophy and we have taken great care to position ourselves at the forefront of this market.

In 2002, there was considerable activity in a variety of sectors, particularly in healthcare, with the advent of ProCure 21 and in transport infrastructure with the introduction of 'early contractor involvement'. The temptation to pursue many different types of projects on a lump sum fixed price basis was indeed great. However, at Costain, we had clearly stated in the strategy that we would identify and focus on certain sectors and only work for enlightened clients who understood the benefits of partnering type arrangements.

We have not veered from this policy. High-risk fixed price contracts have been avoided or rejected. The industry has experienced the pain of these projects and this Company will no longer embark on such potentially damaging ventures to both the client and the contractor. This is encouraging a closer relationship with all parties to any contract - the designers, the subcontractors and the service providers - producing a cohesive approach with a single point of service to the ultimate user. This philosophy has become pivotal in turning Costain around. We are still, however, principally a contractor and will maintain our focus on the utilisation of core skills and avoid the dilution of that focus by moving into other peripheral sectors which fall within the market, eg rail maintenance and facilities management.

Transport and healthcare, coupled with the utilities market and the provision of good quality service, have been very much the recent focus of Government attention. In particular, it has allocated considerable funds, in excess of £2 billion per year in each sector, to the delivery of better quality roads and hospitals over the next two years.

In transport overall, the Government is committed to a spending budget of more than £180 billion over a ten-year period funded from a combination of public and private investment. This includes more than £22 billion on strategic roads. The road building programme has been slow to progress but, in the last year, we have witnessed an increase in pace and we have tendered for a number of projects.

This Company is one of the UK's major road-building contractors. Our relationship with the Highways Agency (HA) is strong and it has been one of the first Government agencies to utilise early contractor involvement, where the successful contractors are engaged early in the process of the initial design and planning of the scheme. This ensures all parties are committed to the same end result with commencement on site starting over a year in advance of the more traditional route. The first of such schemes is the A303 Stonehenge, which we have been awarded in joint venture.

The HA is one of those enlightened clients which has gained a reputation for working in partnership and, in 2002, we formed a highly successful combination to prepare the A43 in time for the British Grand Prix. Costain, its joint venture partner and the HA received Government praise and I am confident that the A43 will act as an example of how, with a conscious attempt being made to resolve outstanding issues in an expeditious way and maintaining an excellent relationship with all affected parties, we can deliver a scheme of such magnitude in a considerably shorter time than was originally considered possible.

In the Railway sector, the Government is also committed to a very aggressive expenditure profile in both maintenance and capital works. We have decided against any involvement in maintenance due to the high entry costs and reducing margins.

Ormskirk Hospital
> Left
Kit Bennett (left), Finance and Programme Director for Southport and Ormskirk Hospital NHS Trust, pictured with Simon Dolan, Contracts Manager for Costain Northern Region.
> Right
Artist's impression of Ormskirk Hospital, part of ProCure 21.

However, we are currently involved in carrying out capital work of some £700 million in joint venture on the Channel Tunnel Rail Link and Kings Cross Station Development. Due to the scope and complexity of the projects, coupled with the need to achieve tight delivery schedules, we have adopted a partnering style of approach and are successfully tackling the inevitable problems of dealing with such complex schemes in high-density populated areas combining the extremes of civil engineering skills with a sympathy for listed building restoration work.

The Government's pledge to improve the nation's health service has been well documented. The Capital Spending review in 2002 indicated capital investment in the health sector is set to rise from £2.3 billion in 2002/03 to £4.2 billion in 2005/06 and to over £6 billion in 2007/08. The Government has committed itself to delivering 7,000 new beds, 500 one-stop primary care centres, 3,000 modernised GP practices and 100 new hospitals by 2010.

This strategy has already had a major impact on the industry in terms of procurement and delivery. Costain is well placed to take advantage of these opportunities and was successful in being one of the contractors to be appointed to carry out new hospital work in the North West and the Midlands under the NHS ProCure 21 initiative.

I have stated that, in addition to the right markets and clients, we must have the right Costain people. We have already concentrated our considerable expertise to focus on transport and infrastructure and are recognised as one of the leading road contractors both in the UK and overseas. However, in healthcare, whilst we possessed the building skills, we were not so well equipped with staff able to manage the interface between ourselves and the end user. The recruitment of people in this area has been crucial to the development of the Company.

Consequently, we appointed Jean Wright as Healthcare Director, a position unique in the UK construction industry. Before joining Costain, Jean had spent her working life with the NHS and is now advising both our PFI and Building teams in forming new relationships with Health Trusts around the country, which will be very valuable to us in the future.

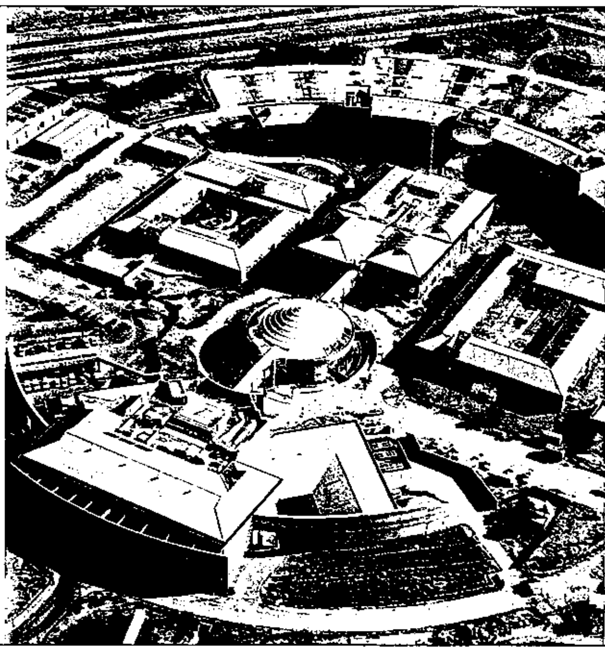
We have continued to strengthen our resource in other key areas as part of an on-going recruitment campaign. Moreover, we have also invested in systems and training. Indeed over the next three years, we will be investing up to £3 million in the IT infrastructure needed to achieve consistent best practice throughout the whole business.

We have focused on six major disciplines including supply chain management and risk management, each sponsored by a member of the Executive Board. We have produced a supply chain management strategy, which reduces the number of Costain suppliers and sub-contractors and focuses on building relationships, leading to much better quality products and service on site and reduced costs.

Adhering to the Costain strategy requires, and will continue to take, constant supervision and stringent management discipline. We have identified the markets, the clients and their needs. We have, through training, systems and recruitment, the right people in place to meet those needs and become an integral part of the client's operation and not a separate entity offering a detached service. The process is working. We have clarity not confusion and the opportunities for the future are wide-ranging and exciting.

Current trading and prospects

The UK construction industry is experiencing a considerable increase in activity. Costain will pursue only those contracts where our particular skills can be profitably utilised to the full. Our experience and expertise have been recognised worldwide and we have been awarded a number of prestigious projects both in the UK and overseas.



We have recently been awarded the £38.5 million design and build contract to improve the A34 Chieveley/M4 Junction 13. The scheme will include a new 3km A34 dual carriageway, which will pass under the M4. In addition, we have been awarded a £10 million contract for the reconstruction of the M4 between junctions 5 and 7.

In our Building Division, we have been named the preferred bidder for the construction of the Diamond Synchrotron Light Source (£70m) – the largest scientific facility to be built in the UK for 30 years. The facility, to be built near Didcot in Oxfordshire, will produce pinpoint ultraviolet and X-ray beams of exceptional brightness. These highly focused light beams will enable scientists and engineers to probe deep into the basic structure of matter and materials, answering fundamental questions about everything from the building blocks of life to the origin of our planet. It is a prestigious project and will provide an opportunity to highlight our building skills to the nation.

Overseas, the Company, in a joint venture with Banesto Bank, owns over 2,000 acres of development land at Alcaidesa, Spain (twenty minutes to the east of Gibraltar and adjacent to Sotogrande) on which we will be building a very prestigious development over the course of the next ten years. We have focused on building the infrastructure during the last year and working closely with the local planning authorities and, in the latter part of the year, secured approval to carry out the first major tranche of development including 1,780 homes, three hotels and a further golf course. The programme of cautious development by either conditional sale, development by others or development of the site using our own resources, will now proceed over the next few years.

Also in International, we continue to benefit from our relationship with Costain major shareholder Kharafi, with the award of the Palapye Sanitation project in Botswana and a number of other projects being discussed in Botswana and the Middle East. Due to the strength of the brand and our recognised past experience, we are being invited to join many joint ventures involved in major infrastructure schemes in Africa, the Middle East and the Far East.

I make no apology for my continual reference to focusing on the right sectors, clients and contracts. A perfect example of a contract, recently won, which fits all those criteria is the £28 million extension of the Port of Felixstowe's Trinity Terminal for Hutchison Port Holdings. We have worked with the client successfully on a number of projects over many years. It is a long-term relationship based on unity not conflict with all parties committed to one goal. We have recently, also with Hutchison, embarked on Phase II at the Freeport Container Port in the Bahamas.

The NHS is pursuing similar relationships with contractors and the health sector, as already stated, will be a major market for construction companies. We have in recent times secured good contracts in several parts of the country and progress will be maintained in both traditional and PFI healthcare sectors.

Another recent step forward for the Company was the award of a contract by the Government to refurbish a number of Job Centres. This was of significant value because it involved the South East region, an area where we are keen to expand with the right type of clients - such as the Department of Work and Pensions and the Department of Social Security.

There are a number of other major opportunities that we are currently pursuing and I am pleased that we have maintained steady progress in all our endeavours. The results reflect a return to profitability in the UK whilst maintaining a high level of cash generation derived from a lower risk and more sustainable workload. This is entirely compatible with the Company strategy and we have not sacrificed overall direction for the sake of high-risk projects, which might add to the turnover in the short-term but may incur substantial financial penalties at a later date.

International

> Left
The Information and Broadcasting Headquarters, Botswana.

> Right
Costain Project Director, Peter Thomas, pictured with Gillian Sharpe, Project Manager for the Ministry of Works transport and communications.

Health, Safety and Environment

Whilst conscious that our overall processes were in order regarding the necessary procedures, to further improve buy-in from all our site operatives we initiated a campaign - BE SAFE - which was launched following detailed consultations with our site teams and those of our sub-contractors. The aim was to change the philosophy of safety into a cultural issue and always keep the issue of safety in the minds of our operatives on site. We asked for suggestions from operatives on how the profile of safety could be further raised. As a result, many of the comments have now been incorporated into our procedures. Other improvements include placing a greater emphasis on promoting control of health related issues.

However, despite achieving progress, it was with deep regret that we had to record the death of Mr Altun, a welder working on a joint venture between Norwest Holst and Costain. This tragic event reinforces the commitment of both Costain Group Main and Executive Boards to maintaining a strict policy on health and safety. As part of that policy, we have recruited four more Health and Safety graduates. This is in addition to our continuing commitment for a fully trained workforce.

Operational review: Asset management

We actively pursued the Asset Management market, particularly the capital programme for major infrastructure providers. As the relationships mature with Wessex, Southern, Thames, United Utilities and Yorkshire Water, we are now working even more closely to set targets for the next round of the capital programme - AMP4. More importantly, the relationships are such that we are now looking at other opportunities working on a joint venture basis with these clients.

We are now close to achieving 40% of overall turnover on contracts, adopting framework mechanisms as the basis of procurement. As the pressure builds up to complete the AMP3 works to satisfy the regulatory requirements, so indeed the volume of work being released is also increasing. Each contract varies in size between £100,000 and £10 million and therefore our overall objective of having 50% of our business involved in Asset Management is well within our sights.

Building

The Building Division experienced major change in 2002 with Mark Gordon appointed as Managing Director and new Regional Directors for London, Midlands and Southern. One of the priorities in the Division was to blend this new capability with the existing and valued Costain Building personnel. This has been accomplished. We also welcomed our Healthcare Director and a new Commercial Director. Each of these individuals is clear on the aim of the Building Division, which is to develop a portfolio of projects based on partnering relationships with key clients. Particular care will be taken to ensure all new contracts have an appropriate balance of risk to reward and we will continue to reject work which does not meet that strict criteria.

Key successes in 2002 included being appointed as one of the five principal supply chain partners on the NHS's ProCure 21 pilot project operating in the North West and Midlands. Qualifying as one of the partners was extremely encouraging and I am pleased to report that we now have secured the Ormskirk Hospital (£12m) and others are under negotiation. We are progressing well with the strengthening of our relationships with the NHS Trusts. In addition, we have also secured work at St Bartholomew's Hospital in London (£8m) and been awarded the contract (£13.5m) to build a diagnostic and treatment centre and a two-storey ward building at the Royal Shrewsbury

Hospital in Shropshire. The latter is particularly pleasing as it was the first contract won by our Midlands office which opened in March 2002. It was exactly the start that we wanted for the region and now places us in a strong position for more local work especially in the health sector.

As part of our philosophy, we have continued to pursue Tesco and Waitrose where we remain Term Contractor in the East for the former and have successfully built a flagship store at Cheltenham for the latter which will act as a benchmark for future developments in the sector.

Civil engineering

Another chapter in Costain civil engineering excellence was highlighted when we prepared the A43 in time for the British Grand Prix. Our efforts were praised by the Government and the success has resulted in another excellent addition to our roads portfolio. The A2/M2 joint venture is proving equally impressive and, in summer 2002, the new 950-metre Medway viaduct was formally opened by Parliamentary-Under-Secretary for Transport, David Jamieson. We will complete the contract during 2003.

At Warrington, we completed the new M62 junction 8 which will give direct access to the forthcoming Omega project - a 226-hectare mixed-use development proposal that will include offices, production, technology and distribution space. It is estimated that over the 25-year life of the development, Omega will bring 12,000 jobs to the region. The Costain construction work has played a major part in bringing this development to life.

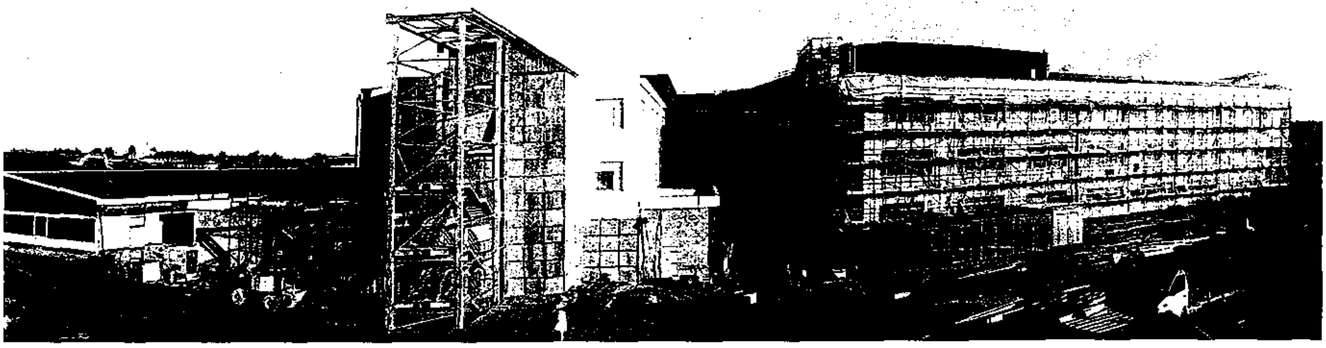
Generally, the roads sector has been strengthened in recent times by a Government pledge to spend £5.5 billion on a number of major national and local transport measures to tackle congestion and improve safety and reliability. The A303, which we have been awarded in joint venture, is one of the designated projects. As a leading UK road-builder, we look forward to tendering for more of these schemes and working with the Government in tackling the problems on our roads.

Railway work has increased in importance to Costain. Award of the fit-out work for the Channel Tunnel Rail Link at St Pancras has produced £311 million of work at the station and Network Rail's award in November of the relining of Strood & Higham tunnels in Kent is an £18 million contract for a strategically targeted client. The tunnel-boring machine for the CTRL contract (Stratford to Barking) was launched in December and successfully mined under the Central Line tunnels. At King's Cross, we have now been awarded all stages of the phase one modernisation contract which is progressing satisfactorily.

On the Marine side, we have secured the new contract for Hutchison Port Holdings to provide a £28 million extension of the Port of Felixstowe's Trinity Terminal. I should also, at this point, praise our Marine people for their work on the Hungerford Millennium Bridge Project. The Bridge, in the heart of London on the River Thames, opened in the autumn and consists of two symmetrical footbridges. Costain, in joint venture, overcame a number of obstacles and produced what has become one of London's most attractive new landmarks.

International

Our business in Southern Spain, focused on Alcaidesa, is proving a tremendous success. We hold a 50% interest in Alcaidesa Holding SA, a residential and leisure company. The first phase of the development scheme, as reported in previous annual reports, has resulted in a good level of house and individual building plot sales being completed and an on-going building programme of housing projects has been agreed. We now have all the required consents to Alcaidesa's Master Plan proposals to take forward the second phase of the project. These consents, on a site of 186 hectares, permit the construction of three hotels, part of a proposed new 18-hole golf course with clubhouse facilities and approximately 1,780 residential units to be built in the Andalucian 'pueblo' style of development.



Met Office
> Left
Geoff Hunt (left), Costain-Skanska Joint Venture's Project Manager - Met Office, presents the keys to the first computer hall at the Met Office to Alan Douglas, Met Office Relocation Director.
> Right
The Met Office under construction.

In consequence, the sale of one hotel site to a major Spanish hotel operator has now been signed and the operator will build a 300-bed, low-rise four-star facility on a site fronting the sea and the existing Alcaidesa links golf course.

Alcaidesa will also continue to build quality housing in its own name, but recognises the risk associated with large scale speculative schemes which are subject to market change and the general economic health of the European target market.

To dilute that risk and at the same time secure profits from development, a joint venture has been formed with a major Spanish residential developer to build 400 housing units over the next four years. The benefits of this venture will accrue over the build-out period and assist in safeguarding Alcaidesa's future profits and cash flow.

Master Plan proposals for phase three of the scheme are well advanced and it is hoped that all necessary consents will be obtained during the course of the year. The third phase of a 100-hectare enclave should permit the building of a further 1,200 residential units with some commercial facilities and the remainder of the new 18-hole golf course forming part of phase two. Longer-term development proposals for a fourth phase on a 209-hectare site will be brought forward over the next two years.

Europe aside, the Board has a plan for targeting clients and countries that are familiar to Costain and selecting projects with commercially acceptable terms and manageable risks. In particular, partnering relationships will be addressed by working with one or more of the three main Costain shareholders - Intria, Kharafi and Raymond - as well as existing regional strategic partners such as China Harbour Engineering in Hong Kong.

Projects successfully completed during the year included the new radio and TV broadcasting complex in Botswana in joint venture with Kharafi, the KCRC Pat Heung Rail Maintenance Centre in Hong Kong and the 70-kilometre Ngezi Road project in Zimbabwe.

Projects under tender include the £500 million plus Stonecutters Bridge in Hong Kong where we are seeking to bid with our partners China Harbour Engineering and NKK of Japan in limited competition for what will be the world's longest cable-stayed bridge. COGAP is preparing a tender for the £140 million Das Island Fourth Train project in joint venture with JGC. Three health sector tenders have been submitted in joint venture with Kharafi in Botswana and a further two are under preparation.

We have been awarded a drainage project in joint venture with Kharafi at Palapye in Botswana, valued at approximately £20 million, and we also secured the expansion of Victoria Falls Airport in Zimbabwe.

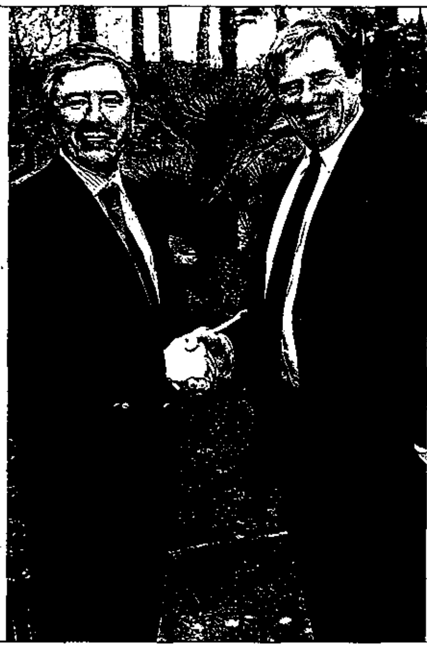
The political situation in Zimbabwe is uncertain and obviously we are closely monitoring developments. However, our exposure is limited and, at present, our construction activity progresses well. We must accept that all international operations are subject to extreme change in terms of political landscape and we will therefore take great care to ensure that all risks are understood and appropriate measures are taken to avoid any impact on the Company.

We continue to proceed with caution recognising the benefits of the association with our major shareholders and joint venturing with partners of long standing and strong track records of success.

PFI

Our major £76 million PFI King's College Hospital project in London in joint venture progressed extremely well during the year and the Golden Jubilee Wing was completed ahead of schedule to the great satisfaction of the client. This success enabled patients to move into the new facilities two months early. To record such a quality performance is extremely pleasing for all concerned. This is exactly the type of reference we need to produce for our healthcare portfolio.

Looking to the future, we expect to be appointed Preferred Bidder (in partnership) for Kingston Hospital and we are Preferred Bidder on two Intermediate Care Homes in Kent.



We are making progress with several other PFI Healthcare schemes, including two currently in the final competitive stage of bidding.

We remain as a shareholder in Bridgend Custodial Services (HM Parc Prison, Bridgend) and the Hospital Partnership Consortium (King's College Hospital).

Construction in joint venture of the new Met Office headquarters in Exeter is progressing well and is ahead of schedule, much to the delight of the client. The topping out ceremony to celebrate completion of the structure was held in December 2002.

Costain Oil, Gas & Process (COGAP)

In the early part of the year, we further strengthened our management team and introduced Bill Dubé as Managing Director. The order intake for COGAP during the year included the Major Plant Overhauls Term Contract for ADGAS by the Abu Dhabi operation. COGAP has embarked on a business strategy of addressing additional markets beyond the traditional oil and gas sectors through our proven competencies in engineering, design, project management and procurement. We are planning to leverage into further opportunities within the oil and gas sectors as well as chemicals, water, consultancy and further shutdown/maintenance contracts.

Construction was completed on two further NTS Compressor Stations at Cambridge and Nether Kellett with successful 24-hour reliability runs. Commissioning has commenced and final performance testing took place in March 2003.

COGAP successfully shipped the largest Nitrogen Rejection Unit of its kind to the end client, Lasmo in Pakistan. Construction work is substantially complete and COGAP personnel are now assisting the client with final commissioning. On Das Island (ADGAS), the gas facility off UAE with over 3,000 employees, we successfully completed a six-week shutdown with an unblemished safety record and an excellent financial result and have now negotiated a further three years of maintenance work.

The £65 million Rivers Fields contract to engineer, procure, construct and project manage for Burlington Resources is proceeding well. The project has an excellent safety record with no incidents in more than a year of site work. Civils work is being undertaken in-house and is on programme. The project is on course to deliver gas on the original programme date of mid-December 2003.

Conclusion

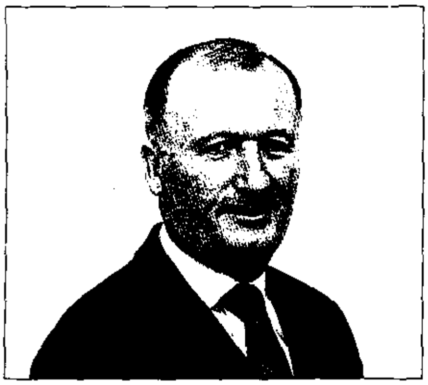
All in all, this has been a very successful year, particularly regarding the type of work we have secured and our continuing success at leveraging the brand to build a solid platform for future profitable growth.

Our strategy, the successful implementation of which has been reflected in virtually a doubling of our share price over the year, is robust and differentiates us from our competitors in that we are adhering to those sectors with considerable growth potential in a focused way and strictly adhering to a low-risk policy. I feel confident that focusing predominantly on contracting and indigenous growth whilst also considering any new opportunities that present themselves will hold us in very good stead for the future.

Stuart J Doughty
Chief Executive
25 March 2003

Alcaidesa
> Left
José Manuel Azcona Peribanez (left), Development Manager for Banesto Bank, pictured with Stuart Doughty, Costain Chief Executive, at the Alcaidesa development.
> Right
The Alcaidesa development on the Costa del Sol in which Costain has a 50% interest.

Financial review by Charles McCole Finance Director



£703m
Work in hand

£3.0m
Positive net assets

Profit before tax has improved by 30% to £11.3 million (2001: £8.7m) on a turnover including joint arrangements (construction joint ventures) up 17% to £543.4 million (2001: £462.9m).

Net interest receivable amounted to £1.4 million (2001: £2.0m) and other finance income amounted to £1.9 million (2001: £4.5m).

The tax charge on profits of £1.8 million (2001: £0.5m) is an effective rate of 16% and reflects the utilisation of Group tax losses.

Earnings per share increased 12% to 2.8p (2001: 2.5p).

Cash flow and borrowings

Despite the changing profile of the business towards framework/ partnered reimbursable contracts, the Group achieved a cash inflow during the year of £3.5 million (2001: £25.1m) that brought the net cash position to £71.3 million (2001: £67.8m). The net position includes £0.5 million of overdrafts, which should be repaid during the year leaving the Group with near to zero gearing.

Order intake

Order intake improved significantly during the year with a work-in-hand position of £703 million (2001: £570m) at the year-end.

Awards since the year-end and growth in existing contracts have increased the work-in-hand position to a sum approaching £1 billion with at least 85% of the order book being secured on a framework/partnered format, thus fully aligning with Group Strategy.

Shareholders' funds

The Group has positive operating net assets of £3.0 million (2001: £5.2m liabilities) for the first time in years. However, the impact of the deficit in the pension scheme, which under FRS 17 is included in the balance sheet produced a negative shareholders' funds position of £21.2 million (2001: £4.1m positive). The Group adopted FRS 17 in full in 2000 to give a fairer view of the pension position but, the volatility in the market, has created significant fluctuations.

The value of assets of the pension scheme has fallen by 9.9% in the year to December 2002, following negative returns on the equity markets. To stabilise the pension liabilities, we have increased contributions to the pension scheme from both employee and employer and we intend to cap pensionable salary increases to inflation.

Shareholder return

The market price of the Group ordinary shares at the close of the financial year was 24.25p, reflecting an 83% increase for the year as against a 25% fall (source: Datastream) on the FTSE Allshare index over the same period.

Treasury

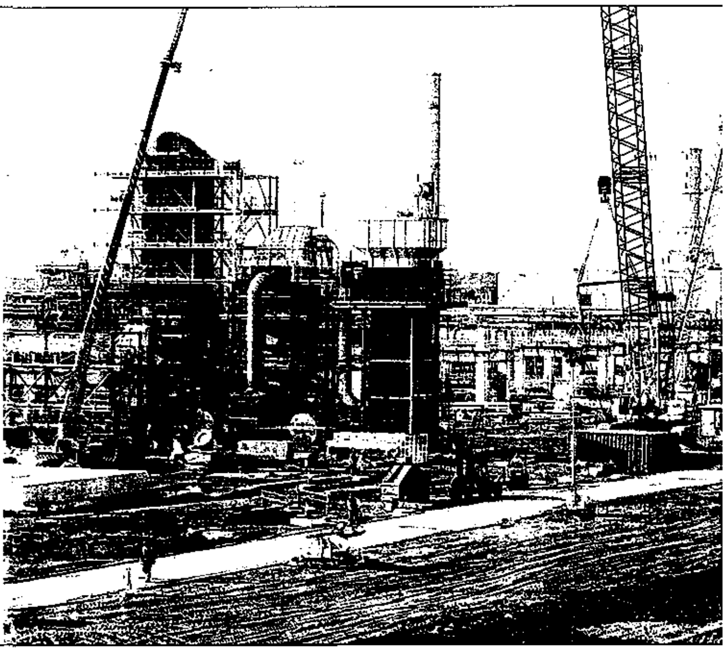
The Group holds financial instruments for two main purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. Various financial instruments - for example, trade debtors, trade creditors, accruals and prepayments - arise directly from the Group's operations. The Group finances its operations through a mixture of working capital and bank borrowings. With the Group's low level of borrowings, the main exposure to interest rates fluctuations arises from the surplus cash, which when available is generally deposited with one of the Group's relationship banks.The Group has borrowing facilities with its relationship banks to a maturity date of 31 March 2004. In addition to its borrowing facilities, the Group also enjoys contract bonding facilities with its relationship banks and St Paul Surety Europe Limited, both of which facilities subsist until 31 March 2004.

The Group has transactional currency exposure arising from commercial activities overseas by subsidiaries in currencies other than the subsidiaries' operating currencies. In such circumstances, the Group requires its subsidiaries to use forward currency contracts to minimise the currency exposure unless a natural hedge exists elsewhere within the Group.

Going concern

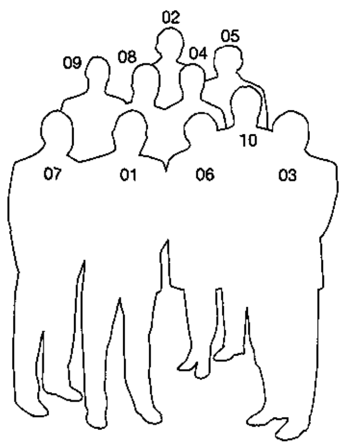
The Directors believe, after due and careful enquiry, that the Group has sufficient working capital for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2002 accounts.

Charles McCole
Finance Director
25 March 2003



COGAP
> Left
Mark Kingsley (left), the Burlington Project Manager, pictured with John Parr, Project Director, COGAP.
> Right
The Rivers Fields Development Project, Onshore Gas Terminal, Barrow-in-Furness.

Board of directors



01 David G Jefferies
CBE, FREng, FIEE (Hon), CCMI, DTech (Hon), LLD (Hon)①②③④
Non-Executive Chairman (2001)
Age 69. Formerly Chairman National Grid Group Plc (1989-1999) and Non-Executive Director and Chairman of Viridian Group Plc (1992-1999). Chairman, 24/Seven Utilities Services Limited (1990-2002). Chairman of Smart Logik Plc (2000-2002). Formerly a board member of the Strategic Rail Authority. Co-Chairman Indo British Partnership. Board Member of the Royal Institution.

02 Abdul Wahid Omar
FCCA ③
Non-Executive Deputy Chairman (2002)
Appointed 21 January 2002
Age 39. Managing Director/Chief Executive Officer of United Engineers (Malaysia) Berhad and Executive-Vice Chairman of Renong Berhad, a Non-Executive Director of Intria Berhad, Plus Expressways Berhad, Pharmaniaga Berhad and Projek Penyelenggaraan Lebuhraya Berhad, all of which are Kuala Lumpur Stock Exchange listed companies.

03 Stuart J Doughty
BSc, CEng, FICE
Chief Executive (2001)
Age 59. Non-Executive Chairman of Alstec Group Limited. Formerly Managing Director John Laing Construction Limited (1985-1986), Director of Tarmac Construction Limited (1987-1991), Director Alfred McAlpine Construction Limited (1992-1994), Director Hyder Plc (1995-1997) and Non-Executive Chairman Kennedy Construction Group Limited (1998-2001). Chairman Trade Partners UK and member of the ECGD Export Advisory Council.

04 Charles J McCole
BA, CA
Finance Director (2002)
Appointed 25 March 2002
Age 50. Formerly Finance Director of Sodexho UK (1994-2002).

05 Saad Shehata
BSc ①③
Non-Executive Director (1997)
Age 77. Sole Principal in Saad Y Shehata, engineers.

06 Mrs Leslie Rogers
BA, MBA ②③
Non-Executive Director (2001)
Appointed 9 January 2001
Age 44. Director of Raymond International WLL.

07 Frederick William Ballard
OBE①③④
Non-Executive Director (2001)
Age 64. Formerly Director of Alstom Power Conversion Limited (1986-2000). Chairman of United Kingdom Airports Group.

08 Aminuddin Yusof Lana
BCA, ACA, ACIS②③
Non-Executive Director (2000)
Managing Director of Intria Berhad; formerly Managing Director of Renong Berhad (1990-1993), Director and subsequently Group Managing Director of Faber Group Berhad (1990-1994) and Managing Director Metacorp Berhad (1995-1996), all of which are Kuala Lumpur Stock Exchange listed companies.

09 David P Allvey
FCA, ATII②③④
Non-Executive Director (2001)
Age 58. Non-Executive Director of Britannic Plc, Intertek Plc and William Hill Plc. Board member of the UK Accounting Standards Board. Formerly Group Finance Director Barclays Bank Plc (1999-2000), Chief Operations Officer, Zurich Financial Services AG and Allied Zurich Plc (1997-1999), and Group Finance Director of BAT Industries Plc (1989-1998) and Non-Executive Director of McKechnie Group Plc (1993-2000).

10 John Bryant
MA (Cantab), FREng, FIM, CEng, DSc (Hon) ①③④
Non-Executive Director (2002)
Appointed 1 February 2002
Age 59. Non-Executive Director Welsh Water Plc and Glas Cymru Limited. Formerly Chief Executive British Steel Plc (1996-1999), Joint Chief Executive of Corus Group Plc (1999-2000) and Non-Executive Director Bank of Wales Plc (1996-2001).

① Member of Remuneration Committee
② Member of Audit Committee
③ Member of Nomination Committee
④ Independent Non-Executive Director

Executive Board
The Executive Board has primary authority for the day-to-day management of the Group's operations following policies laid down by the Board. It consists of the executive directors and certain senior managers and is chaired by Stuart Doughty, the Chief Executive. The other members of the Executive Board are:

Peter Adams
(Operations Director - International)

Bill Dubé
(Managing Director - COGAP)

Clive Franks
(Company Secretary and Group Legal Adviser)

Mark Gordon
(Managing Director - Building)

Stephen Hall
(HR Director)

David Jenkins
(Operations Director - the Regions and Asset Management)

Mark Lye
(Procurement Director)

Charles McCole
(Finance Director)

Symon Taylor
(Operations Director -
Major Civil Engineering Projects)

Report of the directors

The directors submit their report, together with the audited accounts for the year ended 31 December 2002.

Activities
The progress and prospects of the Group's businesses are reviewed on pages 12 to 19.

Fixed assets
The Board is of the opinion that the aggregate market value of the Group's land and buildings is in excess of book value but that this difference is not significant in relation to the affairs of the Group as a whole.

Directors and directors' interests
Present members of the Board are shown on pages 22 and 23.

Mr Charles Joseph McCole was appointed as Finance Director of the Company on 25 March 2002.

Mr Abdul Wahid Omar, a nominee of Daedalus Projects Limited was appointed as a non-executive director on 21 January 2002 and Deputy Chairman on 22 March 2002.

Mr John Martin Bryant was appointed as a non-executive director on 1 February 2002.

In accordance with the Company's Articles of Association, Mr Aminuddin Yusof Lana, Mr Saad Shehata and Mr Frederick William Ballard retire by rotation. No retiring director has a service agreement with the Company. Mr Shehata, having been born on 20 June 1925, will have attained the age of 77 years at the time of the Annual General Meeting and, pursuant to Section 293 of the Companies Act 1985 and Article 76 of the Company's Articles of Association, notice of his age in years must be given.

Details of directors' emoluments and interests in shares in the Company are contained in the Directors' remuneration report which appears on pages 32 to 39.

Related party transactions
Details of transactions with related parties undertaken by the Group during the year are disclosed in Note 27 to the accounts on page 59.

Dividends
No dividends were paid or recommended.

Substantial interests in shares
As at 25 March 2003, the Company had been notified in accordance with Sections 198 to 208 of the Companies Act 1985 of the following interests in its ordinary share capital:

Daedalus Projects Limited*	125,354,541	37.18%
Mohammed Abdulmohsin Al-Kharafi & Sons WLL	79,168,523	23.48%
Raymond International WLL	38,243,750	11.34%
Lloyds TSB Bank PLC	10,674,075	3.16%

*Intria Berhad owns 93% of Daedalus Projects Limited.

Corporate Governance
The Company is committed to the principles of corporate governance contained in the Combined Code which is appended to the Listing Rules of the Financial Services Authority (the "Combined Code") and for which the Board is accountable to shareholders. This statement on Corporate Governance, together with the Directors' remuneration report, explains how the Company has applied the principles set out in Section 1 of the Combined Code throughout the financial year ended 31 December 2002.

The Board and Committees
The Board currently comprises two executive directors and eight non-executive directors of whom four are independent non-executive directors. The remaining four non-executive directors are nominated by major shareholders, namely Daedalus Projects Limited, Mohammed Abdulmohsin Al-Kharafi & Sons WLL and Raymond International WLL. The composition of the Board does not, therefore, comply with provision A3.2 of the Combined Code which requires the majority of non-executive directors to be independent of management and free from any business or other relationship with the Company. The right of these three major shareholders to nominate non-executive directors means that, to comply with provision A3.2 of the Combined Code, additional independent non-executive directors would have to be appointed which may have the effect of making the Board unwieldy.

By virtue of the fact that the shareholders are entitled to appoint nominee non-executive directors for so long as they hold 7% of the aggregate nominal value of the then issued ordinary share capital of the Company, then the Company does not completely comply with provision A6.1 of the Combined Code. The appointment of four independent non-executive directors has brought the Company much closer to compliance with provision A6.1 of the Combined Code. The independent non-executive directors' appointments are for an initial period of three years at the expiry of which time their appointments are to be reviewed by the Nomination Committee to determine whether their appointment continues. The Company's Articles of Association requires that all directors including nominee non-executive directors should be subject to election by shareholders at the first opportunity after their appointment and to re-election thereafter at intervals of no more than three years, thus complying with provision A6.2 of the Combined Code.

Brief biographies of the executive and non-executive directors appear on pages 22 and 23. The biographies illustrate that the non-executive directors have a range of business and financial experience that is important and relevant to the management of the Company.

In the year ended 31 December 2002, the Board met on seven occasions. The Board has adopted a schedule of matters specifically reserved to itself for decision. The principal matters reserved to the Board concern strategic, financial, operational, compliance and risk management issues. The schedule of matters reserved to the Board is reviewed periodically. The Company does not comply with that element of provision A2.1 of the Combined Code which requires the Company to identify a separate senior independent Director for disclosure in the Annual Report and to whom concerns can be conveyed. The Board is of the view that such appointment is unnecessary on account of having an independent non-executive Chairman and separate independent non-executive Chairmen of the Audit and Remuneration Committees. All directors have access to the advice and services of the Company Secretary and a procedure also exists whereby any director, wishing to do so in furtherance of his duties, may take independent professional advice at the Company's expense. In the year ended 31 December 2002, no director sought independent professional advice.

In order to discharge their duties, the directors are provided with full and timely access to papers prior to Board meetings and the directors are free to seek any further information they consider necessary. In addition, between Board meetings, non-executive directors have access to the Chief Executive, Finance Director and Company Secretary in order to progress the Company's business.

All newly appointed directors are provided with a booklet covering the responsibilities and duties of directors of a public company and with additional relevant materials produced by the Company's legal advisers, Slaughter and May. In accordance with the recommendations of provision A1.6 of the Combined Code, the executive and non-executive directors have recently benefited from an in-house seminar conducted by Slaughter and May at which topical corporate governance issues were outlined and discussed and seminar papers were retained by members of the Board for reference.

The principal Board Committees are the Remuneration Committee, the Audit Committee and the Nomination Committee. Full particulars of the Remuneration Committee are given in the Directors' remuneration report which appears later on pages 32 to 39.

The members of the Audit Committee during the earlier part of 2002 were Mr Allvey as Chairman, Mr Jefferies, Mr Lana and Mr Shehata. On 22 March 2002, the members of the Audit Committee were confirmed as Mr Allvey, Chairman, Mr Jefferies, Mr Lana and Mrs Rogers. The Audit Committee has established written terms of reference which were reviewed, revised and re-issued on 29 August 2001 and it met on four occasions in 2002. The executive directors, the external auditors, the internal auditors and Group Financial Controller attend all meetings but provision is also made for discrete meetings between the Audit Committee and the external auditors. The Company Secretary is the Secretary to the Audit Committee.

Although the Remuneration Committee and the Audit Committee only comprise of non-executive directors, the requirements of provision B2.2 and D3.1 of the Combined Code are not strictly complied with. In the case of the Remuneration Committee, not all members are independent non-executive directors and, in the case of the Audit Committee, the majority of members are not independent non-executive directors. This arises from the current composition of the Board. Notwithstanding this non-compliance with the Combined Code, the Board is satisfied that the effectiveness and efficiency of the Audit Committee and Remuneration Committee are not impaired.

The Nomination Committee comprises the Group Chairman and all non-executive directors. The Group Chairman is the Chairman of the Committee. The Nomination Committee has established written terms of reference which were reviewed, revised and re-issued on 29 August 2001. This Committee meets as required to select and propose to the Board suitable candidates for appointment as executive and non-executive directors. In 2002, the role of the Nomination Committee was undertaken by the Board and by a sub-committee of the Board consisting of the Group Chairman, Chief Executive, Mrs Rogers and Mr Ballard.

Relationship with institutional investors and private investors
The Company has increased its communication with institutional investors and brokers. Presentations are now made to brokers' analysts, the press and institutional investors at the time of the announcement of the full year and half-year results. In addition, there are now regular meetings with analysts, financial journalists and institutional investors throughout the year.

The Company has three key shareholders who control the beneficial interest in 72% of the issued share capital of the Company and, also, appoint nominees to sit on the Board of the Company. However, apart from these three large shareholders, the Company has approximately 15,000 other shareholders and the Board recognises that not all of the Company's private investors have regular access to market information. All shareholders are sent copies of Annual and Interim Reports and, where appropriate, circulars and prospectuses and are given notice to enable them to attend the Company's Annual General Meeting. Shareholders whose shares are held by nominees may receive copies of such communications upon request. The Company has an internet web-site, www.costain.com, on which it publishes its magazine, "Blueprint", press releases and other information concerning the Company's business and upon which it will publish its annual and interim results.

In accordance with provision C2.1 of the Combined Code, the Company will announce the votes cast by proxy at the forthcoming Annual General Meeting. The Company complied with this obligation in respect of the Annual General Meeting in 2002.

The Company will comply with the Combined Code by giving 20 working days' notice of the Annual General Meeting. The Company complied with this obligation in respect of the notice for the Annual General Meeting in 2002.

Review of internal controls
The Board is responsible for the Group's system of internal controls and for reviewing its effectiveness. However, such a system can only manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss.

The Board maintains full control over strategic, financial, organisational and compliance issues. Within the overall objectives set by the Board, the management of the Group is delegated to the Chief Executive who is assisted by other members of the Executive Board. The Chief Executive has full authority to act subject to the matters reserved to the Board and to the requirements of Group Policies.

Following publication of guidance for directors on internal control "Internal Control: Guidance for Directors on the Combined Code" (the Turnbull guidance), the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group which has been in place for the year under review and up to the date of approval of the Annual Report and Accounts. This process is reviewed by the Audit Committee on behalf of the Board and accords with the Turnbull guidance.

The Audit Committee has reviewed the effectiveness of the system of internal controls as described below. The review covers all controls, including financial, operational and compliance controls and risk management. In particular:

Risk management
Risk management has been an important issue within the Company for many years but following the publication of the Turnbull guidance the Company undertook a detailed business risk review and identified and evaluated the significant project risks affecting the business. At the direction of the Board, existing procedures were reviewed and, where necessary, new procedures were developed to manage risk. This included a specific project risk management procedure which among other things required a Tender Project Risk Register and a Commercial Risk Review of the contract to be prepared in respect of each contract bid. This identifies key risks, the probability of those risks occurring, their impact if they do occur and the actions necessary to manage those risks to an acceptable level. The risks are divided into four broad categories namely: safety, technical, operational and environmental and are reviewed by the project manager and commercial manager of the project on a continuing basis following award.

The commercial and contractual risks identified as part of the Tender Project Risk Register are monitored and managed by the commercial director and commercial managers within the operations. It is also the responsibility of the commercial director and commercial managers to ensure that the risks accepted are fully understood. The commercial directors regularly report on commercial and contractual issues to the Board.

During 2002, the Company developed a major business improvement initiative, Implementing Best Practice Programme (IBP), which has seen the development of IBP documentation and which sets the minimum standard required to manage risk and opportunity throughout the lifecycle of a project. The key areas developed as part of the IBP programme were planning and programming, design management, supply chain management, subcontract management, proposals management and project management. These minimum standards, which are presented as process flow charts are supported by tools and guides which are available to the staff on the Costain intranet.

A management course has been developed to deliver training in the IBP standards which will be cascaded throughout the Group. The Company has also appointed a Group Risk Co-ordinator who is responsible for reviewing and endorsing the projects risk register at the time of tender and at various contract stages during the project. The Group Risk Co-ordinator will also be involved in settling tenders with a value in excess of £20 million and he will also undertake an end of contract review of the risk register on each project to determine whether there are any lessons to be learnt.

Internal Audit throughout the year audited projects to assess compliance with and the effectiveness of the risk management processes.

Management reviews the role of insurance in managing risks across the Group and bring any important issues to the attention of the Board.

Operational
Controls and procedures are detailed in Group Policy Statements, procedure manuals and other written instructions. A major review of the Group Policy Statements was undertaken in 2002. The procedure manuals are regularly reviewed. The procedures and "lessons learnt" are published on the Costain Intranet.

The Company has developed in the United Kingdom, operational management systems which are registered to BSI 9002/1994 which are designed to set out an operating framework that ensures a systematic approach to management to provide safe construction processes of the highest quality. The IBP standards referred to above are being incorporated within the Project Management Plans for each new contract which forms part of the accredited management system. The implementation and compliance with the management system are monitored and audited on a continual basis by a team of internal quality assurance auditors. External audits of the management systems are undertaken by the British Standards Institution in order to maintain the Company's accreditation.

To improve the monitoring of projects the Company introduced Total Project Reports (TPR). The TPR is submitted through commercial line management and covers programme, cost, value, physical progress, variations and the cash position of projects.

All projects operate in a controlled framework of safety, health and environmental systems. Execution of and compliance with these systems are monitored by the project management and audited by health, safety and environmental advisers. Further detail on safety, health and environmental matters is given on pages 28 and 29.

The Board and Executive Board receive reports at each meeting on health, safety and environmental performance and on significant operational matters. The responsibility for ensuring compliance with the Company's procedures lies with the Executive Board.

Financial
There is a comprehensive annual budgeting system for each business within the Group. The annual budget is discussed by the Executive Board and reviewed by the Chief Executive and Finance Director prior to submission to the Board for approval. An updated forecast is produced quarterly and compared with the annual budget and, where appropriate, the previous quarterly forecast.

Monthly actual performance of each operation is reviewed by management and, subsequently reported against forecast to the Executive Board and the Board. Reports cover profit and loss and cash flow with an accompanying narrative on significant issues underlying the financial reports.

In 2002, the Company decided to collate its site accounting procedures within a single procedural manual. It effectively formalises the existing procedures and instructions.

The Treasury and Tax Managers report to the Finance Director who reports to the Audit Committee from time to time on any issues of significance to the Group.

Compliance
The Group Policies contain a statement on business conduct, which emphasises the legal, ethical and moral standards that have to be employed in all the Company's business dealings. The Company expects the highest standards from all its employees.

Litigation and other legal matters are controlled by the Company Secretary and Group Legal Adviser. A legal report would be submitted to the Board in the event that a critical legal issue arose and, subject to that, a review of all litigation with a value of above £10,000 is submitted to, and reviewed by, the Board annually. Significant changes in laws and regulations are drawn to the attention of the appropriate staff and training is given where necessary.

Report of the directors continued

The processes used by the Audit Committee on behalf of the Board to review the effectiveness of the system of internal controls include the following:

- reviewing and agreeing the external and internal audit work plans;
- monitoring the process for formally identifying, evaluating and managing the significant risks within the business;
- overseeing the establishment of procedures to manage perceived risks;
- consideration of reports from management, internal and external audit on the adequacy and effectiveness of systems of internal control including risk management systems and any material control weaknesses;
- discussion with management of the actions taken on problem areas identified by Board members or in management reports or in the internal/external audit reports and monitoring the follow-up on any agreed remedial action; and
- a review of the self-certification returns on risks and internal controls from the various operating divisions of the Group.

The process of self-certification and hierarchical reporting which is in place provides for a documented and auditable trail of accountability. These procedures are relevant across Group operations and provide assurance to senior management and, finally, to the Board. Internal audit also provides a degree of assurance as to the operation and validity of the systems, processes and checks within internal control.

The Chairman of the Audit Committee reports the outcome of the Audit Committee meetings to the Board and the Board receives the minutes of all Audit Committee meetings.

Corporate Social Responsibility
Although Corporate Social Responsibility is not defined as such, it is generally considered to cover Health and Safety, Environmental, Ethical and Social issues. Corporate Social Responsibility is an increasingly important measure as to how a company is judged and the Board is very conscious of that fact and the need to manage that risk. The Company has for some years included within the Report of the directors a section on Health, Safety and Environment. This will now appear in this section of the Report of the directors.

Health, Safety and Environment
In line with the Health and Safety Commissions view, the Company believes that Health and Safety is central to sustainable development and the securing of a better quality of life for all. It is therefore of paramount importance to both the Board and the Executive Board that:

(i) health risks or accidents to employees, subcontractors, members of the public and others who may come into contact with the Group's activities are avoided;

(ii) the Group meets all applicable government guidelines or regulations and industry codes of practice on the environment in so doing seeks to reduce environmental disturbance in all the Group's activities;

(iii) the Company embraces and supports the efforts of the Major Contractors Group, the enforcing authorities and others through industry initiatives aimed at continually improving the Company's own performance; and

(iv) the Company develops an ethos and culture across the Group so that health, safety and environmental issues are given equal status to all other critical aspects of the business.

In order to achieve these objectives, regular reports on health, safety and the environment are submitted to and considered by the Board. The Executive Board considers health, safety and environmental performance at each monthly meeting. In addition, there is a committee of the Executive Board which is chaired by the Chief Executive and the members are the managing directors and operations directors. This Committee meets bi-monthly and is responsible, among other things, for overseeing the preparation, updating and dissemination of the Group's health, safety and environmental policies, monitoring health, safety and environmental performance, ensuring that appropriate training is undertaken by employees and the employees of subcontractors and taking the appropriate initiatives to deliver steady improvement in the health, safety and environmental performance of the Group.

Mr Doughty, the Chief Executive is the Board member responsible for health and safety.

The Group is committed to continuous improvement in health, safety and environmental performance. To ensure continuous improvement a number of targets for 2002 were set and the following was achieved:

- after reducing the Accident Frequency Rate by 25% in 2000 and 17% in 2001 the Company's Accident Frequency Rate was maintained at 0.54 in 2002, mirroring the results in 2001;

- all the operations directors and managing directors participated in cross boundary health and safety audits during the year;
- in total, 25 full health and safety audits and 22 environmental audits were carried out during the year. The full health and safety audits are in addition to those carried out by the regional safety advisors;
- on the training front, all project related staff received a minimum of one day's demonstrable HSE training relevant to their undertaking during the year. The NEBOSH General Certificate was passed by 17 non-safety staff during the year; and
- the Company is on target to meet the Major Contractors Group drive to have a competent work force enrolled in the CSCS scheme by 2004.

On the environment:
- site environmental plans were produced on all sites;
- the Company is committed to reduce waste and to move towards more sustainable construction. A waste management system was piloted during 2002 and is now being implemented on all sites with a view to waste being recycled or re-used wherever possible and to reduce the waste taken to landfill sites; and
- there were no pollution incidents in 2002.

Both Costain Limited and Costain Oil, Gas & Process Limited are accredited ISO 14001 (the International Environmental Standard).

In 2002, the Company took steps to consolidate its already strong safety culture with a number of new improved initiatives being implemented across the business. Early in the year, the "Be Safe" safety campaign was launched, designed to put safety at the forefront of everybody's mind and to make health and safety more visible to everybody involved in the operations. This campaign was implemented following a survey of some of the workforce on the Company's sites together with a consultation programme that fully engaged a selection of the workforce within the discussions. As a result, many of the suggestions raised during this exercise were included in the "Be Safe" campaign. This has resulted in further improvements in the safety standards on sites. The Company will continue to recognise and promote the contribution of the workforce and in doing so seek to achieve a culture of self-regulation.

The Company has strengthened its professional SHE advisors team by the recruitment of a further four health and safety graduates during the year.

During 2002, Westminster Plant Co Limited was prosecuted for failing to properly maintain a tower crane at the Northgate House project, London. Westminster Plant Co Limited pleaded guilty and was fined £5,000 with £3,200 in costs. Prior to that Westminster Plant Co Limited had an unblemished safety record since 1955.

Group policies
In 2002, the Board reviewed all the Group policies, including policies on:

- Business Conduct policy which covers the legal, ethical and moral standards which the Group must adhere to in all its business dealings. It covers conflict of interest and lays down stringent guidelines for the receiving and the giving of gifts, loans and entertainment and makes it clear that the offering of a gift (however nominal in value) could constitute bribery and corruption. It deals with the statutes covering corruption in the United Kingdom and the Anti-Terrorism Crime and Security Act 2001 which gives extra-territorial scope to the statutes covering the United Kingdom and so covers bribery and corruption of a foreign official notwithstanding the act of bribery and corruption is carried out in a country or territory outside the United Kingdom. The policy also prohibits anti-competitive behaviour;
- Insider Dealing policy which supplements the Model Code on directors dealing which forms part of the Listing Rules of the Financial Services Authority;
- Community Involvement policy which recognises that the work of the Company impacts on communities throughout the world. It is therefore important for the Group to (i) support employees involved in the community for both business reasons and their personal development, (ii) safeguard both the built and natural environment, (iii) create employment, (iv) encourage enterprise and promote regeneration in areas of need, (v) contribute to education and training through true partnerships and (vi) develop awareness of the work and values of the Group and the construction industry as a whole, as a resource for education in the wider community;
- Political and Other Charitable Donations policy which prohibits political donations without Main Board approval. The Company has not made political donations since 1990;
- Equal Opportunities policy provides for non-discrimination and equal opportunities. The policy is directed to avoiding discrimination based on gender, ethnic origin, religion, age, disability or sexual orientation. The policy also contains the Company's code of practice on harassment at work; and
- Public Interest Disclosure policy ("whistleblowing procedure") which encourages employees to report wrong doing by the Company or any of its employees that fall short of the business principles of the Group and ensures that employees who do report wrong doing are protected.

The above only represents some of the Group policies, the majority of which have been in existence for many years and have governed the conduct and action of the Company and its employees. The above policies all apply worldwide.

Employment policies
Group companies adopt employment policies best suited to their operations and in compliance with the requirements of the territories in which they work. Personnel policies are designed to provide equal opportunities to all in accordance with the Group policy outlined above. In particular, the employment of those who have become disabled is continued wherever possible and opportunities are provided for the recruitment, training and career development of disabled people. Although the Company does work in countries outside the Organisation of Economic Co-operation and Development (OECD) the Company takes such action as it can to comply with the majority of the core labour standards contained within the International Labour Organisation (ILO) conventions on:

- discrimination at work;
- prohibiting the employment of children below 15 years and below 18 years in most hazardous work; and
- prohibiting the use of forced labour, indentured labour, slave labour and prison labour.

Community relations
In 2002, the Company launched their "Building Awareness" programme which is designed to encourage young people to consider careers in the construction industry. The programme enables the Company to work with schools, universities, the Construction Industry Training Board (CITB) and other professional institutions to reverse the decline in young people pursuing a career in construction. The scheme operates regionally with the Company's employees volunteering their services to act as regional co-ordinators and administrators. Recently graduated employees act as "young presenters" visiting schools and colleges to speak with youngsters about their experience of the industry.

As part of the programme, participants are taken to the Company's construction sites to learn about how different projects are managed. A variety of work-based projects are completed, aimed at developing the necessary skills and qualities for a career in construction. Older participants can also take part in work placements at the Company's sites. The resulting scheme aims to provide young people with a comprehensive overview of the industry and the range of jobs on offer.

The Company is targeting schools which place a special emphasis on teaching maths, science and technology which are within reasonable proximity to the Company's regional offices or live major projects and have a strong desire to form links with the industry. The first schools are already enrolled in the scheme.

In addition, the Company:

- welcomes teachers and school/college students to undertake accompanied site visits to the majority of the Company's projects;
- arranges community briefings and awareness programmes on major project sites advising on amongst other things the mitigation measures being taken particularly those related to the environment;
- is prepared to be involved and take part in local and regionalised events particularly linked to schools, colleges and universities which have a construction bias;
- is prepared for its executives to give presentations and talks on the Company's projects and other topics of industry interest to professional bodies and special interest groups; and
- takes a particular interest in students who wish to be involved in VSO projects or gap year projects in the Third World.

Policy and practice on payment of suppliers
As a result of the nature of the Group's business, the contractual relationships with suppliers of goods and services and with subcontractors vary according to circumstances. It is the Group's policy to enter into an appropriate form of contractual agreement on payment terms and to pay according to those terms. The Group does not follow any particular code or practice for the payment of creditors. In practice, the Group makes every effort to pay accordingly when it can be confirmed that the supplier has provided the goods or services in accordance with the relevant terms of the contract. The amount for trade creditors of the major subsidiary trading companies represents 53 (2001: 51) days of average daily purchases. The Company has no trade creditors.

Donations
Group charitable donations of £325 were made during the year. No political donations were made.

Auditors
KPMG Audit Plc has expressed its willingness to continue in office as auditor of the Company and a resolution to re-appoint them will be proposed at the forthcoming Annual General Meeting.

Annual General Meeting
The Annual General Meeting of the Company will be held at One Great George Street, Westminster, London SW1P 3AA on Friday, 23 May 2003 at 11:00 am. The following resolutions will be proposed as Special Business:

a. An ordinary resolution will be proposed to renew the directors' authority to allot relevant securities within the meaning of Section 80 of the Companies Act 1985. The current authority lapses on 23 May 2007 but this authority is normally renewed at each Annual General Meeting so that the authority under the resolution (resolution no. 6 in *the Notice of Meeting) will replace the existing authority and will lapse on 22 May 2008. The authority is limited to* shares of a nominal value of £11 million which equates to 110 million ordinary shares of 10p each being approximately 33% of the current issued ordinary share capital.

b. Resolution 7 in the Notice of Meeting is a special resolution for the renewal of the directors' authority (i) to make a rights issue and (ii) to issue a limited number of shares for cash without first offering them to shareholders pro-rata to their holdings. In the latter case the authority is limited to shares of a nominal value of £1.6 million which equates to 16 million ordinary shares of 10p each which is approximately 5% of the currently issued ordinary share capital. The authority contained in the resolution expires at the earlier of next year's Annual General Meeting and 22 August 2004.

   The directors have no current intention of exercising either authority contained in Resolution 6 or 7 in the Notice of Meeting other than in connection with satisfying any allotment of shares made pursuant to amended Article 1(E).

c. In line with the Higgs "review of the role and effectiveness of non-executive directors", the Company has decided to amend Article 1(E) to allow Directors but principally Non-executive Directors the opportunity to take part of their remuneration in the form of shares in lieu of cash. At the same time the Board has decided to increase the maximum limit on the aggregate fees from £250,000 to £500,000 as the limit has not been increased for many years.

Copies of the Memorandum and Articles of Association of the Company in the form in which they will appear if amended will be available for inspection at the registered office during the normal business hours from the date of notice until the date of the Annual General Meeting and for fifteen minutes prior to and at the meeting.

Mr David Allvey the Chairman of the Audit Committee and Mr John Bryant the Chairman of the Remuneration Committee will be available at the Annual General Meeting.

By Order of the Board
Clive L Franks
Secretary
25 March 2003

Directors' remuneration report

Remuneration Committee

The Board has a Remuneration Committee which consists of four non-executive directors. At the beginning of 2002, the members were Mr Jefferies who was appointed Chairman of the Remuneration Committee on 16 January 2002, Mrs Rogers, Mr Lana and Mr Ballard. On 22 March 2002, Mr Bryant was appointed a member and the Chairman of the Remuneration Committee, and, at the same time, the other members were confirmed as Mr Jefferies, Mr Ballard and Mr Shehata. Further details of the members of the committee are given on pages 22 and 23. The Remuneration Committee has established written terms of reference, which were reviewed, revised and re-issued on 29 August 2001 and it met on six occasions in 2002. The Chief Executive is normally in attendance at Remuneration Committee meetings but is always excluded when his own performance and remuneration are under review.

The Remuneration Committee is advised by Mr S Hall the senior human resources manager in the Group and by the Company Secretary. The Remuneration Committee is also entitled to access independent advice from external consultants on individual remuneration packages or the Company's remuneration practices in general. The Remuneration Committee took advice from KPMG LLP during 2002. KPMG LLP advised on a Long-Term Incentive Plan, Save As You Earn Share Option Plan and undertook a benchmarking exercise comparing salary and other terms and conditions of senior executives within the Group with those of other companies in the sector. Save for that, the Remuneration Committee did not take any other independent advice during the financial year ended 31 December 2002. KPMG LLP was appointed by the Company and not by the Remuneration Committee.

The remuneration of non-executive directors is determined by the Board as a whole and no director is involved in determining his own remuneration.

Remuneration policy

The Remuneration Committee makes recommendations to the Board on executive remuneration policy for adoption by the Board and determines specific remuneration packages for each of the Executive Directors on behalf of the Board. In addition, the Remuneration Committee will review and consider on behalf of the Board the Company's policies on total pay and other benefits (in all its or their forms) payable to, and terms of employment of senior executives of the Group (other than the Executive Directors) and shall make or authorise changes where appropriate to ensure such policies are in the best interests of the Company having regard to those adopted from time to time in other companies within the UK-based construction sector and are designed to encourage and reward individual performance in the interests of the Company.

The remuneration policy for Executive Directors and other senior executives is designed to attract, retain and motivate executives of the appropriate calibre and experience so that the Company is managed successfully for the benefit of its stakeholders. The Remuneration Committee is, however, aware that it should avoid paying more than is appropriate or necessary. Accordingly, the Group carries out each year, for the benefit of the Remuneration Committee, an exercise to benchmark remuneration packages and their constituent elements with those of comparable organisations, primarily with the UK-based contracting sector, to ensure that the remuneration packages within the Group bear reasonable comparison with those of other companies. The comparison exercise is only one element to assist the Remuneration Committee in exercising its judgement; the Remuneration Committee also takes into account personal performance.

The main components of Executive Directors' and other senior executives' remuneration packages comprise basic salary, which forms the major element of remuneration, an annual bonus which is dependant on the achievement of short term objectives approved by the Remuneration Committee, long term incentive arrangements, membership of the pension scheme (which includes life cover of four times salary for death in service), a company car (and in certain cases the provision of a fuel benefit) and the provision of health insurance or a contribution to the provision of health insurance.

Since the advent of the Combined Code, the Remuneration Committee has given due consideration to the provisions of B1.1 to B1.6, and to Schedule A of the Combined Code in formulating the remuneration policy of the Group and has noted and taken account of the requirements of provision B1.7 to B1.10 with regard to service contracts and compensation. The Company does substantially comply with provisions B2.1 to B2.6 of the Combined Code with regard to the establishment and procedures of the Remuneration Committee, save that as already noted, the Company does not comply with provision B2.2 of the Combined Code in connection with the membership of the Remuneration Committee. The Remuneration Committee has also taken into account provisions B3.1 to B3.4, the provisions in Schedule B to the Combined Code and The Directors' Remuneration Report Regulations 2002 in the preparation of this report.

At the Annual General Meeting of the Company held on 24 May 2002, the Company approved the introduction of a Long-Term Incentive Plan and the 2002 Save As You Earn Share Option Scheme. Further details of both schemes are given below but, subject thereto and the increase in the maximum annual bonus to 50% of basic salary, there were no material changes made to the remuneration policies of the Company during the year.

The Company's policy on directors' remuneration for the following and subsequent financial years will substantially follow the policy laid down herein, save as where otherwise noted.

Further details of the main components of Executive Directors' and other senior executives' remuneration packages are given below:

Basic Salary - Salary is the major element of the remuneration package. The Remuneration Committee reviews the salaries of the Executive Directors annually and, at the same time, gives guidance to the Chief Executive as to the matters to be taken into account in the salary review of the other senior executives of the Group. Salaries for Executive Directors are based on market rates and take account of an executive's experience, responsibilities and performance. The remuneration of other senior executives is determined in the light of the levels of remuneration generally within the Company and other companies in the UK-based construction sector. The salary review is undertaken in February/March of each year, after a review of the performance of the individual. A salary increase, if awarded, is effective from 1 April in each year.

From April 2002, Mr Doughty's basic salary was increased by 8.33% from £240,000 to £260,000 per annum. Mr McCole's basic salary was fixed at £140,000 per annum upon joining the Company.

Annual Bonus - An annual bonus scheme is a further component of the remuneration package for Executive Directors and other senior executives. In 2002, annual bonuses were increased from a maximum of 40% of basic salary to 50% of basic salary if performance targets were met. This was to bring annual bonuses into line with other companies within the sector. The performance targets for 2002 related to profit at Group level and cash and, in addition, bonuses include a discretionary element. The targets for the annual bonus are reviewed and approved annually by the Remuneration Committee. Mr Doughty received his full bonus for the period 1 July 2001 to 31 December 2001. The bonus was £50,000 of which £30,000 was related to the satisfaction of certain performance criteria and the balance of £20,000 was in the absolute discretion of the Remuneration Committee. For the period ending on 31 December 2002, Mr Doughty was entitled to earn a bonus of £120,000. For the payment of £72,000 of that bonus, the Remuneration Committee has to be satisfied that certain performance criteria relating to profit, cash and turnover have been met. The balance of £48,000 is in the absolute discretion of the Remuneration Committee, but in exercising their discretion, they are entitled to take into account whether certain management issues have been achieved. Mr McCole joined the Company on 25 March 2002 and, for the period 25 March 2002 to 31 December 2002, Mr McCole was entitled to earn a bonus of £50,000. For the payment of £40,000 of that bonus, the Remuneration Committee has to be satisfied that certain performance criteria related to profit and cash have been met. The balance of £10,000 is in the absolute discretion of the Remuneration Committee.

There is no requirement for any bonus earned to be taken as shares. Bonus payments are not pensionable.

Long Term Incentive Arrangements - Following shareholder approval of the Long Term Incentive Plan ("LTIP") for Executive Directors and other senior executives at the 2002 Annual General Meeting awards were made to Executive Directors and other senior executives on 11 October 2002 subject to the conditions set out below. The LTIP is designed to reward Executive Directors and other senior executives by reference to the performance of the Group. As a consequence of these awards, and in accordance with the rules of the LTIP and the terms of his award, each participant receives an option to acquire ordinary shares in the Company up to a maximum number equivalent in value at the date of the award to 37.25% of his basic annual salary, which may be transferred to him if and to the extent that an earnings per share (EPS) growth target is met. The share price of Costain Group PLC ordinary shares at the date of award was 25p. The performance condition for the award made in 2002 is the achievement of an EPS of 5.59p in the financial year ending 31 December 2005. This represents more than a doubling of earnings per share from the results declared for the year ended 31 December 2001 and was considered by the Committee to be a reasonably challenging target. The Remuneration Committee believe that the LTIP will reward only the strongest performance and, in providing incentives and rewards for meeting the objectives of the Group's business plan and increasing profitability, successfully align the interests of the Executive Directors and other senior executives with those of shareholders, whilst at the same time giving effect to the spirit of published institutional shareholder guidelines and the Combined Code on corporate governance. The Remuneration Committee considers that an EPS target is the most appropriate performance target in the shorter term in order to focus on achieving the demanding business plan but anticipates that a move towards total shareholder return (TSR) measurement, which is more commonly adopted, will be applicable in future years as performance against the business plan is achieved. If the performance condition is satisfied, the participant will be entitled to acquire up to 75% of the ordinary shares subject to the award by paying an exercise price of £1 at any time between the fifth working day following the announcement on the London Stock Exchange of the preliminary statement of the annual results for the year ended 31 December 2005 and 10 October 2012. The participant will be ntitled to acquire the balance of the award of the ordinary shares by paying an exercise price of £1 at any time etween the fifth working day following 31 December 2007 and 10 October 2012. The vesting of the balance of the vard is not subject to the satisfaction of any further performance condition. If the performance condition is not tisfied, no award will be made.

Directors' remuneration report continued

Details of the Executive Directors' participation in the LTIP are as follows:

	Date of Grant	Maximum Number of Ordinary Shares*	Exercise Period
S J Doughty	11.10.02	290,611	March 2006 - October 2012
		96,870	January 2008 - October 2012
C J McCole	11.10.02	156,483	March 2006 - October 2012
		52,160	January 2008 - October 2012

* Assumes the performance criteria is met.

The Company will not be entering into an LTIP in 2003 for executive directors and other senior executives.

The Company has two other long-term incentive arrangements. First, the 1994 Executive Share Option Scheme which provides both a Revenue-approved arrangement and also allows options to be granted outside the Revenue-approved arrangement. Executive Directors and other senior executives may participate in the Executive Share Option Scheme. Options over the Company's ordinary shares may be granted each year to Executive Directors and other senior executives and, when granted within the Revenue-approved arrangement of the scheme, the options over shares are limited to an aggregate limit of £30,000. In the non-Revenue approved arrangement under the scheme, options may be granted over shares with an aggregate limit of four times the earnings of the employee to whom the grant is made. The scheme rules do not permit options to be granted with an exercise price at a discount to the market value of the shares at the date of grant. The options are only exercisable following the attainment of a performance condition or conditions measured over a continuous period of at least three years, commencing no earlier than the financial year immediately preceding the date of grant. Options may not be exercised before the third anniversary of the date of grant and lapse if not exercised by the tenth anniversary of the date of grant. When an employee exercises his option, the Board may, at its discretion, pay to such an employee a cash sum equal to the amount by which the value of the ordinary shares, in respect of which the notice of exercise was given, exceeds the total amount payable on any exercise by the employee, instead of allotting or procuring the transfer of ordinary shares to that employee.

The other long-term incentive arrangement is the 1993 Performance Share Scheme which provides a means of awarding Executive Directors and other senior executives options to acquire shares in the Company provided that specific performance criteria have been met. There are various limitations on the grant of options under this scheme, including a prohibition on a grant of an option to an employee unless a period of not less than twenty-two months has elapsed since the date of the previous grant of an option under the scheme and a prohibition on a grant of an option if this would result in an employee holding options under the scheme where the market value of the shares at the date of grant exceeded in aggregate four times the employees salary, exclusive of bonus and the value of other benefits. The scheme also prohibits the grant of an option to an employee within three years of his retirement. The scheme does not permit options to be granted with an exercise price at a discount to the market value of the shares at the date of grant. Options are only exercisable on the attainment of performance criteria measured over a continuous period of three financial years beginning with the financial year in which the grant of the option is first made. The option cannot be exercised until one month following the date of publication of the audited consolidated accounts of the Company for the last financial year of the three year performance period. The shares to satisfy any exercise of an option will be transferred from the Costain Group Employee Trust and so options granted under this scheme do not dilute shareholders equity as they have been purchased on the market.

Options over 15,000 shares are outstanding under the Executive Share Option Scheme. No options are outstanding under the Performance Share Scheme. No options were granted under either the Executive Share Option Scheme or the Performance Share Scheme in 2002. Further details of the options are given in Note 20 to the Accounts on page 55.

At the 31 December 2002, the derived mid-market price of the ordinary shares of the Company, as advised by the Company's Brokers was 24.25p. The range of the share price of the ordinary shares during 2002 was 13.25p to 27.75p.

The Group granted options on 22 October 2002 under a Save As You Earn Share Option Scheme (the "Plan") which was approved by shareholders at the 2002 Annual General Meeting. All eligible employees and Executive Directors are entitled to participate in the Plan provided that they had been in the employment of the Company for twelve months prior to the date of grant. Neither Executive Director participated in the Plan but details of the grants made under the Plan are shown in Note 20 to the Accounts on page 55.

Benefits - benefits comprise primarily of the provision of a company car, fuel and subsidised medical insurance and the amounts stated exclude the pension and life assurance costs identified separately under "Pension Arrangements". The amounts stated also exclude the cost of disability insurance which is provided by the Group to all staff employees under a general policy with no separately-identifiable cost in respect of individual beneficiaries, save in the case of

Mr Doughty and Mr McCole where the premium payable in respect of permanent health insurance for Mr Doughty was £2,220 (2001: £255 but the cover was only effected on 30 November 2001) and the premium payable in respect of permanent health insurance for Mr McCole was £847 (2001: NIL), Mr McCole having joined the Company on 25 March 2002.

No payments were made to or benefits received by Executive Directors during the year under any long-term incentive scheme.

Pension Arrangements - Executive Directors (with the exception of Mr Doughty) and other senior executives participate in the executive section of the Group's main approved UK pension scheme. This section provides enhanced benefits in respect of accrual rate and spouse pension and early retirement ages (e.g. 60 for Executive Directors and other members of senior management). In addition to a maximum pension of two-thirds of final salary, the scheme provides a lump sum death in service benefit of four times basic salary and pensions for dependants of members. The Executive Director in the scheme and all other senior executives participate on a contributory basis.

In the case of Mr Doughty, the Company makes no contribution to his personal pension arrangements. Life assurance cover of four times basic salary is provided through the approved UK pension scheme in respect of earnings up to the Inland Revenue limit (£97,200 per annum with effect from 6 April 2002) and through the Costain Funded Unapproved Retirement and Death Benefit Scheme in respect of the excess. The annual premium payable in respect of life assurance for Mr Doughty was £4,288 (2001: £1,520 for part of the year) and the premium payable in respect of life assurance for Mr McCole was £242 (2001: NIL).

Pension benefits earned by Executive Directors (defined benefit scheme):

	Change in accrued benefits during the year	Accrued benefit at year-end	GN11 transfer value of accrued benefits at year end	GN11 transfer value at the beginning of year	Increase in GN11 transfer value net of director's contributions
	£pa	£pa	£	£	£
C J McCole	1,080	1,080	18,092	–	13,566

Notes to defined pension benefits

(1) The transfer value has been calculated on the basis of actuarial advice in accordance with Actuaries Guidance Notes GN11 and GN27.

(2) The pension entitlement shown is that which would be paid annually on retirement based on service to the end of the year.

(3) Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table.

The Costain Funded Unapproved Retirement and Death Benefit Scheme was established in 1997 to provide benefits for senior executives subject to the Inland Revenue limit (£97,200 per annum with effect from 6 April 2002) on earnings eligible for treatment as pensionable earnings under approved pension schemes.

With the exception of contributions paid to secure life assurance benefits, no contributions were paid to the Costain Funded Unapproved Retirement and Death Benefits Scheme during the year. However, a contribution liability of £11,380 has accrued during the year in respect of Mr McCole and this contribution is being retained, pending clarification of the proposals contained in the Green Paper entitled "Simplicity, Security and Choice: working and saving for retirement" (published in December 2002) and the new tax proposals contained in a consultation paper issued by the Inland Revenue/HM Treasury entitled "Simplifying the taxation of pensions: increasing choice and flexibility for all", particularly those relating to the future tax treatment of unapproved schemes.

Directors' remuneration report continued

Prior to the establishment of the scheme, pension entitlements on earnings in excess of the limit were provided by way of an unfunded reserve. The unfunded liability is being externally funded through the unapproved scheme over a five-year period commencing from 1998 and the current position is:

	£
Unfunded reserve at 31 December 2001	68,287
Payment to unapproved scheme	(30,240)
Interest on balance carried forward	2,953
Unfunded reserve at 31 December 2002	41,000

Contracts of Service - In general, the service agreements with Executive Directors and other senior executives provide for termination by the Group on either one or two years' notice. No Executive Director has a notice period over one year. The Committee considers that such notice periods are reasonable and fair in the interests of the Group and the individual concerned, having regard to prevailing practice amongst public companies both in the industry in which the Group operates and elsewhere.

The Remuneration Committee considers it unlikely that any Executive Director or other senior executive would in the future be engaged with a notice period greater than one year. There is no provision for payment of predetermined compensation in case of wrongful termination by the Group. The Remuneration Committee also believes that a robust line should be taken on reducing compensation to reflect departing Directors' obligations to mitigate loss.

Mr Doughty's service agreement is dated 14 June 2001 and terminates automatically at his normal retirement age of 60 years which he achieves in September 2003. In accordance with the agreement reached between the Board and Mr Doughty, and referred to in the Chairman's Statement, Mr Doughty's contract will continue from year to year following his attainment of normal retirement age, subject to termination by either party on 6 months' notice given at any time and to a formal review at each anniversary. Mr McCole's service agreement is dated 22 May 2002 and, until 24 April 2003, Mr McCole is on six months' notice of termination given at any time and thereafter on 12 months' notice of termination given at any time. His service agreement will end automatically when he reaches normal retirement age of 60 years.

Outside Appointments - In principle, the Company encourages Executive Directors to take outside appointments, with the prior consent of the Company, in the belief that such appointments broaden their skills and the contribution which they can make to the Company's performance. However, not more than one such appointment may be undertaken except in special circumstances. There must be no conflict of interest, and the time to be devoted to the outside appointment must be reasonable in relation to the individuals commitment to the Company. Fees paid for outside appointments may be retained by the individual concerned. The Board has agreed that Mr Doughty can hold more than one outside non-executive appointment.

Performance graph as required by The Directors' Remuneration Report Regulations 2002
The graph at the top of page 39 shows the Company's Total Shareholder Return (TSR) performance compared to the FTSE All Share Index TSR over the last five years namely the period from 1 January 1998 to 31 December 2002.TSR is defined as share price growth plus reinvested dividends but it will be remembered that during the period the Company has not paid dividends. The FTSE All Share Index TSR has been rebased so that it starts at the same TSR point as the Company on 1 January 1998. As a broad index is required for a comparison, the Board is of the opinion that the FTSE All Share Index is the most appropriate for the Company as the Company is a constituent part of that index.

Directors' remuneration

The aggregate directors' remuneration for the year ended 31 December 2002 was £616,639, as set out in the following table:

	Salary/fee	Bonus	Benefits	Other	2002 Total	2001 Total
	£	£	£	£	£	£
Executive Directors						
S J Doughty	255,000	51,590	9,999	-	316,589	126,520
C J McCole [1]	95,487	-	5,456	-	100,943	-
Non-Executive Directors					-	
D G Jefferies	50,000	-	-	-	50,000	25,000
A W Omar [2]	16,647	-	-	-	16,647	-
D P Allvey	25,000	-	-	-	25,000	4,166
F W Ballard	25,000	-	-	-	25,000	18,435
J M Bryant [3]	22,916	-	-	-	22,916	-
A Y Lana	17,500	-	-	-	17,500	17,500
Mrs L A W Rogers	17,500	-	-	-	17,500	17,185
S Y Shehata	17,500	-	-	-	17,500	17,500
B K Vasiliou [4]	7,044	-	-	-	7,044	17,500
Former Directors	-	-	-	-	-	716,494
TOTAL	549,594	51,590	15,455	-	616,639	960,300

Notes:

[1] appointed as Finance Director on 25 March 2002
[2] appointed on 21 January 2002
[3] appointed on 1 February 2002
[4] resigned on 24 May 2002

Performance-related bonus payments of £51,590 were made to Mr Doughty in 2002. A performance-related bonus payment of £11,376 was made to Mr M Roberts in 2002 after he had ceased to be a director of the Company.

No payments were made to or benefits received by Executive Directors during the year under any long-term incentive schemes.

No compensation was payable to Executive Directors for loss of office in 2002 (2001: £300,000).

Payments made to a third party in respect of directors' services amounted to £16,647 (2001: £27,844). This figure is included within the Directors' emoluments.

No payment was made to any alternate director.

The emoluments of the highest paid Director were £316,589 (2001: £463,667) both figures exclude attributed pension contributions.

Directors' remuneration report continued

Directors' interests

Directors' interests recorded by the Company, in accordance with requirements of the Companies Act 1985, are as follows:

		At 1.1.02	At 31.12.02
D G Jefferies	a	100,000	175,000
A W Omar		-*	-
S J Doughty	a	-	86,000
	b	-	387,481
C J McCole	b	-*	208,643
D P Allvey	a	-	30,000
F W Ballard	a	-	17,987
J M Bryant	a	-*	50,000
A Y Lana		-	-
Mrs L A W Rogers		-	-
S Y Shehata		-	-
B K Vasiliou		-	-†

Notes

* at subsequent date of appointment
† at date of resignation
a Costain Group PLC ordinary shares of 10p each
b Options granted on 11 October 2002 to acquire Costain Group PLC ordinary shares of 10p each under the 2002 Long-term Incentive Plan

Mr S J Doughty has purchased 80,000 ordinary shares since the 31 December 2002 bringing his holding to 166,000 ordinary shares in Costain Group PLC. Mr McCole has purchased 80,000 shares since 31 December 2002.

All interests are beneficial. Particulars of Directors' options are contained in the register of Directors' interests.

The basis on which Executive Directors participate in long-term incentive schemes is decided by the Remuneration Committee, except for the Costain Share Saving Scheme which is open to all relevant UK employees. Non-Executive Directors do not participate in any of these schemes.

No options were exercised by Directors during the year.

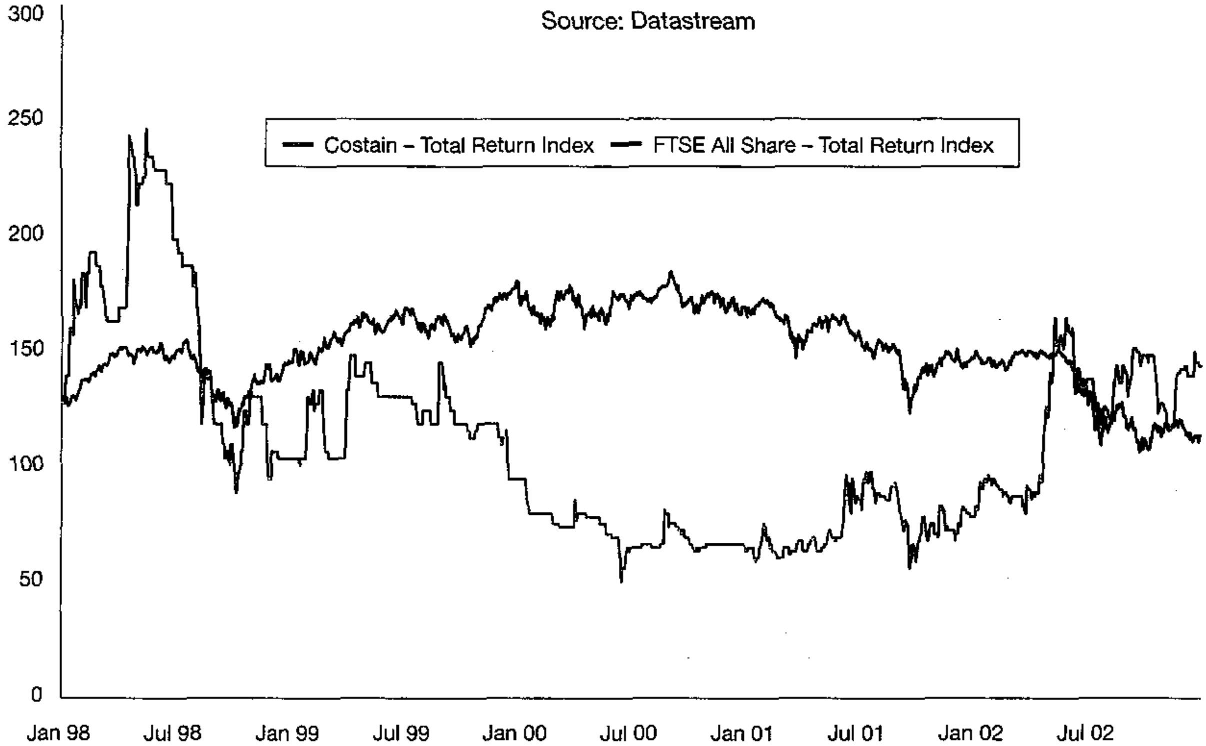
Details of all outstanding options are set out in Note 20 to the accounts on page 55.

The Company's auditors are required to report to the shareholders on the information set out within the Directors' remuneration and Directors' interests sections of this report. Other elements of the Directors' remuneration report are unaudited.

The performance graph referred to on page 36

Costain Total Return Index (against FTSE All Share – rebased)

Source: Datastream



Non-executive directors

The independent non-executive directors have contracts of appointment. These cover, amongst other things, the initial terms for which the independent non-executive directors are appointed, a general statement on their role and duties, and the fees they will receive as a director.

Non-executive directors' initial period of appointment is until their turn comes to retire by rotation under the Articles. This is intended to be three years and will be treated as being three years notwithstanding that because of changes that have taken place on the Board their term to retire by rotation may arise in under three years. The appointment of an independent non-executive director can be terminated by reasonable notice on either side. At the end of the initial period, the appointment may be continued by mutual agreement. Messrs Allvey, Ballard and Bryant are not entitled to compensation for loss of office.

The nominee non-executive directors, as indicated earlier, hold office for as long as the shareholder nominating them holds a specific percentage of the issued share capital of the Company. The nominee non-executive directors are nevertheless required to stand for re-election in the usual way.

In 2002, the Chairman received a fee of £50,000 per annum, the other independent non-executive directors received fees at the rate of £25,000 per annum and the nominee non-executive directors received fees at the rate of £17,500 per annum. The fee for the Chairman was increased to £95,000 per annum with effect from 1 January 2003. Individual directors cannot be involved in determining their own remuneration.

As mentioned earlier, non-executive directors do not participate in any Group share, bonus or pension scheme.

Although there is no requirement to do so, all the independent non-executive directors purchased ordinary shares in the Company shortly after their appointment so aligning their interests further with those of shareholders.

By order of the Board
John M Bryant
Chairman of the Remuneration Committee
25 March 2003

Directors' responsibilities in respect of the preparation of financial statements

The directors are obliged, under company law, to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In addition, the directors are responsible for maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. The directors also have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

For the purposes of the above statement, the term "Company" shall be taken to include the Company and the Group.

Independent auditors' report to the members of Costain Group PLC

We have audited the financial statements on pages 42 to 59. We have also audited the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
The directors are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 40 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the statements on pages 24 to 28 and 32 to 39 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion
We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the directors' remuneration report to be audited.

Opinion
In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 December 2002 and of the profit of the group for the year then ended; and
- the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

25 March 2003

Consolidated profit and loss account Year ended 31 December

	Notes	2002 Continuing £m	2001 Continuing £m
Turnover	2		
Group undertakings and Group share of joint ventures		**543.4**	462.9
Less: Group share of joint ventures turnover		**(21.6)**	(5.8)
Group turnover		**521.8**	457.1
Cost of sales		**(504.8)**	(440.7)
Gross profit		**17.0**	16.4
Administration expenses		**(16.5)**	(16.1)
Operating profit from Group undertakings		**0.5**	0.3
Share of joint ventures operating results		**7.5**	1.9
Operating profit - Group and share of joint ventures		**8.0**	2.2
Net interest receivable/(payable) and similar income/(charges)			
Group undertakings	4	**2.0**	2.5
Joint ventures		**(0.6)**	(0.5)
Other finance income - Group undertakings	5	**1.9**	4.5
Profit on ordinary activities before taxation	2, 3	**11.3**	8.7
Taxation	8	**(1.8)**	(0.5)
Profit on ordinary activities after taxation		**9.5**	8.2
Equity minority interests		**-**	0.1
Profit for the financial year	21	**9.5**	8.3
Earnings per share - basic and diluted	10	**2.8p**	2.5p

During the year and the previous year, no businesses were acquired and therefore all continuing results arise from existing operations.

The notes on pages 46 to 59 form part of these accounts.

Consolidated cash flow statement
Year ended 31 December

	£m	2002 £m	£m	2001 £m
Net cash inflow from operating activities		3.9		19.4
Returns on investments and servicing of finance				
Interest received	2.4		2.8	
Interest paid	(0.4)		(0.3)	
Net cash inflow from returns on investments and servicing of finance		2.0		2.5
Taxation				
Overseas tax paid		(0.4)		(0.2)
Capital expenditure and financial investment				
Purchases of tangible fixed assets	(1.2)		(0.8)	
Sales of tangible fixed assets	0.1		1.0	
Repayments of loans to other investments	0.1		-	
Loans to joint ventures	(0.5)		(0.4)	
Repayment of loans to joint ventures	-		3.1	
Net cash (outflow)/inflow from capital expenditure and financial investment		(1.5)		2.9
Net cash inflow before financing		4.0		24.6
Financing				
Loan repayments	-		(2.9)	
Net cash outflow from financing		-		(2.9)
Increase in cash in the year		4.0		21.7

Reconciliation of net cash flow to movement in net cash

	2002 £m	2001 £m
Increase in cash in the year	4.0	21.7
Cash outflow from reduction in loan financing	-	2.9
	4.0	24.6
Currency realignment	(0.5)	0.5
Movement in net cash	3.5	25.1
Net cash at 1 January	67.8	42.7
Net cash at 31 December	71.3	67.8

The notes on pages 46 to 59 form part of these accounts and the notes to the cash flow statement are shown in note 25.

Consolidated balance sheet
As at 31 December

	Notes	£m	2002 £m	£m	2001 £m
Fixed assets					
Tangible assets	11		**3.3**		2.8
Investments	12		**1.0**		1.1
Investments in joint ventures	12				
Share of gross assets		**59.7**		48.6	
Share of gross liabilities		**(43.0)**		(40.9)	
			16.7		7.7
			21.0		11.6
Current assets					
Stocks			**1.6**		1.1
Debtors	13		**109.7**		95.6
Cash at bank, monies on deposit and in hand	14		**71.8**		69.1
			183.1		165.8
Creditors: amounts falling due within one year					
Bank overdrafts	15		**(0.5)**		(1.3)
Other creditors	17		**(189.8)**		(166.3)
			(190.3)		(167.6)
Net current assets/(liabilities)					
Due within one year			**(11.5)**		(7.3)
Due after one year	13		**4.3**		5.5
			(7.2)		(1.8)
Total assets less current liabilities			**13.8**		9.8
Creditors: amounts falling due after more than one year					
Other creditors	17		**(0.9)**		(0.5)
Provisions for liabilities and charges	18		**(9.9)**		(14.5)
Net assets/(liabilities) excluding pension (liability)/asset			**3.0**		(5.2)
Pension (liability)/asset	19		**(24.1)**		9.5
Net (liabilities)/assets including pension (liability)/asset			**(21.1)**		4.3
Share capital and reserves					
Called up ordinary share capital	20		**33.7**		33.7
Share premium account	21		**119.3**		119.3
Profit and loss account	21		**(174.2)**		(148.9)
Equity shareholders' funds	22		**(21.2)**		4.1
Equity minority interests			**0.1**		0.2
			(21.1)		4.3

The accounts were approved by the Board of directors on 25 March 2003 and were signed on its behalf by:

S.J. Doughty Director
C.J. McCole Director

The notes on pages 46 to 59 form part of these accounts.

Statement of total consolidated recognised gains and losses
Year ended 31 December

	Notes	2002 £m	2001 £m
Profit for the financial year from Group undertakings		**3.3**	6.9
Profit for the financial year from joint ventures		**6.2**	1.4
		9.5	8.3
Currency translation differences		**0.3**	(1.9)
Actuarial loss recognised in the pension scheme	19	**(50.1)**	(39.5)
Deferred tax arising thereon		**15.0**	11.8
Total recognised losses relating to the year	22	**(25.3)**	(21.3)

Historical cost profit is not materially different from reported profit.

The notes on pages 46 to 59 form part of these accounts.

Company balance sheet
As at 31 December

	Notes	2002 £m	2001 £m
Fixed assets			
Investments	12	**120.9**	115.9
Current assets			
Debtors	13	**4.6**	6.1
Cash at bank, monies on deposit and in hand		**37.9**	19.1
		42.5	25.2
Creditors: amounts falling due within one year			
Other creditors	17	**(130.5)**	(111.0)
Net current liabilities		**(88.0)**	(85.8)
Total assets less current liabilities		**32.9**	30.1
Provisions for liabilities and charges	18	**(2.7)**	(3.3)
Net assets		**30.2**	26.8
Share capital and reserves			
Called up ordinary share capital	20	**33.7**	33.7
Share premium account	21	**119.3**	119.3
Profit and loss account	21	**(122.8)**	(126.2)
Equity shareholders' funds	22	**30.2**	26.8

The accounts were approved by the Board of directors on 25 March 2003 and were signed on its behalf by:

S.J. Doughty Director
C.J. McCole Director

The notes on pages 46 to 59 form part of these accounts.

Notes to the accounts

1 Accounting policies

BASIS OF ACCOUNTING
The accounts are prepared in accordance with applicable United Kingdom accounting standards under the historical cost convention. The following principal accounting policies have been applied consistently in dealing with items that are considered material in relation to the Group's accounts.

BASIS OF CONSOLIDATION
a) The Group accounts include the accounts of Costain Group PLC and its subsidiary undertakings as at 31 December 2002. Details of the principal subsidiary undertakings, joint ventures and joint arrangements are shown in note 26.

b) The Group's share of the profits less losses of joint ventures is included in the consolidated profit and loss account and its interest in their net assets is included in investments in the consolidated balance sheet.

c) Where a Group company is party to a joint arrangement, which is not an entity, that company accounts directly for its income and expenditure, assets and liabilities and cash flows. Such arrangements are reported in the consolidated accounts on the same basis.

d) Goodwill represents the excess of the purchase consideration over the fair value of attributable net assets at the date of acquisition. Goodwill arising on acquisitions before 1 January 1998, when FRS 10, 'Goodwill and intangible assets' was adopted, was charged immediately against reserves. When a subsequent disposal occurs any related goodwill previously written off to reserves is written back through the profit and loss account as part of the profit or loss on disposal. There have been no acquisitions since 1 January 1998.

In the Company's accounts, investments in subsidiary undertakings are stated at cost less any impairment in value.

e) The balance sheets of overseas subsidiary undertakings and interests in overseas joint ventures are expressed in sterling at the rates of exchange ruling at 31 December. Profits and losses of overseas subsidiary undertakings and joint ventures are expressed in sterling at average rates of exchange. Exchange differences arising on translation of opening shareholders' funds less related foreign currency borrowings, which finance overseas equity investments, are recorded as a movement on reserves.

TURNOVER
Turnover represents the amounts receivable for goods and services provided, the value of work carried out during the year on long-term contracts, property development sales completed and rental income. Turnover includes the Group's share of turnover of joint arrangement contracts.

FOREIGN CURRENCY TRANSACTIONS
Monetary assets and liabilities in overseas currencies are translated into sterling at year-end exchange rates. Exchange differences on such items and on transactions completed in the ordinary course of business are dealt with in profit on ordinary activities.

HEDGING
The Group protects the sterling value of overseas income, where appropriate, by means of forward sales contracts. Profits or losses arising from these arrangements are accounted for in the period in which the contracts are due to mature. Accordingly, no account is taken of unrealised profits or losses arising on such forward contracts.

DEPRECIATION
Except for land, the cost of tangible fixed assets less any residual value is depreciated over the expected life on a straight line basis. Buildings are depreciated at a rate of 2% (or the life of the lease if that is less than 50 years). Plant and equipment is depreciated over its remaining economic life. The depreciation rates for the principal assets of the Group vary from 8% to 20% per annum.

Additional write-downs are made if, in the opinion of the directors, there has been an impairment in the value of a class of asset, which is assessed by reference to the anticipated cash flows to be generated by those assets over their remaining useful lives.

INTEREST AND FINANCE CHARGES
Interest and finance charges are written off to the profit and loss account as incurred.

1 Accounting policies – continued

TAXATION

Deferred tax has been recognised as a liability or asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more tax in future, or a right to pay less tax in future. An asset is not recognised to the extent that the transfer of economic benefit in future is uncertain. Deferred tax assets and liabilities recognised have not been discounted.

No provision is made to cover any further liability to taxation that would arise in respect of the distribution of profits retained by overseas subsidiary undertakings and joint ventures.

LEASED ASSETS

Assets held under finance leases are included under tangible fixed assets at their capital value and depreciated over their useful lives. Lease payments consist of capital and interest elements and the interest element is charged to the profit and loss account. The annual rentals in respect of operating leases are charged to the profit and loss account.

STOCKS

Stocks comprise raw materials and are stated at the lower of cost and net realisable value.

LONG-TERM CONTRACTS

Amounts recoverable on long-term contracts represents the excess of the value of work carried out over cumulative payments on account. Long-term contracts are valued at cost plus attributable profit earned to date, less provision for foreseeable losses.

PENSIONS

The Group operates a pension scheme providing benefits based on final pensionable salary. The assets of the scheme are held separately from those of the Group.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

The increase in the present value of the liabilities of the Group's defined benefit pension schemes expected to arise from employee service in the period is charged to the operating profit. The expected return on the schemes assets and the increase during the period in the present value of the schemes liabilities arising from the passage of time are included in the other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

Notes to the accounts continued

2 Business and geographical segment information

Business segment information
In the opinion of the directors, the administering of the engineering, construction and property development projects are the only material classes of business.

Geographical segment information by origin

	Turnover		Profit/(loss)		Net assets/ (liabilities)	
	2002 £m	2001 £m	**2002 £m**	2001 £m	**2002 £m**	2001 £m
Continuing operations						
Group undertakings						
United Kingdom	**484.6**	415.6	**2.2**	(1.5)	**(108.8)**	(68.8)
Rest of the world	**37.2**	41.5	**(1.0)**	2.5	**(0.3)**	(2.4)
Reorganisation costs - UK			**(0.7)**	(0.7)		
Turnover, operating profit and net liabilities of Group undertakings	**521.8**	457.1	**0.5**	0.3	**(109.1)**	(71.2)
Joint ventures						
United Kingdom	**3.6**	-	**-**	-	**1.7**	1.6
Rest of the world - property development	**17.9**	5.5	**7.5**	1.9	**16.4**	7.5
Rest of the world - engineering & construction	**0.1**	0.3	**-**	-	**(1.4)**	(1.4)
	543.4	462.9	**8.0**	2.2	**(92.4)**	(63.5)
Net interest receivable/(payable) and similar income/(charges)			**1.4**	2.0		
Other finance income			**1.9**	4.5		
Net cash					**71.3**	67.8
Profit on ordinary activities before taxation and net (liabilities)/assets			**11.3**	8.7	**(21.1)**	4.3

Turnover by destination is not materially different to turnover by origin.

3 Profit on ordinary activities before taxation

	2002 £m	2001 £m
Profit on ordinary activities before taxation is stated after charging:		
Staff costs (note 6)	**68.6**	62.0
Remuneration of directors (note 7)	**0.6**	1.0
Depreciation on assets owned by Group (note 11)	**0.5**	0.8
Hire of plant and machinery	**12.9**	10.6
Rent of land and buildings	**4.0**	4.0
Auditors' remuneration - audit services - Group	**0.3**	0.3
- audit services - Company	**-**	-
- other fees paid to the auditors and their associates	**0.1**	0.1
and after crediting:		
Net income from rents of land and buildings	**1.6**	1.4
Rentals receivable from hire of plant and machinery	**0.3**	1.1

4 Net interest receivable/(payable) and similar income/ (charges) of Group undertakings

	2002 £m	2001 £m
Interest payable on bank loans and overdrafts	(0.4)	(0.3)
Interest receivable	2.4	2.8
	2.0	2.5

5 Other finance income of Group undertakings

	2002 £m	2001 £m
Expected return on pension scheme assets	20.6	22.6
Interest on pension scheme liabilities	(18.7)	(18.1)
Net return (note 19)	1.9	4.5

6 Staff costs

	2002 £m	2001 £m
Wages and salaries	59.6	53.2
Social security costs	4.8	4.4
Pension costs (note 19)	4.2	4.4
	68.6	62.0

The average number of persons employed by the Group during the year was:

	2002 Number	2001 Number
United Kingdom	1,608	1,473
Rest of the world	1,521	1,804
	3,129	3,277

7 Emoluments of directors

Details of directors' emoluments and share options are included on pages 32 to 39 in the Directors' remuneration report.

8 Taxation

	2002 £m	2001 £m
On profit for the year:		
United Kingdom corporation tax at 30%	-	-
Overseas taxation	(0.5)	(0.2)
Joint venture taxation	(0.7)	-
	(1.2)	(0.2)
Deferred taxation	(0.6)	(0.3)
	(1.8)	(0.5)

	2002 £m	2001 £m
Tax reconciliation:		
Profit on ordinary activities before taxation	11.3	8.7
Tax at 30%	(3.4)	(2.6)
Rate adjustments relating to overseas profits	(0.2)	0.1
Sundry disallowed expenses and profits relieved by capital losses	-	(0.2)
Unrelieved overseas taxation	(0.2)	-
Timing differences relating to the pension (liability)/asset	0.7	1.1
Other timing differences	1.8	1.6
Exchange differences	0.1	(0.2)
Adjustments in respect of prior years	-	-
Tax charge for current year	(1.2)	(0.2)

Accumulated tax losses carried forward, mainly in the United Kingdom, are estimated at £22.1m (2001: £15.5m).

The elements of deferred taxation are as follows:

	2002 £m	2001 £m
Accelerated capital allowances	(2.9)	(1.8)
Other timing differences	-	(0.9)
Deferred tax asset (note 13)	(2.9)	(2.7)
Deferred tax on pension (liability)/asset (note 19)	(10.3)	4.0
	(13.2)	1.3

8 Taxation - continued

The movements in the deferred taxation balance were as follows:

	£m
Provision at 1 January 2002	1.3
Amount charged to profit and loss account	0.6
Amount credited to the statement of recognised gains and losses	(15.0)
Exchange differences	(0.1)
Asset at 31 December 2002	**(13.2)**

There are other deferred tax assets that have not been recognised on the basis that their future economic benefit is not assured as at the balance sheet date.

9 Profit attributable to Costain Group PLC

The profit dealt with in the accounts of Costain Group PLC is £3.4m (2001: £0.1m loss). A separate profit and loss account for Costain Group PLC has not been presented as permitted by Section 230 of the Companies Act 1985.

10 Earnings per share

The calculation of earnings per share is based on earnings of £9.5m (2001: £8.3m) and 337,136,350 ordinary shares being the weighted average number of ordinary shares in issue during the year.

Diluted earnings per share are the same as basic earnings per share.

11 Tangible assets - Group

	Land and buildings			Plant and equipment	Total
	Freehold	Leasehold		Owned	
		Over 50 years	50 years and under		
	£m	£m	£m	£m	£m
Cost					
At 1 January 2002	1.1	0.3	4.2	9.5	15.1
Currency realignment	-	-	(0.4)	(0.4)	(0.8)
Additions	-	-	-	1.2	1.2
Disposals	-	-	-	(0.4)	(0.4)
At 31 December 2002	**1.1**	**0.3**	**3.8**	**9.9**	**15.1**
Depreciation					
At 1 January 2002	0.1	0.1	4.0	8.1	12.3
Currency realignment	-	-	(0.4)	(0.3)	(0.7)
Provided in year	-	-	-	0.5	0.5
Disposals	-	-	-	(0.3)	(0.3)
At 31 December 2002	**0.1**	**0.1**	**3.6**	**8.0**	**11.8**
Net book value					
At 31 December 2002	**1.0**	**0.2**	**0.2**	**1.9**	**3.3**
At 31 December 2001	1.0	0.2	0.2	1.4	2.8

Freehold land and buildings includes land of £0.7m (2001: £0.7m) on which no depreciation has been charged.

12 Investments - Group

	Joint ventures £m	Loans to joint ventures £m	Other investments £m	Other loans £m	Total £m
Cost					
At 1 January 2002	25.6	2.3	0.5	1.1	29.5
Currency realignment	1.2	-	-	-	1.2
Additions	-	0.5	-	-	0.5
Repayments	-	-	-	(0.1)	(0.1)
At 31 December 2002	**26.8**	**2.8**	**0.5**	**1.0**	**31.1**
Share of post-acquisition reserves					
At 1 January 2002	(18.5)				(18.5)
Currency realignment	(0.3)				(0.3)
Profit for the year	6.2				6.2
At 31 December 2002	**(12.6)**				**(12.6)**
Amounts written off					
At 1 January 2002	(1.4)	(0.3)	(0.5)	-	(2.2)
Released in the year	1.4	-	-	-	1.4
At 31 December 2002	**-**	**(0.3)**	**(0.5)**	**-**	**(0.8)**
Net book value					
At 31 December 2002	**14.2**	**2.5**	**-**	**1.0**	**17.7**
At 31 December 2001	5.7	2.0	-	1.1	8.8

Investments - Company

Subsidiary undertakings	£m
Cost	**387.6**
Amounts written off	
At 1 January 2002	(271.7)
Amounts written back	5.0
At 31 December 2002	**(266.7)**
Net book value	
At 31 December 2002	**120.9**
At 31 December 2001	115.9

Details of the principal subsidiary undertakings and joint ventures are shown in note 26.

13 Debtors

	Group		Company	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Amounts falling due within one year:				
Trade debtors	**64.2**	58.2	**-**	-
Other debtors	**5.5**	6.6	**-**	-
Amounts recoverable on long-term contracts	**31.9**	23.2	**-**	-
Prepayments and accrued income	**3.7**	2.0	**-**	-
Amounts owed by joint ventures	**0.1**	0.1	**-**	-
Amounts owed by subsidiary undertakings	**-**	-	**4.4**	5.5
Taxation	**-**	-	**0.2**	0.6
	105.4	90.1	**4.6**	6.1
Amounts falling due after more than one year:				
Other debtors	**1.4**	2.8	**-**	-
Deferred tax asset (note 8)	**2.9**	2.7	**-**	-
	4.3	5.5	**-**	-
	109.7	95.6	**4.6**	6.1

Notes to the accounts
continued

14 Cash at bank, monies on deposit and in hand - Group

Cash at bank, monies on deposit and in hand is analysed in note 16 and includes the Group's share of cash held by joint arrangements of £27.6m (2001: £38.0m). There are restrictions on these funds being transferred from the relevant joint arrangement.

15 Bank overdrafts - Group

	2002 £m	2001 £m
Amounts falling due within one year:		
Overdrafts	**0.5**	1.3

16 Financial instruments

An explanation of the Board's objectives, policies and strategies for holding and issuing financial instruments is set out in the financial review on page 21.

Short-term debtors and creditors, as defined in FRS 13, 'Derivatives and other financial instruments: disclosures', have been omitted from all of the financial instruments disclosures, save for those relating to currency risk.

a) Liquidity

The maturity of all financial liabilities is shown in note 15.

b) Undrawn committed borrowings facilities

Undrawn borrowing facilities are available to the Group as set out below. The conditions precedent to the availability of these facilities were all satisfied at the balance sheet date.

	2002 £m	2001 £m
Expiring in one year or less	**3.0**	3.0

c) Interest rate risk

The Group's financial liabilities were all at floating rate and denominated in the following currencies:

	2002 £m	2001 £m
Sterling	-	1.0
Other	**0.5**	0.3
	0.5	1.3

The interest rate on sterling denominated borrowings is based on Base rate.

The Group's financial assets which comprised cash at bank, monies on deposit and in hand were denominated in the following currencies:

	2002 £m	2001 £m
Sterling	**67.7**	61.6
UAE Dirhams	**0.8**	2.2
Hong Kong Dollars	**1.3**	2.9
Zimbabwe Dollars	**0.1**	0.4
US Dollars	**0.6**	0.4
Other	**1.3**	1.6
	71.8	69.1

16 Financial instruments – continued

d) Currency risk

At 31 December 2002, the net monetary assets denominated in currencies other than the functional currency of the operation involved were Hong Kong dollar denominated net assets of £0.9m and US dollar denominated assets of £1.4m in the books of sterling companies. Forward currency sale contracts of US Dollars totalling £1.8m were in place at the year-end as protection against currency fluctuations. At 31 December 2002, the unrealised profit on the forward contracts was £0.1m.

e) Fair value

The fair value of financial assets and financial liabilities is the same as the book value.

17 Other creditors

	Group		Company	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Amounts falling due within one year:				
Trade creditors	**67.0**	63.5	**-**	-
Other creditors	**10.6**	8.8	**0.1**	0.5
Social security	**2.0**	2.9	**-**	-
Credit balances on long-term contracts	**27.6**	21.4	**-**	-
Accruals and deferred income	**80.5**	67.6	**-**	0.3
Amounts owed to subsidiary undertakings	**-**	-	**128.7**	108.4
Taxation	**2.1**	2.1	**1.7**	1.8
	189.8	166.3	**130.5**	111.0
Amounts falling due after more than one year:				
Accruals and deferred income	**0.9**	0.5	**-**	-
	0.9	0.5	**-**	-

18 Provisions for liabilities and charges - Group

	At beginning of year £m	Provided £m	Utilised £m	**At end of year £m**
Engineering & Construction provisions	11.2	0.8	(4.9)	**7.1**
Void space	1.8	-	(0.5)	**1.3**
Other provisions	1.5	-	-	**1.5**
	14.5	0.8	(5.4)	**9.9**

Engineering & Construction provisions are in respect of liabilities incurred on long-term contracts most of which are estimated to be paid over the next two years.

Void space provisions relate to costs of vacant properties. The provisions will be utilised over the next five years.

Other provisions comprise remedial costs and litigation provisions most of which are expected to be utilised over the next year.

Provisions for liabilities and charges - Company

	At beginning of year £m	Provided £m	Utilised £m	**At end of year £m**
Provisions against losses of subsidiary companies	2.5	-	(0.5)	**2.0**
Other provisions	0.8	-	(0.1)	**0.7**
	3.3	-	(0.6)	**2.7**

Notes to the accounts
continued

19 Pensions

The Group operates a number of pension schemes principally of the defined benefit type in the United Kingdom and overseas, under which contributions are paid by Group undertakings and employees. The pension cost charge of the United Kingdom pension schemes amounted to £4.2m (2001: £4.4m).

A full actuarial valuation of the United Kingdom scheme was carried out at 31 March 2001 and was updated to 31 December 2002 by a qualified independent actuary. The major assumptions used by the actuary were (in nominal terms):

	31.12.2002	31.12.2001	31.12.2000
Rate of increase in pensionable salaries	**2.3%**	4.0%	4.0%
Rate of increase in pensions in payment	**2.3%**	2.5%	2.5%
Discount rate	**5.6%**	6.0%	5.9%
Inflation assumption	**2.3%**	2.5%	2.5%

The assumptions used by the actuary are best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus are inherently uncertain, were:

	31.12.2002	**31.12.2002 £m**	31.12.2001	31.12.2001 £m	31.12.2000	31.12.2000 £m
Equities	**6.9%**	**180.7**	7.2%	206.4	7.4%	231.5
Bonds	**4.5%**	**106.9**	4.9%	123.8	4.6%	128.7
Total market value of assets		**287.6**		330.2		360.2
Actuarial value of liability		**(322.0)**		(316.7)		(310.8)
(Deficit)/surplus in the scheme		**(34.4)**		13.5		49.4
Related deferred tax asset/(liability)		**10.3**		(4.0)		(14.8)
Net pension (liability)/asset		**(24.1)**		9.5		34.6

Movement in surplus during the year

	2002 £m	2001 £m
Surplus in scheme at beginning of the year	13.5	49.4
Movement in year (current service cost)	(4.1)	(4.3)
Contributions	4.4	3.4
Net return on assets	1.9	4.5
Actuarial loss	(50.1)	(39.5)
(Deficit)/surplus in scheme at end of the year	**(34.4)**	13.5

The estimated actuarial valuation at 31 December 2002 showed a deficit of £34.4 million. The full actuarial valuation as at 31 March 2001 stated that the employer contribution rate could remain at 9.6% of pensionable salaries until the completion of the next full actuarial valuation to be carried out as at 31 March 2003, subject to actuarial review during this period. However, employer contributions were paid at 9.6% to 31 March 2002 and at 11.6% thereafter.

20 Share capital of Costain Group PLC

	2002 and 2001 Authorised £	Issued and fully paid £
Ordinary shares of 10p each	55,000,000	33,713,635

On 29 March 2001, the Company granted share warrants to the Banks who participated in the refinancing of the Company's then existing term facilities. The Banks may require the Company to issue up to 16,000,000 new ordinary shares at an exercise price of 11.225p per share. There are 10 new ordinary shares in each warrant. The warrants are exercisable at any time after 31 December 2002. The warrants cease to be exercisable after 31 March 2004.

At 31 December 2002, options over a total of 15,000 shares (2001: 15,000 shares) were outstanding under the Costain Executive Share Option Scheme as follows:

Date of grant	Exercise price per share	Number of shares
13 April 1994	£3.57	15,000

The options granted on 13 April 1994 are exercisable up to 12 April 2004.

During the year, no options were granted under The Costain Group Performance Share Scheme. At 31 December 2002, no options (2001: Nil) were outstanding.

Options granted on 22 November 1996 under the Costain Share Saving Scheme lapsed on 1 July 2002. No options were exercised in 2002.

During the year, options were granted under the 2002 Save As You Earn Scheme. At 31 December 2002, options over a total of 13,420,225 shares were outstanding as follows:

Date of grant	Exercise price per share	Number of shares
22 October 2002	£0.20	13,420,225

These options are exercisable up to 1 June 2008.

During the year, options were granted under the 2002 Long Term Incentive Plan. At 31 December 2002, options over a total of 2,047,833 shares were outstanding. The options were granted on 11 October 2002. The exercise price is £1.00 whether on an exercise of the entire award option or any part of it but the option cannot be exercised unless the performance condition is satisfied. These options are exercisable up to 10 October 2012. Details of the performance conditions and the options granted to executive directors are given in the Directors' remuneration report on pages 32 to 39.

Notes to the accounts
continued

21 Reserves - Group

	Share premium account £m	Profit and loss £m
At 1 January 2002	119.3	(148.9)
Net exchange differences	-	0.3
Profit for the financial year	-	9.5
Actuarial loss recognised	-	(50.1)
Deferred tax	-	15.0
At 31 December 2002	**119.3**	**(174.2)**

The closing balance on the profit and loss includes a £24.1m debit (2001: £9.5m credit), stated after deferred taxation of £10.3m (2001: £4.0m) in respect of pension liabilities (2001: assets) of the Group pension fund.

At 31 December 2002, the cumulative goodwill written off on acquisitions prior to 1 January 1998 amounted to £3.3m (2001: £3.3m).

There are no significant restrictions on the ability to remit overseas reserves.

Reserves - Company

	Share premium account £m	Profit and loss £m
At 1 January 2002	119.3	(126.2)
Profit for the year	-	3.4
At 31 December 2002	**119.3**	**(122.8)**

22 Reconciliations of movements in shareholders' funds

	Group		Company	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Profit/(loss) for the financial year	**9.5**	8.3	**3.4**	(0.1)
Other recognised losses in the year	**(34.8)**	(29.6)	**-**	-
Net (reduction)/increase in shareholders' funds	**(25.3)**	(21.3)	**3.4**	(0.1)
Shareholders' funds at 1 January	**4.1**	25.4	**26.8**	26.9
Shareholders' funds at 31 December	**(21.2)**	4.1	**30.2**	26.8

23 Contingent liabilities

	Group		Company	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Under guarantees of bank overdrafts, mortgages and loans:				
To subsidiary undertakings	**-**	-	**0.3**	0.2
To joint ventures	**0.2**	0.2	**0.2**	0.2

Certain subsidiary undertakings have entered into cross-guarantees for loans and overdraft facilities made available to the Group and certain joint ventures. At 31 December 2002, these liabilities amounted to £0.2m (2001: £0.2m) and are included or disclosed in these accounts.

The shares of Alcaidesa Holding SA held by Costain Alcaidesa Limited have been pledged as security for certain loans to Alcaidesa Holding SA.

There are also contingent liabilities in respect of:

- creditors of joint arrangements which are less than the book value of their assets;
- performance bonds and other undertakings entered into in the ordinary course of business.

24 Other financial commitments - Group

	2002		2001	
	Land and buildings £m	**Other operating leases £m**	Land and buildings £m	Other operating leases £m
Annual commitments under non-cancellable operating leases expiring:				
- within one year	**-**	**0.8**	-	0.8
- between one and two years	**0.1**	**0.9**	-	0.9
- between two and five years	**0.4**	**0.9**	0.5	0.7
- after five years	**2.8**	**-**	2.6	-
	3.3	**2.6**	3.1	2.4

25 Notes to the cash flow statement

Reconciliation of operating profit to net cash inflow from operating activities

	2002 £m	2001 £m
Operating profit	**8.0**	2.2
Depreciation	**0.5**	0.8
Amounts written back to investments	**(1.4)**	(2.9)
Joint ventures	**(7.5)**	(1.9)
(Increase)/decrease in stocks	**(0.5)**	0.8
(Increase)/decrease in debtors	**(14.2)**	3.0
Increase in creditors	**23.6**	20.4
Decrease in provisions	**(4.6)**	(3.0)
Net cash inflow from operating activities	**3.9**	19.4

Analysis of changes in net cash

	At 1 January 2002 £m	Currency realignment £m	Cash flow £m	**At 31 December 2002 £m**
Cash (note 14)	69.1	(0.5)	3.2	**71.8**
Overdrafts	(1.3)	-	0.8	**(0.5)**
	67.8	(0.5)	4.0	**71.3**

Notes to the accounts continued

26 Principal subsidiary undertakings, joint ventures and joint arrangements

	Activity	Percentage of equity held	Country of incorporation
Subsidiary undertakings			
Costain Abu Dhabi Co WLL	Process Engineering	49+*	UAE
Costain (Africa) Ltd	Holding & Property Company	100+	Zimbabwe
Costain America Inc	Holding Company	100+	USA
Costain Building & Civil Engineering Ltd	Civil Engineering & Construction	100+	
Costain Ltd	Civil Engineering & Construction	100+	
Costain Construction Ltd	Construction	100+	
Costain Construction (Botswana) Pty Ltd	Construction & Civil Engineering	100+	Botswana
Costain Dubai LLC	Civil Engineering & Construction	49+*	UAE
Costain Engineering & Construction Ltd	Holding Company	100	
Costain International Ltd	Civil Engineering & Construction	100+	
Costain (Malaysia) Sdn Bhd	Civil Engineering & Construction	100+	Malaysia
Costain Oil, Gas & Process Ltd	Process Engineering	100+	
Costain Oil, Gas & Process (Overseas) Ltd	Process Engineering	100+	
Costain USA Inc	Holding Company	100	USA
Costain Zimbabwe (Pvt) Ltd	Civil Engineering & Construction	100+	Zimbabwe
County & District Properties Ltd	Commercial Property	100	
Richard Costain Ltd	Service Company	100	
Yahya Costain LLC	Civil Engineering & Construction	49+*	Oman

	Activity	Issued share capital £m	Percentage of equity held	Country of incorporation
Joint ventures				
Alcaidesa Holding SA	Property Development	19.9	50+	Spain
Jalal Costain WLL	Civil Engineering & Construction	0.1	49+	Bahrain
HpC King's College Hospital (Holdings) Ltd	Construction & Operation of Hospital	0.2	33+	UK

\+ Equity capital held by subsidiary undertakings.

* Treated as subsidiary undertakings due to Costain having dominant influence and control of the composition of the Board of directors.

All undertakings are incorporated in Great Britain, except where otherwise stated, and operate mainly in the country of incorporation with the exception of Costain Building & Civil Engineering Ltd and Costain Ltd which operate inside and outside of the UK and Costain International Ltd and Costain Oil, Gas & Process (Overseas) Ltd which operate in various countries outside the UK. All holdings are of ordinary shares except Richard Costain Ltd where Costain Group PLC holds 100 per cent of the ordinary and preference shares. A full list of Group companies will be included in the Company's annual return.

26 Principal subsidiary undertakings, joint ventures and joint arrangements – continued

	Activity	Percentage of equity held	Country of operation
Major joint arrangements			
Anglo Japanese Contractors Joint Venture	Civil Engineering	33	Hong Kong
Balfour Beatty-Costain Joint Venture - Cardiff Bay Barrage	Civil Engineering	35	UK
Balfour Beatty-Costain Joint Venture - A303 Stonehenge Improvement	Civil Engineering	50	UK
Black & Veatch-Costain Joint Venture - Southern Water	Asset Management	50	UK
Costain-Hochtief Joint Venture - Winchester House	Construction	50	UK
Costain-Norwest Holst Joint Venture - Hungerford Bridge	Civil Engineering	50	UK
Costain Oil, Gas & Process Ltd and UK Construction Ltd Joint Venture - Seal Reception Facilities, Bacton	Process Engineering	50	UK
Costain-O'Rourke-Bachy-Emcor Rail Consortium - CTRL 105 (Combined)	Civil Engineering	27.4	UK
Costain-Skanska - A43 Dualling	Civil Engineering	50	UK
Costain-Skanska - Met Office	Construction	50	UK
Costain-Skanska-Bachy Joint Venture - CTRL 240	Civil Engineering	33	UK
Costain-Skanska Joint Venture - Coventry Shopping Centre	Construction	50	UK
Costain-Skanska Joint Venture - Great Western Hotel	Construction	50	UK
Costain-Skanska Joint Venture - King's College Hospital	Construction	50	UK
Costain-Skanska Joint Venture - Northgate House	Construction	50	UK
Costain-Skanska Joint Venture - Uxbridge Shopping Centre	Construction	50	UK
Costain-Skanska-Mowlem Joint Venture - A2/M2	Civil Engineering	30	UK
Costain-Taylor Woodrow Joint Venture - Jubilee Line	Civil Engineering	50	UK
Costain-Taylor Woodrow - King's Cross	Civil Engineering	50	UK
Galliford-Costain Joint Venture - United Utilities	Asset Management	50	UK
MAK-Costain Joint Venture - Television & Radio Station Project	Construction	50	Botswana
Mitsui-Costain Joint Venture	Civil Engineering	50	Hong Kong
Nishimatsu-Costain-China Harbour Joint Venture	Civil Engineering	33	Hong Kong
Nishimatsu-Costain Joint Venture	Civil Engineering	50	Hong Kong

27 Related party transactions

The Group's related party transactions, as defined by FRS 8, and the nature of the relationships and the amounts involved are summarised below:

	Major shareholders £m	Joint ventures £m	Joint arrangements £m	Total £m
Sales of goods and services to related parties:				
Staff	-	-	16.7	16.7
Management services	-	-	0.2	0.2
Construction services and materials	-	-	0.9	0.9
	-	-	17.8	17.8

Balances with related parties at 31 December 2002	
Amounts due to related parties	-
Amounts due from related parties	-

Balances with joint ventures are disclosed elsewhere in these accounts. Balances with joint arrangements are eliminated on consolidation.

Major shareholders
Mohammed Abdulmohsin Al-Kharafi & Sons WLL, Raymond International WLL and Intria Berhad, are regarded as related parties of Costain Group PLC.

Five-year financial summary

Turnover and profit

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
Group turnover					
Continuing operations	**521.8**	457.1	381.2	373.1	381.9
Discontinued operations	**-**	-	-	-	-
	521.8	457.1	381.2	373.1	381.9
Operating profit/(loss)					
Continuing operations	**0.5**	0.3	(2.8)	2.1	(2.7)
Discontinued operations	**-**	-	-	-	0.8
	0.5	0.3	(2.8)	2.1	(1.9)
Share of joint ventures	**7.5**	1.9	1.3	(0.9)	(0.5)
Net interest receivable/(payable) and other similar income/(charges)	**1.4**	2.0	1.9	0.8	2.5
Other finance income	**1.9**	4.5	4.2	3.2	-
Profit on disposals of fixed assets	**-**	-	1.9	1.2	0.4
Profit on ordinary activities before taxation	**11.3**	8.7	6.5	6.4	0.5
Profit attributable to Costain Group PLC	**9.5**	8.3	5.1	4.9	0.1
Ordinary dividends	**-**	-	-	-	-
Amount retained for the year	**9.5**	8.3	5.1	4.9	0.1
Earnings per share	**2.8p**	2.5p	1.5p	1.5p	0.0p
Summarised balance sheets					
Tangible assets	**3.3**	2.8	4.2	6.3	7.4
Investments	**17.7**	8.8	7.5	4.1	4.0
	21.0	11.6	11.7	10.4	11.4
Pension prepayment	**-**	-	-	-	39.5
Other net current liabilities	**(7.2)**	(1.8)	(2.5)	(7.8)	(4.9)
Total assets less current liabilities	**13.8**	9.8	9.2	2.6	46.0
Long-term liabilities	**(10.8)**	(15.0)	(18.0)	(13.2)	(27.1)
Net assets/(liabilities)	**3.0**	(5.2)	(8.8)	(10.6)	18.9
Pension (liability)/asset	**(24.1)**	9.5	34.6	39.7	-
Net (liabilities)/assets including pension (liability)/asset	**(21.1)**	4.3	25.8	29.1	18.9
Equity shareholders' funds	**(21.2)**	4.1	25.4	28.7	18.5
Minority interests	**0.1**	0.2	0.4	0.4	0.4
	(21.1)	4.3	25.8	29.1	18.9

The figures for 1999 to 2002 comply with FRS 17.

Notice of annual general meeting

Notice is hereby given that the Annual General Meeting of the members will be held at One Great George Street, Westminster, London SW1P 3AA on Friday, 23 May 2003 at 11.00 a.m. for the following purposes:

Ordinary Business

1. To receive and adopt the Directors' report and the audited accounts for the year ended 3l December 2002.
2. To receive, adopt and approve the Directors' remuneration report for the financial year ended 3l December 2002.
3. To elect the following directors who offer themselves for re-election: a – Aminuddin Yusof Lana; b – Mr Saad Shehata (who will be 77 years old at the time of the Annual General Meeting); c – Mr Frederick William Ballard. All directors retire by rotation under Article 81 of the Articles of Association. Each re-election will be proposed and voted on as a separate resolution.
4. To re-appoint KPMG Audit Plc auditors of the Company.
5. To authorise the Directors to determine the remuneration of the Auditors.

Special Business

To consider and, if thought fit, to pass the following resolutions proposed as follows:

6. As an ordinary resolution:

   THAT, in substitution for all subsisting authorities, the directors be and they are hereby generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (within the meaning of Section 80 of the Companies Act 1985) up to an aggregate nominal amount of £11m provided that this authority shall expire on 22 May 2008 save that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of such offer or agreement as if the authority confirmed hereby had not expired.

7. As a special resolution:

   THAT, pursuant to the authority conferred on them by resolution number 6, the directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities for cash (within the meaning of Section 94 of the said Act) as if sub-section (1) of Section 89 of the said Act did not apply to any such allotment provided that this power shall be limited:

   (a) to the allotment of equity securities pursuant to Article 119 (A) and/or in connection with a rights issue in favour of the shareholders where the equity securities respectively attributable to the interests of all such shareholders are proportionate (as nearly as may be) to the respective numbers of shares held by them subject to such exclusions or other arrangements as the directors may think fit in connection with fractional entitlements or legal or practical problems arising in connection with the laws of, or requirements of, any recognised regulatory body or stock exchange in any territory; and

   (b) to the allotment (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an aggregate nominal value of £1.6m

   and shall expire 15 months following the passing of this resolution or, if earlier, at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired.

Notice of annual general meeting continued

8. As a special resolution:

THAT the Articles of Association be amended as follows:

That Article 1(E) be amended by the deletion of the existing Article 1(E) and its replacement by the following:- "(E) The aggregate fees of the Directors as such shall in respect of each financial period of the Company be such sum not exceeding £500,000 as the Board may by resolution determine or such other sum as shall from time to time be determined by an ordinary resolution of the Company. Such fees shall be divided in such proportions and among such of the Directors as the Board may by resolution determine and failing any such determination by the Board, no fees shall be payable hereunder. Subject to the provisions of the Companies Acts and these Articles, the Board may arrange for such proportion of the fees payable to any Director as the Board may decide from time to time to be paid in the form of fully paid up shares in the capital of the Company or to be applied in the purchase or subscription of shares in the capital of the Company on behalf of that Director. The value of any shares allotted in payment of fees and the subscription price of any shares to which fees are applied shall in either case be the closing middle market price as published in the Daily Official List of the London Stock Exchange on the day of allotment or subscription".

By Order of the Board
Clive L Franks
Secretary
17 April 2003

Notes:

1. A member entitled to attend and vote at the meeting may appoint one or more proxies to attend and, on a poll, to vote on his behalf. A proxy need not be a member of the Company. Appointment of a proxy will not preclude a member from attending and voting in person if he so wishes.

2. To be effective, a proxy and the authority (if any) under which it is signed or a notarially certified or office copy of such authority must be deposited with the Company's registrars, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA no later than 11 am on Wednesday 21 May 2003. A proxy may be delivered by facsimile to the Company's registrars, Lloyds TSB Registrars (facsimile number 01903 702341), provided that:

   (a) the facsimile is actually received (whether or not it appears to the sender to have been received) by the Company's registrars no later than 11 am on Wednesday 21 May, 2003.
   (b) the Chairman or the Secretary or any other person authorised by the Board for the purpose determines in his sole discretion (such determination to be conclusive) that such facsimile has been transmitted in an acceptable manner including a determination that such facsimile is complete and is in a clear and legible form; and
   (c) the original instrument appointing the proxy and the authority (if any) under which it is executed or a notarially certified or office copy of such authority must be delivered to the Company's registrars, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA no later than 10 am on Friday 23 May 2003.

3. The Company pursuant to Regulation 41 of the Uncertified Securities Regulations 2001, specifies that only those shareholders registered in the register of members of the company at 6 pm on Wednesday 21 May 2003 shall be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at that time. Changes to entries on the relevant register of securities after 6 pm on Wednesday 21 May 2003 shall be disregarded in determining the rights of any person to attend or vote at the meeting.

Financial calendar

Half year results – Announced 4 September 2002
Full year results – Announced 26 March 2003
Report & Accounts – Sent to shareholders 17 April 2003
Annual General Meeting – To be held 23 May 2003
Half year results 2003 – To be announced September 2003

Analysis of Shareholders

	Accounts	Shares (millions)	%
Institutions, companies and nominees:			
Shareholdings 100,000 and over	100	303.4	90.0
Shareholdings 50,000 – 99,999	50	3.3	1.0
Shareholdings 25,000 – 49,999	57	2.0	0.6
Shareholdings 5,000 – 24,999	130	1.5	0.4
Shareholdings 1 – 4,999	314	0.3	0.1
Individuals:	14,254	26.6	7.9
	14,905	337.1	100.0

Secretary and Registered Office

Secretary
Clive L Franks

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