

Costain the construction brand



Costain is an international engineering, construction and land development group, seen as an automatic choice for projects requiring innovation, initiative, teamwork and high levels of technical and managerial skills.

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Summary

Our strong performance in 2007 saw all of the Group's operations in profit for the first time since 1990 and allowed us to recommend the payment of a dividend for the first time in 17 years. To achieve this, we set and delivered on a number of clear strategic objectives:

- Significant growth in profits in the Civil Engineering operations
- Delivered a return to profit in Building
- Achieved a profit in the Oil, Gas & Process operations for the first time in six years
- Actively traded the PFI portfolio to re-invest in bidding for new projects
- Cash position significantly strengthened to £133 million
- Further improved operational efficiency and reduced costs across the Group
- Secured a higher quality order book of £1.6 billion; repeat orders increased to 80%
- Increased the level of preferred bidder positions to over £800 million

We also successfully put financing in place for the next phase of the Group's development.

- Significantly strengthened balance sheet following £60 million Rights Issue
- Operational capability given added firepower through increased banking and bonding facilities of £200 million

The business is now in a strong position to seize the opportunities presented by the markets in which it operates.

- Clear 'Being Number One' strategy for future development
- Growth in our chosen markets underpinned by major long-term spend commitments by our target blue-chip customers

Year ended 31 December	2007	2006
Revenue*	£877.9m	£886.3m
Profit/(loss) before tax	£19.8m	£(61.7)m
Earnings/(loss) per share	3.6p	(13.2)p**
Net cash	£132.8m	£53.3m
Recommended dividend	0.5p	nil

* including share of joint ventures & associates

** restated following rights issue bonus element

"We set clear objectives for 2007 and I am delighted to report that we have delivered on all of them. The year's achievements have been reflected in the strong recovery in performance and the Board is especially delighted to announce a recommendation to return to the dividend list for the first time in 17 years.

"In as far as 2007 was a landmark year for Costain, we expect 2008 will be a year of further growth and I look forward to reporting on our progress."

David Allvey, Chairman

"We have achieved a great deal over the past year at Costain with a lean and focused business delivering a strong performance.

"We have a focused strategy, a strengthened balance sheet and an ambitious management team determined to see Costain build on its position as one of the UK's premier contractors.

"These are exciting times at Costain and we are looking to the future with great confidence. I believe that we will see further progress during this year, building on the strong performance in 2007 and we are on course to deliver in line with our expectations."

Andrew Wyllie, Chief Executive

Our values

Our brand values and reputation are hugely important in attracting key customers, suppliers and people in a market where quality resources are scarce and good people have plenty of choices. In 2007, we commenced an ongoing communications programme to ensure that all of our representatives fully understand the Group's values and their relevance to the future success of the business.

Customer Focused

Safe and
Environmentally
Aware

Accountable

Natural Choice

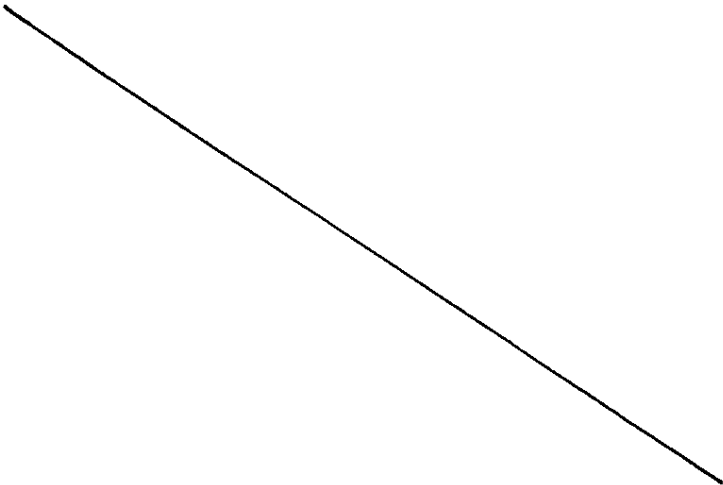
COSTAIN

Open and Honest

Team Players

Improving Continuously
and therefore the . .

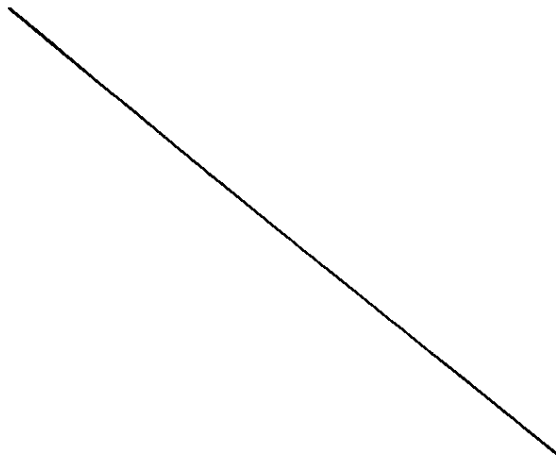
Working values



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Team Players
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Accountable
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Costain at a glance

Our strategy

'Being Number One': a strategy for growth

We have continued to implement successfully our 'Being Number One' strategy, which is centred on leadership through focus and excellence and which leverages Costain's core brand values.

Delivery of our strategy requires us to focus on blue-chip customers who are working with fewer contractors on a longer-term basis. This will allow us to build strong market positions – and win repeat order business – by utilising our technical capability and exceptional customer service. Of the utmost importance, this enables us to build sustainable profit streams

Nowhere is the success of our strategy better reflected than in the improved quality of our order book which includes 80% repeat business from a range of blue-chip customers.

Costain sectors

We are focused on market sectors where we expect there to be significant investment over the next few years and where we can build and maintain strong positions. Our sectors are as follows:

Water

Costain is a major player in the UK water sector, successfully delivering six AMP4 contracts (2005-2010) and will be looking to repeat this success when tendering for the (approx.) £17 billion AMP5 programme (2010-2015).

Waste

Costain is building its position in the growing waste sector having recently secured preferred bidder status for the £300 million Manchester Waste Project.

Nuclear

Costain is active on five nuclear sites in the UK and is looking to grow its share in a market where the Nuclear Decommissioning Agency is spending (approx.) £2 billion per annum and the Government has committed to new investment in power generation.

Highways

Costain is one of the top suppliers to the UK's Highways Agency, which is overseeing a £6 billion investment in strategic schemes. Costain also secured its first maintenance contract in 2007.

Rail

Costain recently completed, in joint venture, the St Pancras International Terminus in London, reinforcing the Group's position in a sector, which will see (approx.) £28 billion investment by Network Rail and TfL as well as the £16 billion Crossrail project.

Marine

Costain is targeting frameworks and capital projects with major port operators. Over £2 billion of investment is expected in schemes including Felixstowe and London Gateway

Airports

Costain was appointed by BAA recently as one of the approved contractors for their £4 billion 'Complex Building Framework', part of a £9 billion spend to upgrade facilities.

Health

Future significant investment in health is expected, including the NHS's £2 billion ProCure21 framework for capital projects in which Costain is a major player.

Education

The Government is maintaining its commitment to investing in education, including the £45 billion Building Schools for the Future (BSF) programme. Costain is a major player in education having secured two 10-year BSF frameworks at Lewisham and Bradford

Retail

Costain, which is a long-term strategic partner for Tesco, was delighted to also be recently appointed as a framework contractor by J Sainsbury and Marks & Spencer. The major retailers are expected to continue investing (approx.) £2 billion per annum on new stores and distribution centres.

Property Development

Costain, in joint venture with Santander Bank, is a long-term strategic land developer in southern Spain. Located near Gibraltar, Costain's land bank and 800-berth marina development give the Group a valuable development asset.

Oil, Gas & Process

Costain has refocused its oil and gas operations on front-end engineering, procurement and project management, skills which are currently in high demand. Recent appointments include the front-end design for Gaz de France's Stablach (Cheshire) Gas Storage facility and a design verification study for a similar project for E.ON.

Chairman's statement

2007: A year of delivery

Last year was one of major achievement for Costain with delivery on clear operational and financial objectives which Andrew Wylie, our Chief Executive, reports on in detail in his review of the year. For me, it was especially encouraging to see a return to profit in our Building operations and a profit delivered in our Oil, Gas & Process operations for the first time since 2001.

On the back of a strong performance, a successful rights issue and increased banking and bonding facilities, we now have the opportunity to expedite the implementation of our 'Being Number One' strategy. The Group finished the year with both its financial and operational reputation significantly strengthened.

The Rights Issue, which raised £60 million (net of expenses) and the extended and enhanced banking and bonding facilities of £200 million give us the financial strength to support our operational resource in delivering our strategic goals. We have already started to capitalise on the opportunities available. We are entering a new phase of the Costain story, one which I feel sure will underline our status as one of the leading names in UK construction.

There were also many significant operational achievements. One, above all, stood out as a great example of what Costain is all about: the completion of St Pancras International, the new terminus for Eurostar trains to Paris and Brussels.

The completion of this project has enabled the UK to take a major step forward in terms of transport infrastructure. The building has attracted praise from around the world and Costain played a central role in delivering successfully a highly technical major project. It was a feat that further enhanced Costain's reputation and was one of the highlights of the UK construction year.

Our strategy, with its focus on excellence and expertise in markets such as Water, Highways and Nuclear, is reaping major benefits as we focus increasingly through longer-term planning on securing more multi-year framework contracts through the provision of integrated full life-cycle services.

In keeping with this theme, it is encouraging that the Government has given the go-ahead for a new generation of nuclear power stations. We have established good relationships with a number of customers in the nuclear industry and we have the specialist skills to ensure that we play a central role in its future development.

Results

Following the decisive management actions in the prior year, including taking a number of write-downs in respect of the closure of the International Division and certain disputed contracts, the Board set a significant recovery in performance as a key objective for 2007. This was achieved.

Revenue for the year was £877.9 million (2006: £886.3 million). Profit before tax was £19.8 million (2006: loss of £61.7 million) and earnings per share were 3.6p (2006: loss per share of 13.2p (restated)).

The Group has no significant borrowings and net cash balances at the year end totalled £132.8 million (2006: £53.3 million), including the Group's share of cash held by construction joint venture arrangements of £28.8 million (2006: £22.0 million).

Dividend

The Board is recommending the payment of a dividend for the full year of 0.5p per share, the first dividend declared since 1991. If approved at the forthcoming Annual General Meeting, the dividend will be paid on 23 May 2008 to shareholders on the register as at 25 April 2008.

Subject to shareholder approval, the Company proposes to introduce a scrip dividend alternative for the dividend payable on 23 May 2008 and all future dividends. A separate letter and a leaflet explaining the scrip dividend scheme together with an election form are enclosed with this Annual Report.

David Allvey
Chairman

Pension

As at 31 December 2007, the deficit in the UK Pension Fund recorded in the Group's balance sheet in accordance with IAS 19 was £36.4 million, net of deferred tax, a reduction of £11.7 million from the position as at 31 December 2006.

As previously reported, we have agreed with the Trustee a new contribution plan that is expected to eliminate the deficit over a shorter period of ten years under the valuation assumptions agreed with the Trustee.

Following an in-principle agreement in 2006 with the Pensions Regulator – and subsequently with the Trustee – that, on resumption of dividend payments, the Group will match any dividends pound for pound by a payment into the UK Pension Fund, we have now confirmed with the Pensions Regulator that a payment to the fund of £3 1 million will be made in the event that shareholders approve the dividend recommendation at the Annual General Meeting

Board

I became Chairman at the start of 2008 as successor to David Jefferies, who retired from the Board. On behalf of everyone at Costain, I would like to thank David for his contribution over six years to the Group. His leadership skills coupled with his experience and knowledge served Costain well.

We have recently welcomed two valuable additions to the Board, Mike Alexander and James Morley, as Non-Executive Directors. Both individuals are senior industry figures and have enjoyed considerable success in a number of sectors. Separately, Mike has been appointed Chairman of the Remuneration Committee and James as Chairman of the Audit Committee

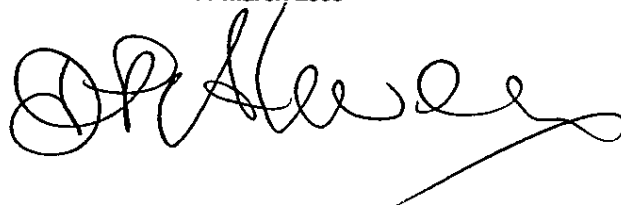
I am also pleased to note that John Bryant has become the Group's first Senior Independent Director, a role that will enhance the Board's compliance with the best standards of corporate governance.

Outlook

We set clear objectives for 2007 and I am delighted to report that we have delivered on all of them. The year's achievements have been reflected in the strong recovery in performance and the Board is especially delighted to announce a recommendation to return to the dividend list for the first time in 17 years.

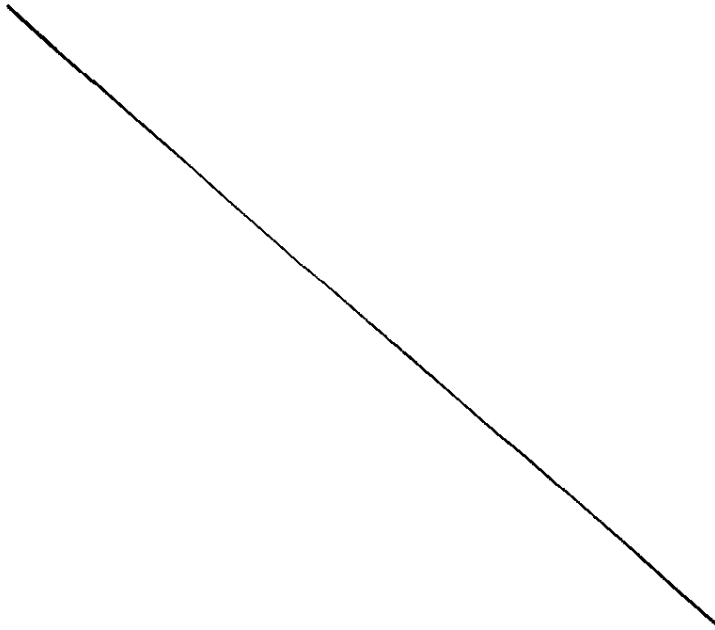
The successful Rights Issue along with our strengthened banking and bonding facilities are enabling us to expedite the implementation of our 'Being Number One' strategy. The Group is capitalising on the opportunities available to it in its chosen market sectors and is strongly positioned to move into the next phase of growth. In as far as 2007 was a landmark year for Costain, we expect 2008 will be a year of further growth and I look forward to reporting on our progress.

David Allvey
Chairman
11 March 2008



Steve Lowe, Costain Ganger (left), receives a Costain 'Unsung Hero of the Year' Award from David Allvey, Chairman at the Group's 2007 Celebrating Success Awards. Steve received the Award for saving the life of a passenger who suffered a heart attack at East Midlands Airport.

Our values Customer Focused



“We chose Costain to take the (Gerrards Cross) Project forward because it is a Company with world-class expertise and the right people for the job.”

Michael Kissman, Corporate Affairs Manager, Tesco

In 2005, the construction of a Tesco store in Gerrards Cross, Buckinghamshire hit the headlines when a tunnel collapsed. Costain was not involved in the tunnel work but Tesco then asked Costain if it could find a way to complete the tunnel and allow the store to be built. Since then teams from Tesco and Costain have worked together to provide solutions to ensure success.

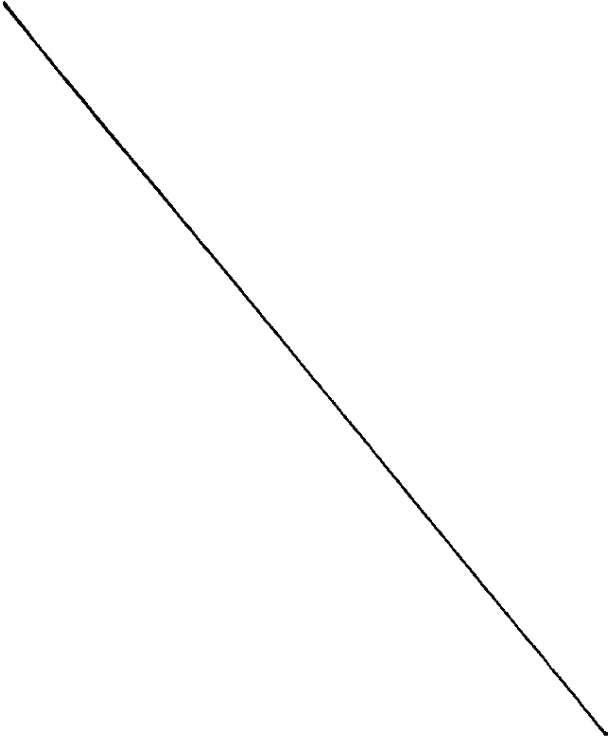
Our values

Open and Honest

Costain's Open and Honest approach is pursued vigorously throughout the Group. The Company employs a transparent partnering approach with customers and suppliers. In addition, the Company's Community Relations Managers ensure a constant flow of information is available on projects to the general public

The Costain magazine, Blueprint, one of the Company's major communication vehicles, has won national awards for the last four years for both its content and design. As a publicly quoted company, Costain regularly provides financial information to its shareholders and the market, which has included TV interviews with one of the world's leading Financial Information Services, Bloomberg

"...quoted companies must also – to the extent necessary for an understanding of the company's business – disclose information on environmental, employee, social and community matters, as well as on contractual and other arrangements essential to the business."



Chief Executive's review

Andrew Wylie
Chief Executive

Strategy

We have continued to implement successfully our 'Being Number One' strategy which is centred on leadership through focus and excellence and which leverages Costain's core brand values.

There is tremendous inherent value in the Costain brand, the result of a long tradition of professionalism, quality and engineering expertise. That brand reputation was further enhanced during the year with the completion of various projects to time and budget, in particular the new Eurostar Terminus at St Pancras.

Our brand values and reputation are hugely important in attracting key customers, suppliers and people in a market where quality resources are scarce and good people have plenty of choices.

Across our business, we are targeting larger, blue-chip customers who increasingly are looking to work with fewer contracting organisations on a longer-term framework or partnership basis. As an example of this, we were delighted recently to be appointed by BAA to their 'Complex Building Framework'. This Framework is worth some £4 billion over ten years.

We also continue to focus on market sectors, for example Water, Highways and Nuclear where we have, or can grow, a strong market position as a route to sustainable profit. Our strategic focus has significantly lessened our exposure to sectors particularly susceptible to the macro-economic climate and interest rate fluctuations.

Our customers are also increasingly looking for contractors to provide an integrated whole life-cycle service offering and we were delighted to win our first such contract, a five-year highways maintenance contract in joint venture during the year

Partly as a result of these trends in procurement, the construction market has continued to consolidate and polarise towards a smaller number of larger contractors. Our strategy will ensure that Costain is one of those larger contractors. We are now in a stronger position to achieve that ambition.

Delivering on our objectives

Following the decisive management actions taken during the latter half of 2006, we set ourselves a number of demanding strategic objectives for 2007 to ensure that we delivered a significant and sustainable recovery in Group profitability.

I am pleased to report that we have delivered on all of those objectives During the year, we:

- Achieved significant growth in profit in the Civil Engineering operations
- Delivered a profit from Building operations
- Produced a profit in the Oil, Gas & Process operations for the first time in six years
- Actively traded the PFI portfolio to re-invest in bidding for new projects
- Significantly strengthened our cash position to £133 million
- Further improved operational efficiency and reduced costs across the Group
- Secured a higher quality order book of £1.6 billion; repeat orders increased to 80%
- Increased the level of preferred bidder positions to over £800 million

Chief Executive's review continued

The Group also continued to manage out certain legacy contracts and good progress has been made during the year, in particular at Costa Azul and Pemex. The projects are nearing completion and commercial discussions are ongoing regarding the final handover of both contracts.

Financing the next phase of the Group's development

We were successful in achieving our key financial objectives in the year. We enhanced the Group's financial position by strengthening the balance sheet and giving the Group's operational capability added firepower through a 60% increase in the level of banking and bonding facilities

The Rights Issue, which raised £60 million (net of expenses), and the £200 million of banking and bonding facilities give Costain the additional resources with which to take full advantage of the many opportunities available to it in the marketplace.

Operations and Order Book

As a result of our strict new business criteria, which places long-term quality ahead of short-term quantity, our order book at £1.6 billion (2006: £1.8 billion) reflects a greater proportion of blue-chip customer work in our targeted sectors, 80% of which is repeat order work. Additionally, we have grown the preferred bidder position to in excess of £800 million (2006: £500 million) and started the year with approximately £700 million of 2008 revenue secured

Our Civil Engineering operations recorded an excellent performance in the year with increases in both profit and revenue. It was encouraging to see that the business, which encompasses a range of infrastructure and environment-related activities, also further consolidated its market-leading positions, in particular in Water and Highways. The business has been successful in developing a platform for future growth in the Nuclear industry, including undertaking a major contract at Sellafield

We delivered a profit from our Building operations following the implementation of remedial actions, including a re-alignment into key sectors, cost reductions and a restructuring of the management team. We expect that under close supervision, and with new management controls in place, we will see further progress through more selective bidding for higher margin work in its targeted sectors across the built community including Education, Health and Retail.

Costain regards its investments in PFI projects in a portfolio including Water, Health, Education and Highways projects as a strategically core activity, not least because PFI is an important procurement route for securing major public sector projects. In line with our strategy of actively trading the PFI portfolio to re-invest in bidding for new projects, including during the year the M25 consortium bid, we disposed of two equity positions in the year.

As previously reported, the result at our Property Development operations (Alcadesa) was impacted by the delay to a major land sale expected during the second half. However, a number of small transactions were completed and the Board remains confident in the medium to longer-term outlook, a sentiment reinforced by our securing a concession for a major 800-berth marina development project near Gibraltar.

Castleford Footbridge

The design and construction of a landmark pedestrian footbridge around a fast flowing weir on the River Aire and the installation of a fish pass at Castleford, West Yorkshire

The Group's Oil, Gas & Process operations performed ahead of expectations, benefiting from our much greater focus on Front End Engineering and Design and project management services. We were delighted to see the delivery of a profit for the first time in six years and we will continue to drive profitability.

Since the year-end, Costain has won a number of contract and preferred bidder awards, including as preferred contractor for the Special Purpose Vehicle (SPV) on the Greater Manchester Waste Disposal Authority's PFI Contract (capital works programme valued in the region of £300 million), as preferred bidder to build a new campus for the University of Worcester (worth approximately £70 million) and the contract, in joint venture, for the A14 in Cambridgeshire.

Health and safety

The proper management of Health and Safety remains our Number One priority

We demonstrated further improvements in our health and safety performance in 2007, and were delighted to receive the Royal Society for the Prevention of Accidents (RoSPA) most prestigious award, the Sir George Earle Trophy.

Our performance was also recognised by a further 33 RoSPA awards.

As a result of a number of initiatives and management actions, we have continued to reduce our Accident Frequency Rate (AFR), and we now have the best performance in the Major Contractors Group of peer companies.

Furthermore, our consideration for the local community was acknowledged by the achievement of 18 awards from the Considerate Constructors Scheme. We continued to focus on the health and safety of our employees and others affected by our operations and activities. We take all precautions possible to prevent environmental harm being caused as a result of our activities and are improving the environmental performance on both our sites and in our offices as part of our drive towards becoming an environmentally conscious company.

There is no room for complacency when it comes to Health, Safety and the Environment and so we have set a series of challenging objectives for 2008. These include a focus on Behavioural Safety as a way of influencing culture and individual actions to avoid accidents.

Chief Executive's review continued

People

We are recruiting talented people to Costain and continue to increase investment in training and development programmes at all levels

We have a first-rate operational management team at Costain and I am proud to lead them. Having revamped the Executive Board in 2006, and ensured that we have the right people in the right positions, there is a new confidence at Costain. This is evident in everything we do but particularly when tendering for new contracts, whether working alongside major partners in joint venture or competing successfully against fellow premier-league companies.

A major benefit of such strength and depth is that we also have a deep pool of talent from which to promote people and develop succession planning across the business.

Supply chain

A key element in making Costain more efficient and productive is our focus on reducing the number of suppliers and working with selected suppliers on a longer-term more strategic basis. This also enhances the service we provide and reduces the cost of project delivery, key ingredients in securing business from customers who are consistently expecting us to deliver 'more for less'.

We have continued to reduce our supplier base and now work with preferred suppliers for each of the key trades. We are now starting to see the benefit of these more collaborative relationships, be it through improved market intelligence, greater innovation, access to the best people or enhanced operational performance

A very successful first conference for our strategic supply chain partners was held at the end of the year at the University of Warwick, and focused on achieving mutual benefit through greater integrated working.

Managing costs

One of the drivers for achieving our significant recovery in profitability this year has been a robust management of costs in the business. The Executive Board reviews the costs in detail every month and actions are taken to further improve efficiency or reduce expenditure

In March 2008, the Group's headquarters moved to a new open plan modern building on the outskirts of Maidenhead, Berkshire which should further improve operational efficiency.

Summary

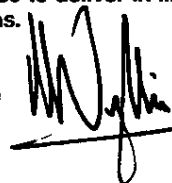
We have achieved a great deal over the past year at Costain with a lean and focused business delivering a strong performance

Growth in our chosen markets is underpinned by the major long-term spend commitments of our targeted blue-chip customers.

We have a focused strategy, a strengthened balance sheet and an ambitious management team determined to see Costain build on its position as one of the UK's premier contractors

These are exciting times at Costain and we are looking to the future with great confidence. I believe that we will see further progress during this year, building on the strong performance in 2007, and we are on course to deliver in line with our expectations.

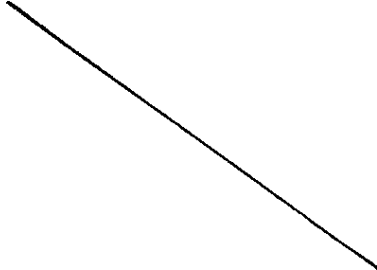
Andrew Wyllie
Chief Executive
11 March 2008



Our values Safe and Environmentally Aware

Costain's commitment to being 'Safe and Environmentally Aware' was recognised in 2007 when the Royal Society for the Prevention of Accidents (RoSPA) awarded the Company the Sir George Earle Trophy for being the UK's premier

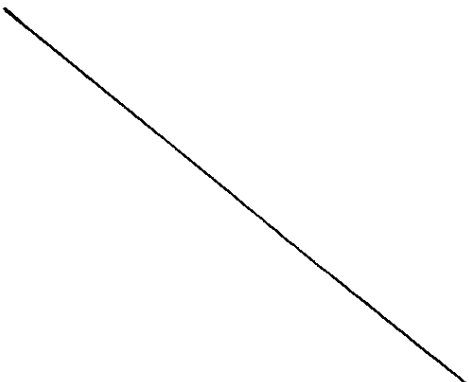
performer for occupational health and safety. Entrants had to be able to demonstrate an excellent safety management system and a minimum of four years' continuously improving performance.



"Factors which led to Costain taking the Trophy included: its senior managers' robust commitment and leadership; the approach to performance target setting and review; initiatives taken to enhance the leadership role of supervisors; and the approach to providing comprehensive occupational health services at site level, including its policy on drugs and alcohol."

Royal Society for the Prevention of Accidents

Lord Jordan of Bourneville (left), Deputy President of RoSPA, presents Alan Kay, Costain Managing Director – Operations, with the Sir George Earle Trophy



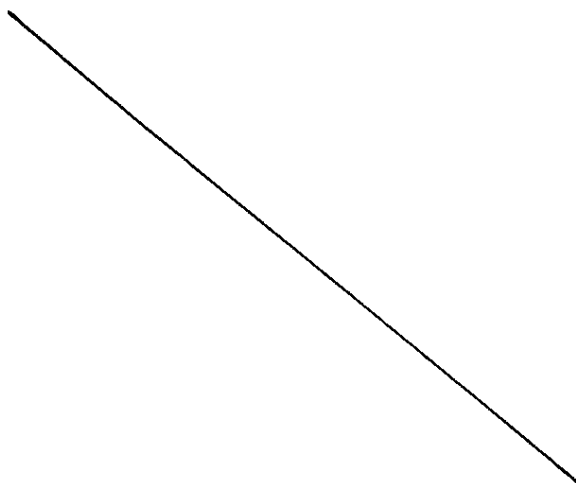
Our values Team Players

“By using innovative traffic management technology, the Highways Agency and its contractors have finished this scheme five months earlier than planned, bringing significant benefits to the thousands of drivers who use this busy route every day.”

Tom Harns MP, Parliamentary Under Secretary of State for Transport

The A2/A282 project was a fitting testament to the successful formation of a multi-disciplined team. The customer, the Highways Agency, brought together some of the industry's top performers, including Costain as main contractor.

To ensure the needs of local communities were met at the start of construction, public exhibitions were staged to show residents and stakeholders the details of the scheme. A 24-hour helpline was made available throughout the project to assist with external queries.



Business & Operational review

Civil Engineering

Revenue (including share of joint ventures and associates) for the period was £539.3 million (2006: £488.1 million), with a profit of £20.0 million (2006: £10.3 million).

Costain is a leader in UK Environmental and Infrastructure projects

Water

During 2007, Costain's position was reinforced as the UK's leading asset management contractor with excellent performance on all of our frameworks: Bristol Water, Southern Water, Thames Water, United Utilities, Welsh Water and Yorkshire Water.

At Southern Water, in a joint venture, Costain has successfully commissioned the £85 million Margate and Broadstairs Waste Water Treatment Plant, with overall completion achieved two months ahead of programme and final handover in March 2008 some three months early.

We secured, in joint venture, a £100 million contract from United Utilities for the construction of the Shell Green sludge treatment project.

Costain, in joint venture, is also preferred bidder for the £200 million Brighton and Hove Waste Water Treatment Works, which is currently going through the planning approvals process. Costain was recently awarded an Advance Contract for design and procurement work in anticipation of a full order during 2008.

Among a number of awards in recognition of our excellence in this sector, our Southern Water/SEC(4D) joint venture won the Partnership Initiative of the Year Award at the inaugural Water Industry Achievement Awards and a RoSPA Gold safety award for the second year running, and we secured Yorkshire Water's Community Contract Partner of the Year Award.

Waste

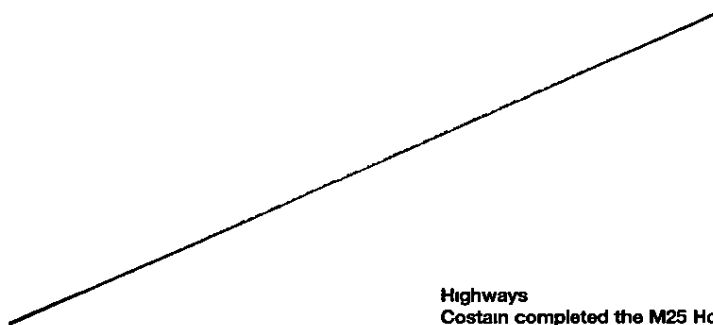
Costain has expanded its operations into the Waste sector, where the Group has the opportunity to use complementary process engineering skills and expertise from its water operations to build a presence in the rapidly expanding UK and European regulated marketplace.

Costain is the preferred bidder and was recently awarded an advance design and construction contract for the Greater Manchester Waste Disposal Authority's PFI contract. The capital works package is valued at some £300 million and we expect full award soon with four years of work.

Towards the end of the year, Costain was named as preferred bidder for the Riverside Resource Recovery Ltd Energy from Waste plant in Belvedere, Kent.

Water

As part of the Company's Thames Water Framework, Costain undertook M&E refurbishment works to the Hampton Stored Water Shaft.



Highways

Costain completed the M25 Holmesdale Tunnel project ahead of schedule and within budget

Nuclear

Costain is delivering the Evaporator D project at Sellafield combining process and civil engineering modularisation expertise

Nuclear

Costain has made steady progress in the Nuclear sector with the successful delivery of the Hunterston MAETP contract, framework contracts for AWE and Trawsfynydd and completion of the UKAEA Winfrith Dragon Phase 1 decommissioning contract. At Sellafield, we have delivered successfully our process and modularisation expertise into the sector-critical Evaporator D project and are making good progress on the site construction phase.

Contract awards in the year have included Hunterston's Solid Active Waste Bunker Retrieval, Solid Intermediate Level Waste Encapsulation and Storage Ponds Decommissioning projects, with preferred contractor status confirmed for the Trawsfynydd Capping Roof project and Berkeley Active Waste Vault Retrieval project.

Highways

Costain strengthened its leading position in the Highways sector, with the delivery of major schemes including the M25 Holmesdale Tunnel, ahead of schedule and under budget, and the A2/A282, a £120 million scheme completed five months early and within budget.

Costain also received a number of contract awards including the £40 million M27 (J3 to J4 and J11 to J12) in addition to being preferred bidder for the £93 million Church Village by-pass with repeat customers Highways Agency and Rhondda Cynon Taf.

The Company has a strong forward order book in Highways with Early Contractor Involvement schemes including the A19, the A34 Wolvercote and the M1 (J10 to J13) with the Highways Agency, the A40 Penblewyn with the Welsh Assembly Government and the recent award, in joint venture, of the Highways Agency's A14 project. We were also pleased to secure, in joint venture, our first five-year MAC maintenance contract.

In line with our strategy of actively trading the PFI portfolio to re-invest in bidding for new projects, including during the year the M25 consortium bid, the Group sold its 50% investment in the Sirhowy Enterprise Way PFI concession.

Costain is part of the FLOW consortium, which has been short-listed for the Highways Agency's £5 billion M25 programme. The preferred bidder is expected to be announced in the first half of 2008.

Business & Operational review continued

Rail

The highlight of 2007 was the successful completion, in joint venture, of the £800 million St Pancras International Terminus. Completion of the Station was the final stage in the new Channel Tunnel Rail Link and has been described as the 'jewel in the crown' of the new High Speed 1 Eurostar service connecting London to mainland Europe.

In line with our Rail strategy, and building on our St Pancras success, Costain secured the first element, in joint venture, of the £400 million Kings Cross Station redevelopment for Network Rail and we are actively bidding for the remaining major elements of the works

We are also tendering for the major redevelopments of both Blackfriars and Farringdon stations in the Network Rail Thameslink programme with a combined potential value of more than £350 million.

Costain also completed, in just twelve months, the design, build and commissioning of the new Langdon Park Station on the Docklands Light Railway (DLR), the first new station build on a live DLR line

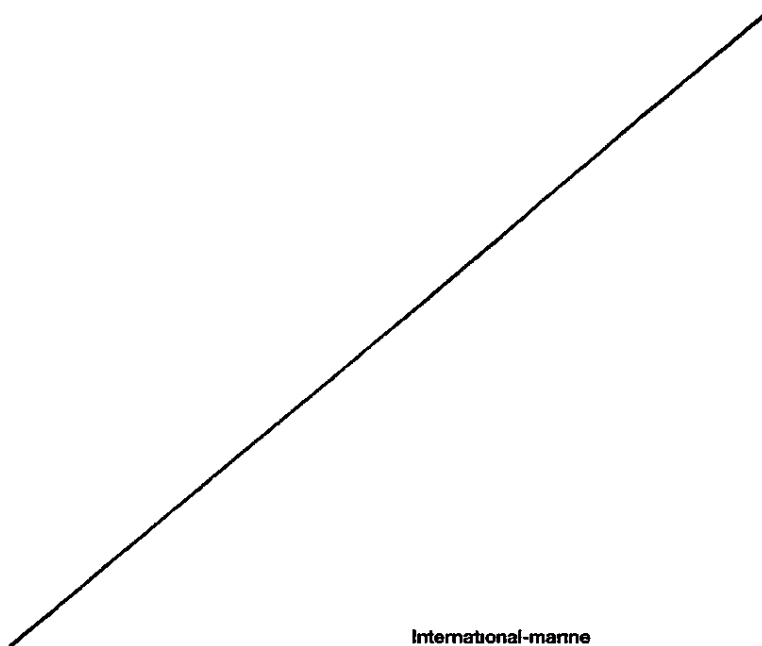
Marine

Costain completed the winter maintenance of the major coastal protection scheme at Whitstable, Kent for Canterbury County Council

Two major Container Port developments, Felixstowe South Reconfiguration and London Gateway Port, have been given final planning consent. Costain is currently in negotiations with Hutchison Port Holdings regarding the Felixstowe project whilst London Gateway Port, for Dubai Ports, is being re-bid for submission in the first half of 2008.

Airports

Costain has been appointed by BAA as one of the approved contractors for their 'Complex Building Framework' This Framework is worth some £4 billion over ten years. We continue to deliver projects for Manchester Airport Group under their current framework agreement.



International-marine
Energia Costa Azul LNG Terminal Breakwater
Turnkey Project, Mexico

Rail
Langdon Park Docklands Light
Railway Station, Tower Hamlets,
London

Our values Accountable

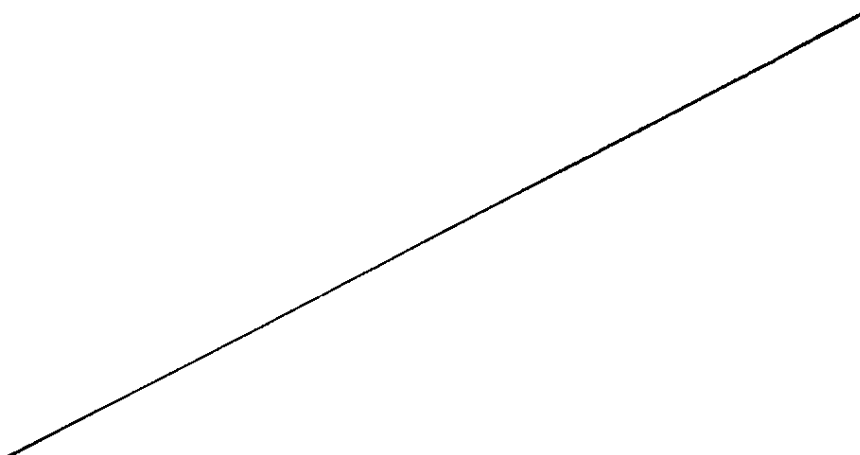
The Costain Group stepped forward in the Summer of 2007 when one of its major customers, Yorkshire Water, faced the dangers of flooding, which affected much of the UK. A seven strong Costain team answered an emergency call when water levels rose above pump

bearings causing them to fail. The Costain team worked round the clock managing to control, and subsequently prevent, water from reaching critical levels until the pumping station was back on line.

“We want to thank Costain staff for their hard work and professionalism. It is comforting to know that our partners are willing to help in any way possible to maintain the continuity of supply to our customers, even in the most difficult of circumstances.”

Richard Flint, Director of the Water Business Unit,
Yorkshire Water

Below: Some of the Costain team involved
in managing the floods during 2007.



Business & Operational review continued

Building

Revenue (including share of joint ventures and associates) for the period was £254.7 million (2006 £298.0 million), with a profit of £0.8 million (2006 loss: £25.9 million)

Health

Costain successfully delivered three projects during the year: the Kingston Hospital Phase V PFI scheme, a new unit providing additional wards and teaching facilities on the Kingston Hospital site; Bridgnorth Hospital extension, a ProCure21 project providing community hospital facilities; and Finch Road Community Unit in the Lozells area of Birmingham.

During the year, two ProCure21 projects were awarded to Costain at Cheltenham and Gloucester Hospitals. We reached Financial Close on all the 3 Shires PFI contracts in 2007 and we were appointed as one of two contractors on a framework for Circle to build approximately 30 private healthcare facilities around the country over five years

Health
NHS Treatment Centre
at QMC, Nottingham

Education

Costain delivered three new PFI secondary schools in Kent along with the remaining two PFI schools at Greenford and Acton as part of the Ealing II PFI scheme. Phase 2 of the John Madejski Academy in Reading was also completed and work has commenced on the University of Reading's new Business School and extension.

Costain made good progress with the construction, in joint venture, of Phase 1 of Bradford's £400 million Building Schools for the Future (BSF) programme. The first three schools are due for delivery in early summer 2008. Negotiations for Phase 2, valued at approximately £160 million, continue with contracts due to be signed before the end of 2008.

During the year, Costain was named as preferred bidder, in joint venture, on Lewisham's £210 million BSF programme. The Company achieved Financial Close on the Phase 1 schools with construction starting on Sedgehill and Catford and design work for Phase 2 is underway. At the close of the year, Costain was confirmed as preferred bidder on the University of Worcester's new £70 million Castle Street campus.

In order to finance the above PFI bidding activity, and in line with our ongoing strategy of actively trading our PFI equity portfolio, the Group sold its shareholding in Bridgend Prison PFI project during the year.

Retail

During the year, we continued to work closely with Tesco and were appointed to their Strategic Partners Group. We are currently in discussion to formalise the Company's appointment under a three year framework agreement which will result in contracts for new stores during 2008. This significantly strengthens our relationship with Tesco as does the work at Gerrards Cross, Buckinghamshire where the two companies are working to progress that scheme.

We were one of six main contractors to be appointed a framework contractor by J Sainsbury and also successfully pre-qualified as a contractor on the Marks & Spencer Register of Approved Suppliers.

Education
Aylesford Sports College, Kent.

Retail
The newly refurbished Sainsbury's store at Harlow, Essex

Business & Operational review continued

Property Development

Revenue (including share of joint ventures and associates) for the period was £3.6 million (2006: £13.2 million), with a profit of £0.2 million (2006: £3.9 million).

The Group's Property Development business in southern Spain (Alcadesa) completed a number of small transactions although, as previously reported, a major land sale expected during the second half of 2007 has been delayed. Consequently, the result for the year was below expectations.

Alcadesa, a joint venture business, does not build property for sale direct to the public. Its principal activity is the purchase of land, securing enhanced planning consents and selling enclaves of consented land to developers. Consequently, Alcadesa has seen a degree of resilience in its market and maintains a long-term high quality land bank. A large disposal is expected in 2008.

The Board remains confident in the medium to longer-term outlook for the division and this view has been reinforced during the year by securing the 30-year concession for the 800-berth marina near Gibraltar.

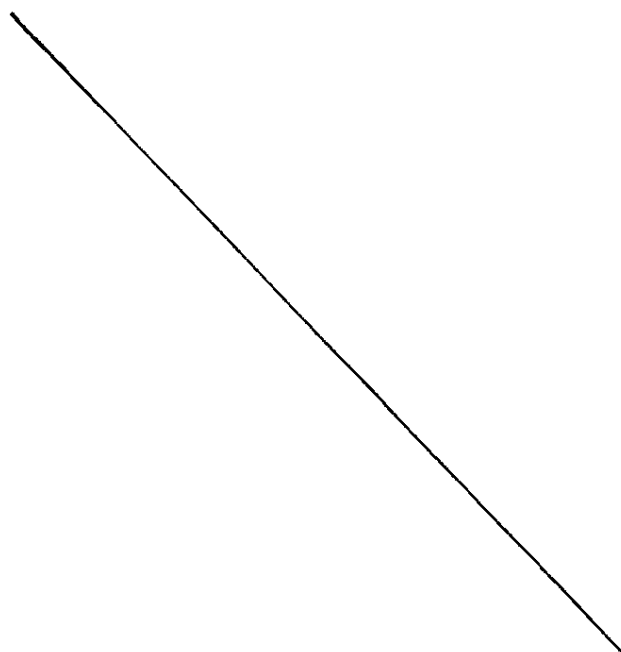
Oil, Gas & Process

Revenue (including share of joint ventures and associates) for the period was £62.3 million (2006: £57.2 million), with a profit of £1.9 million (2006: loss £19.5 million).

The Company performed ahead of expectations in this sector as a result of a refocused strategy, a strong order book and much improved productivity levels.

Within the UK, Costain has been pursuing a number of natural gas underground storage projects and is currently performing the Front End Engineering Design of a plant for Gaz de France's Stubbach (Cheshire) Gas Storage Facility. A design verification study for another underground gas storage project with E.ON has seen Costain well-placed to secure further business in this sector in 2008.

Costain's operations in Abu Dhabi continued to perform well. As one of the principal construction contractors on Das Island for more than 30 years, Costain has been involved in almost every aspect of the island's oil and gas processing complex. With regard to the Pemex contract in Mexico, where good progress has been made during the year, Costain is working with the main contractor towards the completion of the project.



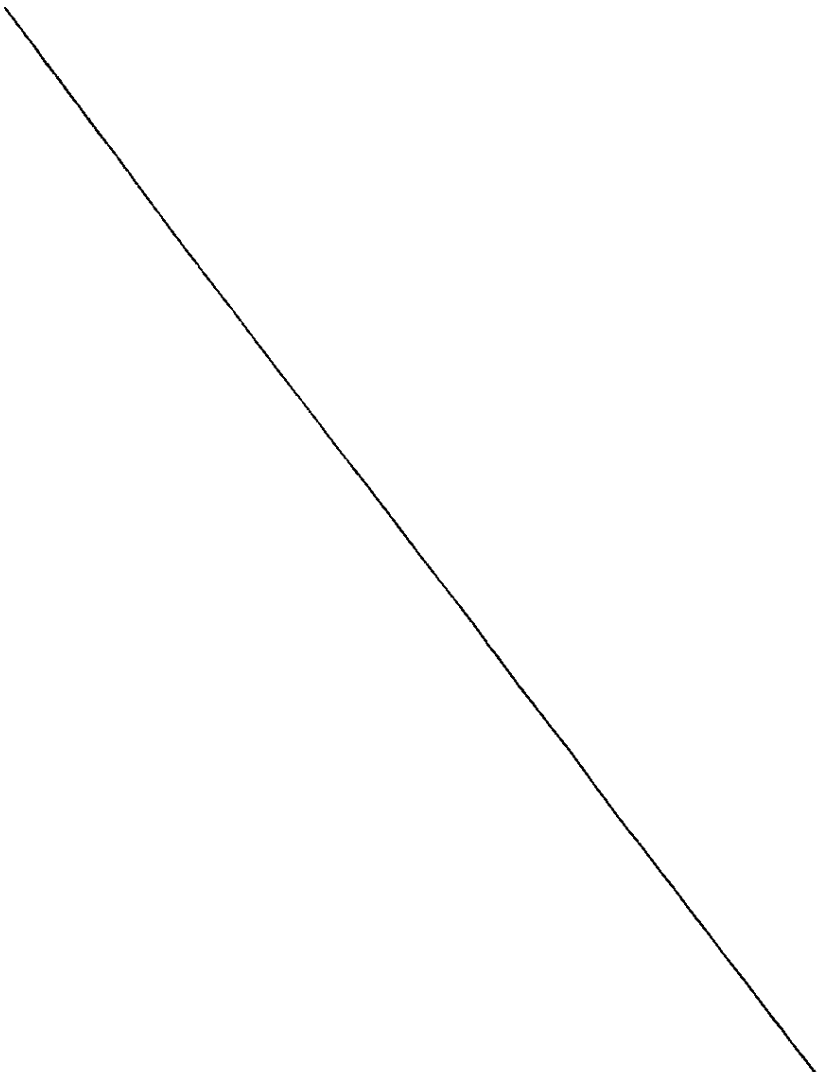
International

Following the decision in 2006 to close the International Division, we continue to work-out the remaining contracts, in particular Costa Azul, where the project is nearing completion and commercial discussions are ongoing regarding the final handover. Any future international projects will be undertaken by the appropriate specialist sector teams.

Order Book

We have a high quality order book, standing at £1.6 billion as at 31 December 2007, of which approximately £700 million relates to 2008 and 80% of which is repeat business. We have also grown our preferred bidder positions to in excess of £800 million

Our focus on quality rather than quantity has resulted in an order book that contains a range of excellent contracts and which provides a stream of high-quality earnings for the Group. We will continue to manage our order book on the basis of securing an increasing proportion of long-term frameworks with blue-chip customers

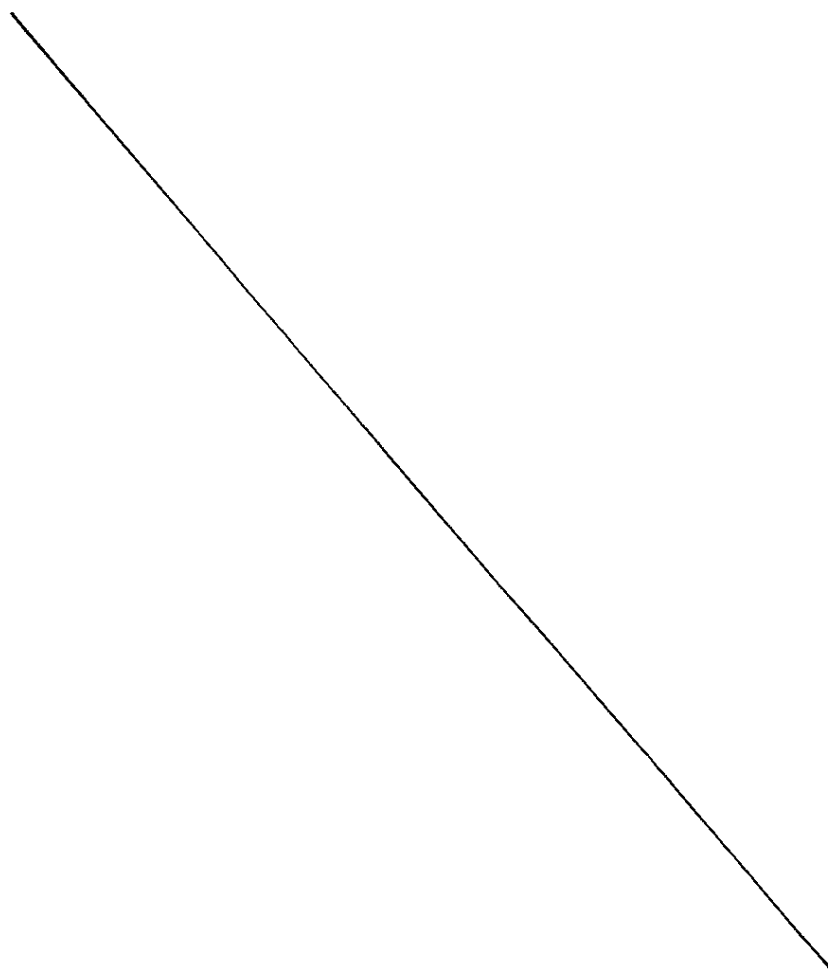


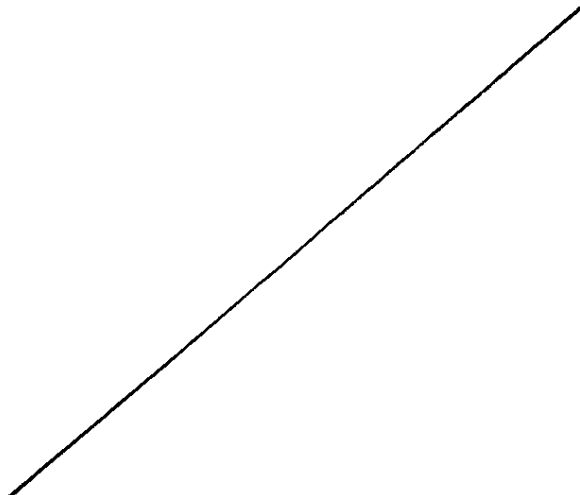
Oil, Gas & Process
Colin Dickanson, Project Manager,
supervising the transportation of the
de-bottlenecking unit for BG Tunisia

Our values
Improving Continuously and
therefore the... Natural Choice

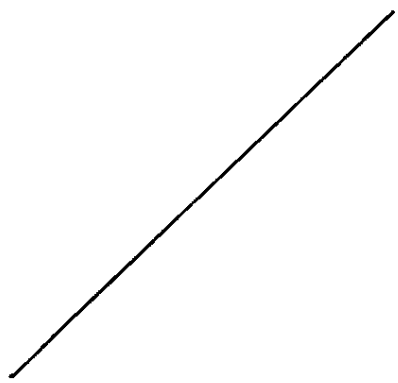
**“St Pancras is not just a building
but a joy to behold.”**

Simon Jenkins, The Guardian, 9 November 2007





One of the 'jewels' in the UK construction crown in 2007 was the refurbishment and extension of St Pancras International station, a Costain joint venture for client London & Continental Railways Ltd. The refurbishment and extension of St Pancras International was part of the £5.8 billion High Speed 1 project which took ten years to complete. At the official opening of St Pancras International by HM the Queen, specific mention was made of the highly technical and intricate nature of the work undertaken.



Financial review

Tony Bickerstaff
Finance Director

Results

Profit before tax for the year ended 31 December 2007 was £19.8 million (2006: loss £61.7 million) on revenue (including Group's share of joint ventures and associates) of £877.9 million (2006: £886.3 million)

In 2006, there were a number of key decisions taken that had a significant impact on the financial results. The result for 2007 represents a return to profit for the Group, reflecting the positive operating impact of the actions taken in 2006 and 2007.

Net interest receivable amounted to £3.3 million (2006: £2.8 million).

Basic earnings per share amounts to 3.6p (2006: 13.2p loss per share (restated*)).

Cash flow and borrowings

The net cash position of £132.8 million (2006: £53.3 million) included £0.6 million of borrowings (2006: £3.1 million).

The cash position is affected by monthly and contract specific cycles and, in order to accommodate these flows, the Group maintains a range of bank facilities.

The high net cash balance reflects the timing of cash flows and the successful £60 million Rights Issue completed during the year.

* Restated for Rights Issue bonus element.

Order book

Order book reduced slightly during the year from the level last year-end to £1.6 billion (2006: £1.8 billion). The reduction reflects the significant level of 5-year framework contracts awarded to the Group in 2005 and a reduction in international contracts, following the closure of the International Division in 2006.

Shareholders' equity

As a result of the Rights Issue and the profit in the year, the shareholders' equity position has improved significantly to a £27.4 million positive position compared to the £55.2 million negative position at the end of 2006. This includes the impact of the deficit, net of deferred tax, in the pension scheme of £36.4 million (2006: £48.1 million).

Dividend

The Board recommends a dividend for 2007 of 0.5p per share (2006: Nil). The Company last made a dividend payment on 25 November 1991.

As previously reported, the Group will make an additional cash contribution to the pension scheme equal to the amount of dividend paid to shareholders. The payment of the dividend has received the necessary clearance from the Pensions Regulator.

Subject to confirmation at the Annual General Meeting, the dividend will be paid on 23 May 2008 to shareholders on the register at the close of business on 25 April 2008.

Treasury controls

Policy

The Group's treasury and funding activities are undertaken by a centralised treasury function, its primary activities are to manage the Group's liquidity, funding and financial risk, principally arising from movements in interest rates and foreign currency exchange rates. The Group's policy is to ensure that adequate liquidity and financial resources are available to support the Group's growth development, while managing these risks. The Group's policy is not to engage in speculative transactions. Group Treasury operates as a service centre within clearly defined objectives and controls and is subject to periodic review by Internal Audit.

Foreign currency exposure

Translation exposure: the results of the Group's overseas activities are translated into sterling at rates approximating to the foreign exchange rates ruling at the dates of the transactions. The balance sheets of overseas subsidiaries are translated at foreign exchange rates ruling at the balance sheet date.

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

Interest rate risks and exposure

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 equity, working capital and bank borrowings. With the Group's low level of borrowings, the main exposure to interest rate fluctuations arises from surplus cash, which is generally deposited with the Group's relationship banks

Liquidity risk

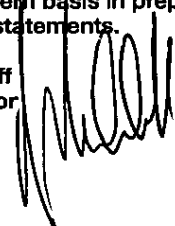
Group policy is to ensure that projected financing needs are supported by adequate committed facilities.

During the year, the Group renegotiated its contract bonding and banking facilities with its relationship banks and surety companies. The facilities were increased to £200 million and extended to a maturity date of 30 June 2009.

Going concern

The directors believe, after due and careful enquiry, that the Group has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2007 financial statements.

Tony Bickerstaff
Finance Director
11 March 2008



The RT Hon Ed Balls MP, Secretary of State for Children, Schools and Families (right) with Tony Bickerstaff, Costain Financial Director

Principal Risks and Key Performance Indicators

Economic and market cycles and volatility

The Group's business may be affected by the general risks associated with all companies operating in the same construction markets as the Group. These markets depend on numerous factors, many of which are beyond the Group's control, and the exact effect of which cannot be accurately predicted. Such factors include general economic and political activities, including the extent of any governmental regulation, taxation and interest rates.

Senior management and skilled personnel
The Group is dependent on members of its senior management team and a flexible, highly skilled and well-motivated work force and believes its future success will depend in part on its ability to attract, develop and retain highly skilled management and personnel. If the Group does not succeed in attracting, developing and retaining skilled personnel, it may not be able to grow its business as anticipated. Further, the departure from the Group of any of the Executive Directors or certain senior employees could, in the short term, have a material adverse effect on the Group's business.

Environmental, health and safety laws, regulations and standards
The Group is subject to a broad range of laws, regulations and standards, including those relating to pollution, the health and safety of employees, protection of the public, protection of the environment and the storage and handling of hazardous substances and waste materials. These regulations and standards are becoming increasingly stringent.

It is the Group's policy to require that all of its subsidiaries, employees, suppliers and sub-contractors comply with applicable laws, regulations and standards. However, violations of such laws, regulations and standards, in particular, environmental and health and safety laws could result in restrictions on the operations of the Group's sites, damages, fines or other sanctions, increased costs of compliance, potential reputational damage and potential loss of future contracts.

The manner in which the Group manages these risks is described in Corporate Governance (including Internal Controls and Risk Management) on pages 36 to 43.

Major incident exposing an inadequate safety regime

The nature of the business conducted by the Group requires the adoption and maintenance of a rigorous health and safety programme. The Group works on a number of significant and high profile projects and therefore the health and safety performance is critical to the success of all areas of the Group's business. The Group takes the management of both operational and occupational safety extremely seriously. Any failure in health and safety performance, which results in a major or significant health and safety incident, is likely to be costly for the relevant business in terms of potential liabilities incurred as a result. Furthermore, such a failure could generate significant adverse publicity and have a negative impact on the Group's reputation and its ability to win new business, which in turn could adversely affect the operating, financial and share price performance.

Pension liabilities

The Group operates a defined benefit pension scheme, which has been closed to new members since 1 June 2005. As at 31 December 2007, there were 919 active members accruing pensionable service.

The valuation under IAS 19 for the scheme as at 31 December 2007 valued the scheme's assets at £460.5 million and liabilities at £511.1 million. This leaves a deficit in the scheme of £50.6 million. Costain has reached an agreement with the Trustee that the deficit is reduced over a period of ten years. The introduction of the Pension Protection Fund increases the costs borne by the Group.

The value of the deficit recognised in the Group's balance sheet pursuant to IAS 19 is dependent on certain critical assumptions including mortality rates, future salary and pension increases, investment returns and inflation and is likely to vary from year to year. Recent and prospective changes in the regulatory environment and funding requirement principles may lead to requirements to increase funding in respect of the scheme in future years (possibly to a level in excess of that needed to achieve solvency on an IAS 19 basis). The powers of the Pensions Regulator may also impact on any plans to make returns of capital from the Group to shareholders. For example, the Pensions Regulator has powers to levy contribution notices and financial support directions in certain circumstances in order to ensure that additional contributions are paid into a pension scheme or that other financial support is put in place to the benefit of a pension scheme. In the event that the market value of the scheme's assets declines in relation to its assessed liabilities, the Group may be required to increase its contributions to cover any further funding shortfalls. This could have an adverse impact on the Group's operational results and cash flow.

Change of Government policy

Certain of the Group's operations are dependent on the current UK Government's policy with regard to improving public infrastructure, buildings and services, notably in the education, roads, health, nuclear and defence sectors. The UK Government may decide in future to change its priorities and programmes, including reducing present or future investment in transport, health or defence projects or other areas in which the Group would expect to compete for work. Any reduction in such government investment and funding would be likely to adversely affect the Group's future revenues and profitability in the relevant sectors.

Risk of incorrectly budgeting/costing long-term contracts

If the Group is unable to accurately estimate the overall risks, revenues or costs on a particular contract, then a lower than anticipated profit may be achieved or a loss incurred on such contract. The Group generally enters into four principal types of contracts with clients: fixed price contracts, 'cost plus' contracts; framework contracts with clients that span a number of years and incorporate an agreed mechanism for bearing costs and sharing profits, and long-term PFI projects.

A significant proportion of the Group's business depends for its profit on costs being controlled and projects being completed on time, such that costs are contained within the pricing structure of the relevant contract.

'Cost plus' contracts provide for reimbursement of the costs required to complete a project, but generally have a lower base fee and an incentive fee based on cost and/or scheduled performance. If actual costs exceed the revenues available under such a contract or are not allowable under the provisions of the contract, Costain may not receive reimbursement for all of these costs.

Cost overruns, whether due to inefficiency, poor design, where the contractor has design responsibilities, faulty estimates, cost escalation, and/or cost overruns by sub-contractors or other factors, result in lower profit or a loss on a project. A significant number of contracts are based in part on cost estimates that are subject to a number of assumptions. If estimates of the overall risks, revenues or costs prove inaccurate or circumstances change, then a lower profit or a loss on the contract may result.

Failing to win contracts

If the Group failed to win major work from a key client this could cause short-term revenue and profitability issues. The Group is always aware of this and seeks a balanced client base.

Contract negotiations

The Group's contracts may require extra or change order work as directed by the customer even if the customer has agreed in advance on the scope or price of the work to be performed. This process may result in negotiations over whether the work performed is beyond the scope of the work included in the original project plans and specifications or, if the customer agrees that the work performed qualifies as extra work, the price the customer is willing to pay for the extra work. Even when the customer agrees to pay for the extra work, the Group may be required to fund the cost of such work for a period of time until the change order is approved and funded by the customer.

Principal Risks and Key Performance Indicators

continued

Risk of missing deadlines

The construction industry is highly schedule driven, and failure to meet schedule requirements within contracts could adversely affect the Group's reputation and/or exposure to financial liability. Many of the Group's contracts are subject to specific completion schedule requirements with liquidated damages charged in the event the construction schedules are not achieved. Failure to meet any such schedule requirements could damage the Group's reputation within the industry and client base, as well as incurring significant liquidated damages.

In particular, and as reported in the 2006 results and in the Prospectus for the Rights Issue, two significant legacy contracts represent potential risks and the current positions on the Costa Azul Breakwater, Mexico and the project for Pemex in Mexico are reported on page 99.

Competition

Contractors are required to compete for new work, which is won through a process of competitive tendering or bilateral negotiation. The contractors' reputation, prior experience with the client and pricing will all have a bearing on gaining new work. The failure by the Group to compete effectively on these criteria could reduce the Group's profitability.

Sub-contractor and supplier failure

The Group is reliant on its supply chain. If a sub-contractor or supplier of goods or services failed financially or was responsible for late or inadequate delivery or poor quality of work on a project then it could damage the Group's reputation and/or cause it to suffer financial losses.

Loss of IT systems

The Group is dependent on IT systems for the delivery of its business. The Group believes that its IT systems are reliable and well protected but recognises that such systems need constant updating and maintenance because their failure could cause financial loss to the Group as well as damage to its brand and reputation.

Insurance

The Group believes it has robust, comprehensive and adequate insurance cover but recognises that a claim could be made against it which exceeds the limits of insurance cover or is in respect of a matter that is uninsurable. In those circumstances the Group could suffer financial loss.

Procurement delays

Certain government-related projects on which the Group may work may require relevant approvals from government ministers or senior civil servants. It is possible that, due to difficulties obtaining such approvals, projects may be delayed before procurement has started, during the tender stage or during the period between the appointment of a preferred bidder and the exchange of contracts. These matters are likely to be beyond the control of the Group and any resulting delays could affect future revenue streams of the Group and have an adverse impact on the Group's businesses, results of operations and financial condition.

Key Performance Indicators

The Group operates a range of performance indicators across the various business units. These start with a formal three-year business plan, which sets out clear strategic targets and objectives and which forms the basis of the budget for the following financial year.

The Board considers the following Financial and Non-financial Key Performance Indicators are the most effective measures for monitoring its objectives:

Non-financial Key Performance Indicators

- **Accident Frequency Rate**

Safety is the number one priority in the Group. We have both corporate and individual responsibility to ensure that our operations are managed in a safe, healthy and environmentally controlled manner. The common measure in the construction sector of measuring safety performance is the Accident Frequency Rate (AFR), which measures the number of lost time incidents per 100,000 of hours worked. The AFR for 2007 for the Group was 0.14, this was a very significant improvement on the 2006 level of 0.21 and represents upper quartile safety performance in the construction sector.

- **Staff retention**

The retention of staff is fundamental in delivering a quality service to customers. The Group undertakes a number of important initiatives to retain key staff, including closely managing their career development. Following staff surveys carried out in 2006 and 2007 a clear action plan is in place to address items such as customer satisfaction, health and safety, reward, training and development and job satisfaction identified in the survey results. The concerned leavers turnover rate was 16% for 2007, which fared positively against our target of 18%.

Financial Key Performance Indicators

- **Profit before tax**

The level of profitability is a key measure of performance across all areas and divisions of the Group. The reported profit before tax of £19.8 million in 2007 compares favourably to the £61.7 million loss reported for 2006.

- **Order book**

The level of secured orders on which work is to be carried out is a key measure for achieving continued profitability and growth. As at the end of 2007, the order book for the Group was £1.6 billion, which is a reduction from the £1.8 billion level as at 31 December 2006. The reduction reflects the significant level of 5 year framework contracts awarded to the Group in 2005 and a reduction in international contracts following the closure of the International Division in 2006.

- **Net cash balance**

The Group has a positive net cash balance and close monitoring and measurement of cash resources is carried out as part of the performance measurement process. As at 31 December 2007, the net cash balance of the Group was £132.8 million and represents a significant increase from the £53.3 million balance as at 31 December 2006. This increase is a result of positive operating cash flow in the year and a successful rights issue, which raised £59.8 million after expenses.

The Group produces every month for each project a Project Manager's Report (PMR) that contains a number of indicators regarding the performance of the project, specifically information on:

- Health and Safety – record of any accidents or incidents and safety inspection scores
- Customer service – feedback from the customer on the Company's performance
- Programme – measure of actual progress against planned
- Financial performance – anticipated financial outcome on the project, including analysis of costs to date and to completion compared to the original budget
- Claims and variations
- Cash management – measurement of the cash flows on the project
- Resource levels – measurement of the number of direct staff and sub-contract staff compared to the level budgeted
- Risk management – analysis of the key risks and opportunities on the project

The PMR is reviewed monthly by the divisional and senior management teams in the Group.

Board of directors

David P Allvey³

FCA, ATII

Non-Executive Director (2001)

Chairman (2008)

Age 63. Non-Executive Director of Resolution Plc, Intertek Plc, William Hill Plc and Thomas Cook Plc, Chairman, Arena Coventry Ltd. Formerly, Group Finance Director Barclays Bank Plc (1999-2000), Chief Operations Officer, Zurich Financial Services AG and Allied Zurich Plc (1997-1999), Group Finance Director of BAT Industries Plc (1989-1998), Board member of the UK Accounting Standards Board (1993-2003), and Non-Executive Director of McKechnie Group Plc (1993-2000).

Mohd Hussein bin Abdul Hamid

ACMA

Non-Executive Director (2007)

Deputy Chairman (2007)

Age 54. Formerly worked for several multinational companies (Exxon, Intel, Goodyear and Motorola) (1977-1994) in Malaysia. Finance Director of Ayer Molek Rubber Company Berhad (1994-1995), Corporate Development Director of Costain Group PLC (1996-1997), Finance Director of National Steel Corporation, Philippines (1998-2000), Chief Financial Officer of PLUS Expressways Berhad (2000-2004), Senior Director of United Engineers (Malaysia) Berhad and a Director of other subsidiaries within UEM Group of companies.

Andrew Wyllie

BSc, MBA, FICE, CEng

Chief Executive (2005)

Age 45. Formerly Managing Director of Taylor Woodrow Construction Limited (2001-2005) and a member of the Taylor Woodrow plc Executive Committee. Joined Taylor Woodrow in 1984 and worked on major contracts in Africa, Middle East, Far East and the UK.

John Bryant¹²³⁴⁵

MA (Cantab), FREng, FIM, CEng,

DSc (Hon)

Non-Executive Director (2002)

Age 64. Non-Executive Director Welsh Water Plc and Glas Cymru Limited since 2001. Formerly Chief Executive of Corus Group Plc (1999-2000), Chief Executive British Steel Plc (1999), Executive Director British Steel Plc (1995-1999) and Non-Executive Director Bank of Wales Plc (1996-2001).

James Morley¹²³⁴

BSc, FCA

Non-Executive Director (2008)

Age 59. Non-Executive Director, the Innovation Group PLC and W S Atkins PLC. Formerly Chief Operating Officer, Primary Group Limited (2006-2007), Group Finance Director, Cox Insurance Holdings Plc (2002-2005), Group Finance Director, Arjo Wiggins Appleton Plc (1999-2001), Group Executive Director Finance, Guardian Royal Exchange Plc (1990-1999), Deputy Chief Executive and Finance Director, Avis Europe Plc (1976-1989) and Non-Executive Director, the Bankers' Investment Trust PLC (1994-2008).

Saad Shehata

BSc, Eng

Non-Executive Director (1997)

Age 82. Principal in Saad Y Shehata Engineers Office, Cairo, Egypt since 1983. Deputy Chairman and Chief Executive of Al-Kharafi – Solar Energy. Formerly Industrial Attaché at the Egyptian Embassy in Germany (1959-1963), General Manager Akana Construction Company, Egypt (1965-1972), General Manager for Construction at MA Kharafi (responsible for Abu Dhabi, Saudi Arabia, Yemen and Egypt) (1972-1980) and Deputy Director General MA Kharafi (Construction) Kuwait (1980-1983).

Tony Bickerstaff
FCCA
Finance Director (2006)
Age 43. Formerly Finance Director of Taylor Woodrow Construction Limited (2001-2006).

Michael R Alexander^{1 2 3 4}
BSc, MSc, FICChem.E, FIET, FIGM, CEng, CSci
Non-Executive Director (2007)
Age 60. Non-Executive Chairman of the Association of Train Operating Companies; Non-Executive Chairman of TGE Marne GmbH; Independent Non-Executive Director of the Payments Council; Executive Director of Lexican Limited; Advisor to Marwyn Investment Management LLP, and Consultant to Ampy Metering. Formerly Chief Executive, British Energy PLC (2003-2005); Executive Director, MD British Gas Trading & Chief Operating Officer, Centrica PLC (1994-2003); Non-Executive Chairman Goldfish Bank Limited (2002-2003); and Non-Executive Director of the Energy Savings Trust Limited (1994-2001).

Frederick William Ballard^{1 2 3 4}
OBE
Non-Executive Director (2001)
Age 69. Chairman and Non-Executive Director of Construct Corporation Ltd, Board Member of DTI Airports Advisory Council until 31 December 2007. Formerly Director of Alstom Power Conversion Limited (1986-2000), Director of Ransomes Rapier Limited (1976-1986) and Newton Chambers Limited.

Mohd Azman Sulaiman
BSc, MSc, MBA
Non-Executive Director (2004)
Age 43. Group Business Development Director United Engineers (Malaysia) Berhad, Director UEM Land Sdn Bhd and Environment Idaman Sdn Bhd.

Dato' Ahmad Pardas bin Senin
resigned as a Non-Executive Director on 25 January 2007. David Jefferies resigned as Chairman and a Non-Executive Director on 31 December 2007.

The 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 Andrew Wyllie, the Chief Executive. The other members of the Executive Board are:

Tony Bickerstaff
(Finance Director)
Clive L Franks
(Company Secretary)
Alistair Handford
(PFI Director)
Martin Hunter
(Group Financial Controller)
David Jenkins
(Managing Director – Operations)
Alan Kay
(Managing Director – Operations)
Charles Sweeney
(Managing Director – COGAP)
Alex Vaughan
(HR Director)
Stephen Wells
(Business Development Director)

Notes
¹ Member of Remuneration Committee
² Member of Audit Committee
³ Member of Nomination Committee
⁴ Independent Non-Executive Director
^{*} Senior Independent Director

Corporate Governance statement

Throughout the year to 31 December 2007, the Company complied with the provisions of the Combined Code on corporate governance issued by the Financial Reporting Council in June 2006 (the 'Combined Code'), except where indicated within this report. The Company is committed to the principles of corporate governance contained in the Combined Code and aims to comply with established best practice, wherever possible and where it is in the Company's interests

The Board and Committees

The Board currently comprises two executive directors and eight non-executive directors of whom one is the Chairman and four are independent non-executive directors. The Board considers its independent non-executive directors to be independent in character and judgement.

No independent non-executive director has:

- been an employee of the Group within the last five years;
- had within the last three years, a material business relationship with the Group,
- received remuneration other than a director's fee;
- had close family ties with any of the Group's advisers, directors or senior employees;
- held cross-directorships or had significant links with other directors through involvement in other companies or bodies;
- represented a significant shareholder; or
- served on the Board for more than nine years.

The Combined Code indicates that a Chairman of the Company should meet the independence criteria on appointment, which the person acting as Chairman throughout 2007 and the current Chairman did, but thereafter the test of independence is not appropriate in relation to the Chairman.

The remaining three non-executive directors are nominated by major shareholders, namely Daedalus Projects Limited and Mohammed Abdulmohsin Al-Kharafi & Sons WLL.

The Company is a member of the FTSE small cap companies and has been throughout the period under review. The requirement under provision A3.2 of the Combined Code that at least half of the Board, excluding the chairman, should comprise non-executive directors determined by the Board to be independent is waived in respect of smaller companies. A smaller company is required to have at least two independent non-executive directors, in respect of which provision the Company complies

The independent non-executive directors all have terms and conditions of appointment, which are available for inspection during normal business hours at the Company's registered office. An independent non-executive director's appointment is for an initial period of three years, at the expiry of which time, the appointment is reviewed to determine whether the appointment should continue. The three nominee non-executive directors are appointed by the two major shareholders and they are entitled to hold such appointments for so long as those shareholders each hold 7% of the aggregate nominal value of the then issued ordinary share capital of the Company. In consequence, the Company does not comply completely with provision A7.2 of the Combined Code, which requires that all non-executive directors should be appointed for a specific term and be subject to re-election. The Company's Articles of Association require 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 A7.1 of the Combined Code.

Brief biographies of the executive and non-executive directors appear on pages 34 and 35. 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.

The Group is controlled through its Board. The Board's main roles are to create value for shareholders, to provide entrepreneurial leadership of the Group, to approve the Group's strategic objectives and to ensure that the necessary financial and other resources are made available to enable the Group to meet those objectives.

Details of Board members' attendance at Board meetings, Audit Committee meetings, Remuneration Committee meetings and Nomination Committee meetings during the year ended 31 December 2007 are given in the following table:

	Board	Audit	Remuneration	Nomination
No of Meetings held in the year	7	5	8	4
D G Jefferies (resigned 31 December 2007)	7 Chairman	–	–	4 Chairman
D P Allvey	7	5 Chairman	–	4
M H Hamid (appointed 25 January 2007)	7	–	–	1
A Wyllie	7	5 (by invitation)	5 (by invitation)	3 (by invitation)
A O Bickerstaff	7	5 (by invitation)	2 (by invitation)	2 (by invitation)
J M Bryant	7	5	8 Chairman	4
S Y Shehata	7	–	–	2
F W Ballard	7	–	8	4
M R Alexander (appointed 25 July 2007)	2	–	1	1
M A Sulaiman	5	–	–	2
Dato' A P Senin (resigned 25 January 2007)	–	–	–	–

Messrs Jefferies, Hamid, Shehata, Ballard, Alexander and Sulaiman did attend one or more of the Audit Committee meetings as invitees.

Messrs Jefferies, Allvey, Hamid and Shehata also attended one or more Remuneration Committee meetings as invitees

The Board has adopted a schedule of matters specifically reserved to itself for decision. The principal matters reserved to the Board include: setting Group strategy and approving an annual budget and medium term projections; reviewing operational and financial performance; approving major acquisitions, divestments and capital expenditure, reviewing the Group's systems of financial control and risk management; ensuring that appropriate management development and succession plans are in place; reviewing the environmental, health and safety performance of the Group; approving appointments to the Board and the appointment of the Company Secretary; approving policies relating to executive directors' remuneration and the severance of executive directors' service agreements; and ensuring that a satisfactory dialogue takes place with shareholders. The schedule of matters reserved to the Board is reviewed periodically. The Company did not comply with provision A3.3 of the Combined Code during the financial year ending 31 December 2007. This provision requires the Company to identify a separate senior independent director for disclosure in the Annual Report and to whom concerns can be conveyed. The Company rectified the position on 9 January 2008 by appointing John Bryant as Senior Independent Director. The Board decided that the role of the Senior Independent Director should encompass the following

- Evaluation and appraisal – meet with the other members of the Board without the Chairman present on at least an annual basis in order to evaluate and appraise the performance of the Chairman.
- Succession – chair the nomination committee when the succession to the role of the Chairman of the Board is being considered
- Shareholder/stakeholder contact – act as a point of contact for shareholders and other stakeholders with concerns which have either not been resolved or which it would not be appropriate to raise through the normal channels of the Chairman, Chief Executive and/or Finance Director
- Executive director contact – act as an alternative point of contact for executive directors, if required, in addition to the normal channels of the Chairman and/or Chief Executive.
- Non-executive director contact – meet with the other members of the Board as and when deemed appropriate

As required by provision A5.3 of the Combined Code, 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 as required by provision A5.2. In the year ended 31 December 2007, no director sought independent professional advice

Corporate Governance statement continued

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. The non-executive directors also receive a weekly report from the Chief Executive and monthly management accounts, internal audit reports and regular management reports and information, which enable them to scrutinise the Group's and its management's performance against agreed objectives.

On appointment, the directors, as required by provision A5.1 of the Combined Code, take part in an induction programme, where they receive information about the Group, the role of the Board and the matters reserved for its decision, the terms of reference and membership of the principal board committees and the powers delegated to the committees, the Group's corporate governance practices and procedures, and the latest financial information about the Group. As to the continuing education of the executive and non-executive directors, a number of Board members, independent of any formal training arranged by the Company, attend seminars and conferences on issues relevant to their appointment as directors of a public company, particularly matters concerned with corporate governance and audit issues. The Company keeps a record of attendances by directors at such seminars and conferences. In addition, the Company arranges, from time to time, for its legal advisors, Slaughter and May, to conduct in-house seminars on topical issues concerned with corporate governance and changes in corporate law.

The Board established a formal process for the evaluation of the performance of the Board and its principal committees. The first evaluation was performed using a questionnaire, which was predominantly focused on the structure and processes of the Board and its Committees. Equity Culture Limited (Equity Culture), the independent adviser who assisted the Company in the exercise, collated the results and its report was discussed by the Board. The Board addressed the shortcomings identified in the first review. The Board engaged Equity Culture to carry out a further evaluation of the Board. The evaluation concentrated on Board processes including its effectiveness in making decisions and monitoring its implementation and the appropriate balance in discussion between strategic and operational issues. The evaluation also concentrated on individual director's contributions to the Board and the extent by which Board members may benefit from ongoing education and training. The evaluation was undertaken using a questionnaire sent to each Board member by the Company Secretary. The responses were sent directly to Equity Culture for collating and preparation of reports. One report provided individual feedback to each Board member. It gave self-scores and the score for the Board collectively and the other report contained an analysis of responses to the questionnaire and recommendations. The reports were discussed extensively and were used as the basis for appraisal and discussion during 2007. The findings arising out of this exercise have been put into practice.

The Company did not comply with parts of provision A6.1 of the Combined Code in that the Chairman during 2007 did not undertake an individual appraisal of each director, although responses to the questionnaire referred to above had provided a self-assessment of director's effectiveness and commitment, other than in the case of non-executive directors appointed in 2007. The Chairman engaged in a regular dialogue with directors, which enabled him to refine his assessments on individual directors and guide them on future performance. The Company does comply with provision A6.1 of the Combined Code in that a performance evaluation was undertaken on the Chairman. The Chairman does hold meetings with the non-executive directors without the executive directors being present, as required by provision A1.3 of the Combined Code.

The Chairman, during 2007, did not have any other significant commitments during the year (provision A4.3 of the Combined Code).

In accordance with provision A1.5 of the Combined Code, the Company has in place Directors' and Officers' Insurance in respect of the directors' duties as directors.

The principal Board Committees are the Audit Committee, the Remuneration Committee and the Nomination Committee. Current members of the Audit Committee are Mr Morley as Chairman, Mr Bryant, Mr Alexander, and Mr Ballard. Mr Allvey resigned as Chairman of and a member of the Audit Committee on 9 January 2008 and Mr Morley was appointed a member of the Audit Committee and its Chairman on 9 January 2008. Mr Alexander and Mr Ballard were also appointed members of the Audit Committee on 9 January 2008. The Company complies with provision C3.1 of the Combined Code. The Audit Committee has established written terms of reference, which were last reviewed, revised and re-issued on 7 March 2007. Details of the attendance at Audit Committee meetings in 2007 are given in the table on page 37. The executive directors, the external auditors, the Group Internal Auditor and Group Financial Controller attend all meetings but provision is also made for discrete meetings between the Audit Committee and the external auditors and internal auditors. The Company Secretary is the Secretary to the Audit Committee.

The Company considered that it had in Mr Allvey, as Chairman of the Audit Committee in 2007, an appropriate person possessing what the Smith Report describes as recent and relevant experience. Mr Allvey, a chartered accountant, was Group Finance Director of Barclays Bank Plc (1999-2000) and Group Finance Director of BAT Industries Plc (1989-1998) and was a board member of the UK Accounting Standards Board (1993-2003). On 9 January 2008, the Board appointed James Morley as a non-executive director and Chairman of the Audit Committee to succeed Mr Allvey. Again, the Company considers that it has in Mr Morley an appropriate person possessing what the Smith Report describes as recent and relevant experience. Mr Morley, a chartered accountant, was Group Finance Director, Cox Insurance Holdings Plc (2002-2005), Group Finance Director, Arjo Wiggins Appleton Plc (1999-2001), Group Executive Director, Finance, Guardian Royal Exchange Plc (1990-1999) and Finance Director, Avis Europe PLC (1976-1989).

Under its terms of reference, the Audit Committee monitors the integrity of the Group's financial statements and any formal announcement relating to the Group's performance. The Committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, re-appointment and remuneration of the external auditors. It is responsible for ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services and fees. The Audit Committee also reviews the Group's system of internal controls and the processes for management of the risks facing the Group. The Committee reviews the effectiveness of the internal audit function and is responsible for approving, upon the recommendation of the Chief Executive, the appointment and termination of the head of that function. The Committee reviews its terms of reference and its effectiveness from time to time and recommends to the Board any changes required as a result of the review. The Committee's terms of reference are available from the Company Secretary and are published on the Company's website.

In 2007, the Audit Committee discharged its responsibilities by:

- reviewing the Group's draft financial statements and interim results prior to Board approval and reviewing the external auditors' detailed reports thereon;
- reviewing the appropriateness of the Group's accounting policies;
- reviewing and approving the audit fee and reviewing non-audit fees payable to the Group's external auditors;
- reviewing the external auditors' plan for the audit of the Group's accounts, (this plan includes the audit scope, key risks on the accounts, confirmation of auditor independence and the proposed audit fee) and approving the terms of engagement for the audit;
- reviewing and monitoring the external auditors' independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- reviewing the Group's system of internal controls and its effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- reviewing the internal audit function's terms of reference, its work programme, internal audit reports and quarterly reports on its work during the year;
- reviewing the risks associated with the business; and
- reviewing and monitoring the development of the Group's commercial and financial IT systems.

The Chairman of the Audit Committee is one of the individuals named in the Company's Public Interests Disclosure Policy (whistle-blowing procedures) to whom employees may communicate any wrongdoing at work, which they believe has occurred or is about to occur. The Audit Committee has wide powers to establish special investigations in the event that any wrongdoing is brought to its notice, in particular, in the case of defalcations, fraud and theft.

The Audit Committee monitors the non-audit services being provided to the Group by its external auditors, and has developed a formal policy on the provision of non-audit services by the external auditors to check this does not impair their independence or objectivity, and that the Group maintains a sufficient choice of appropriately qualified audit firms. The policy sets out four key principles that underpin the provision of non-audit services by the external auditors: the auditors should not audit their own firm's work, make management decisions for the Group, have a mutuality of financial interest with the Group, or be put in the role of advocate for the Group. Prior approval of the Audit Committee is required for any services provided by the external auditors where the fee is likely to be in excess of £25,000. The Audit Committee reviews all services being provided by the external auditors annually to review the independence and objectivity of the external auditors, taking into consideration relevant performance and regulatory requirements so that those are not impaired by the provision of permissible non-audit services.

Full particulars of the Remuneration Committee are given in the Directors' remuneration report, which appears on pages 49 to 57. The Company complies with that element of provision B2.1 of the Combined Code, which requires that all members of the Remuneration Committee are independent non-executive directors. For most of 2007, the Remuneration Committee comprised two independent non-executive directors; a third independent non-executive director, Mike Alexander, was appointed on 1 October 2007. The Remuneration Committee now consists of four independent non-executive directors following James Morley's appointment on 9 January 2008. The Remuneration Committee's terms of reference are published on the Company's website.

Corporate Governance statement continued

The Nomination Committee comprises the Chairman and all non-executive directors. The Chairman is the Chairman of the Committee. The Company did not comply with provision A4.1 of the Combined Code in 2007 in that the majority of members of the Nomination Committee were not independent non-executive directors. The Nomination Committee has established written terms of reference, which were last reviewed, revised and re-issued on 12 March 2004. The Committee's terms of reference are published on the Company's website. This Committee meets, as required, to select and propose to the Board suitable candidates for appointment as executive and non-executive directors. The Company Secretary is the Secretary of the Nomination Committee. In 2007, the Nomination Committee met formally on four occasions but an ad hoc committee of the Board, comprising the Chairman and one or more independent non-executive directors who are resident in the United Kingdom, also met on a number of occasions to consider matters within the remit of the Nomination Committee. Specifically, during 2007, the Nomination Committee addressed succession planning among the non-executive directors and the appointment of a successor to David Jefferies as Chairman. With a number of the independent non-executive directors having been on the Board for close to six years or more, the Board decided that the Company should be making fresh appointments to the Board to ensure proper succession and continuity. The Nomination Committee appointed an executive search consultant and, following an extensive review by the Nomination Committee involving interviewing a number of candidates, the Board appointed Mike Alexander as an independent non-executive director on 25 July 2007. The Chairman, David Jefferies, had given an intimation to the Board in 2006 that he would wish to retire from the Board by no later than the Annual General Meeting in 2008. The Board appointed John Bryant as Chairman of the Nomination Committee charged with finding and recommending a successor to David Jefferies. Following extensive discussions between non-executive directors, discussions with the two major shareholders and soundings taken from the Company's various advisors, the Nomination Committee concluded that the best interests of the Company would be served by appointing David Allvey as the successor to David Jefferies. The Board accepted the recommendation and the Nomination Committee was charged with finding a further independent non-executive director with the appropriate recent and relevant experience to be Chairman of the Audit Committee. The Nomination Committee, with the assistance of an executive search consultant and following review and interviewing of appropriately qualified candidates, recommended to the Board the appointment of James Morley as an independent non-executive director. Mr Morley was appointed to the Board on 9 January 2008. Details of the attendance at the Nomination Committee meetings in 2007 are given in the table on page 37.

The Financial Services Authority implemented Article 6 of the Market Abuse Directive (Directive 2003/6/EC) by publication of the Disclosure Rules, which became effective on 1 July 2005. The Disclosure Rules are now known as the Disclosure and Transparency Rules and replaced the Continuous Disclosure Obligations under the Listing Rules. The Disclosure and Transparency Rules introduced new rules regarding the way listed companies manage inside information. In consequence, the Company introduced a set of procedures, rules and controls to ensure compliance with the Company's obligations under the Listing Rules (including the obligations under the Disclosure and

Transparency Rules) of the United Kingdom Listing Authority (UKLA). It is recommended good practice that each listed company should have a Disclosure Committee. The Company established a Disclosure Committee with its own terms of reference that are available from the Company Secretary. The members of the Disclosure Committee are the Chairman of the Company, the Chairman of the Audit Committee, Chief Executive, Finance Director and Group Financial Controller. The Company Secretary is the Secretary of the Disclosure Committee. The procedures also deal with the insider list process and a code for dealing in securities. The new Model Code is appended to the procedures.

Relationship with institutional investors and private investors

The Company continues to increase its communication with institutional investors and brokers. Presentations are 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 meetings with analysts, financial journalists and institutional investors throughout the year.

The Company has two key shareholders, who control the beneficial interest in 43% of the issued share capital of the Company and, also, appoint nominees to sit on the Board of the Company. However, apart from these two large shareholders, the Company has approximately 14,000 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. The Annual General Meeting is normally attended by all directors, and shareholders are invited to ask questions during the meeting and to meet with directors after the formal proceedings have ended. Shareholders, whose shares are held by nominees, may receive copies of such communications upon request. The Company has an internet website www.costain.com on which it publishes its magazine (Blueprint), press releases, Stock Exchange announcements and other information concerning the Company's business and upon which it also publishes its annual and interim results.

The Company will comply with provision D2.4 of 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 2007. In accordance with changes to the Combined Code introduced in 2007, the Company will provide shareholders voting by proxy with the option of withholding their vote on a resolution and the Company will publish details of proxies lodged on resolutions where votes are taken on a show of hands. The Company adopted these requirements at Extraordinary General Meetings held by the Company on 2 February 2007 and 2 October 2007 and at the Annual General Meeting in 2007.

Internal controls and Risk management

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, operational 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 members of the Executive Board. The responsibilities of the Executive Board include:

- the development and recommendation of strategic plans for consideration and approval by the Board that reflect the longer-term objectives and priorities established by the Board;
- implementation of the strategies and policies of the Group as determined by the Board;
- monitoring of the operating and financial results against the plans and budgets;
- prioritising the allocation of technical and human resources;
- developing and implementing risk management systems; and
- managing and monitoring health, safety and environmental matters.

The Chief Executive has full authority to act subject to the matters reserved to the Board and to the requirements of Group Policies

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. 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. The review covered all controls, including financial, operational and compliance controls and risk management.

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 formalised its risk evaluation processes and at the same time introduced new procedures to assist in the identification and management of risk. These procedures included a specific project risk management procedure, which among other things requires 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: safety; technical; operational, and environmental. They are reviewed by the project manager and commercial manager of the project on a continuing basis following contract award

The Company's risk register now includes opportunities as well as risks. The Company has also established sector business risk registers, which are monitored and updated regularly. The Company has in place a Group Risk/Opportunity Steering Group, which operates under the chairmanship of the Group Commercial Director. This Group, which reviews the significant risks facing the Company, includes senior staff from commercial, accounting, internal audit and legal disciplines and meets on a quarterly basis. The Sector Directors submit quarterly reports to the Group Commercial Director on the risks and opportunities faced by their respective Sectors. The Group Commercial Director analyses these reports and they are then reviewed at meetings of the Group Risk/Opportunity Steering Group. The Group Commercial Director submits a Corporate Risk/Opportunity Register to each Executive Board Meeting with a summary of the main corporate risks facing the Company. This includes a note of actions taken to reduce the risk profile since the provision of the last report and the most significant risks facing the Company's operations, naming the person responsible for their management and the steps being taken to mitigate them. The Group Commercial Director reports on the activities of the Group Risk/Opportunity Steering Group to the Audit Committee and with the Finance Director submits reports to that Committee on the main corporate risks facing the Company

The Project Manager is responsible for ensuring that an initial site workshop takes place and there is a full handover from the tender team. The Area Systems Managers now assist with the risk management inductions and facilitation. Under the Implementing Best Practice (IBP) programme, the Systems Managers ensure, by audit, that both the initial workshop and close-out workshop happen; if not, these show up on the Business Systems Key Performance Indicators (KPIs) schedule.

During the currency of the contract, the Risk/Opportunity Registers are updated monthly and the top five risks and opportunities are included on the Project Management Report (PMR); these are interrogated at the formal monthly PMR meeting attended by Group senior management and relevant divisional management, including the Managing Director, Commercial Director, and, by invitation, representatives from site teams. In addition, Internal Audit carries out site reviews and comments with further follow-up action.

The Executive Investment Panel, which has been operating since 2005, is a sub-group of the Executive Board. It is empowered to review tender bids and risk mitigations in respect of those bids, including projects with joint venture partners and projects that require equity participation. Part of the purpose of the review is to ensure that the Company is as selective as possible when it comes to taking on potential liabilities or recognising opportunities. This approach has proved to be successful and has allowed the Company to build its order book of work in line with published strategy and the Company's desired risk appetite.

Internal controls and Risk management continued

During 2007, the Company continued to progress the Implementing Best Practice (IBP) programme that includes a number of critical business areas: profit margins; risk/opportunity management; planning and programming; design management; supply chain management, sub-contract management; bid management and work winning; temporary works management, and corporate accounting and reporting. These standards are presented as process flowcharts and are supported by tools and guides, which are available to employees of the Group on the Costain intranet (iCosNet). The Company reviewed and re-drafted its temporary works management and corporate accounting and reporting programmes in 2007. The IBP modules are monitored to ensure compliance and have proved a useful tool to identify early any underperforming sites. Training in the IBP standards continued during 2007.

Internal Audit provides the Audit Committee, the remaining members of the Board and corporate and project management with independent assurance that risks inherent to the business processes are reasonably controlled. It assists management in assessing the risks the Company faces in its business activities and helps management in evaluating the effectiveness of internal controls that manage those risks. Internal Audit also promotes best practice in risk management processes to ensure delivery of corporate objectives.

Internal Audit conducted project and departmental reviews in the UK and internationally in 2007 to appraise and report on the effectiveness of the risk management processes. All reviews carried out were subject to appropriate follow-up action. The follow-up action revisits areas previously subject to audit and provides assurance that accepted recommendations have been implemented effectively. The overall assessment is that a strong risk management culture is continuing to develop within the Company.

Internal Audit meets monthly with the Chief Executive, Finance Director and Group Financial Controller. In addition to reviewing the risk based audit plan, these meetings enable Internal Audit to outline key findings from recent reviews and to discuss any management actions that may result. The effectiveness of the controls in place, including risk management, forms a key agenda item. The Group Internal Auditor attends most Audit Committee meetings and reports on the activities of Internal Audit. The Group Internal Auditor also has unfettered access to the Chairman of the Audit Committee.

Internal Audit also meets with the Business Systems Group on a quarterly basis. These forums allow Internal Audit to inform those responsible for developing company systems about key issues and trends from audit assignments, in order to maintain a continuous improvement feed back process. Internal Audit has developed a 'lessons learned' register of non-compliances identified, which is communicated to business units to ensure continuous improvement.

Management reviews the role of insurance in managing risks across the Group and brings 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. The procedure manuals are reviewed regularly by management and are published on iCosNet. A method of navigating the various controls is included in training programmes to ensure all project managers are aware of their obligations and accountability.

In the United Kingdom, the Company has developed operational management systems that are accredited to ISO 9001: 2000. These systems are designed to set out an operating framework that supports management in the provision of safe construction processes of the highest quality. The IBP standards referred to above are incorporated within the Project Management Plan for each new contract and this also forms part of the accredited management system. The implementation and compliance with the management system are monitored and audited by Internal Audit. In order to maintain the Company's accreditation, external audits of the management systems are undertaken twice yearly by the British Standards Institution.

The monthly Project Management Report (PMR) is the key tool for reporting performance at a project level. Each PMR is completed by the Project Manager and is copied to the Chief Executive, Finance Director, Group Commercial Director and the operational Managing Director and Commercial Director. The information provided in the PMR includes, HSE statistics, cash flow, value, cost and profit, claims and variations, risk management, progress and staffing levels. Guidance notes have been issued on the completion of the PMRs.

All projects operate within a controlled framework of best practice, safety, health and environmental guidelines. Execution of and compliance with these systems are monitored by the project management team and audited by Health, Safety and Environmental advisers.

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. The Chief Executive is the Board member responsible for Health and Safety.

Financial

There is a comprehensive annual budgeting system for each business within the Group, which is linked to the annual review of strategy. The annual budget is discussed by the Executive Board and reviewed by the Chief Executive, Finance Director and Group Financial Controller prior to presentation to the Board by the Executive Board for approval. The Company produces monthly a rolling forecast update for the current year, which is compared with the annual budget.

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

The Group Treasurer and Group Taxation Manager 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 of the Company's business dealings. The Company expects the highest standards from all employees and key suppliers.

Litigation and other legal matters were controlled in 2007 by the Head of Legal. A legal report is submitted to the Board in the event of a critical legal issue 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.

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 any significant risks and opportunities within the business;
- overseeing the establishment of procedures to identify and manage perceived and real risks;
- consideration of reports from management, internal and external auditors on the adequacy and effectiveness of the system 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 or 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 operations 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 assurance as to the operation and validity of the systems, processes and checks within the internal control environment.

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

Directors' report

The directors submit to the members their Report and Accounts of the Company for the year ended 31 December 2007. The Business & Operational review (pages 18 to 25), the Principal Risks and Key Performance Indicators (pages 30 to 33), the Report on Corporate Governance (including Internal controls and Risk management) (pages 36 to 43) and the Directors' remuneration report (pages 49 to 57) respectively form part of this Directors' report.

Activities

The progress and prospects of the Group's businesses and the main factors which could affect the future development and performance of the Group are set out in the Chairman's statement (pages 6 and 7), the Chief Executive's review (pages 11 to 14) and the Business & Operational review (pages 18 to 25) and in the Principal Risks and Key Performance Indicators (pages 30 to 33).

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.

Profit and dividends

The profit after tax for the financial year ending 31 December 2007 amounted to £16.0 million. The directors propose to recommend a payment of a dividend at the rate of 0.5 pence per share amounting to £3.1 million. The dividend will be paid on 23 May 2008 to shareholders registered at close of business on 25 April 2008.

In early 2006, the Company agreed in principle with the Pensions Regulator that if it recommenced the payment of a dividend then the Company would make a payment to The Costain Pension Scheme equal to the total amount of the dividends paid to shareholders in order to address the funding deficit of the Scheme. The payment of a dividend represents a type A event for which clearance from the Pensions Regulator must be sought. In February 2008, the Company requested such clearance and obtained it.

The Company proposes, subject to shareholder approval at the 2008 AGM, to introduce a scrip dividend scheme for the dividend in 2008 and all future dividends until further notice. A letter and explanatory leaflet explaining the dividend scheme, together with an election form, will be sent to shareholders at the same time as the Notice of AGM.

Directors and directors' interests

Brief biographies of the present members of the Board are given on pages 34 and 35.

Mr David Jefferies resigned as Chairman and a non-executive director on 31 December 2007. He was succeeded by Mr David Alvey, who became Chairman on 1 January 2008. Mr Michael Richard Alexander was appointed as a non-executive director on 25 July 2007. Mr James Morley was appointed as a non-executive director on 9 January 2008. As Mr Alexander and Mr Morley were appointed by the Board since the last Annual General Meeting, the Company's Articles of Association require that they retire and, being eligible, offer themselves for re-election. In accordance with the Company's Articles of Association, Mr David Alvey and Mr Azman Sulaiman, both being eligible, will offer themselves for re-election at the Annual General Meeting. None of the retiring directors has a service agreement with the Company.

No director had any material interest in any contract of significance with the Group during the period under review. Details of directors' emoluments and interests in shares in the Company are contained in the Directors' remuneration report, which appears on pages 49 to 57.

Related party transactions

Details of transactions with related parties undertaken by the Group during the year are disclosed in Note 24 to the financial statements on pages 97 and 98

Share capital and major shareholders

Details of the share capital of the Company as at 31 December 2007 are set out in Note 19 on page 93

On 14 September 2007, the Company announced a Rights Issue which was approved by shareholders on 2 October 2007. First, the Company increased its authorised ordinary share capital from £37,343,182 to £50,739,400 by the creation of an additional 267,924,352 ordinary shares of 5 pence each in the Company. In the Rights Issue, the Company was raising approximately £60 million (net of expenses) by the issue of 267,923,469 new ordinary shares at 24 pence per share on the basis of three new ordinary shares for every four existing ordinary shares. The last date for acceptance was 25 October 2007 and dealing in the new ordinary shares commenced on the London Stock Exchange on 26 October 2007. Following the Rights Issue, the enlarged share capital of the Company was 625,154,761 ordinary shares of 5 pence each

The five-year savings contracts in the Company's 2002 Save As You Earn Plan and the three-years savings contracts in the Company's 2004 Save As You Earn Plan matured in December 2007. The Save As You Earn Plans had been approved by shareholders at an Annual General Meeting held on 24 May 2002. The Company made an application for a block listing of 10,511,630 ordinary shares of 5 pence each in the capital of the Company on 30 November 2007 of which some 7,252,023 ordinary shares related to the 2002 Plan and 3,259,607 ordinary shares related to the 2004 Plan. The number of shares block listed was the maximum number of shares at the time required to satisfy the options granted to employees under both Plans. However, the Company's share price at the time the 2004 Scheme matured was below the option price for the 2004 Save As You Earn Plan. By 31 December 2007, a total of 3,713,889 ordinary shares of 5 pence each had been allotted to employees.

The issued share capital of the Company as at 31 December 2007 was £31,443,432.50 consisting of 628,868,650 ordinary shares of 5 pence each.

As at 7 March 2008, the Company had been notified, in accordance with the Disclosure and Transparency Rules issued by the Financial Services Authority, of the following interests in its ordinary share capital.

Mohammed Abdulmohsin Al-Kharafi & Sons WLL	138,544,915	22.03%
Daedalus Projects Limited*	138,108,505	21.96%
Gartmore Investments Limited	50,117,835	7.97%

* UEM Builders Berhad owns 93% of Daedalus Projects Limited

Corporate Responsibility

The Company is publishing a separate Corporate Responsibility Review and a copy will be sent to shareholders with this Annual Report. The Corporate Responsibility Review covers.

- Overview
- Chairman's statement
- Chief Executive's statement
- Our Values
- Our Approach
- Health and Safety
- Environment
- Community
- Our People
- Marketplace

Group policies

Group policies are addressed in the Corporate Responsibility Review and further details of some of the policies are given below:

- **Business Conduct policy**, which covers the legal, ethical and moral standards that 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.
- **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 Board approval. The Company has not made political donations since 1990;
- **Equal Opportunities policy**, which 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 wrongdoing 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 wrongdoing are protected.

Group policies are kept under regular review.

Employment policies

Employment is addressed in the Corporate Responsibility Review under the heading 'Our People'. The Company's vision is to have the right people, with the right blend of skills, experience and enthusiasm to exceed the Company's business objectives. To achieve this, the Company has developed values, which drive all employment policies. Costain's employees must be Customer focused, Open and honest; Safe and environmentally aware; Team players, Accountable; Improving continuously; Natural choice

Capitalising on what is unique about individuals and drawing on their different perspectives and experiences will add value to the way the Company conducts its business. By attracting, recruiting and developing talent from the widest possible talent pool, the Company can gain an insight into different markets and generate greater creativity in anticipating customer needs. The Company constantly strives to create a productive environment, representative of, and responsible to, different cultures and groups, where everyone has an equal chance to succeed.

The Company is committed to positive policies, which promote equal opportunities and diversity in employment. The Company believes that it is in its best business interests to offer both employees and potential employees a fair and consistent environment in which they can contribute their best efforts and talent, in the knowledge that the Company will recruit, select, promote and train people on the basis of merit.

The Company acknowledges the importance for its employees in achieving a balance between work and family commitments. The Company follows a range of family friendly policies and will support flexible working practices where possible. The Company has improved its Maternity, Paternity and Adoption policies and introduced Child-care vouchers in 2007.

The Company launched an Employee Assistance Programme for all employees and their families on 1 April 2006. The programme provides a confidential counselling service for work and non-work problems.

The Company has established a duly elected Staff Consultation Forum whose objective is:

- To enable staff to obtain a better understanding of, and wider interest in, matters affecting the organisation as a whole;
- To permit staff and management jointly to examine and discuss problems of concern to both and to seek, where possible, mutually acceptable solutions through a genuine exchange of views and information;
- To provide the opportunity for members of staff to suggest areas for performance improvement or innovation to enhance the competitive position of the Company; and
- To consult on matters that are specifically covered by UK statute, particularly in relation to health and safety, continuity of employment and transfer of undertakings.

In August, as a follow-up on last year's survey, the Company undertook a confidential employee survey to determine employee engagement, and to obtain staff feedback on issues critical to the Company's business performance. There was a 64% response and the results were presented to staff in October during the annual staff roadshows.

Directors' report continued

Employee involvement

The Company provides information to its employees, both of a general company nature and to encourage awareness of financial and economic factors, which affect the Company in various ways. These include a monthly update to all staff from the Chief Executive, an in-house magazine, information via our electronic mail system, circulation of press releases, management briefings on Company results, a report to employees on the annual accounts of the Company and annual pension scheme reports. Participation and involvement are encouraged through regular management meetings with employees. The Company also encourages the involvement of employees in the Company's performance through the Save As You Earn Scheme referred to in the Directors' remuneration report on page 53. A large proportion of the employees who participated in the Save As You Earn Scheme, which matured in December 2005 and December 2007, have retained their shares in the Company.

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 sub-contractors 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 60 (2006: 68) days of average daily purchases. The Company has no trade creditors (2006: Nil)

Significant agreements

The directors are not aware of any significant agreements to which the Company and/or any of its subsidiaries or associates is a party that take effect, alter or terminate upon a change of control of the Company following a takeover bid, save that a subsidiary that ceased to be a subsidiary of the Company would cease to benefit from the Company's financing arrangements.

Donations

Group charitable donations of £35,533 (2006: £13,129) were made during the year. No political donations were made (2006: £Nil).

Disclosure of information to auditors

The directors who held office at the date of approval of this Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's external auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's external auditors are aware of that information.

Auditors

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

Annual General Meeting

The Annual General Meeting of the Company will be held at The Cumberland, Great Cumberland Place, London W1A 4RF on Thursday 8 May 2008 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 9 May 2012 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 7 May 2013. The authority is limited to shares of a nominal value of £10.47 million, which equates to 209.4 million ordinary shares of 5p each, being approximately 33% of the current issued ordinary share capital. The Company does not hold any shares as treasury shares as at the date of this Annual Report.
- (b) Resolution 8 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 £1,572,171 which equates to 31,443,420 ordinary shares of 5p 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 7 August 2009. The directors have no current intention of exercising either authority contained in Resolution 7 or 8 in the Notice of Meeting other than in connection with satisfying options under the Save As You Earn Plans, granting and satisfying options under the Long-Term Incentive Plans and the operation of the Company's proposed scrip dividend scheme.
- (c) Resolution 9 in the Notice of Meeting deals with the amendment to the Articles of Association by the substitution of new Articles for the current Articles. Further details are given below. A copy of the New Articles will be available for inspection during normal business hours on any weekday (Saturdays and public holidays excepted) at the offices of Slaughter and May, One Bunhill Row, London EC1Y 8YY and at the registered office of the Company at Costain House, Vanwall Business Park, Maidenhead, Berkshire SL6 4UB up to and including 8 May 2008.
- (d) Resolution 10 in the Notice of Meeting deals with the introduction of a scrip dividend scheme which will authorise the directors to offer and allot ordinary shares in lieu of a cash dividend to those members who elect to participate in the scrip dividend. This resolution is subject to Resolutions 2 and 9 being approved.

Proposed amendments to the Articles of Association at the Annual General Meeting

The Company has decided to modernise and amend its articles of association primarily to reflect the provisions of the Companies Act 2006. An explanation of the main changes between the proposed articles of association (the 'New Articles') and the existing articles of association (the 'Current Articles') is set out on the following pages.

Articles which duplicate statutory provisions
Provisions in the Current Articles which replicate provisions contained in the Companies Act 2006 are in the main to be removed in the New Articles. This is in line with the approach advocated by the Government that statutory provisions should not be duplicated in a company's constitution. Certain examples of such provisions include provisions as to the form of resolutions, the variation of class rights, the requirement to keep accounting records and provisions regarding the period of notice required to convene general meetings. The main changes made to reflect this approach are detailed below.

Form of resolution

The Current Articles contain a provision that, where for any purpose an ordinary resolution is required, a special or extraordinary resolution is also effective and that, where an extraordinary resolution is required, a special resolution is also effective. This provision is being removed as the concept of extraordinary resolutions has not been retained under the Companies Act 2006. Further, the remainder of the provision is reflected in full in the Companies Act 2006.

Variation of class rights

The Current Articles contain provisions regarding the variation of class rights. The proceedings and specific quorum requirements for a meeting convened to vary class rights are contained in the Companies Act 2006. The relevant provisions have therefore been amended in the New Articles.

Convening extraordinary and annual general meetings

The provisions in the Current Articles dealing with the convening of general meetings and the length of notice required to convene general meetings are being removed in the New Articles because the relevant matters are provided for in the Companies Act 2006. In particular, an extraordinary general meeting to consider a special resolution can be convened on 14 days' notice, whereas previously 21 days' notice was required.

Votes of members

Under the Companies Act 2006, proxies are entitled to vote on a show of hands, whereas under the Current Articles proxies are only entitled to vote on a poll. The time limits for the appointment or termination of a proxy appointment have been altered by the Companies Act 2006 so that the articles cannot provide that they should be received more than 48 hours before the meeting or in the case of a poll taken more than 48 hours after the meeting, more than 24 hours before the time for the taking of a poll, with weekends and bank holidays being permitted to be excluded for this purpose. The New Articles give the directors discretion, when calculating time limits, to exclude weekend and bank holidays. Multiple proxies may be appointed provided that each proxy is appointed to exercise the rights attached to a different share held by the shareholder. The New Articles reflect all of these new provisions.

Age of directors on appointment

The Current Articles contain a provision requiring a director's age to be disclosed, if he has attained the age of 70 years or more, in the notice convening a meeting at which the director is proposed to be elected or re-elected. Such provision could now fall foul of the Employment Equality (Age) Regulations 2006 and so has been removed from the New Articles.

Conflicts of interest

The Companies Act 2006 sets out directors' general duties which largely codify the existing law but with some changes. Under the Companies Act 2006, from 1 October 2008 a director must avoid a situation where he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the company's interests. The requirement is very broad and could apply, for example, if a director becomes a director of another company or a trustee of another organisation. The Companies Act 2006 allows directors of public companies to authorise conflicts and potential conflicts, where appropriate, where the articles of association contain a provision to this effect. The Companies Act 2006 also allows the articles of association to contain other provisions for dealing with directors' conflicts of interest to avoid a breach of duty. The New Articles give the directors authority to approve such situations and to include other provisions to allow conflicts of interest to be dealt with in a similar way to the current position.

There are safeguards which will apply when directors decide whether to authorise a conflict or potential conflict. First, only directors who have no interest in the matter being considered will be able to take the relevant decision, and secondly, in taking the decision the directors must act in a way they consider, in good faith, will be most likely to promote the company's success. The directors will be able to impose limits or conditions when giving authorisation if they think this is appropriate.

It is also proposed that the New Articles should contain provisions relating to confidential information, attendance at board meetings and availability of board papers to protect a director being in breach of duty if a conflict of interest or potential conflict of interest arises. These provisions will only apply where the position giving rise to the potential conflict has previously been authorised by the directors. It is the Board's intention to report annually on the Company's procedures for ensuring that the Board's powers to authorise conflicts are operated effectively.

Notice of board meetings

Under the Current Articles, when a director is abroad he can request that notice of directors' meetings are sent to him at a specified address and if he does not do so he is not entitled to receive notice while he is away. This provision has been removed, as modern communications mean that there may be no particular obstacle to giving notice to a director who is abroad.

Records to be kept

The provision in the Current Articles requiring the Board to keep accounting records has been removed as this requirement is contained in the Companies Act 2006.

Distribution of assets otherwise than in cash

The Current Articles contain provisions dealing with the distribution of assets in kind in the event of the Company going into liquidation. These provisions have been removed in the New Articles on the grounds that a provision about the powers of liquidators is a matter for insolvency law rather than the articles and that the Insolvency Act 1986 confers powers on the liquidator which would enable it to do what is envisaged by the Current Articles.

Directors' report continued

Provision for employees on cessation of business

The Companies Act 2006 provides that the powers of the directors to make provision for a person employed or formerly employed by the Company in connection with the cessation or transfer to any person of the whole or part of the undertaking of the company, may be exercised by the directors or by the company in general meeting. However, if the power is to be exercised by the directors, the articles of association must include a provision to this effect. The New Articles provide that the directors may exercise this power

Directors' indemnities and loans to fund expenditure

The Companies Act 2006 has in some areas widened the scope of the powers of a company to indemnify directors and to fund expenditure incurred in connection with certain actions against directors. In particular, a company that is a trustee of an occupational pension scheme can now indemnify a director against liability incurred in connection with the company's activities as trustee of the scheme. In addition, the existing exemption allowing a company to provide money for the purpose of funding a director's defence in court proceedings now expressly covers regulatory proceedings and applies to associated companies

Quorum

In the Current Articles, the quorum for meetings of the directors has been reduced from four to two and the quorum for general meetings has been reduced from three to two, in each case to reflect modern practice and for practical reasons

Borrowing Powers

The borrowing powers provision in the New Articles reflects the amendments approved by shareholders in general meeting in February 2007.

General

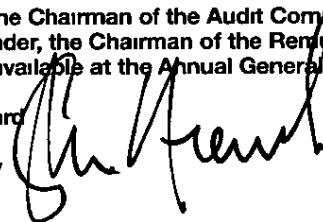
Generally, the opportunity has been taken to modernise and bring clearer language into the New Articles. Such changes include:

- (a) to delete redundant provisions, including those relating to: the distinction between 'Special Provisions' and 'General Provisions', Stock; increasing share capital; the location of the Company's registered office; the definition of ordinary and special business at general meetings and the appointment of Associate Directors;
- (b) to amend the interest rate payable by shareholders, where any amounts due to the Company are late, from 10 per cent. per annum to 5 per cent. greater than the Bank of England base rate;
- (c) to include a provision that a person remains liable jointly and severally with successors in title to his shares to pay calls even after he has transferred the shares to which they relate;
- (d) to align the provisions of the articles on the resignation of directors to the requirements of the Combined Code;
- (e) to permit the Company to fund a director's expenditure on defending proceedings in accordance with the Companies (Audit, Investigation and Community Enterprise) Act 2004;
- (f) to provide that if the details provided by shareholders for the payment of dividends to shareholders are incorrect, the Company may cease to pay dividends using those details;
- (g) to provide for the suspension of rights when a shareholder responds with false or inadequate information to a response under the Companies Act 2006;

- (h) to provide that, within two months of a shareholder providing evidence that he is entitled to shares on transmission, his details shall be recorded in the register of members;
- (i) to clarify the chairman's ability to control the conduct and process of general meetings;
- (j) to permit dividends to be paid in different currencies;
- (k) to provide that the company may invest unclaimed dividends for the benefit of the company in the 12 years before they are forfeited; and
- (l) to permit the directors, if authorised by an ordinary resolution of shareholders, to introduce a scrip dividend plan.

Mr James Morley, the Chairman of the Audit Committee and Mr Mike Alexander, the Chairman of the Remuneration Committee will be available at the Annual General Meeting.

By Order of the Board
Clive L Franks
Company Secretary
11 March 2008



Directors' remuneration report

Remuneration Committee

During the financial year, the members of the Remuneration Committee were Mr Bryant as Chairman and Mr Ballard. Mr Alexander was appointed to the Committee with effect from 1 October 2007. Mr Bryant, on his appointment as Senior Independent Director on 9 January 2008, stood down as the Chairman of the Remuneration Committee, while still remaining a member, and the Board appointed Mr Alexander as Chairman. Mr Morley, following his appointment to the Board on 9 January 2008, was appointed a member of the Committee. The Company complies with that element of Provision B2.1 of the Combined Code which requires that all members of the Remuneration Committee are independent non-executive directors. Further details of the members of the Remuneration Committee are given on pages 34 and 35. The Chief Executive is normally in attendance at Remuneration Committee meetings but is always excluded when his own performance and remuneration are under review. Details of attendance at Remuneration Committee meetings in 2007 is given in the table on page 37. The Company Secretary acts as Secretary to the Remuneration Committee. The Human Resources Director is always in attendance at Remuneration Committee meetings.

The Remuneration Committee has established written terms of reference, which were last reviewed, revised and re-issued on 13 October 2006.

The Remuneration Committee is 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 The Hay Group Management Limited (the Hay Group) during 2007. The Hay Group were appointed by and reported directly to the Remuneration Committee but the information was shared with the Company relating to senior executives. The Hay Group prepared and submitted to the Remuneration Committee a number of papers during 2007 and representatives of the Hay Group attended one Remuneration Committee meeting to discuss a paper they had prepared and to advise the Remuneration Committee generally. The papers submitted to the Remuneration Committee were: 'Analysis of Remuneration Competitiveness for Senior Executives', '2007 NED Remuneration Review' and 'Rights Issue – Consequences for EPS Performance Conditions'. In 2007, the Hay Group had no other connection with the Group. In addition to the Hay Group reports, the Company shared with the Remuneration Committee a report entitled 'Costain Pension Scheme – Financial Risk Management' prepared by PricewaterhouseCoopers (PWC). PWC had no other connection with the Group in 2007. The Company also submitted to the Committee an internally generated report on the Costain Pension Actuarial Valuation as at 31 March 2007.

Save as disclosed, the Remuneration Committee did not take any other independent advice during the financial year ended 31 December 2007. The Remuneration Committee did take advice from the HR Director and the Company Secretary.

The Remuneration Committee sets the overall remuneration policy of the Group and makes recommendations to the Board on the specific remuneration packages for each of the executive directors and the Company Secretary. In addition, the Remuneration Committee will review and consider on behalf of the Board, the terms of employment of senior management of the Group (in particular, those who are the direct reports of the Chief Executive), including basic salary, performance related bonus arrangements, benefits in kind, long-term incentives and pension benefits. The Remuneration Committee, in consultation with the Chief Executive, determines and recommends to the Board the annual fee payable to the Chairman of the Board. The Chairman of the Board, in consultation with the Chief Executive, determines and recommends to the Board the fees payable to the non-executive directors. Further details on the remuneration of the non-executive directors are given on pages 55 and 57.

Remuneration policy

The remuneration policy for executive directors and other senior management 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 Hay Group has, for the benefit of the Remuneration Committee, carried out an exercise to benchmark remuneration packages and their constituent elements with those of comparable organisations, primarily within the UK-based contracting sector, to ensure that the remuneration packages within the Group bear reasonable comparison with those of other companies of a similar size. The Remuneration Committee is, however, conscious that such comparisons must be viewed with caution in order to avoid the risk of an upward ratchet of remuneration levels without corresponding improvement in performance levels. The analysis and comparison exercises referred to earlier are only one element to assist the Remuneration Committee in exercising its judgement; the Remuneration Committee also takes into account personal performance.

The Remuneration Committee has resolved that a review of executive and senior management remuneration be carried out in preparation for the annual review in April 2009. The aim of the review and subsequent recommendation is to implement any possible alternative reward structure that best reflects current remuneration best practice. The composition of the reward structure clearly being role-related recognises current performance, retention and long-term performance. The Remuneration Committee has asked the HR Director to undertake the review in conjunction with a professional consultant.

Remuneration components

The Remuneration Committee considers that annual bonuses and long-term incentive plans are an important part of the total remuneration package of an executive director or other member of senior management and are used to drive and reward performance and so it aligns the incentives of executive directors and other members of senior management with the interests of shareholders. Accordingly, the Remuneration Committee aims to impose challenging performance targets for both annual bonuses and long-term incentive plans.

Directors' remuneration report continued

The main components of executive directors' and other senior management's remuneration packages comprise basic salary, which forms the major element of remuneration, an annual bonus, which is dependent 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 or car allowance (and in certain cases the provision of a fuel benefit) and the provision of health insurance.

The Remuneration Committee gives due consideration to the provisions of B1, B1.1 to B1.4 and Schedule A of the Combined Code in formulating the remuneration policy of the Group and has noted and taken account of the requirements of provisions B1.5 and B1.6 with regard to service contracts and compensation. The Company does comply with provisions B2, B2.1 to B2.4 of the Combined Code with regard to the establishment and procedures of the Remuneration Committee. There were no material changes made to the remuneration policies of the Company during the year.

The Company's policy on the remuneration for executive directors and other senior management for 2008 and subsequent financial years will follow substantially the policy laid down herein, save as where otherwise noted.

Further details of the main components of executive directors' and other senior management's remuneration packages are given below:

Basic Salary – Salary is the major element of the remuneration package. The Remuneration Committee reviews in February/March of each year the salaries of the executive directors and the Company Secretary having reviewed the performance of the individuals 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 other senior management 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 management, including the Company Secretary, is determined in the light of the levels of remuneration generally within the Company and other companies in the UK-based construction sector. A salary increase, if awarded, is effective from 1 April in each year.

From April 2007, Mr Wyllie's basic salary was increased from £325,000 to £345,000 per annum and Mr Bickerstaff's basic salary was increased from £180,000 to £193,000 per annum.

Annual Bonus – An annual bonus scheme is a further component of the remuneration package for executive directors and other senior management. With the exception of the Chief Executive and the Finance Director, annual bonuses up to a maximum of 60% of basic salary were payable if performance targets were met. The performance targets for 2007 related to profit at Group level and to divisional and specific targets. The targets for the annual bonus are reviewed and approved annually by the Remuneration Committee. The Chief Executive will be entitled to earn a bonus of 100% of basic salary if his performance targets are met and the Finance Director will be entitled to earn a bonus of 80% of basic salary if his performance targets are met.

For the year ended 31 December 2007, Mr Wyllie was entitled to earn a bonus of £345,000. For the payment of the bonus, the Remuneration Committee had to be satisfied that the performance conditions relating to certain financial, operational and personal targets had been met. The Remuneration Committee has determined that Mr Wyllie's bonus for 2007 should be the sum of £310,500.

For the year ended 31 December 2007, Mr Bickerstaff was entitled to earn a bonus of £154,400. For the payment of the bonus, the Remuneration Committee had to be satisfied that the performance conditions relating to certain financial, operational and personal targets had been met. The Remuneration Committee has determined that Mr Bickerstaff's bonus for 2007 should be the sum of £154,400.

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

Long-Term Incentive Arrangements – The Long-Term Incentive Plan (LTIP) was approved by shareholders on 24 May 2002. The LTIP is designed to reward executive directors and other senior management by reference to the performance of the Group. The LTIP allows for conditional awards to a participant with a maximum face value of 100% of basic annual salary at the date of grant of the award. Seven awards have been made under the LTIP. The first award which was made on 11 October 2002 lapsed, the second award which was made on 21 April 2004 also lapsed, the third award was made on 26 April 2005, the fourth award was made on 19 September 2005, the fifth award was made on 21 April 2006, the sixth award was made on 10 October 2006 and the seventh award was made on 18 April 2007. For the third and subsequent awards, the Remuneration Committee decided that, in the case of the Chief Executive and Finance Director, they would be entitled to a number of shares calculated by reference to 100% of their annual salary, whereas senior management would be entitled to a number of shares calculated by reference to a proportion of their annual salary. The performance condition for each award was earnings per share (EPS) as the Remuneration Committee considered, that after taking into account the advice of the Hay Group, such a target was the most appropriate performance target in order to focus on achieving a demanding business plan. The performance period for each award will not be less than three consecutive years. The awards in 2002 and 2004 were 'all or nothing' awards so that if the performance target is not met, no award is made.

We have reported elsewhere in this Annual Report that the Company announced a Rights Issue on 14 September 2007. A Rights Issue impacts Save as You Earn Schemes (SAYE) and Performance Share Plans (LTIP) by giving rise to a necessary adjustment and the rules of both schemes recognise that fact. In the case of an SAYE Scheme, HM Revenue & Customs have adopted a formula which they consider acceptable in computing the adjustment to be applied to the original option exercise price to take account of the Rights Issue. This formula has been adopted by the Company in adjusting the option price and number of shares under the SAYE Scheme and the Remuneration Committee exercised their discretion and applied the same formula to the LTIP with a further adjustment to take account of the benefits of additional capital raised from the Rights Issue. The EPS figures given below are the adjusted EPS figures

The performance condition for the 2004 award was the achievement of an EPS of 5.33 p in the financial year ended 31 December 2007; it was not met and the award lapsed.

The Remuneration Committee decided that the performance target for the third award would be on a sliding scale, which was in keeping with the approach that other companies made to their long-term incentive plans

The performance conditions for the third award are as follows.

- In the event that an EPS of 3.38p was achieved for the financial year ended 31 December 2008 then 25% of the award would vest;
- In the event that an EPS of 3.60p was achieved for the financial year ended 31 December 2008 then 50% of the award would vest;
- In the event that an EPS of 3.81p was achieved for the financial year ended 31 December 2008 then 75% of the award would vest; and
- In the event that an EPS of 4.02p was achieved for the financial year ended 31 December 2008 then 100% of the award would vest

The fourth award, which was only for the benefit of Mr Wyllie, has the same performance conditions for the financial year ended 31 December 2008 as the third award.

Under the LTIP Rules, on an award vesting, a participant becomes entitled to ordinary shares in the Company. The Remuneration Committee considered that it would be advantageous to the Company to introduce into the LTIP Rules an ability to satisfy, at its discretion, awards vested instead by a cash payment of equivalent value. The Remuneration Committee engaged Slaughter and May who advised that the amendment to the LTIP Rules was permissible as a minor amendment to benefit the administration of the plan and in those circumstances it would not need the approval of the Company in a general meeting. The Remuneration Committee decided that, for the purpose of calculating the cash equivalent, the shares should be valued on the basis of an average price over a 30 days' period immediately preceding the date of the award vesting

The Remuneration Committee decided to increase the number of participants eligible to take part in the LTIP award in 2006 to include senior managers immediately below the Executive Board. These senior managers will be entitled to conditional awards up to a maximum face value of 60% of their basic annual salary at the date of grant of the award. The Executive Board members (other than the Chief Executive and Finance Director) will be entitled to conditional awards up to a maximum face value of 80% of their basic annual salary at the date of grant of award. The Chief Executive and Finance Director will be entitled to conditional awards up to a maximum face value of 100% of their basic annual salary at the date of grant of award. The performance conditions for the fifth award are as follows:

- In the event that an EPS of 3.25p was achieved for the financial year ended 31 December 2009 then 25% of the award would vest;
- In the event that an EPS of 3.69p was achieved for the financial year 31 December 2009 then 100% of the award would vest; and
- In the event that an EPS was achieved above 3.25p but below 3.69p for the year ended 31 December 2009 then an award would vest on a sliding scale between 25% and 100% pro rata to the EPS actually achieved.

The sixth award, which was for the benefit of Mr Bickerstaff and two other participants, has the same performance conditions for the financial year ended 31 December 2009 as the fifth award.

The seventh award was for the benefit only of Mr Wyllie and Mr Bickerstaff and the performance conditions for this award for the financial year ended 31 December 2010 were as follows:

- In the event that an EPS of 3.27p was achieved for the financial year ended 31 December 2010 then 25% of the award would vest;
- In the event that an EPS of 3.71p was achieved for the financial year 31 December 2010 then 100% of the award would vest; and
- In the event that an EPS was achieved above 3.27p but below 3.71p for the year ended 31 December 2010 then an award would vest on a sliding scale between 25% and 100% pro rata to the EPS actually achieved.

In May 2007, The Remuneration Committee introduced a Phantom Long-Term Incentive Plan (Phantom) for members of the Executive Board (excluding the Chief Executive and Finance Director) and other members of senior management. The rules of the Phantom closely follow those of the LTIP but, whereas the LTIP normally results in the award of shares if performance conditions are met, the Phantom results in the award of cash if the performance target is met. The Phantom is driven by a notional award of shares in the same way as the LTIP but the cash received by the participant is calculated by converting to cash at the time of the award the value of the notional number of shares that the participant would have received if the performance target is met. The Phantom, which did not require shareholder approval, was adopted by the Company on 9 May 2007. The first award was made on 14 June 2007 and was subject to the same performance conditions as the seventh award under the LTIP. The number of shares that each participant would notionally receive has also been adjusted as a result of the Rights Issue

Directors' remuneration report

continued

Details of the executive directors' participation in the LTIP are as follows.

Maximum number of shares subject to award

Name of Director	Date Granted	At 1 Jan 2007	Granted during the year	Lapsed during the year	Vested during the year	Rights Issue adjustments ¹	At 31 Dec 2007	Exercisable from
A Wyllie	19.09.05	677,966	-	-	-	99,749	777,715	March 2009
	21.04.06	607,477	-	-	-	89,378	696,855	March 2010
	18.04.07	-	676,470	-	-	99,528	775,998	March 2011
A O Bickerstaff	10.10.06	333,333	-	-	-	49,043	382,376	March 2010
	18.04.07	-	378,431	-	-	55,678	434,109	March 2011

Notes

(a) The awards, which are expressed as options, are subject to an exercise price of £1.

(b) The average closing middle market price of ordinary shares of 5p each in the Company for the dealing day immediately preceding the date of the grant for the first 2005 award was 47p, for the second 2005 award was 44 25p, for the first 2006 award was 53.5p, for the second 2006 award was 54p and for the 2007 award was 51p

(c) The number of ordinary shares of 5p each still outstanding and the subject of the first 2005 award is 1,164,943 (2006: 1,015,529), the second 2005 award is 777,715 (2006: 677,966), the first 2006 award is 3,773,456 (2006: 3,609,103), the second 2006 award is 661,102 (2006: 576,310) and the 2007 award is 1,210,107. The number of shares still outstanding at 31 December 2007 has been adjusted to take account of the Rights Issue.

¹ In the table above the number of shares subject to the awards as at 31 December 2007 have been adjusted to take account of the Rights Issue

On 19 September 2005, Mr Wyllie was awarded a contingent award over 400,000 ordinary shares of 5p each in the capital of the Company. Subject to Mr Wyllie continuing employment (other than in circumstances where he is entitled to treat himself as having been constructively dismissed) until the results for the financial year ended 31 December 2007 are published in 2008 and not being under notice to terminate his employment at that date, the matching award will vest dependent on the extent to which the following performance target is satisfied. The performance targets have been adjusted as a result of the Rights Issue and are as follows:

- EPS of 3.90p – 114,713 ordinary shares will vest;
- EPS of 4.37p – 229,426 ordinary shares will vest;
- EPS of 4.85p – 344,139 ordinary shares will vest; and
- EPS of 5.33p – 458,852 ordinary shares will vest.

As none of the performance targets were met, the contingent award to Mr Wyllie lapsed.

On 10 October 2006, Mr Bickerstaff was awarded a contingent award of 120,000 ordinary shares of 5p each in the capital of the Company. Subject to Mr Bickerstaff continuing employment (other than in circumstances where he is entitled to treat himself as having been constructively dismissed) until the results for the financial year ended 31 December 2007 are published in 2008 and not being under notice to terminate his employment at that date, the matching award will vest dependent on the extent to which the following performance target is satisfied. The performance targets have been adjusted as a result of the Rights Issue and are as follows:

- EPS of 3.90p – 34,414 ordinary shares will vest;
- EPS of 4.37p – 68,828 ordinary shares will vest;
- EPS of 4.85p – 103,242 ordinary shares will vest; and
- EPS of 5.33p – 137,656 ordinary shares will vest.

As none of the performance targets were met, the contingent award to Mr Bickerstaff lapsed.

On 10 October 2006, Mr Bickerstaff was awarded a second contingent award over 350,000 ordinary shares of 5p each in the capital of the Company. Subject to Mr Bickerstaff continuing employment (other than in circumstances where he is entitled to treat himself as having been constructively dismissed) until the results for the financial year ended 31 December 2008 are published in 2009 and not being under notice to terminate his employment at that date, the matching award will vest dependent on the extent to which the following performance target is satisfied. The performance targets have been adjusted as a result of the Rights Issue and are as follows:

- EPS of 3.38p – 100,374 ordinary shares will vest;
- EPS of 3.60p – 200,748 ordinary shares will vest;
- EPS of 3.81p – 301,121 ordinary shares will vest; and
- EPS of 4.02p – 401,495 ordinary shares will vest.

The Remuneration Committee has reserved the right to alter the performance targets.

At 31 December 2007, the derived mid-market price of the ordinary shares of the Company, as advised by the Company's Brokers, was 27p. The range of the share price of the ordinary shares during 2007 was 24.25p to 53.25p but adjusted for the Rights Issue was 24.25p to 46.42p.

A Save As You Earn Share Option Scheme (the Plan) was approved by shareholders at the 2002 Annual General Meeting. All eligible employees and executive directors are entitled to participate in the Plan. The option prices of the shares under the Plan have been impacted by the Rights Issue and have been adjusted. The basic principle for any adjustment is that the necessary adjustment is one which would adjust the option price (which is based on the market value of the shares at the date of grant) and the number of shares, to what it would have been had the new share structure been in place when the options were first granted. The adjustment is made using a formula acceptable to HM Revenue & Customs who have to approve the adjustment. The option prices given below are the adjusted option prices.

The Group granted options on 22 October 2002 at an option price of 17.43p per share and the entitlement to participate was subject to the proviso that the eligible employee had been in the employment of the Company for 12 months. The Group granted options on 21 October 2004 at an option price of 29.29p and participants were not subject to any service qualification. The Group granted options on 18 May 2007 at an option price of 33.30p and participants were not subject to any service qualification. Mr Wyllie and Mr Bickerstaff participated in the 2007 Plan and details are given below:

Number of Options

Name of Director	Date granted	At 1 Jan 2007	Granted during the year	Exercised during the year	Lapsed during the year	At 31 Dec 2007	Exercise price	Exercisable from
A Wyllie	18.5.07	-	28,377	-	-	-	33.30p	Jul-Dec 2010
A O Bickerstaff	18.5.07	-	28,377	-	-	-	33.30p	Jul-Dec 2010

Details of the grants made under the Plan are shown in Note 18 to the financial statements on page 92.

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

Benefits – Benefits comprise primarily of the provision of a company car or car allowance, fuel and 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. The premiums attributable to Messrs Wyllie and Bickerstaff in respect of permanent health insurance, based on a proportion of total cost, were respectively £2,689 (2006: £2,837) and £1,500 (2006: £934).

Pension Arrangements – neither executive director is a member of the Group's main registered UK pension scheme. Senior management participate in the executive section of the Group's main registered 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. All senior management participate on a contributory basis.

The Group's main registered UK pension scheme is a defined benefit scheme, which was closed to new members with effect from 30 May 2005. Members of senior management joining the Company on or after 1 June 2005 will be offered pension provision on a defined contribution basis, which will carry with it a lump sum death in service benefit of four times basic salary but with no provision for spouse pensions.

In the case of Mr Wyllie, he is entitled, under his terms of engagement, to an annual pension allowance of 22% of his basic salary. The Company contributes the pension allowance to the Scottish Widows Plc stakeholder pension scheme. The Company contributed a sum of £74,800 (2006: £71,035) towards Mr Wyllie's pension provision during the year. Mr Bickerstaff is entitled, under his terms of engagement, to an annual pension allowance of 22% of his basic salary. The Company contributes the pension allowance to the Winterthur Life stakeholder pension scheme. The Company contributed a sum of £41,745 (2006: £22,846) towards Mr Bickerstaff's pension provision during the year.

Life assurance cover of four times basic salary is provided through the Costain Life Assurance Scheme. The annual premiums payable in respect of life assurance for Mr Wyllie and Mr Bickerstaff were respectively £2,886 (2006: £3,375) and £1,609 (2006: £1,260).

Contracts of Service – In general, the service agreements with executive directors and other senior management provide for termination by the Group on either one or two years' notice. No executive director has a notice period over one year. The Remuneration 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.

Directors' remuneration report

continued

The Remuneration Committee considers it unlikely that any executive director or other member of senior management 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.

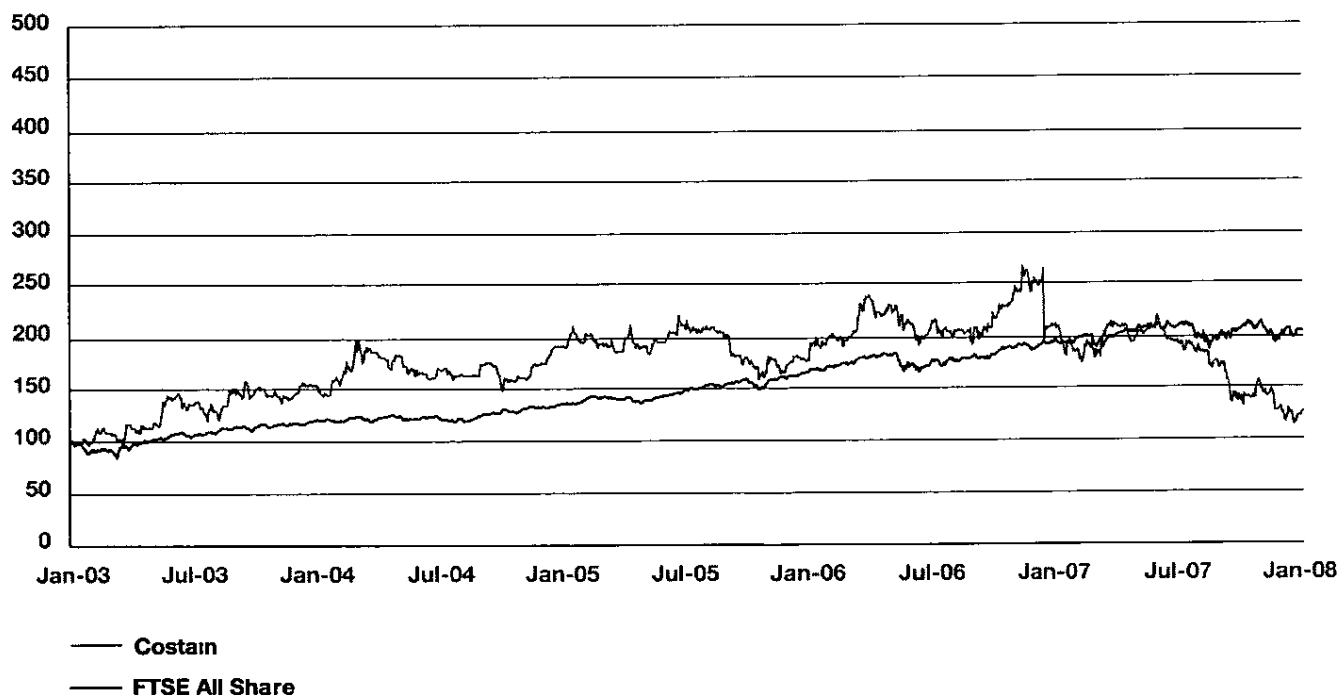
Mr Wyllie's service agreement is dated 25 April 2005 and provides for him to serve the Company as Chief Executive or in such capacity of a like status as the Company may require from a date no later than four months after the date of the service agreement. Mr Wyllie's service agreement terminates automatically when he reaches normal retirement age of 60 years. Subject to that, Mr Wyllie's engagement as Chief Executive can be terminated on 12 months' notice given at any time.

Mr Bickerstaff's service agreement is dated 3 March 2006 and provides for him to serve the Company as Finance Director or in such other capacity of a like status as the Company may require from a date no later than three months after the date of the service agreement. Mr Bickerstaff's service agreement terminates automatically when he reaches normal retirement age of 60 years. Subject to that, Mr Bickerstaff's engagement as Finance Director can be terminated on 12 months notice given at any time.

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 individual's commitment to the Company. Fees paid for outside appointments may be retained by the individual concerned. At present, neither executive director holds an outside appointment.

Performance graph as required by the Companies Act 1985 Schedule 7A

The graph below 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 2003 to 31 December 2007. TSR is defined as share price growth plus reinvested dividends but it should be noted 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 2003. 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 2007 was £1,376,740 as set out in the following table:

Name of Director	Salary/fee £	Bonus £	Benefits £	2007 Total £	2006 Total £
Executive Directors					
A Wyllie	340,000	310,500	13,179	663,679	430,207
A O Bickerstaff	189,750	154,400	11,680	355,830	235,953
Non-Executive Directors					
D P Allvey	43,500	-	-	43,500	42,500
M H Hamid ¹	33,578	-	-	33,578	-
M R Alexander ²	16,256	-	-	16,256	-
F W Ballard	36,000	-	-	36,000	35,000
J M Bryant	41,000	-	-	41,000	40,000
J Morley ³	-	-	-	-	-
S Y Shehata	36,000	-	-	36,000	35,000
M A Sulaiman	36,000	-	-	36,000	35,000
D G Jefferies ⁴	112,500	-	-	112,500	110,000
Dato' A P Senin ⁵	2,397	-	-	2,397	35,000
Former Directors	-	-	-	-	328,561
Total	886,981	464,900	24,859	1,376,740	1,327,221

¹ Appointed 25 January 2007

² Appointed 25 July 2007

³ Appointed 9 January 2008.

⁴ Resigned 31 December 2007

⁵ Resigned 25 January 2007

The Company discloses the bonuses above on a payable basis

Mr Wyllie is entitled to a performance related bonus for 2007 of £310,500. Mr Bickerstaff is entitled to a performance related bonus for 2007 of £154,400. No payments were made to or benefits received by executive directors during the year under any Long-Term Incentive Plan.

No compensation was paid to a former director for loss of office during 2007 (2006: £170,539).

Payments made to third parties in respect of directors' services amounted to £71,975 (2006: £70,000). This figure is included within the directors' emoluments.

No payment was made to any alternate director.

The emoluments of the highest paid director were £663,679 (2006: £430,207); both figures exclude attributable pension contributions

Directors' remuneration report

continued

Directors' interests

Directors' interests recorded by the Company are as follows:

Name of Director		At 01 01 07	Rights Issue Adjustment	At 31 12 07
D G Jefferies	a	225,000	168,750	393,750
M H Hamid		— ^o	—	—
A Wyllie	a	100,000	90,000	210,000 ⁺
	b	677,966	99,749	777,715
	c	400,000	58,852	458,852
	d	607,477	89,378	696,855
	h	—	99,528	775,998
	i	—	—	28,377
A O Bickerstaff	a	40,000	30,000	70,000 [*]
	e	333,333	49,043	382,376
	f	120,000	17,656	137,656
	g	350,000	51,495	401,495
	h	—	55,678	434,109
	i	—	—	28,377
D P Allvey	a	30,000	22,500	52,500
F W Ballard	a	8,994	6,745	15,739
J M Bryant	a	50,000	37,500	87,500
M R Alexander	a	— ^o	—	40,000
S Y Shehata		—	—	—
M A Sulaiman		—	—	—
Dato' A P Senin		—	—	— ⁺

Notes

- (a) Costain Group PLC ordinary shares of 5p each.
 (b) Options granted on 19 September 2005 to acquire Costain Group PLC ordinary shares of 5p each under the 2005 Long-Term Incentive Plan
 (c) Options granted on 19 September 2005 to acquire Costain Group PLC ordinary shares of 5p each.
 (d) Options granted on 21 April 2006 to acquire Costain Group PLC ordinary shares of 5p each under the 2006 Long-Term Incentive Plan
 (e) Options granted on 10 October 2006 to acquire Costain Group PLC ordinary shares of 5p each under the 2006 Long-Term Incentive Plan
 (f) Options granted on 10 October 2006 to acquire Costain Group PLC ordinary shares of 5p each.
 (g) Options granted on 10 October 2006 to acquire Costain Group PLC ordinary shares of 5p each.
 (h) Options granted on 18 April 2007 to acquire Costain Group PLC ordinary shares of 5p each under the 2007 Long-Term Incentive Plan
 (i) Options granted on 18 May 2007 to acquire Costain Group PLC ordinary shares of 5p each under the 2007 Save As You Earn Share Option Plan.

The Rights Issue Adjustment column includes shares subscribed under the Rights Issue and adjustments to option plans.

^o At date of appointment.

⁺ At date of resignation

[†] Mr Wyllie purchased an additional 20,000 ordinary shares in Costain Group PLC early in 2007

^{*} Mr Wyllie and Mr Bickerstaff each purchased 50,000 ordinary shares in Costain Group PLC on 10 January 2008.

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 Plans is decided by the Remuneration Committee, except for the Costain SAYE 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 18 to the financial statements on pages 90 to 92.

The Company's external auditors are required to report to the shareholders on the information contained in sections relating to 'Long-Term Incentive Plan', 'Save As You Earn Share Option Scheme', 'Pension', 'Sums paid to third parties' and on the tables relating to directors' remuneration and directors' interests section of this report. Other elements of the Directors' remuneration report are unaudited.

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.

A non-executive director's initial period of appointment is until the time comes to retire by rotation under the Company's 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, Alexander, Ballard, Bryant and Morley are not entitled to compensation for loss of office.

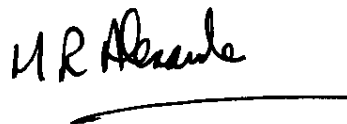
The nominee non-executive directors, as indicated in the Report of the directors, hold office for as long as the shareholder nominating them holds a specific percentage of the issued share capital of the Company. The nominee non-executive directors are nevertheless required to stand for re-election in the usual way and are not entitled to compensation for loss of office.

Under the terms of reference of the Remuneration Committee, the fee of the Chairman is determined and recommended to the Board following consultation between the non-executive directors acting through the Remuneration Committee and the Chief Executive. The fees payable to all other non-executive directors are recommended to the Board following consultation between the Chairman and the Chief Executive. The fees of the Chairman and the other non-executive directors will be reviewed annually in October and on the second anniversary from when the fees were last raised or benchmarked, there will be a benchmark review by an independent remuneration consultant.

A review was undertaken by the Hay Group in 2007 to determine the appropriate level of fees for the Chairman and non-executive directors of the Company. As a result of the advice received from the Hay Group, it was decided that the fees paid to the Chairman and the non-executive directors would be adjusted. The fee of the Chairman was increased from £110,000 to £120,000 per annum and the fee for non-executive directors was increased from £35,000 to £39,000 per annum. The increases were effective from 1 October 2007. In addition to the fee of £39,000 per annum, the Senior Independent Director and the Chairman of the Remuneration Committee are each paid an additional £5,000 in fees and the Chairman of the Audit Committee is paid an additional £7,500 in fees.

This report was approved by the Board of directors on 11 March 2008 and has been signed on its behalf by:

Michael R Alexander
Chairman of the Remuneration Committee
11 March 2008



Statement of directors' responsibilities in respect of the Annual Report and the financial statements

The directors are responsible for preparing the Annual Report and the group and parent company financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

The group and parent company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the group and the parent company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' report, Directors' remuneration report and Corporate Governance statement that comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditors' Report to the members of Costain Group PLC

We have audited the group and parent company financial statements (the 'financial statements') of Costain Group PLC for the year ended 31 December 2007, which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statements of Recognised Income and Expense, and the related notes. These financial statements have been prepared under the accounting policies set out therein. 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' responsibilities for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 58.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the financial statements.

In addition, we report to you if, in our opinion, 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 other transactions is not disclosed.

We review whether the Corporate Governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, 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 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. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company'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 group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2007 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2007;
- 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 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Report of the Directors is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
11 March 2008

KPMG Audit Plc

Consolidated income statement

Year ended 31 December

	Notes	2007 £m	2006 £m
Revenue (Group and share of joint ventures and associates)	2	877.9	886.3
Share of joint ventures and associates	11	(130.3)	(137.9)
Group revenue		747.6	748.4
Cost of sales		(716.2)	(785.9)
Gross profit/(loss)		31.4	(37.5)
Administrative expenses		(21.7)	(20.9)
Group operating profit/(loss)		9.7	(58.4)
Profit on sales of investments		2.7	3.6
Profit on sales of interests in joint ventures and associates		3.2	-
Amounts written off loans to associate	11	-	(2.7)
Share of results of joint ventures and associates	11	0.9	(7.0)
Profit/(loss) from operations	3	16.5	(64.5)
Financial income	6	29.6	26.7
Finance costs	6	(26.3)	(23.9)
Net financing income		3.3	2.8
Profit/(loss) before tax	3	19.8	(61.7)
Income tax (expense)/credit	8	(3.8)	7.7
Profit/(loss) for the period attributable to equity holders of the parent	2	16.0	(54.0)
Earnings/(loss) per share – basic*	7	3.6p	(13.2)p
Earnings/(loss) per share – diluted*	7	3.5p	(13.2)p

* (2006 figures restated)

During the year and the previous year, no businesses were acquired. The impact on the results of the businesses disposed was not material and, therefore, all results are classified as arising from continuing operations.

The notes on pages 66 to 99 form part of these financial statements.

Consolidated statement of recognised income and expense

Year ended 31 December

	Notes	2007 £m	2006 £m
Exchange differences on translation of foreign operations		2.0	–
Cash flow hedges			
Effective portion of changes in fair value (net of tax) during period – Group		(0.1)	0.3
Effective portion of changes in fair value (net of tax) during period – joint ventures and associates		(0.1)	3.1
Change in fair value of assets classified as available for sale		(2.6)	(0.8)
Actuarial gains on defined benefit pension scheme		11.7	26.0
Tax recognised on actuarial gains recognised directly in equity		(3.3)	(7.8)
Tax rate adjustment to brought forward actuarial losses recognised directly in equity		(1.7)	–
Net income recognised directly in equity		5.9	20.8
Profit/(loss) for the period		16.0	(54.0)
Total recognised income and expense for the period attributable to equity holders of the parent	20	21.9	(33.2)

Statement of recognised income and expense – Company

The Company does not have any recognised income and expense other than the loss for the period of £1.8 million (2006 £3.7 million).

The notes on pages 66 to 99 form part of these financial statements.

Consolidated balance sheet

As at 31 December

	Notes	2007 £m	2006 £m
Assets			
Non-current assets			
Property, plant & equipment	9	3.5	5.7
Intangible assets	10	2.7	3.4
Investments in joint ventures	11	29.0	25.0
Investments in associates	11	2.2	1.2
Loans to joint ventures	11	7.3	3.3
Loans to associates	11	1.6	2.0
Other investments	11	–	3.6
Other debtors	12	6.7	10.1
Deferred tax assets	8	21.2	30.6
Total non-current assets		74.2	84.9
Current assets			
Inventories		2.0	2.4
Trade and other receivables	12	150.3	160.6
Cash and cash equivalents	13	133.4	56.4
Total current assets		285.7	219.4
Total assets		359.9	304.3
Equity			
Share capital	19	31.4	17.9
Share premium		1.1	0.6
Special reserve		–	12.8
Fair value reserve		–	2.6
Foreign currency translation reserve		0.9	(1.2)
Hedging reserve		(1.8)	(1.6)
Retained earnings		(4.2)	(86.3)
Total equity attributable to equity holders of the parent	20	27.4	(55.2)
Liabilities			
Non-current liabilities			
Retirement benefit obligations	18	50.6	68.7
Other payables	16	3.7	6.6
Provisions	17	5.0	4.1
Total non-current liabilities		59.3	79.4
Current liabilities			
Trade and other payables	16	268.1	266.1
Tax liabilities	8	1.8	2.7
Overdrafts	13	–	1.4
Interest bearing loans and borrowings	14	0.6	1.7
Provisions	17	2.7	8.2
Total current liabilities		273.2	280.1
Total liabilities		332.5	359.5
Total equity and liabilities		359.9	304.3

The financial statements were approved by the Board of Directors on 11 March 2008 and were signed on its behalf by

A Wyllie
Director

A O Bickerstaff
Director

The notes on pages 96 to 99 form part of these financial statements.

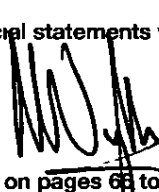
Company balance sheet

As at 31 December

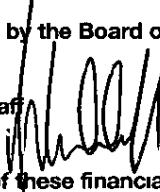
	Notes	2007 £m	2006 £m as restated
Assets			
Non-current assets			
Investments in subsidiaries	11	112.8	112.6
Total non-current assets		112.8	112.6
Current assets			
Trade and other receivables	12	3.8	1.6
Cash and cash equivalents	13	60.1	32.7
Total current assets		63.9	34.3
Total assets		176.7	146.9
Equity			
Share capital	19	31.4	17.9
Share premium		1.1	0.6
Special reserve		–	12.8
Non-distributable reserve		0.7	0.5
Retained earnings		53.2	(4.3)
Total equity attributable to equity holders of the parent	20	86.4	27.5
Liabilities			
Non-current liabilities			
Provisions	17	1.2	1.7
Total non-current liabilities		1.2	1.7
Current liabilities			
Trade and other payables	16	86.9	115.2
Tax liabilities		1.7	1.8
Provisions	17	0.5	0.7
Total current liabilities		89.1	117.7
Total liabilities		90.3	119.4
Total equity and liabilities		176.7	146.9

The financial statements were approved by the Board of Directors on 11 March 2008 and were signed on its behalf by:

A Wyllie
Director



A O Bickerstaff
Director



The notes on pages 68 to 99 form part of these financial statements.

Consolidated cash flow statement

Year ended 31 December

	Notes	2007 £m	2006 £m
Cash flows from operating activities			
Profit/(loss) for the period		16.0	(54.0)
Adjustments for:			
Depreciation and amortisation	3	2.8	2.7
Financial income	6	(29.6)	(26.7)
Finance costs	6	26.3	23.9
Share-based payments expense	4	0.2	0.3
Income tax	8	3.8	(7.7)
Profit on sales of investments	3	(2.7)	(3.6)
Profit on sales of interests in joint ventures and associates	3	(3.2)	-
Share of results of joint ventures and associates	11	(0.9)	7.0
Amounts written off loans to associate	11	-	2.7
Cash from/(used by) operations before changes in working capital and provisions		12.7	(55.4)
Decrease/(increase) in inventories		0.4	(0.4)
Decrease in receivables		13.3	2.2
Increase in payables		1.9	32.6
Movement in provisions and employee benefits		(8.0)	(2.6)
Cash from/(used by) operations		20.3	(23.6)
Interest paid		(0.5)	(0.3)
Income taxes paid		(0.3)	(0.2)
Net cash from/(used by) operating activities		19.5	(24.1)
Cash flows from investing activities			
Interest received		2.8	2.6
Dividends received from joint venture		-	6.1
Additions to property, plant & equipment	9	(0.8)	(1.9)
Additions to intangible assets	10	(0.2)	(0.9)
Proceeds from sales of property, plant & equipment		-	0.2
Additions to investments	11	(0.2)	(0.1)
Disposal of subsidiary, net of cash disposed		(1.4)	-
Proceeds from sales of investments and interests in joint ventures and associates		9.4	7.1
Loans to joint ventures and associates	11	(10.1)	(10.2)
Net cash (used by)/from investing activities		(0.5)	2.9
Cash flows from financing activities			
Issue of ordinary share capital	20	65.0	0.3
Share issue costs	20	(4.5)	-
(Payment of)/proceeds from borrowings		(1.0)	0.9
Payment of finance lease liabilities		(0.1)	(0.2)
Net cash from financing activities		59.4	1.0
Net increase/(decrease) in cash and cash equivalents		78.4	(20.2)
Cash and cash equivalents at beginning of period	13	55.0	75.0
Effect of foreign exchange rate changes		-	0.2
Cash and cash equivalents at end of period	13	133.4	55.0

The notes on pages 66 to 99 form part of these financial statements.

Company cash flow statement

Year ended 31 December

	Notes	2007 £m	2006 £m
Cash flows from operating activities			
Loss for the period	20	(1.8)	(3.7)
Adjustments for:			
Amounts written off investments	11	-	6.0
Financial income		(1.0)	(6.8)
Finance costs		3.0	2.6
Income tax		(3.2)	(0.9)
Cash used by operations before changes in working capital and provisions		(3.0)	(2.8)
Decrease/(increase) in receivables		0.1	(0.3)
Decrease in payables		(28.7)	(10.4)
(Decrease)/increase in provisions		(0.7)	0.6
Cash used by operations		(32.3)	(12.9)
Interest paid		(2.7)	(0.1)
Income taxes received		1.0	1.7
Net cash used by operating activities		(34.0)	(11.3)
Cash flows from investing activities			
Interest received		0.9	0.8
Dividends received		-	6.0
Net cash from investing activities		0.9	6.8
Cash flows from financing activities			
Issue of ordinary share capital	20	65.0	0.3
Share issue costs	20	(4.5)	-
Net cash from financing activities		60.5	0.3
Net increase/(decrease) in cash and cash equivalents		27.4	(4.2)
Cash and cash equivalents at beginning of period		32.7	36.9
Cash and cash equivalents at end of period		60.1	32.7

The notes on pages 66 to 99 form part of these financial statements.

Notes to the financial statements

1 Significant accounting policies

Costain Group PLC (the Company) is a public limited company incorporated in the United Kingdom. The address of its registered office and principal place of business is disclosed in the back of the Annual Report. The principal activities of the Company and its subsidiaries (together referred to as the Group) are described in note 2.

The consolidated financial statements of the Company for the year ended 31 December 2007 comprise the Group and the Group's interests in associates and jointly controlled entities. The parent company financial statements present information about the Company as a separate entity and not about its Group.

The financial statements were authorised for issue by the directors on 11 March 2008.

Statement of compliance

Both the Company financial statements and the Group consolidated financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU (Adopted IFRS). On publishing the parent Company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved financial statements.

Basis of preparation

The Group's financial statements are presented in Pounds sterling, rounded to the nearest hundred thousand. They are prepared on the historical cost basis except that financial assets and derivative financial instruments are stated at their fair value as required.

The preparation of financial statements in conformity with Adopted IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. Judgements made by management in the application of Adopted IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 25.

The accounting policies set out below have, unless otherwise stated, been applied consistently by the Group to all periods presented in these financial statements.

- In the current year, the Group has adopted IFRS 7 Financial Instruments. Disclosures, which is effective for annual reporting periods beginning on or after 1 January 2007, and the consequential amendments to IAS 1 Presentation of Financial Statements. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see notes 6, 12 and 15).
- Four interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) are effective for the current period. These are: IFRIC 7 Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies; IFRIC 8 Scope of IFRS 2; IFRIC 9 Reassessment of Embedded Derivatives, and IFRIC 10 Interim Financial Reporting and Impairment. The adoption of these Interpretations has not led to any changes in the Group's accounting policies, except for IFRIC 8, which has been applied retrospectively and has resulted in a prior year adjustment in the Company balance sheet. The effect is to increase investments and equity.

Accounting standards and interpretations issued but not yet adopted will have the following impact on the Group in future years.

- IFRS 8 Operating Segments is applicable for the Group's financial statements for the year ending 31 December 2009. The application of IFRS 8 would not have affected primary statements as the only impact of the standard is on disclosure.
- IFRIC 11 Group and Treasury Share Transactions is applicable for the Group's 2008 financial statements (effective for annual periods beginning on or after 1 March 2007) and is not expected to have any impact on the consolidated financial statements but is expected to increase the investments shown in the Company's balance sheet.
- IFRIC 12 Service Concession Arrangements is relevant from 2008 and will impact the way in which the Group accounts for its Private Finance Initiative (PFI) investments. IFRIC 12 is yet to be endorsed but is currently not expected to have significant impact on reported profit. See PFI investments policy note on page 69.
- IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction is applicable for the Group's financial statements for the year ending 31 December 2008. The effect of the application of IFRIC 14 has not been considered at this time.

Basis of consolidation

- (a) The Group's financial statements include the accounts of Costain Group PLC and subsidiaries controlled by the Company. Control exists where the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.
- (b) Associates are operations over which the Group has the power to exercise significant influence but not control, generally accompanied by a share of between 20% and 50% of the voting rights. Associates are accounted for using the equity method. If the Group's share of losses equals its investment, the Group does not recognise further losses, except to the extent that the Group has amounts receivable that may not be recoverable or has further commitments to provide funding.
- (c) Jointly controlled entities are those joint ventures over whose activities the Group has joint control, established by contractual agreement. Jointly controlled entities are accounted for using the equity method from the date that the jointly controlled entity commences until the date that joint control of the entity ceases. If the Group's share of losses equals its investment, the Group does not recognise further losses, except to the extent that the Group has amounts receivable that may not be recoverable or has further commitments to provide funding.
- (d) Jointly controlled operations are those joint ventures over which the Group has joint control, established by contractual agreement, which are not entities. Where a Group company is party to a jointly controlled operation, that company accounts for the assets it controls, the liabilities and expenses it incurs and its share of income. Such jointly controlled operations are reported in the consolidated financial statements on the same basis.
- (e) Intragroup balances and transactions together with any unrealised gains arising from intragroup transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with jointly controlled entities and jointly controlled operations are eliminated to the extent of the Group's interest in the entity or operation. The Group's share of unrealised gains arising from transactions with associates and joint ventures is eliminated against the investment in the associate or joint ventures. The Group's share of unrealised losses is eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Currency translation

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Pounds sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments, are translated to Pounds sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Pounds sterling at rates approximating to the foreign exchange rates ruling at the dates of these transactions.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges are recognised directly in equity and those that have arisen since 1 January 2004, the date of transition to Adopted IFRS, are presented as a separate component of equity. Cumulative exchange differences are released into the income statement upon disposal. Translation differences that arose before the date of transition to Adopted IFRS in respect of all foreign operations are not presented as a separate component.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, net of value added tax and includes the Group's share of revenue of jointly controlled operations.

Revenue from construction contracts is described below

Revenue from the sale of goods is recognised when the Group has transferred the significant risks and rewards of ownership of the goods to the buyer, the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group.

Revenue in respect of property development sales is recognised on the transfer to the buyer of the significant risks and rewards of ownership. This is typically achieved when the legal title is transferred. If at the time that the sale reaches legal completion there remain infrastructure works to complete, the nature and extent of the Group's continuing involvement is assessed to determine whether it is appropriate to recognise revenue. Where the conditions for revenue recognition are met, an appropriate amount is recognised. Amounts deferred in respect of infrastructure works are only recognised when such works are substantially complete.

Rental income is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives are recognised as an integral part of the total rental income on a straight-line basis over the term of the lease.

Notes to the financial statements continued

1 Significant accounting policies – continued

Construction contracts

Revenue arises from increases in valuations on contracts. Where the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. Stage of completion is assessed by reference to the proportion of contract costs incurred for the work performed to date relative to the estimated total costs, except where this would not be representative of the stage of completion.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Variations and claims are included in revenue where it is probable that the amount, which can be measured reliably will be recovered from the customer.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable those costs will be recoverable.

Contract costs are recognised as expenses in the period in which they are incurred.

Bid costs

Costs associated with bidding for contracts are written off as incurred. When it is probable that a contract will be awarded, usually when the Group has secured preferred bidder status, costs incurred from that date to the date of financial close are carried forward in the balance sheet.

When financial close is achieved on PFI contracts, costs are recovered from the special purpose vehicle and pre-contract costs within this recovery that were not previously capitalised are credited to the income statement. When the Group retains an interest in the special purpose vehicle and accounts for its interest as an associate or joint venture, the credit is recognised over the life of the construction contract to which the costs relate.

Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities (including contingent liabilities) of a subsidiary, jointly controlled entity or associate at the date of acquisition.

The classification and accounting treatment of business combinations that occurred prior to 1 January 2004 have not been reconsidered in preparing the Group's opening Adopted IFRS balance sheet at 1 January 2004. Prior to 1 January 1998, it was the Group's policy to eliminate goodwill arising on acquisition against reserves and such goodwill will remain eliminated against reserves

Positive goodwill is stated at cost less any accumulated impairment losses and is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement. In respect of associates and jointly controlled entities, the carrying amount of goodwill is included in the carrying amount of the investment in the associate or jointly controlled entity. Negative goodwill arising on an acquisition is recognised directly in the income statement.

Other intangible assets

Other intangible assets are carried at cost less accumulated amortisation and impairment losses. Amortisation begins when an asset is available for use and is calculated on a straight-line basis to allocate the cost of assets over their estimated useful lives (computer software – generally 3 to 5 years). Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Property, plant & equipment

Property, plant & equipment is carried at cost less accumulated depreciation and impairment losses. Where parts of an item of property, plant & equipment have different useful lives, they are accounted for as separate items. Cost comprises purchase price and directly attributable costs. Freehold land is not depreciated. For all other property, plant & equipment, depreciation is calculated on a straight-line basis to allocate cost less residual values of the assets over their estimated useful lives as follows.

Freehold buildings	50 years
Leasehold buildings	Shorter of 50 years or lease term
Plant & equipment	Remaining useful life (generally 3 – 12½ years)

Trade and other receivables

Construction work in progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less amounts billed and is included in amounts due from customers for contract work. Amounts valued and billed to customers are included in trade receivables. Cost includes all expenditure related directly to specific projects and an appropriate allocation of fixed and variable overheads incurred in the Group's contracting activities based on normal operating capacity. Where the cash received from customers exceeds the value of work performed, the balance is included in credit balances on long-term contracts.

Trade and other receivables do not carry interest and are stated at their initial value less impairment losses.

Investments – Company

Company investments in subsidiaries are carried at cost less impairment losses less any pre-acquisition dividends received.

PFI investments

IFRIC 12, if endorsed, will be mandatory for the Group for the year ending 31 December 2008. Although the principles of IFRIC 12 can be applied to the extent they do not conflict with current standards, the Group has opted to continue to apply elements of the approach set out in UK Financial Reporting Standard 5 Reporting the substance of transactions in accounting for its interests in PFI projects. The Group recognises the FRS 5 finance debtors relating to concession arrangements at amortised cost, as defined by IAS 39 FRS 5 fixed assets relating to concession arrangements are accounted for in accordance with IAS 16 property, plant & equipment. The impact of adopting IFRIC 12 is not expected to be significant.

The PFI associates and jointly controlled entities use derivatives to manage the financial risks to which they are exposed in relation to changes in interest rates and the Retail Price Index (RPI). Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Impairment

The carrying amounts of the Group's assets, other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit is less than the recoverable amount. Impairment losses are recognised in the income statement.

An impairment loss is reversed if there has been a change in the estimates resulting in the recoverable amount rising above the impaired carrying value of the asset. An impairment loss is reversed only to the extent that the carrying amount of the assets does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on the taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all temporary differences except for those specific exemptions set out below and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or other assets and liabilities (other than in a business combination) in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax is calculated at the tax rates based on those enacted or substantially enacted at the balance sheet date. Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Additional taxes arising from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

Leases

Leases are classified as finance leases where substantially all the risks and rewards of ownership are transferred to the Group. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Lease payments are apportioned between the liability and finance charge to produce a constant rate of interest on the finance lease balance outstanding. Assets capitalised under finance leases are depreciated over the shorter of the useful life of the asset or the lease term and adjusted for impairment losses. The interest expense component of finance lease payments is recognised in the income statement using the effective interest rate method.

Notes to the financial statements continued

1 Significant accounting policies – continued

Leases – continued

Leases other than finance leases are classified as operating leases. Payments made under operating leases are recognised as an expense in the income statement on a straight-line basis over the lease term. Any incentives to enter into operating leases are recognised as a reduction of rental expense over the lease term on a straight-line basis. Operating lease income is credited to the income statement as it is earned.

Retirement benefit obligations

The Group operates a pension scheme in the United Kingdom providing benefits based on 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 liability recognised in the balance sheet in respect of the defined benefit pension scheme is the present value of the defined benefit obligation less the fair value of scheme assets at the balance sheet date.

The increase in the present value of the liabilities of the Group's defined benefit pension scheme expected to arise from employee service in the period is charged to profit from operations. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities arising from the passage of time are included in financial income and finance costs respectively. Actuarial gains and losses are recognised in the consolidated statement of recognised income and expense.

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

Share-based payments

The Group operates various equity share option schemes. For equity settled share options, the services received from employees are measured by reference to the fair value of the share options. The fair value is calculated at the grant date and is recognised in the consolidated income statement, together with a corresponding increase in shareholders' equity, on a straight-line basis over the vesting period, based on an estimate of the number of options that are expected to eventually vest.

IFRS 2 has been applied, in accordance with IFRS 1, to equity settled share options granted after 7 November 2002 and not vested at 1 January 2005.

Where the Company grants options over its own shares to the employees of its subsidiaries, it recognises in its individual financial statements an increase in the cost of investment in its subsidiaries equivalent to the equity-settled share-based payment charge recognised in its subsidiaries' financial statements, with the corresponding credit being recognised directly in equity.

Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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

Financial assets and liabilities

Financial assets and financial liabilities are recognised in the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial assets

Investments are recognised and derecognised on trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned. Investments are measured initially at fair value, plus transaction costs, except financial assets classified as at fair value through profit or loss, which are measured initially at fair value.

Financial assets are classified as 'available-for-sale' financial assets, 'loans and receivables' and financial assets classified as at fair value through profit and loss. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period. Income is recognised on an effective interest basis for debt instruments.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. It is reversed only to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity

Financial liabilities

Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

Derecognition of financial liabilities

The Group derecognises financial liabilities only when the Group's obligations are discharged, cancelled or expire.

Derivative financial instruments

The Group uses derivative financial instruments in order to manage risks arising from changes in foreign exchange rates, interest rates and inflation. The directors review and agree policies for managing each of these risks and risk management is carried out by Group Treasury, which identifies, evaluates and hedges financial risk in close co-operation with the Group's subsidiaries. It is the Group's policy that no trading in financial instruments shall be undertaken.

Derivative financial instruments are measured at their fair value and those utilised by the Group or its investments include interest rate and RPI swaps and forward foreign exchange contracts. The fair value of forward exchange contracts is their quoted market value at the balance sheet date. The fair value of interest rate and RPI swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date. Valuations for forward exchange contracts and interest rate and RPI swaps are determined using valuation techniques supported by reference to market values for similar transactions.

Certain derivative financial instruments are designated as hedges in line with the Group's risk management policies. Hedges are classified as follows:

- Fair value hedges that hedge the exposure to changes in the fair value of a recognised asset or liability
- Cash flow hedges that hedge exposure to variability in cash flows that is attributable to either a particular risk associated with a recognised asset or liability or a forecast transaction.

For fair value hedges, any gain or loss from re-measuring the hedging instrument at fair value is recognised in the income statement and any gain or loss on the hedged item is adjusted against the carrying amount of the hedged item and similarly recognised in the income statement.

For cash flow hedges, the portion of the gain or the loss on the hedging instrument that is determined to be an effective hedge is recognised in equity, with any ineffective portion in the income statement. When hedged cash flows result in the recognition of a non-financial asset or liability, the associated gains or losses previously recognised in equity are included in the initial measurement of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same period in which the hedged cash flow affects the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss on the hedging instrument previously recognised in equity is retained in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

Any gains or losses arising from changes in fair value of derivative financial instruments not designated as hedges are recognised in the income statement. Borrowings are measured at amortised cost except where they are the hedged item in an effective fair value hedge relationship, in which case the carrying value is adjusted to reflect the fair value movements associated with the hedged risk.

Financial guarantee contracts

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

Notes to the financial statements

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2 Business and geographical segment information by origin

In the opinion of the directors, the business segments are Civil Engineering, Building, Oil, Gas & Process and International, which undertake engineering and construction projects, Property Development operations in Spain and Central costs. These represent the Group's primary segments. Secondary segments are presented geographically.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Central costs comprise mainly corporate expenses. Segment capital expenditure is the total cost incurred during the period to acquire segment assets that are expected to be used for more than one period.

Year ended 31 December 2007	Civil Engineering £m	Building £m	Oil, Gas & Process £m	International £m	Property Development £m	Central costs £m	Total £m
Group revenue	441.4	249.7	53.8	2.7	–	–	747.6
Share of revenue of JVs and associates	97.9	5.0	8.5	15.3	3.6	–	130.3
Total revenue	539.3	254.7	62.3	18.0	3.6	–	877.9
Group operating profit/(loss)	16.9	(2.3)	1.7	(0.2)	–	(6.4)	9.7
Profit on sale of investment	–	2.7	–	–	–	–	2.7
Profit on sales of JVs and associates	3.0	–	–	0.2	–	–	3.2
Share of results of JVs and associates	0.1	0.4	0.2	–	0.2	–	0.9
Segment result	20.0	0.8	1.9	–	0.2	(6.4)	16.5
Net financing income							3.3
Income tax expense							(3.8)
Profit for the year							16.0
Group assets	115.0	29.4	17.9	2.9	–	–	165.2
Investments in and loans to JVs and associates	1.6	8.8	0.1	3.4	26.2	–	40.1
Segment assets	116.6	38.2	18.0	6.3	26.2	–	205.3
Unallocated assets							154.6
Total assets							359.9
Group liabilities	(168.5)	(77.3)	(24.4)	(5.0)	–	(0.6)	(275.8)
Provisions against JVs and associates	(0.8)	(2.7)	(0.2)	–	–	–	(3.7)
Segment liabilities	(169.3)	(80.0)	(24.6)	(5.0)	–	(0.6)	(279.5)
Unallocated liabilities							(53.0)
Total liabilities							(332.5)
Capital expenditure	0.3	0.1	0.5	0.1	–	–	1.0
Depreciation/amortisation	1.7	0.8	0.2	0.1	–	–	2.8

Year ended 31 December 2006	Civil Engineering £m	Building £m	Oil, Gas & Process £m	Inter- national £m	Property Develop- ment £m	Central costs £m	Total £m
Group revenue	400.3	288.5	51.4	8.2	-	-	748.4
Share of revenue of JVs and associates	87.8	9.5	5.8	21.6	13.2	-	137.9
Total revenue	488.1	298.0	57.2	29.8	13.2	-	886.3
Group operating profit/(loss)	10.0	(29.6)	(19.8)	(13.0)	-	(6.0)	(58.4)
Profit on sale of investment	-	3.6	-	-	-	-	3.6
Amounts written off loans to associate	-	-	-	(2.7)	-	-	(2.7)
Share of results of JVs and associates	0.3	0.1	0.3	(11.6)	3.9	-	(7.0)
Segment result	10.3	(25.9)	(19.5)	(27.3)	3.9	(6.0)	(64.5)
Net financing income							2.8
Income tax credit							7.7
Loss for the year							(54.0)
Group assets	106.4	52.1	19.0	8.3	-	-	185.8
Investments in and loans to JVs and associates	3.9	2.3	(0.2)	1.6	23.9	-	31.5
Segment assets	110.3	54.4	18.8	9.9	23.9	-	217.3
Unallocated assets							87.0
Total assets							304.3
Group liabilities	(147.9)	(90.7)	(26.7)	(13.0)	-	(1.0)	(279.3)
Provisions against JVs and associates	(0.6)	(1.0)	(0.2)	(3.9)	-	-	(5.7)
Segment liabilities	(148.5)	(91.7)	(26.9)	(16.9)	-	(1.0)	(285.0)
Unallocated liabilities							(74.5)
Total liabilities							(359.5)
Capital expenditure	1.0	1.0	0.1	0.7	-	-	2.8
Depreciation/amortisation	1.0	1.0	0.3	0.4	-	-	2.7

	Revenue		Segment result	
	2007 £m	2006 £m	2007 £m	2006 £m
United Kingdom	833.8	816.9	16.3	(22.1)
Spain	3.6	13.2	0.2	3.9
Rest of the world	40.5	56.2	-	(46.3)
	877.9	886.3	16.5	(64.5)

	Segment assets		Capital expenditure	
	2007 £m	2006 £m	2007 £m	2006 £m
United Kingdom	167.4	175.3	0.6	2.1
Spain	26.2	25.6	-	-
Rest of the world	11.7	16.4	0.4	0.7
	205.3	217.3	1.0	2.8

Notes to the financial statements

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3 Other operating expenses and income

	2007 £m	2006 £m
Profit/(loss) before tax is stated after charging:		
Depreciation (note 9)	1.9	1.7
Amortisation (note 10)	0.9	1.0
Hire of plant and machinery	30.7	25.5
Rent of land and buildings	3.2	4.3
and after crediting:		
Income from rents of land and buildings	1.6	1.9
Profit on sales of interests in joint ventures and associates (see below)	3.2	-
Profit on sales of investments (see below)	2.7	3.6

In 2006, the loss before tax included £72.6 million arising from the impact of write-downs of the amounts recoverable on a number of contracts, losses arising on works where the costs were anticipated to exceed the total contract revenues and the cost of the decision to exit from the International business segment.

During 2007, the Group sold its investment in Bridgend Custodial Services Ltd and its interest in the joint venture, Sirhowy Enterprise Way (Holdings) Ltd, for a net aggregate cash consideration of £8.4 million generating profits on disposal of £2.7 million and £3.0 million respectively.

The Group also disposed of its interests in Nigeria. These comprised the Group's associate Costain (West Africa) Plc, sold for a net cash consideration of £1.0 million, generating a profit of £0.2 million, and the Group's subsidiary undertaking, Richard Costain Construction & Engineering Ltd. The consideration and net assets for this subsidiary undertaking at the date of sale are shown below:

	£m
Consideration received	-
Net assets disposed:	
Property, plant & equipment	0.9
Trade and other receivables	0.7
Cash and cash equivalents	1.4
Trade and other payables	(3.0)
	-

In 2006, the Group sold its remaining interest in HpC King's College Hospital (Holdings) Ltd for a net cash consideration of £3.6 million

Auditor remuneration

	2007 £m	2006 £m
Fees payable to the Group's auditor for the audit of the annual accounts	0.1	0.1
Fees payable to the Group's auditor and its associates for other services:		
The audit of the company's subsidiaries, pursuant to legislation	0.4	0.4
Other services relating to corporate finance transactions	0.4	0.1
	0.9	0.6

Amounts paid to the Company's auditors and their associates in respect of services to the Company, other than the audit of the Company's financial statements, have not been disclosed as the information is required to be disclosed on a consolidated basis

4 Personnel expenses Group

	2007 £m	2006 £m
Wages and salaries	104.0	100.2
Social security costs	9.6	8.6
Pension costs (note 18)	8.1	7.6
Share-based payments	0.2	0.3
	121.9	116.7

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

	2007 Number	2006 Number
Civil Engineering	1,667	1,702
Building	515	626
Oil, Gas & Process	702	592
International	714	378
Central costs	24	21
	3,622	3,319

Company

The Company does not employ any personnel, except for the directors considered in note 5.

5 Remuneration of directors

Details of directors' remuneration, pension entitlements, LTIPs, contingent awards and share options are included on pages 49 to 57 in the Directors' remuneration report.

6 Net financing income

	2007 £m	2006 £m
Interest income from bank deposits	2.4	2.1
Interest income from other loans and receivables	0.5	0.5
Expected return on defined benefit pension scheme assets	26.7	24.1
Financial income	29.6	26.7
Interest expense	(0.5)	(0.3)
Interest cost on the present value of the defined benefit obligations	(25.8)	(23.6)
Finance costs	(26.3)	(23.9)
Net financing income	3.3	2.8

Interest income from other loans and receivables relates to shareholder loan interest receivable from the Group's PFI investments.

Notes to the financial statements

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7 Earnings/(loss) per share

The calculation of earnings/(loss) per share is based on profit attributable to equity holders of the parent of £16.0 million (2006: loss £54.0 million) and the number of shares set out below:

	2007	2006 (restated)
Weighted average number of shares for basic earnings per share calculation	449,535,401	409,582,962
Dilutive potential ordinary shares:		
SAYE Scheme	5,404,067	7,131,715
Weighted average number of shares for fully diluted earnings per share calculation	454,939,468	416,714,677

The weighted average number of shares and the number of dilutive potential ordinary shares have been adjusted to take account of the bonus element of the Rights Issue. The comparative figures have been restated.

The anti-dilutive effect of the potential ordinary shares has been excluded for the purposes of calculating the 2006 diluted earnings per share because this would decrease the diluted loss per share

8 Income tax

	2007 £m	2006 £m
On profit/(loss) for the year:		
United Kingdom corporation tax at 30%	0.1	0.1
Adjustments in respect of prior years	0.8	0.2
Overseas taxation	(0.3)	–
Current tax credit for the year	0.6	0.3
Deferred taxation	(4.0)	6.6
Adjustments in respect of prior years	(0.4)	0.8
Total income tax (expense)/credit in the income statement	(3.8)	7.7
	2007 £m	2006 £m
Tax reconciliation:		
Profit/(loss) before tax	19.8	(61.7)
Income tax at 30%	(5.9)	18.5
Rate adjustments relating to overseas profits	0.4	(0.2)
Share of results of joint ventures and associates at 30%	0.3	(2.1)
Disallowed provisions and expenses	(0.5)	(4.4)
Profits relieved by capital losses or non-taxable gains	1.8	1.1
Unrelieved overseas tax	(0.2)	–
Increase in temporary differences	(0.4)	(6.2)
Rate adjustment relating to deferred tax	0.3	–
Adjustments in respect of prior years	0.4	1.0
Total income tax (expense)/credit in the income statement	(3.8)	7.7

The income tax above does not include any amounts for joint ventures and associates, whose results are disclosed in the income statement net of tax.

The current tax liabilities of £1.8 million (2006: £2.7 million) represent the amount of income taxes in respect of current and prior periods

Accumulated tax losses carried forward, mainly in the United Kingdom, are estimated at £17.0 million (2006: as reported £9.6 million; revised £16.2 million)

The elements of deferred taxation are as follows.

	2007 £m	2006 £m
Accelerated capital allowances	1.9	1.4
Short-term temporary differences	5.1	8.6
Retirement benefit obligations	14.2	20.6
Deferred tax asset	21.2	30.6

The movements in the deferred taxation balance were as follows:

	2007 £m	2006 £m
Asset at 1 January	30.6	31.1
Amount (charged)/credited to the income statement	(4.0)	6.6
Adjustments in respect of prior years	(0.4)	0.8
Amount charged to equity	(5.0)	(7.9)
Asset at 31 December	21.2	30.6

	2007 £m	2006 £m
Deferred tax recognised in the income statement:		
Accelerated capital allowances	0.5	(0.3)
Short-term temporary differences	(3.4)	9.1
Retirement benefit obligations	(1.5)	(1.4)
Deferred tax recognised directly in equity:		
Relating to defined benefit pension scheme	(3.3)	(7.8)
Tax rate adjustment to brought forward amounts	(1.7)	-
Relating to cash flow hedges	-	(0.1)

Factors that may affect future tax charges are:

(a) No deferred tax has been recognised on the un-remitted earnings of overseas subsidiaries and joint ventures, except where remittances are expected.

(b) The Group has potential deferred tax assets in its UK operations that have not been recognised at 31 December 2007 on the basis that their future economic benefits were not assured at the balance sheet date.

The full potential deferred tax assets not recognised at 31 December 2007 at 28% (2006: 30%) were:

	Group		Company	
	2007 £m	2006 £m	2007 £m	2006 £m
Accelerated capital allowances	1.0	0.3	-	-
Short-term temporary differences	5.6	6.7	0.1	0.2
Trading tax losses	5.6	3.9	-	-
Management expenses and charges	15.9	17.1	15.9	17.1
Total temporary differences	28.1	28.0	16.0	17.3
Surplus ACT	9.6	10.2	-	-
Capital losses	77.8	84.4	68.0	73.6

The increase in temporary differences and capital losses in respect of the current year was £0.4 million.

There are no expiry dates and tax relief will be obtained if suitable profits arise in future accounting periods.

Notes to the financial statements

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9 Property, plant & equipment – Group

	Land and buildings			Plant and equipment	Total
	Freehold	Leasehold			
	£m	Over 50 years £m	50 years and under £m	£m	£m
Cost					
At 1 January 2006	1.1	0.3	0.1	13.7	15.2
Currency realignment	-	-	-	(0.3)	(0.3)
Additions	0.1	0.1	-	1.7	1.9
Disposals	-	-	-	(0.5)	(0.5)
At 31 December 2006	1.2	0.4	0.1	14.6	16.3
At 1 January 2007	1.2	0.4	0.1	14.6	16.3
Currency realignment	-	-	-	(0.3)	(0.3)
Additions	-	-	0.1	0.7	0.8
Disposals	-	(0.1)	-	(0.2)	(0.3)
Disposal of subsidiary	-	-	-	(1.3)	(1.3)
At 31 December 2007	1.2	0.3	0.2	13.5	15.2
Depreciation					
At 1 January 2006	0.1	0.1	-	9.1	9.3
Currency realignment	-	-	-	(0.1)	(0.1)
Provided in year	-	0.1	-	1.6	1.7
Disposals	-	-	-	(0.3)	(0.3)
At 31 December 2006	0.1	0.2	-	10.3	10.6
At 1 January 2007	0.1	0.2	-	10.3	10.6
Currency realignment	-	-	-	(0.1)	(0.1)
Provided in year	-	-	-	1.9	1.9
Disposals	-	(0.1)	-	(0.2)	(0.3)
Disposal of subsidiary	-	-	-	(0.4)	(0.4)
At 31 December 2007	0.1	0.1	-	11.5	11.7
Net book value					
At 31 December 2007	1.1	0.2	0.2	2.0	3.5
At 31 December 2006	1.1	0.2	0.1	4.3	5.7
At 1 January 2006	1.0	0.2	0.1	4.6	5.9

Freehold land and buildings includes land of £0.7 million (2006: £0.7 million) on which no depreciation has been charged.

Included in the total net book value of plant and equipment is £0.1 million (2006: £0.2 million) in respect of assets held under finance leases. Depreciation for the year on these assets was £0.1 million (2006: £0.1 million).

10 Intangible assets – Group

	2007 £m	2006 £m
Cost		
At 1 January	4.8	3.9
Additions	0.2	0.9
At 31 December	5.0	4.8
Amortisation		
At 1 January	1.4	0.4
Provided in year	0.9	1.0
At 31 December	2.3	1.4
Net book value		
At 31 December	2.7	3.4
At 1 January	3.4	3.5

Net book value of intangible assets comprises £2.5 million (2006: £3.3 million) relating to software development costs and £0.2 million (2006: £0.1 million) relating to software licences.

Notes to the financial statements

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11 Investments Group

	Joint ventures £m	Associates £m	Loans to joint ventures £m	Loans to associates £m	Other investments £m	Total £m
Cost or fair value						
At 1 January 2006	21.8	0.5	1.2	4.1	4.4	32.0
Currency realignment	(0.7)	-	-	-	-	(0.7)
Additions	0.1	-	8.5	1.7	-	10.3
Disposals	-	-	-	-	(3.4)	(3.4)
Fair value adjustment	-	-	-	-	2.6	2.6
At 31 December 2006	21.2	0.5	9.7	5.8	3.6	40.8
At 1 January 2007	21.2	0.5	9.7	5.8	3.6	40.8
Currency realignment	1.6	-	-	-	-	1.6
Additions	-	0.2	9.3	0.8	-	10.3
Disposals	-	(0.4)	(1.8)	(4.6)	(3.6)	(10.4)
At 31 December 2007	22.8	0.3	17.2	2.0	-	42.3
Share of post-acquisition reserves						
At 1 January 2006	3.2	(3.7)	-	-	-	(0.5)
Currency alignment	-	0.4	-	-	-	0.4
Total recognised income and expense	(10.1)	0.1	-	-	-	(10.0)
At 31 December 2006	(6.9)	(3.2)	-	-	-	(10.1)
At 1 January 2007	(6.9)	(3.2)	-	-	-	(10.1)
Currency alignment	0.5	-	-	-	-	0.5
Total recognised income and expense	(1.7)	3.9	-	-	-	2.2
At 31 December 2007	(8.1)	0.7	-	-	-	(7.4)
Amounts written off						
At 1 January 2006	-	(0.2)	-	-	-	(0.2)
Additions	-	-	-	(2.7)	-	(2.7)
At 31 December 2006	-	(0.2)	-	(2.7)	-	(2.9)
At 1 January 2007	-	(0.2)	-	(2.7)	-	(2.9)
Disposals	-	0.2	-	2.7	-	2.9
At 31 December 2007	-	-	-	-	-	-
Reclassification (see page 81)						
At 1 January 2006	2.6	3.6	(1.0)	(1.1)	-	4.1
During the year	8.1	0.5	(5.4)	-	-	3.2
At 31 December 2006	10.7	4.1	(6.4)	(1.1)	-	7.3
At 1 January 2007	10.7	4.1	(6.4)	(1.1)	-	7.3
During the year	3.6	(2.9)	(3.5)	0.7	-	(2.1)
At 31 December 2007	14.3	1.2	(9.9)	(0.4)	-	5.2
Net book value						
At 31 December 2007	29.0	2.2	7.3	1.6	-	40.1
At 31 December 2006	25.0	1.2	3.3	2.0	3.6	35.1
At 1 January 2006	27.6	0.2	0.2	3.0	4.4	35.4

Group – continued

Presentation in the balance sheet in respect of joint ventures and associates restricts the minimum carrying value to £Nil. If the carrying value becomes negative, the corresponding value of any loans or other advances to those investments is reduced or, where future funding obligations exist, a provision is made. These transfers are shown within the reclassifications.

The analysis of the Group's share of joint ventures and associates is set out below

	2007					2006				
	Alcaldesa Holding SA £m	4Delivery Ltd £m	Other joint ventures £m	Associates £m	Total £m	Alcaldesa Holding Ltd £m	4Delivery Ltd £m	Other joint ventures £m	Associates £m	Total £m
Revenue	3.6	93.8	25.1	7.8	130.3	13.2	84.6	26.5	13.6	137.9
Profit/(loss) before tax	0.4	–	0.3	0.9	1.6	6.1	–	(10.9)	0.1	(4.7)
Income tax expense	(0.2)	–	(0.1)	(0.4)	(0.7)	(2.2)	–	(0.1)	–	(2.3)
Profit/(loss) for the period	0.2	–	0.2	0.5	0.9	3.9	–	(11.0)	0.1	(7.0)
Non-current assets	7.7	–	4.2	0.5	12.4	5.7	–	7.2	2.4	15.3
Current assets	31.0	21.5	114.3	58.6	225.4	33.6	25.1	82.1	51.4	192.2
Current liabilities	(1.9)	(21.5)	(25.5)	(6.9)	(55.8)	(8.1)	(25.1)	(20.0)	(12.9)	(66.1)
Non-current liabilities	(10.6)	–	(90.2)	(50.0)	(150.8)	(7.3)	–	(68.2)	(39.7)	(115.2)
Investments in joint ventures and associates	26.2	–	2.8	2.2	31.2	23.9	–	1.1	1.2	26.2
Financial commitments	–	–	10.3	–	10.3	–	–	9.3	–	9.3
Capital commitments	–	–	50.8	–	50.8	–	–	25.1	–	25.1

Net interest payable by joint ventures and associates in 2007 was £0.3 million (2006: £1.8 million receivable).

The applicable interest rates are income of 3.0%-5.4% per annum (2006: 3.2%-5.2%) and expense of 4.5%-12.5% per annum (2006: 4.5%-12.1%).

The financial commitments relate to joint ventures involved in PFI schemes and the capital commitments to construction work being undertaken by the Costain Group. All figures are the Group's share.

The analysis of the total revenue, income, assets and liabilities of joint ventures and associates in which the Group has an interest is set out below:

	2007					2006				
	Alcaldesa Holding SA £m	4Delivery Ltd £m	Other joint ventures £m	Associates £m	Total £m	Alcaldesa Holding Ltd £m	4Delivery Ltd £m	Other joint ventures £m	Associates £m	Total £m
Revenue	7.2	234.4	50.3	29.7	321.6	26.4	211.3	53.2	41.9	332.8
Profit/(loss) before tax	0.7	0.1	0.4	3.2	4.4	12.3	–	(20.1)	(1.1)	(8.9)
Income tax expense	(0.4)	–	(0.1)	(1.5)	(2.0)	(4.4)	–	(0.2)	–	(4.6)
Profit/(loss) for the period	0.3	0.1	0.3	1.7	2.4	7.9	–	(20.3)	(1.1)	(13.5)
Non-current assets	15.3	–	8.5	1.6	25.4	11.4	–	14.3	8.0	33.7
Current assets	62.0	53.8	274.4	206.4	596.6	67.2	62.6	153.7	181.6	465.1
Current liabilities	(3.9)	(53.7)	(53.3)	(29.6)	(140.5)	(16.2)	(62.6)	(39.2)	(48.7)	(166.7)
Non-current liabilities	(21.1)	–	(222.7)	(169.4)	(413.2)	(14.6)	–	(126.5)	(135.7)	(276.8)
Equity	52.3	0.1	6.9	9.0	68.3	47.8	–	2.3	5.2	55.3

Details of the principal subsidiary undertakings, joint ventures and associates are shown in note 23.

Notes to the financial statements

continued

11 Investments – continued

Company

Investments in subsidiaries	£m
Cost	
At 1 January 2006 as restated	387.8
Additions	0.3
At 31 December 2006 as restated	388.1
Additions	0.2
At 31 December 2007	388.3
Amounts written off	
At 1 January 2006	269.5
Additions	6.0
At 31 December 2006 and 31 December 2007	275.5
Net book value	
At 31 December 2007	112.8
At 31 December 2006 as restated	112.6
At 1 January 2006 as restated	118.3

Additions relate to the application of IFRIC 8 Scope of IFRS 2.

12 Trade and other receivables

	Group		Company	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts included in current assets:				
Trade receivables	83.8	107.8	-	-
Other receivables	8.2	5.8	-	-
Amounts due from customers for contract work	45.8	35.7	-	-
Prepayments and accrued income	4.9	3.0	0.7	0.2
Amounts owed by joint ventures and associates	7.6	8.3	-	-
Amounts owed by subsidiary undertakings	-	-	3.1	1.4
	150.3	160.6	3.8	1.6
Amounts included in non-current assets:				
Other receivables	6.7	10.1	-	-

At 31 December 2007, amounts due from customers for contract work falling due within one year and other receivables falling due after more than one year include retentions of £15.9 million (2006: £20.6 million) relating to construction contracts in progress.

The directors consider that the carrying amount of trade and other receivables approximates to their fair value. Based on prior experience, the directors believe that the trade receivables are recoverable and there is no allowance for doubtful debts (2006: £Nil).

The average credit period within trade receivables on amounts billed for construction work and on sales of goods is 41 days (2006: 53 days). The analysis of the due dates of the trade receivables was £50.1 million (2006: £79.0 million) due within 30 days, £32.7 million (2006: £27.8 million) due between 30 days and 60 days and £1.0 million (2006: £1.0 million) due after 60 days.

Included in the Group's trade receivables balance are debtors with a carrying amount of £7.2 million (2006: £17.3 million), which are past due at the reporting date for which the Group has not provided as there has not been a significant change in credit quality and the amounts are considered recoverable. The Group does not hold any collateral over these balances.

The aggregate amount of costs incurred plus recognised profits (less recognised losses) for all contracts in progress at the balance sheet date was £1,796.2 million (2006: £1,209.1 million).

13 Cash and cash equivalents

Cash and cash equivalents are analysed below, and include the Group's share of cash held by jointly controlled operations of £28.8 million (2006: £22.0 million).

	Group		Company	
	2007 £m	2006 £m	2007 £m	2006 £m
Cash and cash equivalents	133.4	56.4	60.1	32.7
Bank overdrafts	-	(1.4)	-	-
Cash and cash equivalents in the cash flow statement	133.4	55.0	60.1	32.7

14 Interest bearing loans and borrowings – Group

	2007 £m	2006 £m
Current liabilities:		
Finance leases	-	0.1
Bank loans	0.6	1.6
Total interest bearing loans and borrowings	0.6	1.7

The minimum lease payments under finance leases amount to £Nil (2006: £0.1 million).

15 Financial instruments

The Group's centralised treasury function manages the Group's financial risk, principally arising from movements in foreign currency rates, interest rates and inflation rates, and liquidity and funding risks. To manage these risks, the Group uses forward foreign currency sale and purchase contracts in respect of its foreign currency requirements and its PFI investments have entered into interest rate and RPI swaps. The Group does not enter into speculative transactions. The Company does not have any forward foreign currency contracts or other derivatives.

Interest rate risk

The Group has interest bearing borrowing facilities available. However, no interest rate hedging is currently being undertaken by the Group and its subsidiary undertakings. The Group's PFI investments have entered into interest rate derivatives as a means of hedging interest rate risk. The PFI investments' policy is to fix the interest cost on variable rate financing on specific PFI projects by taking out floating to fixed interest rate swaps; these swaps are designated to hedge underlying debt obligations and are expected to be effective for cash flow hedge accounting purposes.

A 1% rise in interest rates would have increased the annual net interest income on the Group's cash balances by £0.4 million.

Inflation risk

The Group's PFI investments have entered into RPI derivatives as a means of hedging inflation risk. These RPI swaps hedge the variability of inflation over the concession period. The Unitary Payment received as revenue is 100% RPI linked, thus in order to hedge this potential movement a proportion of the unitary payment is fixed in order to match the underlying fixed cost within the project. The proportion of revenue that is fixed will vary from project to project but will ensure that neither debt servicing nor shareholder returns vary too widely.

Foreign currency risk

The Group has transactional currency exposures arising from sales or purchases by its operating companies in currencies other than the operating company's measurement currency. Its current strategy is to hedge 100% of both committed and forecast foreign currency exposures where applicable and where the transaction timing and amount can be determined reliably and no natural hedge exists. It is not the Group's policy to enter into forward contracts until a firm commitment is in place. The Group's policy is to negotiate the terms of the hedge derivatives to match the terms of the hedged item to maximise hedge effectiveness.

At 31 December 2007, the net monetary assets denominated in currencies other than the functional currency of the operation involved were Hong Kong dollar denominated net liabilities of £0.6 million (2006: £0.7 million), US Dollar denominated net assets of £2.6 million (2006: £1.4 million) and Euro denominated net assets of £0.3 million (2006: £0.2 million) in the books of sterling companies. A 1% strengthening in the US Dollar would have adversely impacted the results by £0.2 million.

Notes to the financial statements

continued

15 Financial instruments – continued

Cash flow hedges

At 31 December 2007, the Group held five foreign currency contracts designated as hedges of expected future sales to customers for which the Group has firm commitments. The Group also had two foreign currency contracts outstanding at 31 December 2007 designated as hedges of expected future purchases.

The Group classifies its forward exchange contracts, which hedge forecasted transactions, as cash flow hedges and states them at fair value. The net fair value of these contracts at 31 December 2007 was £Nil (2006: £0.1 million (asset)), comprising assets of £Nil (2006: £0.1 million) and liabilities of £Nil (2006: £Nil). These amounts were recognised as fair value derivatives.

The terms of the foreign currency contracts have been negotiated to match the terms of the commitments. There were no ineffective hedges at 31 December 2007 (2006: Nil).

At 31 December 2007, the Group's PFI investments held the following interest rate swaps, which related to the fixing of the interest cost on variable rate debt and are being used to reduce the exposure to interest rate risk, and RPI swaps being used to hedge inflation risk. The Group classifies these swaps as cash flow hedges and states them at fair value. The net fair value of these swaps at 31 December 2007 was £1.7 million (liability) (£2.4 million less tax of £0.7 million) (2006: £1.7 million (liability) (£2.4 million less tax of £0.7 million)), comprising assets of £2.0 million (2006: £0.7 million) and liabilities of £3.7 million (2006: £2.4 million). These amounts were recognised within the value of the investment or within provisions, as appropriate, as fair value derivatives. £Nil (2006: £Nil) was deemed to be ineffective and recognised in the income statement.

	2007				2006			
	Total £m	Within one year £m	Between one and five years £m	After 5 years £m	Total £m	Within one year £m	Between one and five years £m	After 5 years £m
PFI swap obligations (before tax)								
Interest rate swaps	1.0	–	–	1.0	0.7	–	–	0.7
RPI swaps	1.4	–	–	1.4	1.7	–	–	1.7
	2.4	–	–	2.4	2.4	–	–	2.4

Liquidity and funding risk

Ultimate responsibility for liquidity and funding risk rests with the Board of directors, which has put in place a monitoring and reporting framework to manage the Group's requirements. The Group manages liquidity risk by monitoring actual and forecast cash flows and the maturity profile of financial assets and liabilities and by maintaining adequate cash reserves and banking and surety bonding facilities. During 2007, the Group raised £59.8 million (net of expenses) by way of a rights issue to increase liquidity and negotiated increased banking and surety bonding facilities.

The Group has the following committed unsecured borrowing facilities available:

	2007 £m	2006 £m
Expiring between one and two years	25.0	20.0

Financial liabilities and assets

The Group's financial liabilities were all due within one year, at floating rate and denominated in the following currencies:

	2007 £m	2006 £m
Overdraft – Sterling	–	1.0
Finance lease liabilities – Sterling	–	0.1
Bank overdrafts – UAE Dirhams	–	0.2
Bank overdraft – Kuwait Dinars	–	0.2
Bank loan – Hong Kong Dollars	0.6	1.6
	0.6	3.1

The bank loans and overdrafts are unsecured

The Company did not have any financial liabilities at 31 December 2007 (2006: £Nil).

The currency and maturity of the Group's financial assets, which comprised of cash and cash equivalents and loans to joint ventures and associates, were as follows:

	2007				2006			
	Total £m	Within one year £m	Between one and five years £m	After 5 years £m	Total £m	Within one year £m	Between one and five years £m	After 5 years £m
Cash and cash equivalents:								
Sterling	128.9	128.9	-	-	52.4	52.4	-	-
UAE Dirhams	2.5	2.5	-	-	0.2	0.2	-	-
US Dollars	0.4	0.4	-	-	1.2	1.2	-	-
Euro	0.5	0.5	-	-	0.5	0.5	-	-
Botswana Pula	0.2	0.2	-	-	0.3	0.3	-	-
Other	0.9	0.9	-	-	1.8	1.8	-	-
	133.4	133.4	-	-	56.4	56.4	-	-
Loans to JVs and associates: Sterling	8.9	2.6	0.2	6.1	5.3	0.8	-	4.5
	142.3	136.0	0.2	6.1	61.7	57.2	-	4.5

The effective interest rates of financial assets and liabilities are:

	2007 %	2006 %
Financial assets:		
Cash and cash equivalents	0.0-6.1	2.5-5.1
Loans to JVs and associates	8.4-12.0	8.4-12.0
Current liabilities:		
Overdrafts	-	6.5-8.6
Bank loans	6.0	6.0
Finance leases	-	4.9

The Company's financial assets comprised cash at bank of £60.1 million (2006: £32.7 million) denominated in Pounds sterling and maturing within one year.

There are no significant differences between the carrying values of the Group's financial assets and liabilities and their fair values.

Credit risk

Before entering into a contract with a customer, the Group uses an external credit scoring system to assess the potential customer's credit quality. Only if that assessment is satisfactory will the Group enter into the contract. Transactions involving derivative financial instruments are with counter-parties with whom the Group has a signed netting agreement as well as sound credit ratings. Given their high credit ratings, management do not expect any counter-party to fail to meet its obligations.

At the balance sheet date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet. For further information see note 12.

Notes to the financial statements

continued

16 Trade and other payables

	Group		Company	
	2007 £m	2006 £m	2007 £m	2006 £m
Current liabilities:				
Trade payables	119.3	125.3	-	-
Other payables	29.0	16.0	-	-
Social security	3.3	3.3	-	-
Credit balances on long-term contracts	7.2	6.8	-	-
Accruals and deferred income	109.0	112.6	0.2	0.2
Amounts owed to joint ventures and associates	0.3	2.1	-	-
Amounts owed to subsidiary undertakings	-	-	86.7	115.0
	268.1	266.1	86.9	115.2
Non-current liabilities:				
Accruals and deferred income	3.7	6.6	-	-

At 31 December 2007, credit balances on long-term contracts included advance payments from customers of £Nil (2006: £5.2 million).

The directors consider that the carrying amount of trade payables approximates to their fair value.

The Group has financial risk management policies in place that seek to ensure that all payables are paid within the credit timeframe.

17 Provisions

Group

	Engineering & Construction £m	Void space £m	PFI Investments £m	Other £m	Total £m
Current					
At 1 January 2006	0.1	0.8	-	0.4	1.3
Provided	6.5	0.5	0.2	0.3	7.5
Utilised	(0.1)	(0.5)	-	-	(0.6)
At 31 December 2006	6.5	0.8	0.2	0.7	8.2
At 1 January 2007	6.5	0.8	0.2	0.7	8.2
Provided	-	0.1	0.6	0.4	1.1
Utilised	(6.1)	(0.7)	-	(0.1)	(6.9)
Transfer	0.8	-	-	-	0.8
Reversed	(0.2)	-	-	(0.3)	(0.5)
At 31 December 2007	1.0	0.2	0.8	0.7	2.7
Non-current					
At 1 January 2006	1.5	0.2	4.1	1.0	6.8
Currency alignment	-	-	-	(0.1)	(0.1)
Provided	-	0.1	-	0.1	0.2
Utilised	-	(0.1)	(2.7)	-	(2.8)
At 31 December 2006	1.5	0.2	1.4	1.0	4.1
At 1 January 2007	1.5	0.2	1.4	1.0	4.1
Provided	-	0.2	1.5	-	1.7
Transfer	(0.8)	-	-	-	(0.8)
At 31 December 2007	0.7	0.4	2.9	1.0	5.0

Company

	Obligations to non-trading overseas subsidiary £m	Other £m	Total £m
Current			
At 1 January 2006	0.2	0.1	0.3
Provided	–	0.5	0.5
Utilised	(0.1)	–	(0.1)
At 31 December 2006	0.1	0.6	0.7
At 1 January 2007	0.1	0.6	0.7
Provided	–	0.1	0.1
Transfer	0.3	–	0.3
Utilised	(0.1)	(0.5)	(0.6)
At 31 December 2007	0.3	0.2	0.5
Non-current			
At 1 January 2006	1.5	0.1	1.6
Provided	0.1	–	0.1
At 31 December 2006	1.6	0.1	1.7
At 1 January 2007	1.6	0.1	1.7
Provided	–	0.2	0.2
Transfer	(0.3)	–	(0.3)
Utilised	(0.4)	–	(0.4)
At 31 December 2007	0.9	0.3	1.2

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

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

PFI investment provisions relate to interest rate and other swaps entered into by PFI investments, where the resulting carrying value of the investment would be negative and the Group has an obligation to provide further funding. The provisions are expected to reverse over the lives of the concessions, which can extend up to thirty-two years.

Other provisions mainly comprise remedial costs and litigation provisions most of which will be utilised over the next year and a provision for staff benefits payable to the staff of an overseas subsidiary company, which will be utilised over the next five years.

Provisions in the Company relate mainly to funding obligations to a non-trading overseas subsidiary. The provision eliminates on consolidation.

Notes to the financial statements

continued

18 Employee benefits

Pensions

The Group operates a defined benefit pension scheme in the United Kingdom and a number of defined contribution type pension plans in the United Kingdom and overseas. Contributions are paid by subsidiary undertakings and employees. The total pension charge for the Group in the income statement was £7.2 million (2006: £7.1 million). The Company does not operate a pension scheme

Defined benefit scheme

The defined benefit scheme was closed to new members on 1 June 2005 and from 1 April 2006, future benefits were calculated on a Career Average Revalued Earnings basis. A full actuarial valuation of the defined benefit scheme was carried out at 31 March 2007 and was updated to 31 December 2007 by a qualified independent actuary.

	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligations	(511.1)	(509.4)	(501.9)
Fair value of scheme assets	460.5	440.7	402.6
Recognised liability for defined benefit obligations	(50.6)	(68.7)	(99.3)

Movements in present value of defined benefit obligations.

	2007 £m	2006 £m
At 1 January	509.4	501.9
Current service cost	5.8	5.9
Past service cost	1.2	1.2
Interest cost	25.8	23.6
Actuarial gains	(15.9)	(8.5)
Benefits paid	(19.5)	(19.2)
Contributions by members	4.3	4.5
At 31 December	511.1	509.4

Movements in fair value of scheme assets:

	2007 £m	2006 £m
At 1 January	440.7	402.6
Expected return on scheme assets	26.7	24.1
Actuarial (losses)/gains	(4.2)	17.5
Contributions by employer	12.5	11.2
Contributions by members	4.3	4.5
Benefits paid	(19.5)	(19.2)
At 31 December	460.5	440.7

Expense recognised in the income statement:

	2007 £m	2006 £m
Current service cost	5.8	5.9
Past service cost	1.2	1.2
Interest cost on defined benefit obligations	25.8	23.6
Expected return on scheme assets	(26.7)	(24.1)
Total	6.1	6.6

The expense is recognised in the following line items in the income statement:

	2007 £m	2006 £m
Cost of sales	6.2	6.3
Administrative expenses	0.8	0.8
Financial income	(26.7)	(24.1)
Finance costs	25.8	23.6
Total	6.1	6.6

The history of the scheme for the last four years is as follows.

	2007	2006	2005	2004
Experience adjustments.				
Experience gain/(loss) on scheme liabilities (£m)	6.5	-	10.2	(9.0)
	1%	-	2%	(2%)
Change in assumptions on scheme liabilities (£m)	9.4	8.5	(48.3)	(25.2)
	2%	2%	(11%)	(6%)
Experience adjustments on scheme assets (£m)	(4.2)	17.5	38.3	11.4
	(1%)	4%	10%	3%
Total gain/(loss) (£m)	11.7	26.0	0.2	(22.8)
Cumulative gain/(loss) (£m)	15.1	3.4	(22.6)	(22.8)

Cumulative actuarial gains have been reported in the statement of recognised income and expense since 1 January 2004, the transition date to Adopted IFRS.

The fair value of the scheme assets and the return on those assets were as follows

	2007 £m	2006 £m
Equities	262.2	265.3
Government bonds	118.7	147.3
Corporate bonds	49.3	-
Absolute return funds and cash	30.3	28.1
	460.5	440.7
Actual return on scheme assets	22.5	41.6

The pension scheme does not have any assets invested in the Group's financial instruments or property (or other assets) used by the Group

Principal actuarial assumptions (expressed as weighted averages):

	2007 %	2006 %
Discount rate	5.80	5.10
Expected rate of return on scheme assets	6.14	6.09
Future salary increases	3.40	3.00
Future pension increases	3.40	3.00
Inflation assumption	3.40	3.00

The expected rate of return on scheme assets is determined by reference to relevant indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolio.

Weighted average life expectancy from age 65 as per mortality tables used to determine benefits at 31 December 2007 and 31 December 2006 is:

	2007		2006	
	Male (years)	Female (years)	Male (years)	Female (years)
Currently aged 65	20.2	23.0	18.8	21.8
Non-retirees	21.2	24.0	20.0	23.0

The scheme is closed to new entrants and with time the average age of the remaining members will increase. Under the projected unit method, the service cost will increase as the average age of members increases.

Notes to the financial statements

continued

18 Employee benefits – continued

The discount rate, inflation and pension increase and mortality assumptions have a significant effect on the amounts reported. Changes in these assumptions would have the following effects on the Group's defined benefit scheme:

	Pension liability £m	Pension cost £m
Decrease discount rate by 0.2%, increases pension liability and pension cost by:	16.8	0.5
Decrease inflation (and pension increases) by 0.2%, decreases pension liability and pension cost by:	(14.2)	(1.4)
Increase life expectancy by one year, increases pension liability and pension cost by:	15.1	1.1

The Group expects to contribute approximately £16.0 million to its defined benefit scheme in the next financial year.

Defined contribution plans

The Group operates a number of defined contribution pension plans. The total expense relating to these plans in the current year was £1.1 million (2006: £0.5 million).

Share-based payments

The amounts recognised in the income statement (before taxes) for share-based payment transactions with employees is £0.2 million (2006: £0.3 million).

The number of shares granted under the option schemes, the fair value per granted instrument and, where appropriate, the exercise price have been adjusted to take account of the bonus element of the Rights Issue.

Long-term incentive plans and contingent awards

The following outstanding grants of share options and incentive schemes, made after 7 November 2002, arrange for the grant of shares at an exercise price of £1 per option. They have been valued using a Black-Scholes valuation model assuming 2% dividend yield on the 2007 schemes (0% dividend yield pre-2007) and 20% volatility. The expected volatility for the share option arrangements uses historical volatility, determined by the analysis of daily share price movements over the past three years, as a basis for estimating the future volatility. The EPS targets have been adjusted to take account of the capital raised and the increased number of shares in issue.

Arrangement	LTIP 2005	LTIP 2005	LTIP 2006
Date of grant	26 April 2005	19 September 2005	21 April 2006
Number of instruments granted	1,732,974	677,966	3,818,449
Share price at date of grant	47.0p	44.25p	53.5p
Contractual life	4 Years	3.5 Years	4 Years
Vesting conditions	3 year service period & 4 EPS targets of between 3.38p and 4.02p in 2008	3 year service period & 4 EPS targets of between 3.38p and 4.02p in 2008	3 year service period & EPS targets of between 3.25p and 3.69p in 2009
Settlement	Shares	Shares	Shares
Normally exercisable in periods to	25 April 2015	18 September 2015	20 April 2016
Expected option life at grant date	4 Years	3.5 Years	4 Years
Risk-free interest rate	5.0%	5.0%	5.0%
Fair value per granted instrument determined at the grant date	11.9p	11.2p	12.8p
Number of ordinary shares – 2006	1,015,529	677,966	3,609,103
Number of ordinary shares – 2006 restated	1,164,943	777,715	4,140,108
Number of ordinary shares – 2007	1,164,943	777,715	3,773,456

Arrangement	LTIP 2006	LTIP 2007	LTIP 2007
Date of grant	10 October 2006	18 April 2007	14 June 2007
Number of instruments granted	576,310	1,054,901	4,139,642
Share price at date of grant	54.0p	51.0p	48.75p
Contractual life	3 Years	4 Years	4 Years
Vesting conditions	3 year service period & EPS targets of between 3.25p and 3.69p in 2009	3 year service period & EPS targets of between 3.27p and 3.71p in 2010	3 year service period & EPS targets of between 3.27p and 3.71p in 2010
Settlement	Shares	Shares	Cash
Normally exercisable in periods to	9 October 2016	17 April 2017	13 June 2017
Expected option life at grant date	4 Years	4 Years	4 Years
Risk-free interest rate	5.0%	4.5%	4.5%
Fair value per granted instrument determined at the grant date	11.7p	8.4p	7.1p
Number of ordinary shares – 2006	576,310	–	–
Number of ordinary shares – 2006 restated	661,102	–	–
Number of ordinary shares – 2007	661,102	1,210,107	4,614,013

Arrangement	Contingent award
Date of grant	10 October 2006
Number of instruments granted	350,000
Share price at date of grant	54.0p
Contractual life	2 Years
Vesting conditions	4 EPS targets of between 3.38p and 4.02p in 2008
Settlement	Shares
Normally exercisable in periods to	30 April 2009
Expected option life at grant date	3 Years
Risk-free interest rate	5.0%
Fair value per granted instrument determined at the grant date	6.2p
Number of ordinary shares – 2006	350,000
Number of ordinary shares – 2006 restated	401,495
Number of ordinary shares – 2007	401,495

During the year, three participants in the LTIPs left the employ of the Group and ceased to participate in the LTIP 2006 and one ceased to participate in the LTIP 2007 (2006: three participants left the employ of the Group). The only new grants in the year were the 2007 LTIPs.

Notes to the financial statements

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18 Employee benefits – continued

Save As You Earn plans

The following outstanding Save As You Earn plans, made after 7 November 2002 have been valued using a Black-Scholes valuation model assuming 2% dividend yield (0% pre 2007) and 20% volatility

Arrangement	SAYE 2004 3 Year	SAYE 2004 5 Year	SAYE 2007 3 Year	SAYE 2007 5 Year
Date of grant	22 October 2004	22 October 2004	18 May 2007	18 May 2007
Number of instruments granted	4,274,887	3,173,116	5,854,721	4,132,235
Exercise price	29.29p	29.29p	33.30p	33.30p
Share price at date of grant	42.0p	42.0p	47.75p	47.75p
Contractual life	3 Years	5 Years	3 Years	5 Years
Vesting conditions	3 year service period & savings requirement	5 year service period & savings requirement	3 year service period & savings requirement	5 year service period & savings requirement
Settlement	Shares	Shares	Shares	Shares
Normally exercisable in periods to	1 June 2008	1 June 2010	31 December 2010	31 December 2012
Expected option life at grant date	3 Years	5 Years	3 Years	5 Years
Risk-free interest rate	4.5%	4.5%	4.5%	4.5%
Fair value per granted instrument determined at the grant date	11.83p	14.28p	11.27p	12.63p
Number of ordinary shares – 2006	3,241,490	2,480,656	–	–
Number of ordinary shares – 2006 restated	3,718,258	2,845,575	–	–
Number of ordinary shares – 2007	2,027,273	2,316,405	6,356,539	4,560,142

The recognition and measurement principles in IFRS 2 have not been applied to share option arrangements granted before 7 November 2002 in accordance with transitional provisions in IFRS 1 and IFRS 2. At 31 December 2007, share options outstanding under exempt arrangements related to the SAYE 2002 5 year Plan. Under this plan, which vested during the year, 3,406,509 shares remained under option, exercisable to 1 June 2008 at a price of 17.43p per share. At 31 December 2006, there were 7,759,977 (as restated) shares under option under this arrangement.

The number and weighted average exercise prices of share options issued under all SAYE plans is as follows:

	2007		2006	
	Weighted average exercise price p	Number of options	Weighted average exercise price p	Number of options
Outstanding at the beginning of the period	26.2	12,486,940	26.1	14,648,785
Adjustment for bonus element of Rights Issue	–	1,836,870	–	–
Forfeited during the period	29.1	(2,925,089)	29.2	(1,228,185)
Exercised during the period	17.6	(4,187,731)	20.0	(933,660)
Granted during the period	33.3	11,455,878	–	–
Outstanding at the end of the period	29.5	18,666,868	26.2	12,486,940
Exercisable at the end of the period	21.9	5,443,782	–	–

The share options exercised during the year related to the SAYE 2002 5 year Plan and the SAYE 2004 3 year Plan.

19 Share capital of Costain Group PLC

	2007		2006	
	Number	Nominal value £	Number	Nominal value £
Authorised share capital –				
Ordinary shares of 5p each	1,014,788,000	50,739,400	746,863,648	37,343,182
Shares in issue at beginning of year –				
Ordinary shares of 5p each, fully paid	357,231,292	17,861,565	356,141,452	17,807,073
Issued in year (see below)	271,637,358	13,581,868	1,089,840	54,492
Shares in issue at end of year –				
Ordinary shares of 5p each, fully paid	628,868,650	31,443,433	357,231,292	17,861,565

The five-year savings contract in the Company's 2002 Save As You Earn Plan and the three-year savings contract in the Company's 2004 Save As You Earn Plan matured in December 2007. The Company made an application for a block listing of 10,511,630 ordinary shares of 5p each in the capital of the Company on 11 November 2007. This was the maximum number of shares, at that time, required to satisfy the options granted to employees under the two savings contracts. By 31 December 2007, a total of 3,713,889 ordinary shares of 5p each had been allotted to employees, raising £0.7 million

On 14 September 2007, the Company announced a Rights Issue, which was approved by shareholders on 2 October 2007. The Company raised £59.8 million (net of expenses of £4.5 million) by the issue of 267,923,469 new ordinary shares at 24 pence per share on the basis of three new ordinary shares for every four existing ordinary shares. The last date for acceptance was 25 October 2007 and dealing in the new ordinary shares commenced on the London Stock Exchange on 26 October 2007. Following the Rights Issue, the enlarged share capital of the Company was 625,154,761 ordinary shares of 5 pence each

The issued share capital of the Company as at 31 December 2007 was £31,443,432.50 consisting of 628,868,650 ordinary shares of 5p. All shares rank *par passu* regarding entitlement to capital and dividends

The share options outstanding at 31 December 2007 are shown in note 18.

Details of the performance conditions and the options granted to Executive Directors are given in the Directors' remuneration report on pages 49 to 57.

The directors are proposing a dividend of 0.5p per share (2006: Nil), which would have a total cost of £3.1 million. If approved by shareholders at the Annual General Meeting, the dividend is expected to be paid on 23 May 2008. The payment will be matched by a contribution to the Group's defined benefit pension scheme and is included in the expected contributions figure in note 18.

Notes to the financial statements

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20 Capital and reserves

Group	Share capital £m	Share premium £m	Special reserve £m	Fair value reserve £m	Translation reserve £m	Hedging reserve £m	Merger reserve £m	Retained earnings £m	Total equity £m
At 1 January 2006	17.8	0.4	13.1	3.4	(1.2)	(5.0)	–	(51.0)	(22.5)
Total recognised income & expense	–	–	–	(0.8)	–	3.4	–	(35.8)	(33.2)
Share-based payments	–	–	–	–	–	–	–	0.2	0.2
Shares issued (note 19)	0.1	0.2	(0.3)	–	–	–	–	0.3	0.3
At 31 December 2006	17.9	0.6	12.8	2.6	(1.2)	(1.6)	–	(86.3)	(55.2)
At 1 January 2007	17.9	0.6	12.8	2.6	(1.2)	(1.6)	–	(86.3)	(55.2)
Total recognised income & expense	–	–	–	(2.6)	2.1	(0.2)	–	22.6	21.9
Share-based payments	–	–	–	–	–	–	–	0.2	0.2
Shares issued (note 19)	13.5	0.5	(12.8)	–	–	–	46.5	12.8	60.5
Transfer	–	–	–	–	–	–	(46.5)	46.5	–
At 31 December 2007	31.4	1.1	–	–	0.9	(1.8)	–	(4.2)	27.4

Company	Share capital £m	Share premium £m	Special reserve £m	Non-distributable reserve £m	Merger reserve £m	Retained earnings £m	Total equity £m
At 1 January 2006 as previously reported	17.8	0.4	13.1	–	–	(0.9)	30.4
Prior year adjustment	–	–	–	0.2	–	–	0.2
At 1 January 2006 as restated	17.8	0.4	13.1	0.2	–	(0.9)	30.6
Total recognised income & expense	–	–	–	–	–	(3.7)	(3.7)
Share-based payments	–	–	–	0.3	–	–	0.3
Shares issued (note 19)	0.1	0.2	(0.3)	–	–	0.3	0.3
At 31 December 2006 as restated	17.9	0.6	12.8	0.5	–	(4.3)	27.5
1 January 2007 as restated	17.9	0.6	12.8	0.5	–	(4.3)	27.5
Total recognised income & expense	–	–	–	–	–	(1.8)	(1.8)
Share-based payments	–	–	–	0.2	–	–	0.2
Shares issued (note 19)	13.5	0.5	(12.8)	–	46.5	12.8	60.5
Transfer	–	–	–	–	(46.5)	46.5	–
At 31 December 2007	31.4	1.1	–	0.7	–	53.2	86.4

At 31 December 2007, the cumulative goodwill written off through retained earnings on acquisitions prior to 1 January 1998 amounted to £3.3 million (2006: £3.3 million)

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

Merger reserve

As disclosed in note 19, during the year the Company raised £59.8 million (net of expenses) through a Rights Issue. The Rights Issue was effected through a structure, which resulted in a merger reserve arising under Section 131 of the Companies Act. Following the receipt of the cash proceeds through the structure, the excess of the net proceeds over the nominal value of the share capital issued has been transferred to retained earnings.

Non-distributable reserve

Costain Group PLC (the Company) grants three of its subsidiaries rights to its equity instruments. The Group adopted IFRIC 8 in 2007 in order to recognise these grants in the parent company. The impact is recognised within the non-distributable reserve and has been implemented by prior year adjustment with comparative figures restated.

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Company, as well as from the translation of liabilities that hedge the Group's net investment in a foreign subsidiary.

Special reserve

On 18 May 2005, Court approval of a capital restructuring was granted under which the deficit on the Company's retained earnings was eliminated using a special reserve created from restructuring the share capital and the share premium. This reserve can be released to the extent the Company issues new shares. Following the share issues during 2007, the remaining balance on the reserve has been released

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

21 Contingent liabilities

	Group		Company	
	2007 £m	2006 £m	2007 £m	2006 £m
Under guarantees of bank overdrafts and loans:				
To subsidiary undertakings	-	-	0.5	3.0

Certain subsidiary undertakings have entered into cross-guarantees for overdraft facilities made available to the Group. At 31 December 2007, these liabilities amounted to £Nil (2006: £1.0 million)

There are also contingent liabilities in respect of:

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

22 Other financial commitments**Group****Leases as lessee**

	2007		2006	
	Land and buildings £m	Other operating leases £m	Land and buildings £m	Other operating leases £m
Total operating lease commitments under non-cancellable leases are as follows.				
Within one year	4.0	2.2	3.7	2.1
Between one and five years	15.6	1.7	12.4	2.0
After five years	15.5	-	5.4	-
	35.1	3.9	21.5	4.1

Leases as lessor

	2007 £m	2006 £m
Land and buildings		
Total income commitments under non-cancellable leases expiring:		
Within one year	1.6	1.4
Between one and five years	5.4	4.9
After five years	1.1	2.2
	8.1	8.5

Company

The Company does not have any financial commitments (2006: £Nil).

Notes to the financial statements

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23 Principal subsidiary undertakings, jointly controlled entities and jointly controlled operations

	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 Building & Civil Engineering Ltd	Civil Engineering & Building	100 [^]	UK
Costain Construction (Botswana) Pty Ltd	Civil Engineering & Building	100 [^]	Botswana
Costain Engineering & Construction Ltd	Holding Company & Service Company	100	UK
Costain International Ltd	Civil Engineering & Building	100 [^]	UK
Costain Ltd	Civil Engineering & Building	100 [^]	UK
Costain Oil, Gas & Process Ltd	Process Engineering	100 [^]	UK
Costain Zimbabwe (Pvt) Ltd	Civil Engineering & Building	85 [^]	Zimbabwe
Richard Costain Ltd	Service Company	100	UK

	Activity	Issued share capital £m	Percentage of equity held	Country of incorporation	Reporting date
Jointly controlled entities					
ACM Health Solutions Ltd	Construction of Hospitals	–	33 [^]	UK	31 Dec
Alcaidesa Holding SA	Property Development	9.2	50 [^]	Spain	31 Dec
Arden Partnership (Derby) Holdings Ltd	Construction & Operation of Hospital	–	50 [^]	UK	31 Dec
Arden Partnership (Leicester) Holdings Ltd	Construction & Operation of Hospital	–	50 [^]	UK	31 Dec
Arden Partnership (Lincolnshire) Holdings Ltd	Construction & Operation of Hospital	–	50 [^]	UK	31 Dec
China Harbour–Costain Mexico S de RL de CV	Civil Engineering & Building	–	50 [^]	Mexico	31 Dec
Costain Petrofac Ltd	Process Engineering	–	50 [^]	UK	31 Dec
4Delivery Ltd	Civil Engineering	–	40 [^]	UK	31 Mar
Integrated Care Solutions (East Kent) Holdings Ltd	Operation of Care Homes	0.1	50 [^]	UK	31 Dec
Integrated Care Solutions (Shropshire) Holdings Ltd	Operation of Care Homes	0.1	50 [^]	UK	31 Dec
Integrated Bradford LEP Ltd	Construction & Operation of Schools	0.1	40 [^]	UK	31 Mar
Integrated Bradford SPV One Ltd	Construction & Operation of Schools	0.1	29 [^]	UK	31 Mar
Lewisham Schools for the Future LEP Ltd	Construction & Operation of Schools	0.1	40 [^]	UK	31 Mar
Lewisham Schools for the Future SPV Ltd	Construction & Operation of Schools	–	40 [^]	UK	31 Mar
Seafort Holdings Ltd	Construction & Operation of Schools	–	45 [^]	UK	31 Mar
Associates					
Coast to Coast Holdings Ltd	Asset Management	0.5	20 [^]	UK	31 Mar
C2C Services Ltd	Asset Management	–	20 [^]	UK	31 Mar
Kent Education Partnership Ltd	Construction & Operation of Schools	–	30 [^]	UK	31 Dec
Prime Care Solutions (Kingston) Holdings Ltd	Construction & Operation of Hospital	–	40 [^]	UK	31 Dec

[^] Equity capital held by subsidiary undertakings

* Treated as subsidiary undertakings due to Costain having power to influence and control of the composition of the board of directors

All undertakings operate mainly in the country of incorporation, with the exception of Costain Ltd, which operates inside and outside of the UK and Costain Building & Civil Engineering Ltd and Costain International Ltd, which operate outside the UK. All holdings are of ordinary shares except Richard Costain Ltd, where Costain Group PLC holds 100% of the ordinary and preference shares. A full list of Group companies will be included in the Company's annual return.

	Activity	Percentage held	Country of operation
Major jointly controlled operations			
A-one+ Integrated Highway Services – MAC 10	Civil Engineering	25	UK
Black & Veatch-Costain Joint Venture – Margate & Broadstairs	Civil Engineering	50	UK
Costain-Bachy Soletanche – Canary Wharf	Civil Engineering	50	UK
Costain-China Harbour-Aarsleff Joint Venture	Civil Engineering	45	Hong Kong
Costain-Mowlem Joint Venture – M1 Widening & A5/M1 Link	Civil Engineering	50	UK
Costain-O'Rourke-Bachy-Emcor Rail Consortium – CTRL 105 (Combined)	Civil Engineering	27	UK
Costain-Taylor Woodrow – King's Cross	Civil Engineering	50	UK
Educo UK Joint Venture – Bradford Schools	Building	50	UK
Galliford-Costain-Atkins Joint Venture – United Utilities	Civil Engineering	42	UK
Stream Three Joint Venture – Costain-VWS (UK) Ltd	Civil Engineering	50	UK

24 Related party transactions

The Group has a related party relationship with its major shareholders, subsidiaries, joint ventures and associates, jointly controlled operations and with its directors and executive officers.

	Major shareholders £m	Joint ventures and associates £m	Jointly controlled operations £m	Total £m
2007				
Sales of goods and services to related parties:				
Staff	0.1	19.4	22.6	42.1
Construction services and materials	–	20.6	2.0	22.6
	0.1	40.0	24.6	64.7

Balances with major shareholders at 31 December 2007:

Amounts due from related parties	6.7
Provision (see below)	(6.7)
	–

	Major shareholders £m	Joint ventures and associates £m	Jointly controlled operations £m	Total £m
2006				
Sales of goods and services to related parties:				
Staff	0.4	10.8	16.4	27.6
Construction services and materials	2.1	6.9	13.6	22.6
	2.5	17.7	30.0	50.2

Balances with major shareholders at 31 December 2006

Amounts due from related parties	6.7
Provision (see below)	(6.7)
	–

The Group had related party transactions with its PFI joint ventures and associates of £63.0 million (2006: £81.2 million), in respect of bid costs incurred, construction works undertaken and staff seconded to the PFI companies.

An advance of £0.3 million from a major shareholder outstanding at 31 December 2006 was repaid during the year.

The amount due from a major shareholder relates to work carried out under a subcontract. Discussions among all the parties continue but, due to uncertainty of recovery, full provision was made.

Notes to the financial statements

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24 Related party transactions – continued

Balances with joint ventures and associates are disclosed elsewhere in these accounts. Balances with jointly controlled operations are eliminated on consolidation

The Company has no transactions with related parties (2006: none)

Major shareholders

Mohammed Abdulmohsin Al-Kharafi & Sons WLL and UEM Builders Berhad are regarded as related parties of Costain Group PLC.

Transactions with key management personnel

Directors of the Company and their immediate relatives control 0.1% of the voting shares of the Company.

In addition to their salaries, the Group also provides non-cash benefits to directors and executive officers and contributes to defined contribution pension plans in respect of the executive directors and a defined benefit pension scheme in respect of the other executive officers. Directors and executive officers are eligible to retire at age 60 or 62½.

Executive officers also participate in the Group's share options programmes (note 18).

The compensation of key management personnel (including the directors) is as follows:

	Group	
	2007 £m	2006 £m
Directors' emoluments	1.3	1.2
Executive officers' emoluments	1.5	1.7
Post retirement benefits	0.4	0.1
Compensation for loss of office	–	0.2
Share-based payments	0.2	0.3
Equity compensation benefits	–	0.1
	3.4	3.6

Total remuneration is included in 'personnel expenses' (note 4).

25 Significant areas of judgement

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The Group believes that the most critical accounting policies and significant areas of judgement and estimation arise from the accounting for defined benefit pension schemes under IAS 19 Employee benefits and for long-term contracts under IAS 11 Construction contracts

Defined benefit pension schemes are accounted for in accordance with the advice of independent qualified actuaries but significant judgements are required in relation to the assumptions for inflation, future salary and pension increases, investment returns and member longevity that underpin the valuations. The assumptions in relation to the Group's defined benefit pension scheme are set out in note 18.

A significant amount of the Group's activities are undertaken via long-term contracts. These contracts are accounted for in accordance with IAS 11, which requires estimates to be made for contract costs and revenues

Management base their judgements of contract costs and revenues on the latest available information, which includes detailed contract valuations. In many cases, the results reflect the expected outcome of long-term contractual obligations, which span more than one reporting period. Contract costs and revenues are affected by a variety of uncertainties that depend on the outcome of future events and often need to be revised as events unfold and uncertainties are resolved. The estimates are updated regularly and significant changes are highlighted through established internal review procedures. The impact of the changes in accounting estimates is then reflected in the ongoing results.

The Group undertakes construction contracts that may require it to perform extra or change order work. This can result in negotiations over the extent to which the work is outside the scope of the original contract or the price for the extra work. In addition, many contracts specify the completion schedule requirements and allow liquidated damages to be charged in the event of failure to achieve that schedule; on these contracts, this could result in the Group incurring liquidated damages.

Two significant legacy contracts, in particular, represent potential risks.

Costa Azul Breakwater, Mexico (joint venture between Costain and China Harbour Engineering Company) – significant progress has been made during the year and the contract is nearing completion. The final offshore works are weather related and may be affected by sea conditions. Commercial discussions are ongoing and the Group believes it is entitled to additional monies in respect of the works performed and commercial negotiations to this end have reached an advanced stage. Judgement as to the outcome of these negotiations is required at the balance sheet date and a quantification of the probable recoveries has been made in establishing the anticipated loss on this contract. However, until the Breakwater has been handed over and the final account agreed, there will be some residual risk. The directors quantified this risk as being up to £10 million in the 30 June 2007 interim statements. Whilst this exposure remains, the directors remain confident that the current loss provisions taken on the contract are adequate.

Pemex Nitrogen Rejection Unit, Mexico – Costain is a sub-contractor on this contract, which has suffered substantial delays and cost overruns. Costain and Techint SA de CV, the main contractor, are working together towards its conclusion. Although, if either party fails to meet its respective obligations, the matter may be subject to protracted legal dispute; the directors believe appropriate provision has been made

Five-year financial summary

	2007 £m IFRS	2006 £m IFRS	2005 £m IFRS	2004 £m Restated IFRS	2003 £m UK GAAP*
Revenue and profit					
Revenue (Group and share of joint ventures and associates)	877.9	886.3	773.2	695.2	650.2
Share of joint ventures and associates	(130.3)	(137.9)	(95.1)	(22.0)	(26.7)
Group revenue	747.6	748.4	678.1	673.2	623.5
Group operating profit/(loss)	9.7	(58.4)	8.7	10.2	5.4
Profit on sales of investments	2.7	3.6	-	-	-
Profit on sales of interests in joint ventures and associates	3.2	-	3.5	-	-
Amounts written off loans to associate	-	(2.7)	-	-	-
Share of results of joint ventures and associates	0.9	(7.0)	13.4	(0.9)	10.1
Profit/(loss) from operations	16.5	(64.5)	25.6	9.3	15.5
Financial income	29.6	26.7	23.5	22.9	19.2
Finance costs	(26.3)	(23.9)	(24.1)	(21.7)	(18.6)
Net financing income/(costs)	3.3	2.8	(0.6)	1.2	0.6
Profit/(loss) before tax	19.8	(61.7)	25.0	10.5	16.1
Profit/(loss) for the period attributable to equity holders of the parent	16.0	(54.0)	23.6	8.8	13.2
Earnings/(loss) per share – basic[^]	3.6p	(13.2)p	5.8p	2.2p	3.3p
Earnings/(loss) per share – diluted[^]	3.5p	(13.2)p	5.7p	2.2p	3.2p
[^] (2003 to 2006 restated)					
Summarised consolidated balance sheets					
Property, plant & equipment	3.5	5.7	5.9	4.9	4.9
Intangible assets	2.7	3.4	3.5	0.5	-
Investments	40.1	35.1	35.4	17.9	21.1
Other non-current assets	27.9	40.7	41.3	37.3	23.3
	74.2	84.9	86.1	60.6	49.3
Current assets	285.7	219.4	243.7	217.4	196.0
Total assets	359.9	304.3	329.8	278.0	245.3
Current liabilities	273.2	280.1	238.8	216.4	194.4
Pension liability	50.6	68.7	99.3	99.5	77.8
Other non-current liabilities	8.7	10.7	14.2	6.6	9.7
Total liabilities	332.5	359.5	352.3	322.5	281.9
Net assets/(liabilities)	27.4	(55.2)	(22.5)	(44.5)	(36.6)
Equity attributable to equity holders of the parent	27.4	(55.2)	(22.5)	(44.6)	(36.7)
Minority interests	-	-	-	0.1	0.1
	27.4	(55.2)	(22.5)	(44.5)	(36.6)

* As permitted, the audited result for 2003 has not been restated under IFRS, except the pension liability has been shown separately from the attributable deferred tax

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting of the members will be held at The Cumberland, Great Cumberland Place, London W1A 4RF on Thursday 8 May 2008 at 11 00 am, for the following purposes.

Ordinary business

- 1 To receive and adopt the Directors' report and the audited accounts for the year ended 31 December 2007.
- 2 That a dividend of 0.5p per share in respect of the year ended 31 December 2007 be and is hereby declared due and payable on 23 May 2008 to shareholders on the register at 6.00 pm on 25 April 2008.
- 3 To elect the following directors who offer themselves for re-election. (a) Mr Michael Richard Alexander; (b) Mr James Morley; (c) Mr David Philip Allvey; and (d) Mr Mohd Azman Sulaiman. Mr Alexander and Mr Morley both retire under Article 77 of the Articles of Association having been appointed since the last Annual General Meeting and Mr Allvey and Mr Sulaiman retire by rotation under Article 81. Each re-election will be proposed and voted on as a separate resolution.
- 4 To re-appoint KPMG Audit Plc as auditors of the Company
- 5 To authorise the Directors to determine the remuneration of the Auditors.
- 6 To receive, adopt and approve the Directors' remuneration report for the year ended 31 December 2007.

Special Business

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

- 7 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 £10 470 million provided that this authority shall expire on 7 May 2013 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 conferred hereby had not expired.

- 8 As a special resolution.

That, pursuant to the authority conferred on them by resolution number 7, 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 the allotment of equity securities in connection with a rights issue, open offer or any other pre-emptive offer or a scrip dividend alternative in favour of ordinary shareholders (excluding any shareholder holding shares as treasury shares); and
- (b) to the allotment (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an aggregate nominal value of £1,572,171 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.

- 9 As a special resolution:

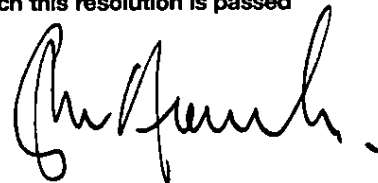
That the Articles of Association produced to this meeting and initialed by the Chairman of this meeting for the purpose of identification be adopted as the Articles of Association for the Company in substitution for, and to the exclusion of, the existing Articles of Association.

- 10 As an ordinary resolution:

Subject to Resolutions 2 and 9 being approved, that the directors be and hereby are authorised to offer and allot ordinary shares to ordinary shareholders in lieu of cash dividend from time to time or for such period as they may determine pursuant to the terms of Article 122 of the Company's Articles of Association, provided that the authority conferred by this resolution shall expire at the end of the fifth Annual General Meeting of the Company after the date on which this resolution is passed

By Order of the Board

Clive L Franks
Secretary
11 March 2008



Notice of Annual General Meeting

continued

Notes:

- 1 A member entitled to attend and vote at the meeting is entitled to appoint a proxy or proxies (who need not be a member of the Company) to exercise all or any of his rights to attend, speak and vote at the meeting. A shareholder may appoint more than one proxy in relation to the AGM provided that each proxy is appointed to exercise the rights attached to a different share or shares held by that member.
- 2 To be effective, a proxy and the authority (if any) under which it is signed or a notanally certified or office copy of such authority must be deposited with the Company's registrars, Equinrt, Aspect House, Spencer Road, Lancing, West Sussex BN99 6LX no later than 11.00 am on Tuesday 6 May 2008. A proxy may be delivered by facsimile to the Company's registrars, Equinrt (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 11.00 am on Tuesday 6 May 2008;
 - (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 notanally certified or office copy of such authority must be delivered to the Company's registrars, Equinrt, Aspect House, Spencer Road, Lancing, West Sussex BN99 6LX no later than 10.00 am on Thursday 8 May 2008.
- 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 6.00 pm on Tuesday 6 May 2008 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 6.00 pm on Tuesday 6 May 2008 shall be disregarded in determining the rights of any person to attend or vote at the meeting.
- 4 In order to facilitate voting by corporate representatives at the meeting, arrangements will be put in place at the meeting so that
 - (a) if a corporate shareholder has appointed the Chairman of the meeting as its corporate representative with instructions to vote on a poll in accordance with the directions of all of the other corporate representatives for that shareholder at the meeting, then on a poll those corporate representatives will give voting directions to the Chairman and the Chairman will vote (or withhold a vote) as corporate representatives in accordance with those directions; and
 - (b) if more than one corporate representative of the same corporate shareholder attends the meeting but the corporate shareholder has not appointed the Chairman of the meeting as its corporate representative, a designated corporate representative will be nominated, from those corporate representatives who attend, who will vote on a poll and the other corporate representatives will give voting directions to that designated corporate representative. Corporate shareholders are referred to the guidance issued by the Institute of Chartered Secretaries and Administrators on proxies and corporate representatives – www.icsa.org.uk – for further details of this procedure. The guidance includes a sample form of representation letter if the Chairman is being appointed as described in (a) above.
- 5 Any person to whom this notice is sent who is a person that has been nominated under Section 146 of the Companies Act 2006 to enjoy information rights (a 'nominated person') does not have a right to appoint a proxy. However, a nominated person may, under an agreement with the registered shareholder by whom they were nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the AGM. Alternatively, if a nominated person does not have such a right, or does not wish to exercise it, they may have a right, under any such agreement to give instructions to the registered shareholder as to the exercise of voting rights.

Electronic proxy appointment through CREST

CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for the Annual General Meeting to be held on 8 May 2008 and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf

In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a 'CREST Proxy Instruction') must be properly authenticated in accordance with EUROCLEAR UK & IRELAND LIMITED's specifications and must contain the information required for such instructions, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or to an amendment to the instruction given to a previously appointed proxy must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID 7RA01) by the latest time(s) for receipt of proxy appointments specified in the notice of meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the message by the CREST Applications Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means

CREST members and, where applicable, their CREST sponsors or voting service providers should note that EUROCLEAR UK & IRELAND LIMITED's does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting service providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Financial calendar

Financial calendar

Half-year results	- announced 14 September 2007 within the Rights Issue Prospectus
Full year results	- announced 12 March 2008
Annual Report 2007	- sent to shareholders 4 April 2008
Annual General Meeting	- to be held 8 May 2008
Interim Management Statement	- to be announced 8 May 2008
Half-year results 2008	- to be announced 27 August 2008
Interim Management Statement	- to be announced 13 October 2008

Dividend

Subject to approval at the Annual General Meeting, a recommended dividend of 0.5p will be payable on 23 May 2008 to ordinary shareholders whose names appear in the Register of Members at the close of business on 25 April 2008. The ex-dividend date is 23 April 2008.

Analysis of Shareholders

	Accounts	Shares (millions)	%
Institutions, companies, individuals and nominees:			
Shareholdings 100,000 and more	226	582.38	92.61
Shareholdings 50,000-99,999	176	12.51	1.99
Shareholdings 25,000-49,999	278	9.67	1.54
Shareholdings 5,000-24,999	1,517	16.46	2.62
Shareholdings 1-4,999	11,756	7.84	1.24
	13,953	628.86	100.00

Secretary and Registered Office

Secretary
Clive L Franks

Registered Office
Costain House
Vanwall Business Park
Maidenhead
Berkshire SL6 4UB

Telephone 01628 842444
www.costain.com
info@costain.com
Company Number 1393773

Registrar
Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Telephone 0871 384 2250
Calls to this number are charged at 8 pence per minute from a BT landline. Other telephony provider costs may vary.

Unsolicited mail

The Company is legally obliged to make its share register available to the general public. Consequently some shareholders may receive unsolicited mail, including correspondence from unauthorised investment firms. Shareholders who wish to limit the amount of unsolicited mail they receive can contact:

The Mailing Preference Service
Freepost (LON20771)
London WE1 0ZT

Shareholder information

The Company's Registrar is Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. For enquiries regarding your shareholding, please telephone 0871 384 2250. You can also view up-to-date information about your holdings by visiting the shareholder website at www.shareview.co.uk. Please ensure that you advise Equiniti promptly of a change of name or address.

ShareGIFT

The Orr Macintosh Foundation (ShareGIFT) operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomic to sell them. Details of the scheme are available on the ShareGIFT website www.sharegift.org. Equiniti can provide stock transfer forms on request. Donating shares to charity in this way gives rise neither to a gain nor a loss for Capital Gains Tax purposes. This service is completely free of charge.

**Costain Group PLC
Costain House
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Maidenhead
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SL6 4UB**

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