COSTAIN GROUP PLC

2016 ANNUAL REPORT & ACCOUNTS

COMPANY NUMBER: 1393773

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COSTAIN GROUP PLC | ANNUAL REPORT 2016

ENGINEERING TOMORROW

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ENGINEERING TOMORROW

Costain helps to improve people's lives by deploying technology-based engineering solutions to meet urgent national needs across the UK's energy, water and transportation infrastructures. We have been shaping the world in which we live for the past 150 years. Our people are committed to delivery, performance and reliability.

UNIQUE BUSINESS MODEL

We offer a broad range **of innovative services** across the whole life-cycle of our customers' assets, through the delivery of **integrated** consultancy, asset optimisation, technology and complex delivery services.

Our services:

Consultancy (advisory, design, programme management)

Complex delivery

Technology

Asset optimisation

Our customer-centric approach enables us to become a trusted partner to our customers. Central to this is our people and the expertise and professionalism they bring, and our 'One Costain' culture, which takes an holistic approach to customer challenges.

4,100+

Experts delivering solutions

1,200

people in technology, advisory or design service roles.

Read more about our business model on **pages 14 to 15**

STRONG MARKET FOCUS

Our focus is on **meeting urgent national needs** in three major areas to improve the quality of key assets and bring benefits to end users.

Our three business areas:

Water

Energy

Transportation

We are focused on the UK market which offers a significant opportunity for Costain.

Our 'Engineering Tomorrow' strategy involves focusing on blue chip customers whose major spending plans are underpinned by strategic national needs, regulatory commitments or essential maintenance requirements.

The markets in which the Costain Group is active have, in total, an anticipated spend of just under,

£92bn

per annum of which over

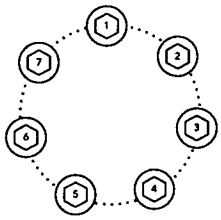
£20bn

per annum is addressable.

Read more about the opportunity in our markets on **pages 16 to 17**

CLEAR SET OF PRIORITIES

Our **'Engineering Tomorrow'** strategy outlines the core areas that we are focusing on in order to create a sustainable business.



1. Unique customer focus
2. Skills and experience of the team
3. Technology integration capability
4. Range of innovative services
5. Financial strength
6. Proven track record
7. Reputation, values and responsibility

Underpinning everything we do are our values:

Customer focused

Open and honest

Safe and environmentally aware

Team players

Accountable

Improving continuously and therefore the ...

Natural choice

Read more about our strategy and performance on **pages 18 to 23**

PROVEN TRACK RECORD

We have a proven history of **delivering results for all our stakeholders** – and continue to create value for customers, society, our people and shareholders.

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+90%

Repeat business

40+

Blue chip customers

Read our divisional and financial reviews on **pages 24 to 27 and 34 to 37**

HIGHLIGHTS

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	2016	2015
Revenue		
– Including share of JVs and associates	**£1,658.0m**	£1,316.5m
– Reported	**£1,573.7m**	£1,263.6m
Operating profit		
– Underlying[1]	**£41.1m**	£33.2m
– Reported	**£34.9m**	£29.6m
Profit before tax		
– Underlying[1]	**£37.5m**	£29.9m
– Reported	**£30.9m**	£26.0m
Basic earnings per share		
– Underlying[1]	**31.5p**	25.1p
– Reported	**25.7p**	21.8p
Net cash balance[2]	**£140.2m**	£108.2m
Dividend per share	**12.7p**	11.0p

1 Before other items; amortisation of acquired intangible assets and employment related and other deferred consideration.

2 Net cash balance is cash and cash equivalents less interest bearing loans and borrowings.

3 2014 earnings per share benefited from a lower tax charge and was based on a lower average number of shares than in 2015.

These are the definitions used throughout the Strategic report.

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To find out more about how Costain collaborates with customers on a wide range of contracts, please visit our website: **costain.com**

THE CHALLENGE

Costain is a key partner in the eight$_2$O alliance – the team responsible for delivering Thames Water's Assets Management Period (AMP) programme. With the key objectives of boosting efficiency and lowering costs, Costain is identifying innovative solutions and utilising the latest technologies to help meet a critical national need by increasing capacity, improving customer service and lowering costs for Thames Water's clients. This strong offering is one that involves collaborative team-working, innovation and a diverse and experienced skill set.

* For more information about our strategic priorities **see page 18 to 23**

CUSTOMER

- Thames Water UK

SERVICES

- Consultancy
- Complex delivery
- Asset optimisation

KEY BENEFITS

- Improved service delivery
- Exceeded regulatory targets
- Reduced costs

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WATER

DELIVERING A SAFE WATER SUPPLY...

Costain is playing a central role in the delivery of the AMP6 five year programme, as part of the eight$_2$O alliance on behalf of Thames Water.

Our focus is on improving and maintaining water quality standards, supply resilience and meeting anticipated demographic shifts. Costain is deploying its full range of integrated capabilities to deliver improved customer service, innovative solutions and achieve significant total expenditure efficiency savings.

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eight$_2$O is a revolutionary platform delivering the AMP programme for Thames Water. We have a fantastic team with a diverse skillset, from design to delivery to asset integration. Working on this programme is a fantastic opportunity for us to develop our presence within the water sector and we look forward to further collaboration in the future."

Craig Reade | Head of Delivery CABV JV of eight$_2$O

ENERGY

...ENSURING ENERGY SECURITY...

Ensuring that the UK has a secure and reliable energy mix is another area of national need in which Costain is playing a key role.

Following completion of a successful Front End Engineering Design (FEED) project, via competitive tender, Costain was awarded a contract by National Grid to upgrade its Peterborough and Huntingdon compressor stations. The primary driver for the programme is to reduce emissions associated with moving gas around the UK to support EU legislation; added benefits include increased system resilience and reduced overall risk on the National Transmission System by replacing ageing assets with modern, efficient equipment.

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This has been a fantastic project to be involved with and has been a great demonstration of our project management capabilities including the deployment of technology-based solutions. We are delivering a high quality result for National Grid."

Gerard Shore | Director, Oil & Gas

THE CHALLENGE

As both compressors are adjacent on the National Transmission Service, they cannot be taken out of service at the same time. The Costain team has devised a complex delivery programme to minimise any impact on the NTS and avoid outages during the winter months. This will ensure National Grid's customers are provided with a seamless service during the project and will benefit from a much enhanced supply when it is completed.

CUSTOMER

- National Grid

SERVICES

- Consultancy

KEY BENEFITS

- Improved environmental performance and efficiency
- Enhanced operational resilience
- Built-in future capacity capability

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THE CHALLENGE

The M1 is one of the UK's major road arteries but road users suffer from excessive traffic levels, congestion and ultimately delays. Costain has been working to transform junctions 28-35 into a Smart Motorway, increasing its capacity, reducing congestion and improving safety. This is achieved by converting the hard shoulder into a running lane, using innovative technology automatically to identify congestion and maintain traffic flows using variable speed limits, ensuring roads are run as efficiently as possible. The new motorway will be complete in 2017 and remain maintenance free for 5 years.

CUSTOMER

- Highways England

SERVICES

Consultancy

- Technology

KEY BENEFITS

- Increasing motorway capacity and reducing congestion
- Faster journey times enabling improved productivity
- Facilitating economic growth along motorway corridors

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TRANSPORTATION

...REVOLUTIONISING BRITAIN'S ROAD NETWORK.

Costain is playing a key role keeping the UK's strategic road network open and available for safe use by all... today and in the future.

Technology-based solutions are ensuring that motorways and other major roads can manage ever-increasing volumes. New technologies are enabling us to upgrade our existing infrastructure and Costain is leading the design and delivery on many of the UK's Smart Motorways. The recent acquisition of SSL has further enhanced Costain's technology offering.

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Costain's Smart Motorways technology will minimise disruption and ensure greater reliability on one of the country's essential strategic roads."

Mal Bell | Project Director, M1 J28-35a Smart Motorway Scheme

CHAIRMAN'S STATEMENT

I am pleased to report that Costain has delivered another strong result, with continued growth in both revenue and profit, and has maintained a record forward order book."

Dr Paul Golby CBE | Chairman

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FINAL DIVIDEND

8.4 pence per share

to bring the total for the full year to 12.7 pence per share

This is my first statement since joining the Board and becoming Chairman on 5 May 2016. I am pleased to report that Costain has delivered another strong result, with continued growth in both revenue and profit, and has maintained a record forward order book.

I was delighted to have been asked to join Costain. It is a great British engineering success story with an outstanding brand and leading market positions.

I look forward to playing a part in delivering further success as the Group accelerates its growth.

Costain's opportunity

These are exciting times for Costain.

The cross-party political support for investment in infrastructure as a facilitator of sustainable economic growth, coupled with our customers' committed multi-billion pound investment programmes, creates a positive environment for the Group to continue to grow. This is evidenced through recent decisions to progress investment programmes at Hinkley, Heathrow and High Speed 2.

Meanwhile, the increasingly complex demands of the Group's blue chip customers present engineering challenges which require an even greater emphasis on technology-based solutions. Costain's unique and focused 'Engineering Tomorrow' strategy has successfully positioned the business as one of only a few companies able to provide those solutions.

Costain is continuing to grow its skills and capabilities and this is enabling the Group to win substantial new contracts and contract extensions thereby maintaining a high quality order book.

Dividend

The Group has a progressive dividend policy, targeting an ongoing dividend cover of around two times underlying earnings, translating strong performance directly in to shareholder value.

Our performance this year, and our confidence in the opportunities for future growth, has resulted in the Board recommending a final dividend of 8.4 pence per share (2015: 7.25 pence) which, if approved, will be paid on 19 May 2017 to shareholders on the register as at 7 April 2017. This represents an increase of 15% in the total dividend for the year to 12.7 pence per share (2015: 11.0 pence).

Pension

A triennial actuarial review of the Costain defined benefit scheme, reflecting updated market and liability assumptions, has been carried out as at 31 March 2016 and a plan agreed with the scheme Trustee regarding the associated deficit recovery. The amount of annual total contributions has been agreed at the same overall level as previously established, based on the Group's dividend matching policy.

Governance

I have joined a company with a Board committed to the highest standards of governance and a first-rate executive team implementing a robust strategy.

Our Annual Report will set out and explain the processes we have put in place to deliver long-term success whilst also ensuring that the Company complies with all applicable laws and regulations and meets the requirements of our shareholders and their representative bodies.

We measure the Board's effectiveness by holding an externally facilitated evaluation of Board performance every three years and take appropriate action where required. The most recent external evaluation was in 2014 and, in the interim, we undertake annual internal follow-up reviews to ensure that we are delivering agreed actions.

Board and people

I joined the Board and succeeded David Allvey as Chairman at the conclusion of the Annual General Meeting on 5 May 2016. David had been Chairman for seven years, and on behalf of everyone at Costain, I would like to thank him for the substantial role he played, and we wish him and his family all the very best for the future.

The success of any company is down to the quality of its leadership and the depth of talented and skilled people throughout the organisation.

On behalf of the Board, I would also like to thank all of Costain's people for their commitment, dedication and hard work. The strong result we have achieved this year would not be possible without them.

Corporate citizenship

Costain takes seriously its wider corporate responsibility and the role the business plays in society. That corporate perspective is also integral to the development of long-term relationships with our blue-chip customers who increasingly place a demonstrable commitment to corporate responsibility high on their selection criteria for preferred suppliers.

Outlook

Our major customers are committed to spending billions of pounds to improve people's lives by enhancing the UK's energy, water and transportation infrastructures. In order to deliver solutions to their increasingly complex requirements, Costain will continue to provide the broadest range of innovative integrated services and technology-based solutions.

The Group's continuing success is, therefore, the direct result of its 'Engineering Tomorrow' strategy and the deliberate acceleration of growth, both organically and by targeted acquisition.

Costain is well-positioned to take advantage of the opportunities that lie immediately ahead and this, combined with the good visibility we have over the medium term, reinforces our confidence for the future.

That confidence is reflected in the recommendation to increase the total dividend for the year by 15% and I look forward to reporting on future progress.

Dr Paul Golby CBE | Chairman
28 February 2017

INFRASTRUCTURE INVESTMENT

Our customers are committed to multi-billion pound infrastructure investment programmes.

TECHNOLOGY-BASED SOLUTIONS

We will continue to provide the broadest range of innovative integrated services and technology-based solutions.

HIGH QUALITY ORDER BOOK

We have continued to grow our skills and capabilities which enabled us to win substantial new contracts and contract extensions.

CHIEF EXECUTIVE'S STATEMENT

Our purpose at Costain is to improve people's lives by deploying technology-based engineering solutions to meet urgent national needs across the UK's energy, water and transportation infrastructures."

Andrew Wylie CBE | Chief Executive

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Our purpose at Costain is to improve people's lives by deploying technology-based engineering solutions to meet urgent national needs across the UK's energy, water and transportation infrastructures.

I am pleased to report on another good year, during which we delivered a strong overall result, continued to accelerate the growth of the business through investing in our skills and capabilities, maintained our market leading position and secured a record amount of work for the following year.

Strong trading performance

Revenue, including the Group's share of joint ventures and associates, for the year increased 26% to £1,658.0 million (2015: £1,316.5 million).

Group underlying operating profit increased 24% to £41.1 million (2015: £33.2 million).

Underlying profit before tax was £37.5 million (2015: £29.9 million), and underlying basic earnings per share increased to 31.5 pence (2015: 25.1 pence). Reported profit before tax was £30.9 million (2015: £26.0 million) and reported earnings per share were 25.7 pence (2015: 21.8 pence).

Although we have two core operating and reporting divisions within our business (Infrastructure and Natural Resources) we have continued to implement our 'One Costain' philosophy which enables us to constantly focus our resources on identifying and securing the most attractive business opportunities across the markets in which we operate.

The Infrastructure division delivered increases in revenue and operating profit and maintained a record order book. The Natural Resources division saw an increase in revenue with the overall result impacted by further costs in relation to the legacy Greater Manchester Waste contract awarded in 2007, as detailed in the Divisional review.

Costain finished the year with a strong net cash position of £140.2 million (2015: 108.2 million) reflecting positive timing of receipts at the period end. This is after significant further investment in the Group's strategic development including the £17 million acquisition in July 2016 of Simulation Systems Limited (SSL), which has been fully integrated and which will be earnings enhancing in 2017.

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1 Before other items; amortisation of acquired intangible assets and employment related and other deferred consideration.

Accelerating growth: investing in 'Engineering Tomorrow'

Our performance is the result of our unique, focused and continually evolving 'Engineering Tomorrow' strategy which has successfully positioned the business to provide the range of innovative integrated services demanded by our major customers who are spending billions of pounds on projects, underpinned by legislation, regulation or essential capital spend in the UK, upgrading and renewing the country's energy, water and transportation infrastructures.

Through increasing the capacity of road and rail infrastructure networks, improving the security of water and power supplies and enhancing the service provided to consumers, Costain is playing a key role in enhancing the lives of millions of people across the country.

Additionally, the Group's blue-chip customers' increasingly complex requirements to ensure future-proofed capacity, high quality service, security of supply and efficiency in delivery present numerous opportunities which demand an ever greater emphasis on innovative engineering and technology-based solutions. We have previously referred to the revolution taking place in the deployment of technology and this is gathering momentum as our customers increasingly recognise it as a major facilitator in the delivery of infrastructure. Costain is, and intends to remain, at the forefront of that revolution.

Following the referendum vote in June, there has been no adverse impact on Costain. We have noted the increased emphasis from the Government on the vital role infrastructure plays in promoting economic growth and an allied commitment to investment in key sectors, including technology, to ensure that the country continues to compete on the global stage. This presents Costain with additional opportunity.

Consequently, we are reinforcing our strategic focus on our major customers who are already committed to spending billions of pounds addressing critical UK infrastructure needs and we will continue to accelerate the growth of the business, investing both organically and by acquisition, in people and skills and in innovation and capabilities.

In July, we successfully acquired SSL to enhance further the range of technology-led solutions we can provide to our customers. SSL, established in 1979 and with 165 people, provides integrated hardware and software-based solutions across a broad spectrum of traffic monitoring and management solutions with the potential for wider application across our customer groups. The business has now been fully integrated into the Group and is performing well.

4,100 people

1,200 of those are now in technology, advisory or design roles

750

chartered professionals across a wide range of disciplines

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+200 graduates

+120 apprentices

CHIEF EXECUTIVE'S STATEMENT
CONTINUED

50,000 hours
of training and development in the year

£3.9 bn
Order book maintained at record level

These are exciting times with billions of pounds being spent upgrading and renewing the country's energy, water and transportation infrastructures.

Combining an award winning team and leading-edge innovation

The success of Costain is built on the strength and experience of our team and it is essential that we continue to attract, retain and develop the best talent. Costain today has over 4,100 people and, reflecting the development and changing nature of the business, over 1,200 of those are now in technology, advisory or design service roles.

At Costain there are over 750 chartered professionals across a wide range of disciplines. Additionally, there are over 200 graduates on our award-winning graduate development programme and 120 apprentices on a structured development programme undergoing training across the business.

Across the Group, there has been over 50,000 hours of training and development in the year. A number of the members of the senior leadership team have participated in executive education programmes during the year at leading business schools including Harvard and INSEAD.

In order to ensure we continue to generate thought leadership on key issues, we are currently sponsoring 13 PhD students undertaking leading-edge research at renowned universities including Cambridge, Imperial College, Edinburgh and Manchester.

Along with our engineering centre in Manchester, where over 300 of our people are based, we currently have research and development relationships with 15 leading universities and with whom we continue to progress a number of patent applications.

This investment in people and R&D continued to deliver a number of exciting innovations including:

- Advanced Vehicle Technology: Automatic vehicle recognition technology for the management of vehicles, removing the need for traditional toll booths and automatic crossing charging and therefore reducing traffic congestion;
- Analytics and predictive services: our technology is being used to manage critical infrastructure when experiencing extreme events;
- The deployment of workforce and workflow technology to the delivery of complicated maintenance contracts. Through the use of this technology we are improving the local customer experience, improving event management and improving efficiency of operations through automatic workforce management;
- Capturing asset operational data and maintenance records, through the use of algorithms, to optimise maintenance and operations achieving significant reductions in both capex and opex costs.

Record order book providing visibility of earnings

As a consequence of its strong customer relationships, and its engineering and technology-led solutions, Costain secured a significant number of new orders and contract extensions including:

- Development of the M4 corridor around Newport for the Welsh Government;
- Peterborough and Huntingdon compressor station upgrade for National Grid;
- Contract for the East works package of the Thames Tideway Tunnel in London;
- High Speed 2 South Enabling Works contract;
- Appointment to the Decommissioning Delivery Partnership framework by Sellafield Ltd;
- Three asset maintenance support contracts for Highways England;
- Transport for London's Surface Transport Major Projects Framework.

As a result, the Group's order book at the year-end was maintained at the record level of £3.9 billion (31 December 2015: £3.9 billion).

The Group has increased its revenues secured for 2017 to over £1.2 billion (as at 31 December 2015: over £1.1 billion secured for 2016). The order book also provides good medium-term visibility with £2.7 billion of revenues secured for 2018 and beyond. In addition to the order book, the Group has maintained its preferred bidder position at over £500 million, and is actively seeking to secure further new work across all of its target markets.

The strategic nature of Costain's long-term customer relationships has once again ensured that over 90% of the order book comprises repeat business. We deliberately work with major customers who utilise target cost, cost reimbursable contracts as the most appropriate contract form to deliver their complex and changing requirements. As a consequence, over 90% of the order book is in this lower-risk form of contract.

Given the changing nature of the business and the evolving profile of the order book, we will also increasingly use consultancy-related indicators, such as utilisation.

Costain Cares

The management of Safety, Health and Environment is a core value at Costain. The Group's Accident Frequency Rate (AFR) in the year was 0.09, which although slightly behind the best-ever performance of 0.08 achieved in 2015, still compares well with our industry peer group.

We received a total of 21 RoSPA awards in 2016 including two Orders of Distinction, two President's Awards and the International Dilmum Environmental Trophy.

Notwithstanding this industry leading safety performance, the Group still had a number of serious safety incidents in the year, including a fatality on the M1 J16-19 Managed Motorway contract, which reinforced the need for continuous learnings, vigilance and improvement in our safety performance.

We remain committed to further improvement in our safety performance and are implementing a strategy to reduce by a further 50% the number of incidents in the business by the end of 2018.

Our customers place great emphasis on the good citizen credentials of their strategic supply chain partners. Given the profile of their businesses and the nature of the activities we undertake, how we deliver our services is as important to them as what we do. Increasingly, customers insist that their tier-one providers share their corporate and social responsibility values and failure to do this would mean a failure to pre-qualify for future work.

The Costain Charitable Foundation is the focus of the range of charitable and community work we undertake, both individually and as a Group. Following the success in 2015 of the 'Costain 150 Challenge', which raised over £1.1 million for good causes, we set a challenge for 2016 of 10,000 hours of volunteering by Costain people and I am delighted to report that we achieved a total of over 12,000 hours.

Outlook

These are exciting times with billions of pounds being spent upgrading and renewing the country's energy, water and transportation infrastructures.

There is a revolution in the deployment of technology-led innovative solutions to meet the increasingly complex requirements of our national infrastructure needs and we are continuing rapidly to transform our business to be at the heart of the opportunity this presents.

We started 2017 with a maintained record order book giving good visibility over the medium term and we look forward to the future with confidence.

Andrew Wyllie CBE | Chief Executive
28 February 2017

12,000 hours
volunteered by Costain people

We started 2017 with a maintained record order book giving good visibility over the medium term and we look forward to the future with confidence.

OUR BUSINESS MODEL

Our integrated business model describes how we create value for our stakeholders.

We deploy technology-based solutions to meet urgent national needs across the UK's energy, water and transportation infrastructures. Our target customers are large organisations that need solutions to their complex business challenges.

Our key inputs

We rely upon some critical resources and relationships in order to run our business effectively:

FINANCIAL STRENGTH
The financial resources (through shareholder capital, retained profits and cash generation) we need to run our business.

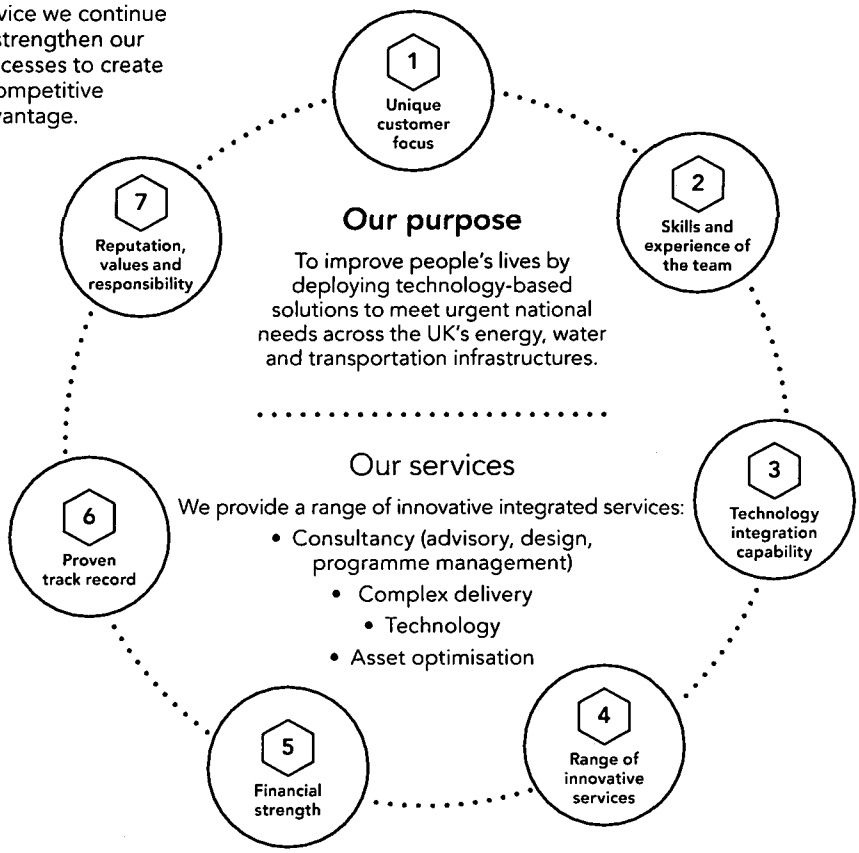
PEOPLE
The skills, experience, productivity, diversity and expertise of our people enable us to deliver solutions for our customers.

STAKEHOLDER RELATIONSHIPS
We develop strategic relationships with all our stakeholders to support the development of broader services and technology solutions for our customers.

LICENSE TO OPERATE
Our brand and reputation for outstanding delivery, technical excellence, health, safety and sustainability performance gives us a license to operate.

What we do

To provide the best service we continue to strengthen our processes to create a competitive advantage.



How we operate

What we do is supported by robust processes and procedures to manage risk and drive efficiency.

ONE COSTAIN
We implement a 'One Costain' philosophy which enables us to focus our resources on identifying and securing the most attractive business opportunities across the markets in which we operate.

OUR VALUES
Underpinning everything we do are the Costain values and a culture where all our employees embody our values.

We are a trusted delivery partner that collaborates strategically at all levels with our customers.

We are successful because we develop insightful and trusted relationships with our customers enabling a better understanding of their needs allowing us to identify, create and deliver the best solution.

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The value we create

ECONOMIC AND OPERATIONAL GROWTH
We deliver sustainable, profitable growth and attractive returns for our shareholders. We continue to invest in the Group to support our strategy for growth.

DIVIDEND PER SHARE
12.7p

REPEAT BUSINESS
The strategic nature of our long-term customer relationships has once again ensured that over 90% of the order book comprises repeat business.

REPEAT BUSINESS
+90%

THE BEST TEAM IN THE INDUSTRY
Our success is built on the strength and experience of our team and it is essential that we continue to attract, retain and develop the best talent.

THE COSTAIN TEAM
4,100+

LEADING BRAND AND REPUTATION
We are proud of our brand and reputation, we have been shaping the world in which we live for the past 150 years.

VOLUNTEERING
12,000
hours volunteered by our employees

CLEAR MARKET FOCUS
We focus on markets where there is committed spend, underpinned through legislation, regulation or essential national need.

Read more on **pages 16 to 17**

ROBUST CORPORATE GOVERNANCE
We have rigorous policies, procedures and mandatory training to ensure we have a responsible business culture.

Read more on **pages 38 to 86**

EFFECTIVE RISK MANAGEMENT
Our robust risk management processes identify, manage and mitigate potential risk to the success of the business.

Read more on **pages 28 to 33**

MARKET OVERVIEW

The markets in which the Costain Group is active have, in total, an anticipated spend of just under **£92 billion per annum**, of which over £20 billion is addressable. Customers in these markets continue to spend at **consistent levels**. Below is a summary of the activity in those markets.

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POWER

The UK recognises the need to continue to invest in a reliable and sustainable power supply.

Total* £17.1bn
Addressable** £2.7bn

The UK Power market continues to be driven by the four energy policy imperatives of affordability, security of supply, reliability and reduced carbon. Asset optimisation remains the predominant investment balanced with capital infrastructure spend.

OFGEM Regulator reforms will play a key role in determining remaining RIIO Phase1 capital investment and outlook for RIIO Phase 2. The Government is supporting the market to deliver a diverse range of technologies.

The National Infrastructure Plan 2016–2021 highlights a period of planned energy spend of £58.3bn, which is focused around maintaining a reliable, secure, affordable and low carbon energy system.

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OIL & GAS

The oil & gas market continues to recover with rising oil prices creating new engineering opportunities.

Total* £16.5bn
Addressable** £1.1bn

Whilst remaining a competitive environment, opportunities exist in emerging markets and traditional differentiation areas for Costain.

Midstream business outlook is good in 2017 with the UK continuing to increase its reliance on gas. Costain is a market leader in engineering for Gas Processing, Storage and Distribution.

The upstream market is starting to recover from the effects of low oil price and we will focus on the growing number of decommissioning opportunities, in addition to our offshore topside and sub-sea engineering and advisory services.

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WATER

As the water companies near the mid-point of the sixth asset management plan (AMP6) they are planning for the next price review in 2019.

Total* £12.2bn
Addressable** £3.1bn

The water sector is in the middle of the regulatory spend cycle, AMP6. Costain is working with our customers to deliver outcomes and support preparations for the 2019 price review.

The water industry is evolving with great emphasis on efficiency and resilience, incorporating technology to assist with this transformation. Customers seek to reduce their operating costs and produce greater value and service for their customers. Support opportunities lie in advisory services and technology-based solutions.

* Total – Total spend in the market.

** Addressable – Current market spend addressable to Costain with existing customers and current skills and capabilities.

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Water

Energy

Transportation

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RAIL

Investment in the UK rail infrastructure remains a high priority for the nation.

Total* £26.0bn
Addressable** £7.0bn

Rail remains an enabler for national economic growth and the Government have announced further investment focused on future technology and digitisation. This is essential to support the increase in passenger journeys.

Network Rail continues to evolve and the introduction of contestability will open up new opportunities. Control Period 6 bidding will start later this year and is expected to be of the same magnitude as Control Period 5.

As Crossrail heads towards a successful commissioning and opening, further infrastructure investment in the South East continues to gain support.

The first HS2 enabling contracts have been awarded and the transition to major programme delivery will follow on from these activities.

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NUCLEAR

Nuclear power is integral to meeting the UK's energy needs; decommissioning programmes continue.

Total* £11.1bn
Addressable** £1.6bn

The industry has significant opportunities within nuclear new build, decommissioning, generation and the defence markets.

Hinkley Point C has been given the go ahead with the final investment decision reached by EDF and the UK Government. This paves the way for new nuclear in the UK. Consultations continue on the Moorside, Wylfa Newydd and Sizewell C projects.

The NDA has set significant decommissioning milestones to be achieved by 2020, in particular defuelling all 11 Magnox reactors, drawing fuel reprocessing at Sellafield to a close and fulfilling their accelerated decommissioning for Bradwell. Defence spending is set to increase with the proposed Dreadnought Class submarine programme.

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HIGHWAYS

There is renewed commitment to improve the UK's road network.

Total* £8.8bn
Addressable** £4.1bn

The Autumn 2016 statement committed an additional investment of £1.1bn to reduce congestion and upgrade local roads and transport and is also providing £390 million in support for the transport technology of the future.

Highways England continue to progress their 2015–2020 Road Investment Strategy (RIS) which outlines £15 billion of spend. The development of RIS2 (2020–2025) will outline further requirements across the UK network.

Other organisations, such as TfL, continue to recognise the need to modernise the road network to make them more reliable, safer and greener.

OUR STRATEGY OVERVIEW

Enhancing growth and market position whilst driving shareholder value

Our focus is to enhance our growth and market position as we continue to drive shareholder value. In order to do this our strategic priorities are focused on continually improving our processes to enhance further our competitive advantages across our business.

Our strategic priorities

To ensure we deliver we have seven clear priorities which will ensure that we remain industry leaders in our chosen markets and create a sustainable and profitable business:

Core to our business model are our seven strategic priorities below:

1

Unique customer focus

We develop trusted strategic relationships with our customers which enables us to really understand them and their needs.

2

Skills and experience of the team

We continue to enhance our capabilities in line with our customer needs.
We aim to attract, retain and develop the best people by investing in a diverse and knowledgeable workforce with transferable skills.

3

Technology integration capability

Investments in research, innovation and technology is crucial to deliver value in the services we provide to meet the needs of our customers.

4

Range of innovative services

We continue to provide a broad range of innovative integrated services and technology-based solutions.

Our customers' increasingly complex requirements to ensure future-proofed capacity, high quality service, security of supply and efficiency in delivery present numerous opportunities which demand an ever greater emphasis on these services.

5

Financial strength

We deliver sustainable, profitable growth, providing attractive returns for shareholders. We are committed to grow the business organically and through targeted acquisitions.

6

Proven track record

Our proven track record as a trusted partner helps us to build strong strategic customer relationships.

We continue to provide the highest standards of quality and reliable, safe, service delivery.

7

Reputation, values and responsibility

Building a long-term sustainable business that creates economic, environmental and social value for all our stakeholders and embedding sustainable practices in everything we do, specifically:

- Ensuring Costain is a safe and great place to work;
- Creating a better environment;
- Supporting our local community and leaving a positive lasting legacy;
- Providing better solutions for the marketplace.

OUR PERFORMANCE

Unique customer focus | Proven track record

1 6

MEASURE	PERFORMANCE	TARGET	PRINCIPAL RISKS AND UNCERTAINTIES
Order book **Performance:** Forward order book maintained at record level of £3.9 billion	Graph Removed	Continue to build a strong order book in line with the business plan	• Safety, Health and Environment • Political, economic and market conditions • Winning new work • Operational delivery • People and skills • Acquisitions
Customer satisfaction **Performance:** We continue to receive consistently high customer satisfaction scores	Graph Removed	Enhance customer engagement to gain a greater insight into our performance	• Safety Health and Environment • Winning new work • Operational delivery • People and skills
Repeat business **Performance:** Over 90% of order book comprises of repeat orders	Graph Removed	Continue to build strategic relationships with our customers	• Safety, Health and Environment • Winning new work • Operational delivery • People and skills

OUR PERFORMANCE
CONTINUED

Skills and experience of the team

2

MEASURE	PERFORMANCE	TARGET	PRINCIPAL RISKS AND UNCERTAINTIES
Headcount **Performance:** We have over 4,100 people and, reflecting the development and changing nature of the business, over 1,200 of those are now in technology, advisory or design service roles	Graph Removed	Continue to grow and enhance our capabilities	• Safety, Health and Environment • Political, economic and market conditions • Operational delivery • People and skills
Staff turnover **Performance:** Staff turnover remains below industry average	Graph Removed	Provide initiatives and working conditions to maintain a culture where people want to work for Costain	• Safety, Health and Environment • Political, economic and market conditions • Operational delivery • People and skills
Investment in learning and development **Performance:** We continue to invest significantly in our people	Graph Removed	Grow skills and capabilities in line with the business plan	• Winning new work • Operational delivery • People and skills
Diversity and inclusion **Performance:** We have increased the number of women in senior management roles within the business	Graph Removed	Our workforce represents society	• Winning new work • People and skills

Technology integration capability | Range of innovative services

3 4

MEASURE	PERFORMANCE	TARGET	PRINCIPAL RISKS AND UNCERTAINTIES
Number of innovations **Performance** 27% increase in number of innovations in the last 12 months	Graph Removed	Continue to extract innovative solutions through an open innovation programme	• Winning new work • Operational delivery
Investment in research and development **Performance** We continue to generate new knowledge through collaboration with UK universities and by investing in people to bring new solutions to solve customer challenges	**14** Total number of research grants secured **+£46m** Total value of collaborative research grants **Costain sponsored PhDs** 2016 13 2015 8	Continue to lead the market and bring thought leadership to accelerate innovative solutions into practice	• Winning new work • Operational delivery • People and skills

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Acquisition of Simulation Systems Limited (SSL)

In July, we successfully acquired Simulation Systems Limited to further enhance the range of technology-led solutions we can provide to our customers.

OUR PERFORMANCE
CONTINUED

Financial strength

5

MEASURE	PERFORMANCE	TARGET	PRINCIPAL RISKS AND UNCERTAINTIES
Underlying operating profit **Performance:** Up 24% to £41.1 million	Graph Removed	In line with business plan	• Financial strength
Cash **Performance:** Strong net cash position of £140.2 million	Graph Removed	Maintain a net cash balance at an appropriate level to suit the business requirements	• Financial strength • Acquisitions
Revenue including share of joint ventures and associates **Performance:** Revenue increased to £1.7 billion	Graph Removed	Continue to accelerate the growth of the business, investing both organically and by acquisition, in people and skills and in innovation and capabilities	• Financial strength

1 Before other items; amortisation of acquired intangible assets and employment related and other deferred consideration.

2 Net cash balance is cash and cash equivalents less interest bearing loans and borrowings.

Reputation, values and responsibility 7

MEASURE	PERFORMANCE	TARGET	PRINCIPAL RISKS AND UNCERTAINTIES
Accident Frequency Rate (AFR) **Performance:** The Group's AFR has decreased over the last six years, however, in 2016 there was a slight increase from our best ever safety performance in 2015	Graph Removed	Continue to improve safety performance towards our goal of zero harm, achieving a target of 0.06 in 2017	• Safety, Health and Environment • Operational delivery
CO_2 equivalent emissions **Performance:** 41% reduction in emissions intensity and a 15% reduction in non-operational carbon emissions	**CO_2 equivalent emissions** tCO_2e / **2016** / 2015 / 2014 Total emissions / **18,523** / 25,094* / 24,692 Scope 1 / **15,255** / 19,488* / 20,600 Scope 2 / **3,267** / 5,606 / 4,092 Emissions intensity / **11.19** / 19.06 / 21.99 **Non operational carbon (tCO2e/£M) (permanent offices, business mileage)** **2016** / 2015 **4.3** / 5.05 * restated figures	Continue to reduce our measured emissions	• Safety, Health and Environment • Political, economic and market conditions • Operational delivery
Considerate constructors score **Performance:** We continue to achieve consistently high scores, with the A556 Knutsford to Bowdon Improvement Scheme winning the most considerate site award	Graph Removed	Support the local communities in which we operate, ensuring we leave a lasting legacy	• Safety, Health and Environment • Operational delivery
Supply chain performance **Performance:** Our supply chain continues to achieve consistently high performance scores	Graph Removed	Average key supplier performance greater than 50%	• Political, economic and market conditions • Financial strength

For more detailed information about our sustainability performance please visit our website: **costain.com/sustainability**

DIVISIONAL REVIEW

Our customer-aligned Infrastructure and Natural Resources divisions have continued to deliver technology-based solutions to meet urgent natural needs across the UK's energy, water and transportation infrastructures.

REVENUE

£1,276.1m

Infrastructure

ORDER BOOK

£2.9bn

Infrastructure

Operational review

Under our 'One Costain' operating model the Group has two core operating and reporting divisions within the business: Infrastructure and Natural Resources.

Infrastructure

The Costain Infrastructure division, which operates in the highways, rail and nuclear markets, has had a strong year with an increase in revenue and operating profit. Revenue (including share of joint ventures and associations) increased to £1,276.1 million (2015: £996.1 million) and operating profit (before other items) rose to £56.6 million (2015: £50.9 million). Reported (after other items) operating profit was £54.6 million (2015: £49.9 million). The underlying operating profit margin delivered in the division is within the targeted blended range of 4% to 5%.

The forward order book for the division has increased to £2.9 billion (2015: £2.8 billion) and the level of tendering activity is high as we continue to prioritise the Group's bidding activity in the areas that currently provide the greatest opportunity.

Highways

In Highways, major milestones have been achieved on the M1 Junction 28 to 35 Managed Motorways contract for Highways England, the M6 to Heysham Link Road for Lancashire County Council and the A465 Heads of the Valleys Dualling for the Welsh Government.

We continue to provide 24/7 operational capability to key customers who require immediate response to incidents and severe weather events, keeping our strategic road network open and available for safe use by all. Following successful awards by Highways England, the Areas 4 and 12 Asset Support Contracts (ASCs) have been successfully mobilised and, in December, we were awarded the Area 14 Maintenance and Response contract.

Our Highways operational capability was recognised further with the award of our first local authority operations and maintenance contract for East Sussex County Council and which has also been successfully mobilised.

The acquisition of SSL in July has already enabled us to secure important contract wins as a consequence of the additional capabilities the business brought to Costain, particularly across technology services. These new capabilities are now being deployed on the recently awarded TMT2 framework for Highways England and the refurbishment of the critical M4 Brynglas Tunnels for the Welsh Government.

Rail

This year has seen a significant growth in activity as we work with Network Rail and others to modernise ageing infrastructure. During the year we successfully, and on time, opened the first phase of the major London Bridge station redevelopment. This was a major landmark, achieved whilst having to keep one of London's busiest transport hubs open for business.

We also responded swiftly to the closure of the Folkestone to Dover line as a consequence of the damage to the sea wall in the December 2015 storms. This contract has been completed well ahead of schedule and budget and the railway line was back into full operation in September 2016.

Capacity constraints on the national rail network are being alleviated by our rail electrification joint venture, ABC Electrification Limited which continues to deliver significant sections of the National Electrification Programme in the Midlands, Scotland and on the Great Western Line.

Crossrail will improve journey times across London and will ease congestion while offering significantly enhanced connectivity. On this iconic programme of work we continue to deliver the landmark Paddington and Bond Street stations and have made significant progress on the System Wide contract to provide

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the operational railway on the central section of Europe's largest infrastructure programme. On associated works for London Underground, both the Bond Street station upgrade and the Bakerloo Line link at Paddington have made excellent progress in the year.

In order to increase rail capacity and reduce travel times into London from the Midlands and the North, the Government is developing a high-speed rail network known as HS2. This programme has made good progress in the year with Costain being awarded, in joint venture, the southern section enabling works contract.

Nuclear
As part of the programme to manage the decommissioning of the UK's legacy nuclear power stations, Costain made significant progress towards completion of the Evaporator D contract for Sellafield Limited and we have mobilised a team for Sellafield's design and delivery partner framework.

With regard to the upgrade programme of the country's existing nuclear power station fleet, Costain successfully secured in December the project controls programme management advisory project for EDF which, importantly, demonstrates the broadening of the Group's capabilities across integrated services and consultancy. We are also undertaking advance works for EDF at Hinkley Point.

Natural Resources

The Natural Resources division, which operates in the water, power and oil & gas markets, has seen some good progress in underlying performance. Revenue in the division has increased as a consequence of the expected cyclical growth in spend in the AMP6 programmes in the water sector, the full benefit from the integration of the acquisition of the Rhead Group in August 2015 and despite the impact of the continued difficult oil and gas market conditions.

DIVISIONAL REVIEW
CONTINUED

REVENUE

£377.3m

Natural Resources

ORDER BOOK

£1.0bn

Natural Resources

Revenue (including share of joint ventures and associations) increased to £377.3 million (2015: £317.6 million) with an operating loss (before other items), including the impact of the increased costs and provisions on the legacy waste PFI contract detailed below, of £8.6 million (2015: £11.1 million loss). Reported (after other items) loss from operations was £12.6 million (2015: £13.4 million loss). Excluding the impact of the legacy waste contract the division generated an underlying operating profit of £6.5 million in 2016.

The loss in the period includes further costs and provisions arising in the year totalling £15.1 million in relation to the completion of the legacy Greater Manchester Waste Disposal Authority PFI contract awarded in 2007. As reported previously, all 46 facilities on the scheme are operating and processing waste. These facilities are all either fully completed or in the warranty period under the terms of the contract during which further work and plant modifications are to be completed. In the period, the Group has incurred further costs and has taken additional provisions to reach Final Acceptance on the contract, which is now targeted this year; and to complete the remaining works when access is available in accordance with the operational running of the plants under an agreed schedule to 2019. Costain has received significant payments from, and remains in discussions on further payments with relevant contract counterparties and the Group's insurers regarding the issues that have arisen on this contract. It has been the Group's policy since 2009 not to pursue fixed price contracts of this nature.

The division has a forward order book of £1.0 billion (2015: £1.1 billion).

Water

The Group is now in year two of the AMP6 five year programmes for Thames Water, Severn Trent and Southern Water with a focus on improving and maintaining water quality standards, supply resilience and meeting anticipated demographic shifts.

These programmes are utilising the full range of integrated capabilities available in the Group to deliver improved customer service, innovative solutions and achieve significant total expenditure efficiency savings.

In Glasgow, Costain is improving water quality and resilience of supply through the delivery of the Shieldhall Tunnel for Scottish Water, reducing flooding issues in the city's wastewater network. This is one of the largest infrastructure investments in Scotland and the main tunnel drive and associated works are progressing well.

Costain's joint venture for the east section of the Thames Tideway project has now successfully mobilised and is progressing well. This major project will form an integral part of the modernisation of London's Victorian sewerage system and significantly improve water quality in the River Thames, providing capacity to cope with the demands of the city well in to the 22nd century.

Power

Ensuring that the UK has a secure and reliable energy mix is another area of national need in which Costain is playing a key role.

The River Humber pipeline is a strategically important asset, connecting the gas import facility at Easington on the Yorkshire coast and which provides 70 – 100 million cubic metres of natural gas per day, to the national network. Costain is delivering the project services contract to deliver the replacement of the Humber Estuary Crossing for National Grid.

Following completion of a successful Front End Engineering Design (FEED) project, Costain was awarded the contract by National Grid to upgrade its Peterborough and Huntingdon compressor stations. The programme of work is part of National Grid's Emissions Reduction Project to ensure that both compressor stations comply with the Industrial Emissions Directive and Pollution Prevention and Control regulations. The project will also increase system resilience and reduce overall risk on the National Transmission System by replacing ageing assets with modern, efficient equipment.

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Oil & Gas

The Group continues to secure new repeat order work for its front end design studies, programme management, complex project delivery and asset supports including the new Hydrochloric Acid Dosing Plant Construction Contract with Total, building on the Condensate Mercury Removal System for its Edradour-Glenlivet facility.

Costain's programme management services to Ithaca on the Stella field development continue to programme, as well as the ongoing support services to Total and Phillips 66 at their Immingham refineries.

There was a noticeable increase in new business opportunities towards the end of 2016 as customers restructure their operations and investment projects to accommodate prevailing market conditions, providing us with some improvement in visibility of potential workload in 2017.

Alcaidesa

In July 2015, we announced, by mutual agreement with our partner Santander Bank, that we had completed a reorganisation of the Spanish non-core joint venture that resulted in the assets being split equally between the parties. Costain now owns the Alcaidesa group, which incorporates the operating assets of the golf courses, the associated parcel of land and the 624-berth marina concession, adjacent to Gibraltar, and has retained its portion of the debt, amounting to €11.5 million.

Revenue in the year was £4.6 million (2015: £2.8 million) and the loss from operations was £0.7 million (2015: £0.9 million loss). The result reflects some early improvement in market conditions in Spain for this non-core activity.

RISK MANAGEMENT

This section highlights the principal risks and uncertainties facing the Group together with the **key mitigating activities** that have been put in place to manage those risks.

Risk management processes are incorporated within the Group's normal management and governance systems at all levels.

Risk management framework

The Board formally reviews the material risks and ensures that these are appropriately managed by the management team. The Board retains the ultimate responsibility for the Group's risk management framework, however, it has delegated responsibility for annually reviewing the overall effectiveness of the risk management programme to the Audit Committee. The Group Risk Management function provides assurances to the Audit Committee of the effectiveness of the internal control procedures through completion of the annual audit plan which takes into account current business risks.

Risk management processes are incorporated within the Group's normal management and governance systems at all levels and form an integral part of the day-to-day activity of the Company. The Group Risk Management function leads the process for the review and assessment of risk, focused principally at the strategic operations of the Group. This supplements and integrates with the processes already established at contract level, is in line with ISO 31000 and provides a consistent approach to risk management activities Group-wide. Risks, which form the basis for the principal risks and uncertainties detailed in this section, are challenged and validated by the Group Executive Board and the Board on a regular basis.

Risk appetite

The Board keeps under constant review the relationship between our strategic ambitions and the management of risk. The Company continues to operate a formal risk appetite document which includes, amongst other things, the Investments Committee tender review procedures and formal guidelines for joint ventures. The Company continues to expand its business activities and is now entering into knowledge and innovation based contracts. As a result of this, procedures for this type of work have been strengthened, levels of authority have been reviewed and guidelines implemented. Further details of the Company's appetite to risk is provided overleaf.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 01 to 37. Principal risks and uncertainties are described on pages 30 to 33. In addition, Note 17 to the financial statements on pages 117 to 122 includes the Group's objectives, policies and processes for managing its exposures to interest rate risk, foreign currency risk, counterparty risk, credit risk and liquidity risk. Details of the Group's financial instruments and hedging activities are also provided in Note 17.

The Directors believe, after due and careful enquiry, that the Group has adequate resources to continue operations for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the accounts.

Turn over for a full description of our principal risks and information about how we manage them. **See pages 30 to 33.**

Viability statement

In accordance with provision C.2.2 of the Code, the Directors have assessed the viability of the Group over a three-year period.

This assessment has been made taking into account the current position of the Group, the annual corporate planning process and the potential impact of the principal risks stated on pages 30 to 33. The plans and projections prepared as part of the corporate planning process consider the Group's cash flows, *profits, contracted work, dividends and other* key financial indicators over the period.

The principal risks have been taken into consideration in preparing the projections, with particular emphasis on:

- A major health, safety or environmental incident;
- Reduction in new work won;
- Operational delivery issues;
- Deterioration in pension liabilities;
- Making an acquisition that does not achieve the planned profit;
- A major IT systems failure.

The projections have then been incorporated into a sensitivity analysis which reflects plausible, but severe, combinations of the above variables, and the impact of these on the Group's liquidity and banking arrangements. Given the long-term nature of a significant element of the Company's activities, a number of the principal risks potentially impact the Group's ability to win new work. This has therefore formed a key element of the assessment.

The period of three years has been chosen because this is a time period in which the Company has a reasonable visibility of secured work and pipeline of opportunities. It is also the period reviewed by the Board in the business planning process.

Based on this assessment, the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the three-year period to 31 December 2019.

In making this statement, the Directors carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

Risk management and control responsibility framework

Top-down

Oversight, identification, assessment and mitigation at corporate level

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The Board

- Sets strategic objectives and defines the risk appetite
- Maintains overall responsibility of the Group's risk management and internal control systems
- Considers the variety and extent of risk exposure against the risk appetite for our principal risks
- Provides leadership to ensure an effective risk management culture

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Group Executive Board

- Assesses and mitigates risk
- Monitors the implementation of risk management processes and internal controls
- Directs resources to effectively implement controls

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Audit Committee

- Reviews the effectiveness of risk management and internal control systems
- Supports the Board in monitoring exposure against the risk appetite

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Internal Audit

- Reviews the effectiveness of risk management and internal control systems in order to support the Audit and Executive Committees

Bottom-up

Identification, assessment and mitigation at contract and functional levels

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Operational level

- Implements the risk management processes to ensure internal controls are embedded throughout operational management
- Identifies, manages and maintains accountability for risk within local areas of responsibilities
- Embeds a culture of awareness to develop and enhance the quality of risk management

PRINCIPAL RISKS AND UNCERTAINTIES

The table below lists the principal risks and uncertainties facing the Group at the date of this report and the mitigations that we have in place to manage the impact of these risks upon the business.

This list is not intended to be exhaustive. Some risks have not been included in this section on the basis that they are not considered to be material.

RISK AND IMPACT	RISK APPETITE	MITIGATION	CHANGE IN 2016
1. Safety, Health and Environment • Failure to prevent a major safety incident/ accident or environmental event which could adversely affect the Group's reputation and its operational and financial performance. • Failure to deliver ongoing improvements to performance result in failure to secure new work.	Costain recognises that we operate in a high-risk field but we have a zero tolerance approach to the safety and health of our workforce and other stakeholders, and in relation to the protection of the environment.	• The health and safety of our people and everyone who is impacted by Costain remains our highest priority. • A comprehensive strategy for the improvement of our Safety, Health and Environment performance enhanced in 2016 to deliver further progress to our goals. • Detailed Safety, Health and Environment management processes. • The Costain Behavioural Safety (CBS) programme, accredited by The Cambridge Centre for Behavioural Studies, is used to create an environment where, through exhibiting leadership, everyone understands the importance of taking responsibility for their own safety and those around them. • Regular monitoring visits by experienced professionals and senior leaders from across the business, and on-site training take place to reduce the risk of human error. • Performance metrics in the Group's Annual Incentive Plan also include a key non-financial indicator for health and safety.	⏸
2. Political, economic and market conditions Whilst the long-term nature of Costain's contracts limits sudden fluctuations in revenue, changes in the cost of Costain doing business or reductions in the addressable market could arise as a result of: • Changes in Government policy on spending including an increased burden on corporate entities. • The implications of the EU referendum result. • The changing nature of international politics and their influence on the UK market.	Costain's business is based on taking informed decisions on the future market conditions but this can only happen where there is a high level of insight.	• Our focus is on major customers in the UK energy, water and transportation markets defined by significant and long-term expenditure programmes underpinned by committed regulated spend and essential capital investment, e.g. the UK Government's National Infrastructure Plan has identified investment of over £320 billion to 2020–21. • The period of contracts providing significant protection from immediate change to Government policy. • Monitoring of policy development via industry groups and close contact with customers in our target markets. • High levels of engagement with our customers and other key stakeholders in Government and third parties.	⏸

▲ Increased risk

⏸ No change to risk

▼ Decreased risk

RISK AND IMPACT	RISK APPETITE	MITIGATION	CHANGE IN 2016
3. Financial strength Costain must establish sufficient financial strength to operate its business. Without this the Group will: • Be unable to demonstrate to customers the required level of financial resource resulting in failure to win long-term contracts. • Be unable to maintain a competitive scale in a consolidating market within the engineering sector. • Fail to maintain adequate working capital to operate the business.	Costain prioritises its financial strength to ensure it can continue to win work: • Foreign currency exposure risk to be hedged. • Parent Company guarantee is the preferred option, and any performance bonds to be a maximum of 10% and surety bonds are preferred. • There is zero tolerance to fraud and bribery.	• A strong balance sheet including positive net cash position. • Extensive unutilised banking and bonding facilities. • The strategic use of joint venture partners to help achieve the required financial and operational strength only in markets where this is not demonstrated by the Group in isolation.	II
4. Winning new work Costain maintains a pipeline of orders that now extends to £3.9 billion. There is a need for Costain to continue to innovate in order to win further work and maintain a leading position in the sector which could be at risk from: • Competition and failure to win work from core customers. • Costain not being able to demonstrate the ability to provide an end-to-end delivery function as demanded by our customers.	Costain has no appetite for winning work that will impact the financial strength of the business: • Only sectors and customers which form part of the Group strategy to be pursued. • Target cost is the preferred contract form. • All contracts to be at least cash neutral. • Operations are to be in line with the Group Commercial Expectations document. • Opportunities should be pursued alone unless there is a compelling reason otherwise.	• The order book at year end stands at £3.9 billion, providing long-term visibility of earnings. • A focus on blue-chip customers whose major spending plans are underpinned by strategic national needs, regulation commitments or essential maintenance requirements by following the Group's unique 'Engineering Tomorrow' strategy. • The accelerated implementation of programme management and technology services via strategic acquisitions. • Continuing to develop and maintain strong relationships with customers across key markets on the back of our track record for delivery. • Regularly monitoring pipeline opportunities and ensuring resources are centrally allocated to the most advantageous business development activities. • Continuously striving to broaden the skills and breadth of our capability (organically and by acquisition) to meet the increasingly broad requirements of the market. • Continuing to develop the Group's market proposition through the introduction of new technologies and the strong Costain brand.	II

PRINCIPAL RISKS AND UNCERTAINTIES
CONTINUED

RISK AND IMPACT	RISK APPETITE	MITIGATION	CHANGE IN 2017
5. Operational delivery Costain delivers works through a number of often large contracts containing defined output requirements. There is a risk that Costain is unable to deliver these services to the time, cost or quality required in the contract as a result of: • A failure to accurately assess our works (including costs and time required) or contractual terms at tender. • Design faults that result in additional works to rectify. • An interruption to our supply chain that provides part of the services or materials to complete the works. • Refusal of claim by insurers following a loss. • Compensation events or increase in scope not being fully reimbursed by our customers.	All operations to follow the Costain Way. Only approved suppliers to be used. All legislation and regulations to be complied with at all times.	• The Costain Way provides a comprehensive management system including policies, processes and procedures for all parts of the contract life-cycle; from tendering to contract close-out. • The use of experienced and qualified staff to prepare bids and manage the contracted works. • Defined delegated authority levels for approving all tenders where all significant contracts are subject to escalation from the Executive Investment Committee to the Board. • Extensive review of the supply chain strength prior to engagement and a requirement to use performance bonds where they are appropriate. • Regular contract leaders' meetings are used to discuss safety, progress, quality, financial performance, end forecast, risk, etc. • Work on site is audited by in-house specialists and reports are prepared so that corrective action, where required, can be taken. • A senior executive is responsible for overall quality issues, the updating of best practice and ensuring compliance in both existing operations and in line with the changing business. • Enhanced controls regarding the administration of insurance claims and the management of contracted design was developed in 2015 including the evolution of processes to minimise exposure to the customer, whilst preserving subrogation with the Group's supply chain. • Compensation events are closely monitored by our project teams, and are included in the monthly reporting process through to senior management. Robust processes are in place to ensure compliance with contractual requirements regarding such compensation events, including timely notification, documented discussions with the client, and maintenance of appropriate supporting records.	⏸
6. People and skills The success of the Group is built on the strength and experience of our people. Failure to continue to attract, retain and develop our best-in-class team in an increasingly competitive market may limit the Group's ability to grow the business as anticipated, or cause a short-term impact on performance.	The right skills and capabilities to carry out Group operations are essential.	• The Group's remuneration policy is designed to attract and retain high-calibre individuals and to remunerate fairly, whilst not encouraging inappropriate business risk to be taken. • The Group has a high staff retention rate and engaged workforce. • Pay and conditions of employment are regularly reviewed against the prevailing market and bench marked against competitors to ensure that the Group remains competitive at all levels. • An internal recruitment team provides a dedicated service to the identification and enrolment of new staff who are provided with training as part of a comprehensive induction process. • A well-developed succession planning process is regularly monitored. • Talent reviews and ongoing personal development are proactively supported at all levels. • Active liaison with employees is achieved through the Costain Ground Force employee committee and engagement surveys.	⏸

RISK AND IMPACT	RISK APPETITE	MITIGATION	CHANGE IN 2017
7. Pension liabilities The Group has a deficit of £73.5m in its defined benefit pension scheme which was closed to new members from 1 June 2005 and to future accrual on 30 September 2009. Failure to manage the scheme so that the liabilities are within a range appropriate to its capital base could have an adverse impact on the Group's operational results.	All current and future pension arrangements to be on a defined contribution basis.	• Regular reviews, including the use of independent professional advisers, are held to mitigate long-term risk associated with the legacy defined benefit scheme. • Ongoing active management of the obligations of the scheme including the transfer of assets into the scheme and the implementation of Enhanced Transfer Value and Pension Increase Exchange exercises. • An actuarial valuation of the scheme as at 31 March 2016 has been carried out and an associated deficit recovery plan has been agreed with the Trustee.	▲
8. Acquisitions The Group has a growth plan that is partly facilitated by the effective acquisition of companies that will enhance the achievement of its strategy. Failure to integrate successfully an acquired business or recognise and mitigate new and related risks could have a damaging impact on the Group's future revenue and profits.	Acquisitions must focus on the creation of shareholder value through capability-broadening opportunities that can be cross-sold via our existing customer base.	• Full due diligence is carried out before any acquisition is made. • Integration plans are put in place and managed by a dedicated and experienced team. • Regular progress reports using pre-agreed performance indicators are made to the Board. • Lessons are fed back into future integration exercises.	▮
9. Failure of IT systems Costain has a high reliance upon IT systems to operate efficiently, process transactions and report on results. The failure of a system as well as the failure to store key documentation securely could cause financial loss to the Group and expose the Group to breaches of legislation and fines. It may also have a negative effect on the ability to secure further contracts. This risk has increased due to increasing levels of cyber security threats within society.	All critical systems are to be regularly backed up and a disaster recovery contingency plan put in place.	• Transition underway to cloud-based systems for enhanced security and monitoring. • There is at least duplication in core hosting systems supporting data recovery efforts. • A suitably qualified team for support, including specialist outsourced suppliers, ensures knowledge is maintained. • Regular internal and external testing and assurance exercises are carried out. • Established business continuity systems and procedures, routinely tested and developed, ensure rapid recovery and data retrieval. • Security training is provided for safe usage and storage of documentation for all staff. • The system is accredited to the ISO 27001:2013 Information Security Management System providing independent assurance of best practice.	▲

▲ Increased risk

▮ No change to risk

▼ Decreased risk

FINANCE DIRECTOR'S REVIEW

Our performance in 2016 reflects the effective implementation of the Group's focused strategy which has continued to deliver good financial results over a number of years."

Anthony Bickerstaff | Finance Director

Image Removed

£1.7bn
Revenue increased

This review brings together the key financial metrics of the Group and sets out the matters of financial significance.

Overview

In 2016, the Group had another year of strong financial performance with increases in revenue and profit and finished the year with a record order book and an excellent net cash position. This performance reflects the effective implementation of the Group's focused strategy which has continued to deliver good financial results over a number of years.

In addition, investment has been made in enhancing the Group's skills and capabilities through the acquisition made in the period. The Group continues to attract good support from its banking and surety bond providers and has enhanced and extended its facilities during the year.

Revenue, including share of joint ventures and associates, was £1,658.0 million for the year to 31 December 2016 (2015: £1,316.5 million). The Group generated a 24% increase in underlying operating profit to £41.1 million (2015: £33.2 million). The increased profit reflects the Group's continued focus on long-term repeat orders with blue-chip customers.

Reported revenue, excluding share of joint ventures and associates, was £1,573.7 million for the year to 31 December 2016 (2015: £1,263.6 million).

Profit before tax, before other items, for the year was £37.5 million (2015: £29.9 million). Basic earnings per share, before other items, amounted to 31.5 pence (2015: 25.1 pence).

Reported profit before tax for the year was £30.9 million (2015: £26.0 million). Reported basic earnings per share were 25.7 pence (2015: 21.8 pence).

The Group secured a number of new contracts and extensions and the Group's order book was maintained at £3.9 billion (31 December 2015: £3.9 billion).

The results of the Group's operating divisions are considered in the Divisional review section and are shown in the segmental analysis in the financial statements.

Other items

In order to aid understanding of the underlying performance of the Group, throughout the Annual Report underlying operating profit and underlying profit before tax have been used. These measures exclude 'other items' which are acquisition related charges including amortisation of intangible assets and deferred consideration treated as an employment expense. These 'other items' are shown in a separate column in the consolidated income statement.

Acquisitions

On 5 July 2016, the Group acquired SSL a provider of technology-based solutions, primarily for the highways sector, but with the potential for wider applications across the Group. SSL was acquired for a total cash consideration of £17.0 million on a debt free/cash free basis with normalised working capital. £1.5 million of consideration has been deferred and is payable in July 2019.

In 2015, the Group acquired Rhead Group, a professional services consultancy with a focus on programme and commercial management. The acquisition was made for a total consideration of £36 million on a debt free/cash free basis with normalised working capital. £3 million of the consideration was deferred and was payable in two equal tranches with the first paid in August 2016 and the second is payable in August 2017.

Also in 2015, the Group, by mutual agreement with its joint venture partner, reorganised the net assets held by the non-core Costain-Santander joint venture (JV) in Spain. The reorganisation resulted in Costain acquiring the partner's 50% stake in the JV and the partner acquiring certain real estate assets owned by the JV.

Interest

Net finance expense amounted to £4.2 million (2015: £3.5 million). The interest payable on bank overdrafts, loans and other similar charges was £3.3 million (2015: £2.7 million) and the interest income from bank deposits and other loans and receivables amounted to £0.6 million (2015: £0.8 million). In addition, the net finance expense includes the interest cost on the net liabilities of the pension scheme of £1.1 million (2015: £1.3 million) and £0.4 million (2015: £0.3 million) unwind of discount on deferred consideration.

Tax

The Group's effective rate of tax was 14.6% of the profit before tax (2015: 14.6%). The lower than normal rate of tax arose owing to Research and Development tax relief and the reversal of timing differences including the use of tax losses not previously recognised as deferred tax assets.

Dividend

The Board has recommended a final dividend for the year of 8.4 pence per share (2015: 7.25 pence per share) to bring the total for the year to 12.7 pence per share (2015: 11.0 pence per share).

In accordance with the pension deficit recovery plan agreed with the Trustee of The Costain Pension Scheme (CPS), the Group will make an additional cash contribution to the pension scheme to match the total deficit contribution to the total amount of dividends paid to shareholders.

Shareholders' equity

Shareholders' equity decreased in the year to £99.6 million (2015: £120.6 million). The profit for the year amounted to £26.4 million and other comprehensive expenses to £39.8 million. The movements are detailed in the consolidated statements of comprehensive income and expense and changes in equity in the financial statements, the decrease in the year is primarily due to the re-measurement of the Group's legacy pension scheme defined benefit obligations to reflect current market-based assumptions.

Pensions

As at 31 December 2016, the Group's pension scheme deficit in accordance with IAS 19, was £73.5 million (2015: £36.7 million). The scheme deficit position has increased primarily as a result of a decrease in the discount rate used to calculate the liabilities, which is based on corporate bond yields, and an increase in the assumed inflation rate partially offset by the return on assets and Company contributions.

£41.1m

Underlying operating profit up 24%

FINANCE DIRECTOR'S REVIEW
CONTINUED

8.4 pence per share

Final dividend to bring the total for the full year to 12.7 pence per share

£140.2m

Strong net cash position

The table below sets out the key details of the pension scheme deficit calculation:

	2016 £m	2015 £m
Present value of defined benefit obligations	**(827.5)**	(687.4)
Fair value of scheme assets	**754.0**	650.7
Recognised liability for defined benefit obligations	**(73.5)**	(36.7)

Principal actuarial assumptions (expressed as weighted averages)	%	%
Discount rate	**2.70**	3.80
Future pension increases	**3.10**	2.95
Inflation assumption	**3.20**	3.00

In accordance with the pension regulations a triennial actuarial review of the Costain defined benefit pension scheme was carried out as at 31 March 2016. In February 2017, an updated deficit recovery plan has been agreed with the scheme Trustee resulting in cash contributions of £10.0 million for the 12 months to 31 March 2017 and then £9.6 million per annum (increasing annually with inflation) until the deficit is cleared, which would be in 2031 on the basis of the assumptions made in the valuation and agreed recovery plan.

In addition, as previously implemented, the Group will continue to make an additional contribution so that the total deficit contributions match the total dividend amount paid by the Company each year. Consequently, the total amount of contribution is anticipated to be at the same overall level to that under the previous plan. Any additional payments in this regard would have the effect of reducing the recovery period in the agreed plan.

Cash flow and borrowings

The Group has a positive cash balance, which was £210.2 million as at 31 December 2016 (2015: £146.7 million) and borrowings of £70.0 million (2015: £38.5 million). This included cash held by joint operations of £68.1 million (2015: £42.7 million).

The increase in the net cash position reflects positive operating cash flow and working capital, in particular benefiting from the timing of receipts at the year-end. These positive movements have been partially offset by the payment of acquisition related consideration, dividend payments and pension deficit contributions made during the year. The average month-end net cash balance during 2016 was £69.1 million (2015: £103.7 million).

Contract bonding and banking facilities

The Group's long-term contracting business is dependent on it being able to supply performance and other bonds as necessary. This means maintaining adequate facilities from banks and surety bond providers to meet the current and projected usage requirements. During the year, the Group has increased its contract bonding and banking facilities to £555 million and extended the maturity date to 25 June 2021 with its relationship banks and surety companies. These facilities are made up of £400 million of contract bonding, a £125 million revolving credit facility and a £30 million term loan.

Treasury

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.

Liquidity risk

The Group finances its operations primarily by a mixture of working capital, funds from shareholders, retained profits and borrowings. The Directors regularly monitor cash usage and forecast usage to ensure that projected financing needs are supported by adequate cash reserves or bank facilities.

Foreign currency exposure

Translation exposure: the results of the Group's overseas activities, mainly non-core activities in Spain, 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 and investments are translated at foreign exchange rates ruling at the balance sheet date. The Group holds a currency hedge against the assets held in its Spanish subsidiary.

Transaction exposure: the Group has transactional currency exposures arising from subsidiaries' commercial activities overseas and from overseas supply purchases for business in the UK. Where appropriate, the Group requires its subsidiaries to use forward currency contracts to minimise any currency exposure unless a natural hedge exists elsewhere within the Group.

Interest rate risks and exposure

The Group enters into financial instruments, where necessary, to finance its operations. Various financial instruments (for example, trade receivables and trade payables) arise directly from the Group's operations.

The main exposure to interest rate fluctuations within the Group's operations arises from surplus cash, which is generally deposited with the Group's relationship banks, and bank borrowings.

Anthony Bickerstaff | Finance Director
28 February 2017

£3.9bn

Forward order book maintained at record level

INTRODUCTION TO CORPORATE GOVERNANCE

I have two key objectives as your Chairman. First, the Board must maintain and encourage the highest standards of corporate governance. Secondly, the Board must be effective, particularly in ensuring that the Group has a robust strategy and the best management team in place to implement it."

Dr Paul Golby CBE | Chairman

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Chairman's summary statement

Dear Shareholder

I joined the Board and succeeded David Allvey as Chairman at the conclusion of the Annual General Meeting on 5 May 2016.

I have two key objectives as your Chairman. First, the Board must maintain and encourage the highest standards of corporate governance. My fellow Directors and I will continue to promote a robust governance framework that encourages transparency and accountability, as well as a meticulous and efficient approach to internal control and risk management.

Secondly, the Board must be effective, particularly in ensuring that the Group has a robust strategy and the best management team in place to implement it.

Successfully achieving these objectives facilitates the continuing development, growth and sustainability of the business.

COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE

As a premium listed company on the London Stock Exchange, the Company is reporting in accordance with the UK Corporate Governance Code published in 2014 (the Code)[1], which sets out standards of good practice in relation to board leadership, effectiveness, accountability, remuneration and relations with shareholders.

The Board considers that the Company has applied the main principles of the Code which it considers to be central to the effective management of the business and to maintaining the confidence of investors. Throughout the entire year, the Company complied with all the provisions of the Code. The Audit Committee report on pages 53 to 56, the Nomination Committee report on pages 57 and 58 and the Directors' Remuneration report on pages 59 to 78 are also incorporated into this report by reference.

1 A copy of the Code is publicly available at www.frc.org.uk.

Some of the key priorities during the year were:

Strategy

This year, the Board has again undertaken wide-ranging discussions on key strategic issues. This has included a number of workshops attended by members of the Group Executive Board and third-party advisers. These conversations continued to be focused on implementing our unique, focussed and continually evolving 'Engineering Tomorrow' strategy. A three-year business plan was approved in December 2016.

Risk

During the year the new Group Risk Manager has further reviewed and enhanced the risk management and monitoring framework and the clarity of reporting to the Audit Committee and Board in this area.

Board composition and succession planning

The report from the Nominations Committee on pages 57 to 58 explains the process the Board and Nominations Committee followed in undertaking a search for a new Chairman. Board and senior management succession has been a regular feature of our Board and Nomination meetings.

Board effectiveness

Each year, the Board undertakes a formal evaluation of its effectiveness and that of its Committees. This year the process has been internally facilitated and led by me as the Chairman. It has built on the work carried out two year's ago by independent external facilitators, SCT Consultants Ltd. In addition, James Morley, the Senior Independent Director, has also led a review of my performance with input from the other Directors. Further details of the evaluation process can be found on page 58. Following this review, I am satisfied that the Board and its Committees are working effectively and that there is the appropriate balance of skills, experience, diversity and independence.

On the following pages, we explain our approach to corporate governance, demonstrating how the Board and its Committees have fulfilled their responsibilities to ensure robust governance practices are embedded throughout the Company.

Dr Paul Golby CBE | Chairman
28 February 2017

BOARD OF DIRECTORS
EXPERIENCED AND EFFECTIVE LEADERSHIP

DR PAUL GOLBY[3]
CBE, FREng, FIET, FIMechE, FEI, FCGI

Non-Executive Chairman

Image Removed

Appointment
May 2016

Skills and experience
Paul Golby was appointed as Chairman of Costain in May 2016. A Fellow of the Royal Academy of Engineering, Paul has held a variety of roles within the engineering and energy industries. Following an early career with Dunlop Holdings plc and BTR plc he joined Clayhithe plc, becoming an Executive Director in 1992. In 1998, Paul joined East Midlands Electricity plc as Managing Director and following its acquisition by PowerGen (subsequently E.ON UK plc) was appointed Executive Director, UK operations. In 2002, Paul became Chief Executive and later Executive Chairman, stepping down from the E.ON Board in December 2011. Paul was also Non-Executive Chairman of AEA Technology Group plc (2009-2012) and Chairman of Engineering UK (2010-2016).

External appointments
Non-Executive Director of National Grid plc since February 2012 and Non-Executive Chairman of the National Air Traffic Services (NATS Holdings Ltd.) since October 2014. Paul has also been Chairman of the Engineering and Physical Sciences Research Council since 2012. Paul was appointed as Pro-Chancellor of Aston University and Chair of Council in 2009. He was also appointed as a member of the Prime Minister's Counsel for Science and Technology in June 2011.

ANDREW WYLLIE
CBE, FREng, MBA, BSc, CEng, FICE, CCMI

Chief Executive

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Appointment
September 2005

Skills and experience
Andrew Wyllie was appointed Chief Executive in September 2005. He was previously Managing Director of Taylor Woodrow Construction Ltd (2001-2005) and a member of the Taylor Woodrow plc Executive Committee. Andrew joined Taylor Woodrow in 1984 and worked on major contracts in Africa, the Middle East, the Far East and the UK.

Andrew has an MBA from London Business School, is a Fellow of the Royal Academy of Engineering, Vice President of the Institution of Civil Engineers, a Fellow of the Institute of Directors and the British American Project. He is also a member of the CBI Construction Council and a Companion of the Chartered Management Institute. Andrew was awarded a CBE for services to construction and engineering in the 2015 New Year's Honours list.

External appointments
Non-Executive Director of Scottish Water.

ANTHONY BICKERSTAFF
FCCA

Finance Director

Image Removed

Appointment
June 2006

Skills and experience
Tony Bickerstaff was appointed Finance Director in June 2006. Tony has extensive knowledge of the construction and support services sectors both in the UK and overseas. He is responsible for all aspects of the financial management of the Group as well as playing a major role in the Group's strategic and operational development. Previously, Tony was with the Taylor Woodrow Group, which he joined in 1982. He held a number of senior management and financial positions in Taylor Woodrow including Finance Director of Taylor Woodrow Construction Limited. Prior to becoming Finance Director, he was Divisional Operations Director in charge of Taylor Woodrow Group's PFI projects.

External appointments
Non-Executive Director and Chair of the Audit Committee of Low Carbon Contracts Company Limited and Electricity Settlements Company Limited.

JAMES MORLEY[1,2,3]
BSc, FCA

Senior Independent Director

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Appointment
January 2008

Skills and experience
James Morley was appointed as the Senior Independent Director in January 2013 prior to which he served as Chairman of the Audit Committee from January 2008 until the end of October 2012. He is a Chartered Accountant with some 27 years' experience as a board member of both listed and private companies. Previous roles include Chief Operating Officer of Primary Group Ltd (2006-2007), Group Finance Director of Cox Insurance Holdings plc (2002-2005), Group Finance Director of Arjo Wiggins Appleton plc (1999-2001), Group Executive Director Finance of Guardian Royal Exchange plc (1990-1999), Deputy Chief Executive and Finance Director of Avis Europe plc (1976-1989), Non-Executive Director of the Bankers' Investment Trust plc (1994-2008), Non-Executive Director of W S Atkins plc (2001-2009), Non-Executive Director of Trade Indemnity Group plc (1991-1996), Non-Executive Director of The Innovation Group plc (2007-2015), Non-Executive Chairman of Acumus Ltd. (2011-2012), Non-Executive Director of Speedy Hire plc (2009-2015) and Non-Executive Director of BMS Group Ltd. (2011-2015).

External appointments
Non-Executive Director of Clarkson plc and Minova Insurance Holdings Ltd.

JANE LODGE[1,2,3]
FCA, BSc

Independent Non-Executive Director

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Appointment
August 2012

Skills and experience
Jane Lodge was appointed as a Non-Executive Director in August 2012 and was appointed Chair of the Audit Committee with effect from the end of October 2012. Prior to this Jane spent 35 years at Deloitte LLP (UK), 25 as an audit partner advising global companies, particularly in the manufacturing, house-building and property and construction sectors. She was senior partner of the Birmingham office and the Deloitte UK Manufacturing Industry Sector. Jane was previously a Non-Executive Director and Chair of the Audit Committee, Moorgate Industries Limited (2014-2015) and a Non-Executive Director of Black Country Living Museum Trust Limited.

External appointments
Non-Executive Director and Chair of the Audit Committee at Devro PLC, DCC plc and Sirius Minerals plc. Non-Executive Director, Bromsgrove School Foundation.

DAVID MCMANUS[1,2,3]
BSc

Independent Non-Executive Director

Image Removed

Appointment
May 2014

Skills and experience
David McManus was appointed as a Non-Executive Director with effect from 12 May 2014. David began his career with the Fluor Corporation (1975-1980) after graduating in civil engineering and went on to hold a number of executive positions in Shell UK (1980-1989), LASMO plc (1989-1994), Atlantic Richfield Company (ARCO) (1994-2000), BG Group (2000-2004) and as Executive Vice President, International Operations of Pioneer Natural Resources (2004-2012). David was formerly a Non-Executive Director of Cape plc (2004-2012), serving as Chairman from 2006 to 2008 and was also a Non-Executive Director of Caza Oil & Gas Inc. (2011-2015).

External appointments
Non-Executive Chairman of Rockhopper Exploration plc and FlexLNG. Non-Executive Director at the Hess Corporation .

ALISON WOOD[1,2,3]
MBA, BA

Independent Non-Executive Director

Image Removed

Appointment
February 2014

Skills and experience
Alison Wood was appointed as a Non-Executive Director with effect from 1 February 2014 and was appointed as Chairman of the Remuneration Committee from the beginning of April 2014. Alison is the former Global Director of Strategy and Corporate Development at National Grid plc (2008-2013). Before that, Alison spent nearly 20 years in a number of strategy and leadership roles at BAE Systems plc including Group Strategic Development Director. Alison has also held Non-Executive Director positions with BTG plc (2004-2008) and Thus Group plc (2007-2008).

Alison is a Director of the Costain Charitable Foundation.

External appointments
Non-Executive Director and Chairman of the Remuneration Committee at Cobham plc and TT Electronics plc. Senior Independent Director at e2v technologies plc. Non-Executive Director of British Standards Institute.

Former Director
David Allvey retired as Non-Executive Chairman with effect from 5 May 2016.

Committee membership
[1] Member of the Remuneration Committee

[2] Member of the Audit Committee

[3] Member of the Nomination Committee

Group Executive Board
See pages 42 to 43

Committee activities
See pages 44 to 45

GROUP EXECUTIVE BOARD
AN EXPERIENCED LEADERSHIP TEAM TO DELIVER THE STRATEGY

The Group Executive Board chaired by Andrew Wyllie, focuses on running the business and delivering the Group strategy. The members are:

ANDREW WYLLIE
CBE

Chief Executive

Image Removed

Board of Directors profiles
See pages 40 to 41

ANTHONY BICKERSTAFF
FCCA

Finance Director

Image Removed

Board of Directors profiles
See pages 40 to 41

SALLY AUSTIN
BSc (Hons), FCIPD

Group HR Director

Image Removed

Appointment
July 2015

Skills and experience
Sally Austin joined Costain in 2005 and is currently Group HR Director. She began her career with BAE Systems, moving to Eaton Corporation in 2000 where she held a number of HR management roles supporting US, EMEA and European facilities. In her current role she holds responsibility for Executive remuneration, Group-wide HR operations, recruitment, Learning & Development, HR Shared Services and Pensions. Sally holds a BSc(Hons) in Psychology and is a Fellow of the CIPD.

NIGEL CURRY
CEng, BEng, MBA

Consulting & Advisory Services Director

Image Removed

Appointment
August 2015

Skills and experience
Nigel Curry is COO of the Infrastructure division as well as Executive Board Director responsible for Consulting and Advisory Services. He is a qualified Chartered Mechanical Engineer with an Executive MBA and has attended Harvard and INSEAD on their Director programmes. Nigel was granted the Freedom of the City of London in 2008 and has been a trustee of IGEM. Nigel has extensive experience managing the construction of complex programmes in the Energy, Power and Defence Sectors. He joined Costain when it acquired the Rhead Group in 2015.

MATTHEW HARRIS
FCA

Group Strategy and Risk Director

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Appointment
December 2016

Skills and experience
Matthew Harris was appointed Group Strategy and Risk Director in 2016. He is a Fellow of the Institute of Chartered Accountants in England and Wales, achieved a BSc at the University of Warwick and qualified as a Chartered Accountant with Price Waterhouse. Matthew gained finance and management experience with BMW, Thames Water, American Water and Hanson. He joined Costain in 2012 as Finance Director for the Natural Resources Division and has led a number of Group-wide projects since then.

MARTIN HUNTER
BA, ACA

Group Financial Controller

Image Removed

Appointment
April 1999

Skills and experience
Martin Hunter holds the position of Financial Controller and held a number of head office finance positions since 1984. Previously, Martin worked for Stoy Hayward, a London based firm of chartered accountants. He is a member of the Institute of Chartered Accountants in England and Wales.

DARREN JAMES
CEng, FICE, FCIHT, FIoD

Managing Director Infrastructure

Image Removed

Appointment
September 2008

Skills and experience
Darren James has held the position of Managing Director of the Infrastructure division since 2008. He initially joined as an Industrial Placement Student during his undergraduate studies at the University of Surrey, where he obtained a degree in civil engineering. He has held a number of positions in the Group. In his current role Darren has profit and loss responsibility for the division which provides services to customers in the Rail, Highways and Nuclear sectors. Additionally Darren has Group-wide responsibility for Health Safety and Environment.

External appointments
Non-Executive Director of the Port of London Authority.

DAVID TAYLOR
FRICS, FIoD

Group Commercial Director

Image Removed

Appointment
January 2015

Skills and experience
David Taylor joined the Company in 2009 and was appointed Group Commercial Director in January 2015. He has held a number of senior commercial roles within the business and is currently responsible for the Commercial, Supply Chain & Design Management functions. Prior to joining Costain, David acquired more than 25 years' experience with Taylor Woodrow where he held the position of Commercial Director for its UK operations.

ALEX VAUGHAN
BSc (Hons) MRICS, Dip IoD, FIoD

Managing Director Natural Resources

Image Removed

Appointment
October 2006

Skills and experience
Alex Vaughan is Managing Director of the Natural Resources division, where he is responsible for our services to Water, Oil & Gas and Power customers. He has held this position since 2013. He is qualified as a Chartered Quantity Surveyor and initially joined as an industrial placement student quantity surveyor in 1990. He has worked on infrastructure projects in the UK and internationally. He is currently also responsible for the development of customer facing technology solutions across the Group.

TRACEY WOOD
LLB

Legal Director and Company Secretary

Image Removed

Appointment
July 2008

Skills and experience
Tracey Wood joined the Company in February 2006 as Head of Legal. She has a construction and commercial law background and was formerly a partner at Hammonds. She has had a number of senior roles and was appointed to the Executive Board as HR Director in July 2008. She became Legal Director and Company Secretary in June 2010 and currently also has responsibility for human resources across the Group. Tracey is a Director of The Costain Charitable Foundation.

External appointments
Non-Executive Director and Chair of Remuneration Committee of Bristol Water PLC.

CORPORATE GOVERNANCE REPORT

Our governance structure

The Group's organisational structure is established and overseen by the Board and designed to allow effective decision-making and to meet corporate governance standards. A diagram illustrating the structure is shown below:

OUR BOARD

Key responsibilities:

- The Board is collectively responsible for the management of the Company. The Board's main role is to create long-term value for shareholders by providing entrepreneurial and prudent leadership of the Company. It does this by setting the Company's strategic aims and overseeing

The Board has adopted a schedule of matters specifically reserved for its approval. The schedule details key aspects of the affairs of the Company which the Board does not delegate, including key strategic, operational and financial issues.

CHAIRMAN

The role of the Chairman and Chief Executive are separately held and *responsibilities clearly established*

Responsible for:

- The Chairman, Dr Paul Golby, is responsible for the effective leadership and operation of the Board.

NON-EXECUTIVE DIRECTORS

Comprises Senior Non-Executive Director and three other Independent Non-Executive Directors

Responsible for:

- The Non-Executive Directors all bring valuable experience, insight and perspective to the Board, through their former executive roles and their other non-executive positions, which are held across a wide range of businesses and disciplines, and this facilitates robust decision-making by the Board as a whole.
- The Non-Executives, together with the Chairman, also meet without the Executive Directors being present from time to time as a matter of good corporate governance.

Specific responsibilities of the Senior Independent Director:

- The role of the Senior Independent Director, James Morley, involves providing a sounding board for the Chairman, acting as a point of contact for shareholders to raise concerns should they arise and meeting with the other Non-Executive Directors, without the presence of the Chairman or Executive Directors, to discuss such matters as the appraisal of the Chairman's performance.

BOARD COMMITTEES

Key responsibilities:

- The Board has established Committees which are responsible for audit and risk, remuneration, appointments and succession. Each Committee plays a vital role in helping the Board to ensure that high standards of corporate governance are maintained throughout the Group.

AUDIT COMMITTEE

Key responsibilities:

- Monitors and reviews the integrity of Costain's financial statements.
- Manages the relationship with the external auditor.
- Oversees our systems for internal control and risk management.

NOMINATIONS COMMITTEE

Key responsibilities:

- Monitors and reviews the composition and balance of the Board and its Committees to ensure Costain has the right structure, skills and experience in place for the effective management of the Group.

REMUNERATION COMMITTEE

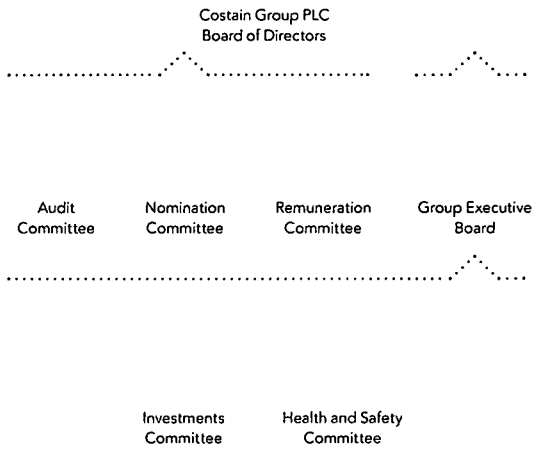
Key responsibilities:

- Determines the remuneration for Executive Directors and the Executive Committee members.
- Oversees Costain's overall remuneration policy, strategy and implementation.

The Committees are governed by terms of reference which are reviewed annually and can be viewed in the corporate governance section of the Company's website. The members of each Committee and details of their attendance are shown on **page 46**.

their delivery, ensuring that the necessary financial and other resources are available, and by maintaining a balanced approach to risk within a framework of effective controls.

A copy of the schedule of matters can be found on the Company's website at **costain.com**.



EXECUTIVE DIRECTORS/CHIEF EXECUTIVE

Responsible for:

- The Chief Executive, Andrew Wyllie, is responsible for managing the business of the Company through the implementation of policies and strategies as determined by the Board.

See Board biographies on **pages 40 and 41**.

GROUP 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 Group Board.

Key responsibilities:

- The Group Executive Board is accountable for running the business and delivering the Group strategy. It consists of the Executive Directors and other senior managers, is chaired by Andrew Wyllie (Chief Executive) and works with the support of a number of operational Committees and functions.

See Board biographies on **page 42 and 43**.

INVESTMENTS COMMITTEE

Key responsibilities:

- Responsible for allocating the Group's work winning resources and other investments.

HEALTH AND SAFETY COMMITTEE

Key responsibilities:

- Responsible for setting and monitoring compliance with the Group's health & safety policies.

CORPORATE GOVERNANCE REPORT
CONTINUED

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Leadership

Role of the Board

For more information please refer to diagram on pages 44 to 45.

Board composition and attendance

The Board currently comprises the Chairman, two Executive Directors and four independent Non-Executive Directors. The membership of the Board and biographical details of all the Directors can be found on pages 40 and 41.

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 Board believes that there is an appropriate balance between Executives and Non-Executives and that this balance is enhanced by the varying lengths of service, gender balance and expertise of the Non-Executive Directors which is depicted in the pie charts on this page.

The Board recognises the importance of greater diversity (including gender diversity) in the boardroom and throughout the business, further details of which are given in the Nomination Committee report on pages 57 and 58.

The Board meets regularly, with eight scheduled meetings having taken place during the year. The Directors' attendance record at the scheduled Board meetings and Board Committee meetings for the year ended 31 December 2016 is shown in the table below. For the Board and Committee meetings, attendance is expressed as the number of meetings that each Director attended out of the number that they were eligible to attend. In addition, ad-hoc meetings were arranged to deal with matters between the scheduled meetings as appropriate.

Board roles

For more information please refer to diagram on pages 44 to 45.

Board independence

The Board considers each of its Non-Executive Directors to be independent in character and judgement and there are no relationships or circumstances which are likely to affect (or could appear to affect) the judgement of such Non-Executive Directors, notwithstanding that, in the case of Mr James Morley, the Senior Independent Director, he has served on the Board for more than nine years as at the date of this report.

At the time of his original appointment in May 2016, the Chairman of the Company was considered independent by the Board. However, in accordance with the Code[1], the ongoing test of independence is not applicable in relation to the Chairman.

The Company complies with the requirement under provision B.1.2 of the Code that at least half of the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent, notwithstanding that this requirement is waived in respect of smaller companies, such as the Company, which is a member of the FTSE SmallCap Index.

1 A copy of the Code is publicly available at www.frc.org.uk.

Board attendance

	Board Maximum 8	Audit Committee Maximum 4	Remuneration Committee Maximum 4	Nomination Committee Maximum 2
Executive Directors				
Andrew Wyllie	8/8	4[a]	2[a]	2[a]
Anthony Bickerstaff	8/8	4[a]	3[a]	2[a]
Non-Executive Directors				
Paul Golby	5/5	3[a]	2[a]	1/2
James Morley	7/8	3/4	4/4	2/2
Jane Lodge	8/8	4/4	4/4	2/2
Alison Wood	8/8	4/4	4/4	2/2
David McManus	8/8	3/4	4/4	2/2
David Allvey[b]	2/3	1[a]	1[a]	1/1

(a) Not a member of the Committee – attendance at meeting by invitation.

(b) Retired from the Board with effect from 5 May 2016.

JULY 2016 BOARD VISIT TO LONDON:

Offsite visits and Board meetings give the Board further insights into the business. In July 2016, a 3 day Board visit to London included:

- Site visit to London Bridge Station Redevelopment project
- Site visit to Crossrail C610 project
- Presentation by participants of the Emerging Leaders Programme
- Board dinner with senior managers and other invited guests

I find these site visits provide the Board with further insight into the business and assist the Board in supporting executive management in the delivery of the Group's strategy"

David McManus
Non-Executive Director

Appointments to the Board and retirement of Directors

David Allvey retired from the Board as Non-Executive Chairman at the conclusion of the Company's AGM on 5 May 2016 with Dr Paul Golby CBE being appointed as his successor. Dr Golby's biography can be found on page 40.

The appointment and replacement of Directors is governed by the Company's Articles of Association, the Code, the Companies Act 2006 and related legislation. The Articles of Association may be amended by a special resolution of the Company's shareholders. The Company's Articles of Association require that all 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. The Company's Articles of Association also provide that Non-Executive Directors who have served for longer than nine years should be subject to annual re-election. Accordingly, the aforementioned provisions of the Company's Articles of Association comply with provision B.7.1 of the Code, as applicable to smaller companies below the FTSE 350.

The Executive Directors have contracts of employment with the Company, terminable on 12 months' notice, whilst the Chairman and Non-Executive Directors all have letters of appointment with the Company. 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. All contracts and letters of appointment are available for inspection at the Company's registered office during normal business hours.

In accordance with an Undertaking entered into in October 1997, UEM Group Berhad had been entitled to appoint a Non-Executive Director as long as they held more than 7% of the aggregate nominal value of the then issued share capital of the Company, although they had not taken advantage of this option since 4 December 2009. In November 2016 UEM's holding in the Company fell below 7% and as 31 December 2016 they no longer held any interest in the Company's shares.

The Company therefore complied with provision B.2.3 of the Code throughout the whole of the year, which requires that all Non-Executive Directors should be appointed for a specific term.

Board effectiveness

Performance

The Board has established a formal process for the evaluation of the performance of the Board and its principal Committees and further details are provided on page 58 of the Nomination Committee report. The Board considers that the performance evaluations demonstrate that each Director continues to contribute effectively and the Board as a whole demonstrates good practice on the key indicators of Board effectiveness.

Board induction and training

On appointment, the Directors take part in an induction programme, pursuant to which 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 regards the continuing professional development of the Executive and Non-Executive Directors, Board members, independent of any formal training arranged by the Company, are encouraged to attend seminars and conferences on issues relevant to their appointment as Directors of a public company, particularly matters concerned with corporate governance, audit and remuneration issues. In addition, Board site visits are considered essential to ensure that Directors have a thorough understanding of the business operations and issues that affect the Group. The Board also takes part in the Company's Health and Safety training programmes.

CORPORATE GOVERNANCE REPORT
CONTINUED

HOW THE NON-EXECUTIVE DIRECTORS ARE KEPT INFORMED

- Presentations from business sectors or functions
- Visits to regional offices or operational sites
- Access to key Executive personnel between meetings
- Weekly reports from the Chief Executive
- Regular management accounts and internal reports
- Updates on legal, regulatory and governance matters
- Presentations from external advisers

DIRECTORS DUE TO OFFER THEMSELVES FOR RE-ELECTION AT THE 2017 AGM

- Dr Paul Golby
- James Morley
- Alison Wood

HEALTH AND SAFETY

The Board consider health and safety its number one priority. The Board therefore regularly take part in twice yearly Company Health and Safety impact days.

Operation of the Board

The Chairman sets the Board's agenda and ensures that adequate time is available for discussion of all agenda items. In order to discharge their duties, the Directors are provided with full and timely access to papers prior to Board meetings via a fully encrypted electronic portal system. Directors have access to all information relating to the Group and are free to seek any further information they consider necessary. After each meeting, the Company Secretary operates a comprehensive follow-up procedure to ensure that actions are completed as agreed by the Board.

Senior executives below Board level are invited to attend Board meetings from time to time in order to deliver presentations on issues that are relevant to their particular business sector or function. During the year, the Directors set aside several days to combine scheduled Board and Committee meetings with visiting regional offices and operational sites in order to provide the Non-Executives with an opportunity to meet both senior managers and other members of staff and to obtain a greater insight into particular aspects of the business and projects that the Company is engaged in.

In July 2016, the Board travelled to London in order to visit the Company's London Bridge and Crossrail projects and the highlights of their visit are detailed in the table shown on page 47.

In addition, between Board meetings, the Chairman and Non-Executive Directors have access to the Chief Executive, Finance Director and Company Secretary in order to progress the Company's business. The Chairman and Non-Executive Directors also receive a weekly report from the Chief Executive, monthly management accounts, internal audit reports and regular management reports and information, which enable them to scrutinise the Group and its management's performance against agreed objectives. The Board is also kept up to date on legal, regulatory and governance matters by both the Company Secretary and external advisers. An example of training undertaken this year was a session held for all the Directors by the Company's corporate lawyers on the new Market Abuse Regulations which came into force in July 2016.

All Board members have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures are followed and applicable rules and regulations are followed, and who is also the Company's Legal Director. The appointment and removal of the Company Secretary is a matter reserved for Board approval. The Board also obtains advice from professional advisers as and when required at the expense of the Company.

Re-election of Directors

In accordance with Article 78 of the Company's Articles of Association and provision B.7.1 of the Code, Dr Paul Golby, James Morley and Alison Wood are due to offer themselves for re-election at the 2017 Annual General Meeting (AGM). Dr Paul Golby, having been appointed by the Board since the last AGM, is required to stand for re-election. Alison Wood, having served on the Board at the time of the two preceding AGMs without retiring, and James Morley having been in office for a continuous period in excess of nine years, are also both required to stand for re-election at the 2017 AGM. Dr Paul Golby, James Morley and Alison Wood have letters of appointment with the Company, details of which are set out in the Directors' Remuneration report on page 67.

Having due regard to the results of the externally facilitated review of the Board's performance conducted by SCT Consultants Ltd, and to periodic internal evaluations (further details provided on page 58 of the Nomination Committee report), the Board confirms that it is of the opinion that each of the Directors standing for re-election continues to be independent in character and judgement. The Board also confirms that these Directors continue to perform effectively, and that they demonstrate commitment to their particular roles and that they ensure that proper time is devoted to Board and Committee meetings and should therefore be re-elected at the forthcoming AGM.

The Company remains committed to maintaining good relationships with both institutional and private shareholders.

Directors' conflicts of interest and external appointments

The Non-Executive Directors may serve on a number of other company boards provided they continue to demonstrate the requisite commitment to discharge their duties to the Company effectively and such external appointments are seen as being beneficial to the overall decision-making process of the Board as a whole. The Company also encourages the Executive Directors to take up non-executive positions, with the prior consent of the Company, in the belief that such appointments broaden their skills and enhance the contribution which they can make to the Company's performance. Generally, no more than one such appointment may be undertaken by the Executive Directors. The Company has procedures in place for managing conflicts of interest. Directors are required to declare all external appointments or relationships with other companies and the Board has adopted appropriate processes to manage and, if appropriate, approve any such appointment or relationship which could result in a possible conflict of interest. The Board has satisfied itself that there is no compromise to the independence of the Directors who have appointments on the boards of, or relationships with, other companies.

Corporate Responsibility (CR)

The Board receives reports from the Company's CR Director and monitors progress on a regular basis.

Remuneration

Details of the Company's remuneration policy and how it has been implemented, together with the activities of the Remuneration Committee are to be found on pages 59 to 78 of the Directors' Remuneration report.

Shareholder communication and engagement

The Company remains committed to maintaining good relationships with both institutional and private shareholders. There continues to be regular dialogue with institutional investors and brokers.

At the time of the announcement of the full-year and half-year results, presentations are made to brokers' analysts, the press and institutional investors. These presentations are available on the Company's website at **costain.com**. In addition, there are meetings with analysts, financial journalists and institutional investors throughout the year including a 'Capital Markets Day' which took place in June 2016.

The Chairman is available to discuss strategy and governance issues with shareholders, and James Morley, as the Senior Independent Director, is available to shareholders if they have any concerns that have not been, or cannot be, addressed through the normal channels of Chairman, Chief Executive or Finance Director.

The Company obtains feedback from its brokers, Investec and Liberum Capital, on the views of institutional investors on a non-attributed basis. As a matter of routine, the Board reviews reports from its brokers on issues relating to recent share price performance, trading activity and institutional sentiment. The Board also receives copies of relevant analysts' reports on an ad-hoc basis.

The Board regards the AGM as an important opportunity to communicate directly with shareholders. The AGM provides shareholders with an opportunity to ask questions of the Directors during the meeting and also on a more informal basis following the conclusion of the meeting, at which senior members of staff are also present. The AGM also gives shareholders an opportunity to listen to a presentation from the Chief Executive on the current trading performance and developments within the business. Board members, including the Chairs of the Remuneration, Nomination and Audit and Risk Committees, attended the 2016 AGM and propose to attend the 2017 AGM, where they will be available to answer questions.

Shareholders may raise issues or concerns by contacting the Group's Investor Relations Director via the email address stated on the Company's website or by writing to the Company Secretary.

CORPORATE GOVERNANCE REPORT
CONTINUED

The preparation of this Annual Report and Accounts involved input from a number of functions across the Group and the Board was involved at an early stage to enable review, challenge and discussion ahead of approving the final publication.

Accountability

Financial and business reporting

The Board is required by the Code to present a fair, balanced and understandable assessment of the Company's position and prospects and reference is made to the statement of Directors' responsibilities on page 83 together with the statement on the status of the Company as a going concern and the financial viability statement on page 28.

The preparation of this Annual Report and Accounts involved input from a number of functions across the Group and the Board was involved at an early stage to enable review, challenge and discussion ahead of approving the final publication.

The Board also recognises that its responsibility to present a fair, balanced and understandable assessment also extends to interim and other price-sensitive reports that the Company may publish from time to time.

Business model

The Strategic report on pages 01 to 37 gives details of the Company's business model and the strategy for delivering the objectives of the Company.

Risk management and internal control

Risk management

Risk management is firmly established and plays a critical role ensuring the Group continues to meet its objectives. The Board is responsible for making a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity and for ensuring that appropriate mitigating actions are in place to manage them. The principal risks and uncertainties facing the Company at the date of this report can be found on pages 30 to 33 of the Strategic report.

Enterprise Risk Management approach

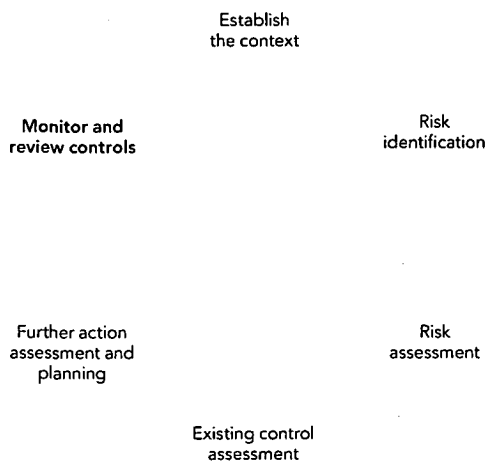
The Enterprise Risk Management (ERM) approach assesses and manages on an ongoing basis the most significant risks to the Group's objectives. The ERM process covers all types of risk including operational, financial, legal and regulatory. The Company's assessment of risk includes explicit consideration of the possible impacts of the risks on the reputation of the Group as a whole, analysing both the potential causes and impact of risk. Using this process, suitable consideration of the controls needed to minimise the likelihood of risks occurring and those which can help to maximise resilience to risks are made.

The ERM framework is recurrent; reviewing risk levels regularly and ensuring frequent monitoring of control implementation. Whilst coordinated and supported by the Group Risk Management function, ownership of risk is maintained at the relevant business unit level.

The ERM process ensures the Costain Way, a common platform which contains all governance, controls, policies and procedures for the Company, is further fine-tuned to enhance the control environment. This approach provides review and development of the formal and informal controls necessary to ensure we meet our objectives.

The Company's assessment of risk includes explicit consideration of the possible impacts of the risks on the reputation of the Group as a whole, analysing both the potential causes and impact of risk.

Enterprise Risk Management Process



Our risk focus for 2017

During 2016, the emphasis on risk management was more strategic in nature, with the Group's broader market activities being monitored in order to ensure further development of the competitive edge. For 2017, there is a focus on resilience and critical business functions, as well as the strategic and operations management.

The overall assessment is that there is a strong risk management culture within the Group which is continuing to develop, supported centrally by the Group Risk Management function.

Ensuring the effectiveness of the system of risk management and internal controls

The Board is responsible for the effective and ongoing monitoring and review of the Group's system of internal controls. In addition, the Board supported by the Audit Committee also carries out an annual review of the effectiveness of the systems. Such a system, however, 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. The Chief Executive has full authority to act subject to the matters reserved to the Board and to the requirements of Group policies, and is expressly responsible for Health and Safety.

The Board and Group Executive Board receive regular reports on Safety, Health and Environmental performance and significant operational matters. The Group Executive Board is responsible for ensuring compliance with Company procedures.

Operational controls

The Company uses the Costain Way, its operational management system, to detail controls and procedures, including Group policy statements, procedure manuals and other written instructions, which are reviewed and updated regularly. The objectives of the Costain Way are to provide assurance that:

- Company activities across the business are compliant with appropriate legislation and codes of practice;
- Company systems, procedures and processes are effective at mitigating identified risks;
- customer expectations are understood, communicated and effectively delivered;

CORPORATE GOVERNANCE REPORT
CONTINUED

Internal Audit monitors compliance against the Costain Way using a risk-based approach to ensure the focus is on high-risk activities and thus verify the appropriate implementation of controls.

- management controls are consistently applied across the Group; and
- performance is reviewed, validated and continually improved.

The Costain Way has been externally certified by BSI as compliant to management standards including ISO 9001 (quality), ISO 14001 (environment), OHSAS 18001 (health and safety), ISO 22301 (business continuity), ISO 27001 (information security) and BS 11000 (collaboration).

Each contract leader is wholly accountable for performance of their operations. They complete a monthly report that provides detailed information on Safety, Health and Environmental performance, cash flow, value, cost and profit, claims and variations, risk management, progress and staffing levels. This enables management to monitor performance and intervene where appropriate. All contracts operate within a controlled framework of best practice assured by second (system design and senior management review) and third (internal and third-party audit) line defences.

Financial controls

There is a comprehensive annual budgeting system, linked to the annual strategy review, for each business unit within the Group. The budget for the following year is reviewed and finalised by the Executive Board, alongside the three-year business plan, before final approval by the Board each December.

The Company has in place internal controls and risk management systems in relation to the Company's financial reporting process and the Group's process for preparation of consolidated accounts. These are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes.

Each division's performance is reviewed monthly by management and reported against budget to the Board and Executive Board. The reports cover profit and loss and cash flow with an accompanying narrative on significant issues underlying the financial reports. Furthermore, a review of the consolidated financial statements is completed by management to ensure that the financial position and results of the Group are appropriately reflected therein. The Group Treasurer and Group Taxation Manager report to the Audit Committee, via the Finance Director, on any issues of significance to the Group.

Compliance

The Company expects the highest standards from all employees, suppliers and joint venture partners. The Group's policies contain a statement on business conduct, emphasising the legal, ethical and moral standards that must be employed in all the Company's business dealings. This statement is regularly reviewed and updated as appropriate to ensure compliance with any change in legislation.

Internal Audit monitors compliance against the Costain Way using a risk-based approach to ensure the focus is on high-risk activities and thus verify the appropriate implementation of controls. This independent assurance ensures risks inherent to the Company's business processes are reasonably controlled and assists management in assessing requirements for further controls.

In the event of a critical legal issue, a legal report is submitted to the Board. An annual review of all litigation valued above £50,000 is submitted to the Board for review. Significant legal and regulatory changes are notified to the appropriate staff and training given where necessary.

AUDIT COMMITTEE REPORT

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JANE LODGE
Chairman

Chairman's summary statement

Dear Shareholder

I am pleased to take this opportunity, on behalf of the Board, to present our report on the work of the Audit Committee (the Committee) in respect of the year ended 31 December 2016.

In 2016 the Committee continued to focus on the integrity of the Group's financial reporting, the effectiveness of the Group's risk management and internal controls systems and the robustness of the internal and external audit processes.

Our control functions have continued to develop during the year, benefiting from the first full year appointment of a dedicated Group Risk Manager, who has enabled a more integrated approach to risk management and an increase in the scope and depth of reviews across the business. This has also led to increased oversight by the Audit Committee on issues such as the management of joint ventures and cyber security.

More details of the Group's principal risks can be found on pages 30 to 33.

The External Auditor plays a critical role in ensuring the integrity of the Group's financial reporting. This year, the Committee conducted a full tender of the External Auditor position. Following the completion of that process, the Committee recommended the appointment of PricewaterhouseCoopers LLC as the Company's statutory auditor, subject to shareholder approval. Further details of the External Auditor tender process are set out in this report.

Operation of the Committee

The Committee is comprised exclusively of independent Non-Executive Directors. The members of the Committee and details of their attendance at meetings are given on page 46. The Company Secretary is the Secretary to the Committee.

The Company considers that I as Chairman, possess the necessary recent and relevant financial experience to effectively contribute to the Committee. In addition, the Company considers that all the members of the Committee possess relevant skills and experience to meaningfully support the activities of the Committee. Full details of their experience can be found in their biographies shown on pages 40 to 41.

During 2016, the Committee held 4 meetings. The meetings of the Committee are normally also attended by the Chairman, the Chief Executive, the Finance Director, the Group Risk Manager, the Head of Internal Audit, the Group Financial Controller and the External Auditor. Other senior executives will attend as required to provide information on matters being discussed which fall into their area of responsibility. The Committee also regularly meets privately with the External Auditor, the Group Risk Manager and the Head of Internal Audit.

Role of the Committee

In accordance with its terms of reference and in compliance with the Code, the Committee is responsible for:

- monitoring the integrity of the Group's financial statements and any formal announcements relating to the Group's performance, and reviewing significant financial judgements contained in them;
- reviewing the effectiveness of the Group's system of internal controls and the processes for management of the risks facing the Group;
- reviewing the effectiveness of the internal audit function and approving, in consultation with the Chief Executive, the appointment and termination of employment of the head of that function;
- monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, reappointment and remuneration of the External Auditor;
- ensuring that an appropriate relationship between the Group and the External Auditor is maintained, including reviewing non-audit services and fees;
- reviewing the Group's systems for detecting fraud, preventing bribery and allowing employees to raise concerns in a safe and confidential manner; and

TERMS OF REFERENCE

The Committee's terms of reference are available from the Company Secretary and are published on the Company's website at **costain.com**. These are reviewed annually, and following review this year no amendments were considered to be required at this time.

AUDIT COMMITTEE REPORT
CONTINUED

SIGNIFICANT ACCOUNTING MATTERS THIS YEAR

- Key contract judgements
- Pension
- The carrying value of goodwill and intangible assets
- Alcaidesa Holding SA
- Going concern and viability statement
- Future IFRS and UK GAAP developments

- reviewing its terms of reference and its effectiveness from time to time and recommending to the Board any changes required as a result of the review.

Principal activities during the year

In 2016, the principal activities of the Committee and the manner in which it discharged its responsibilities were as follows:

Financial statements
The Committee reviewed and evaluated the Group's draft financial statements, preliminary and interim results and reports from the External Auditor on the outcome of its reviews and audits in 2016. At the Board's request, it also considered whether the Annual Report and Accounts, taken as a whole, was fair, balanced and understandable and provided the information necessary for shareholders to assess the Company's performance, business model and strategy.

Significant accounting matters
The Committee considered key accounting issues, matters and judgements in relation to the Group's financial statements and disclosures relating to:

(A) Key contract judgements
As more fully explained in Note 2 on pages 101 to 102, a significant proportion 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. These costs and revenues may be affected by a number of uncertainties that depend on the outcome of future events, and may need to be revised as events unfold and uncertainties are resolved.

Management uses detailed contract valuations and cost forecasts when formulating its judgements of costs and revenues and its assessments of the expected outcome of each long-term contractual obligation. Given the Company's portfolio of contracts, the Committee spent time during the year reviewing the positions and judgements taken by management on a number of material contracts across the Group. This was mainly achieved through discussions with management and the External Auditor.

This review included, amongst other things, consideration of the Manchester Waste Disposal Authority PFI contract awarded in 2007. As reported previously, all 46 facilities on the scheme are operating and processing waste. These facilities are all either fully completed or in the warranty period under the terms of the contract during which further work and plant modifications are to be completed. In the period, the Group has incurred further costs and has taken additional provisions to reach Final Acceptance on the contract, which is now targeted this year; and to complete the remaining works when access is available in accordance with the operational running of the plants under an agreed schedule to 2019. Costain has received significant payments from, and remains in discussions on further payments with, relevant contract counterparties and the Group's insurers regarding the issues that have arisen on this contract. It has been the Group's policy since 2009 not to pursue fixed price contracts of this nature.

On the basis of its review of material contracts, the Committee concluded that it was content with the judgements that had been made by management and that appropriate disclosures had been made at the relevant times.

(B) Pension
The Group's defined benefit scheme requires significant judgements to be made in relation to the assumptions for inflation, future pension increases, investment returns and member longevity that underpin the valuation. Each year, in selecting the appropriate assumptions, the Company takes written advice from an independent qualified actuary. These assumptions and sensitivities are set out in Note 20 on pages 124 to 126.

A triennial actuarial review was also carried out as at 31 March 2016 and in February 2017, an updated deficit recovery plan was agreed with the scheme Trustee.

(C) The carrying value of goodwill and intangible assets
As set out in Note 11 on pages 111 to 112, the goodwill and acquired intangible balances within the Group relate to companies acquired by the Group. In particular, the Committee reviewed the carrying value of the goodwill within the Natural Resources Division. The Committee also critically reviewed the analysis performed by management on the valuation of intangibles on the acquisition of Simulation Systems Limited and the impairment considerations in respect of the goodwill and intangibles. The Committee agreed with the amortisation charge in respect of intangibles, and the conclusion that no impairment to goodwill was necessary.

The Committee, on behalf of the Board, has evaluated the effectiveness of the systems of risk management and internal controls operated within the Group pursuant to the FRC's guidance on internal control.

(D) Going concern and viability statement
The Committee reviewed the Group's processes for the management of cash flow and working capital, committed funding, its ability to generate cash and its ability to raise further funding. It also challenged management's sensitivity analysis including in relation to mitigating actions. The Committee also considered the period over which the Viability Statement (set out on page 28) should apply. Based on this analysis, we recommended to the Board that it could approve and make the Viability Statement and that the Group can adopt the going concern basis in preparing its financial statements.

(E) Future IFRS and UK GAAP developments
During the year, the Committee received a management report from the External Auditor regarding the future accounting developments likely to affect the presentation of the Group's financial statements, including capitalisation of operating leases and revenue recognition on long-term contracts.

Evaluation of effectiveness of the Committee

An internal effectiveness review of the Committee's performance has been carried out in respect of the year ended 31 December 2016 as part of the review into the effectiveness of the Board conducted at the end of 2016. The review concluded that there were no significant areas for concern in respect of the performance of the Committee or any of its members.

Risk management and internal controls

Details of the Group's internal controls and risk management framework are more fully set out on pages 28 to 29 of the Strategic report and pages 50 to 52 of the Corporate Governance report.

The Committee, on behalf of the Board, has evaluated the effectiveness of the systems of risk management and internal controls operated within the Group pursuant to the FRC's guidance on internal control. The evaluation covered all material controls, including financial, operational and compliance controls. The review did not identify any significant weaknesses in the system of internal control and risk management.

The Committee has also considered the confidential reporting and whistle-blowing procedures the Company has in place and is satisfied with these procedures.

Internal audit

The Group has an internally resourced internal audit function which reports directly to the Committee. The Committee is responsible for monitoring and reviewing the operation and effectiveness of this function and approves the scope of its annual plan. During the year, the Committee undertook an internal assessment of the effectiveness and independence of the internal audit function which evidenced continued improvement across all areas, including better alignment between audit planning and the Group's strategic objectives, resulting in the improved effectiveness of internal audit reporting. Accordingly, the Committee is satisfied that the quality, experience and expertise of the function is appropriate for the business.

The Committee has received regular reports on the internal audit function's programme and findings at each of its meetings during the course of the year, and has been presented with action plans to resolve any highlighted areas. As part of the integration of risk management and internal audit, during the year, the roles of the Group Risk Manager and Head of Internal Audit were replaced with a new role, Head of Risk and Assurance. This new role will have direct reporting access to the Committee and will manage the risk and internal audit resources and will commence in March 2017.

Independence of the External Auditor

The Company's External Auditor for the year ended 31 December 2016 was KPMG LLP (KPMG) who have been the Company's auditors for more than 20 years.

In accordance with best practice and professional standards, the Company requires its External Auditor to adhere to a rotation policy whereby the audit engagement partner is rotated after five years. The External Auditor is also required to periodically assess whether, in its professional opinion, it is independent and to share those views with the Committee.

The Senior Statutory Auditor (who has signed the Audit report on behalf of KPMG on page 86) is Andrew Marshall, who was appointed as the lead audit partner at the beginning of 2013.

In order to ensure the independence and objectivity of the External Auditor, the Committee monitors the non-audit services being provided to the Group by its External Auditor, and has adopted a policy on the provision of non-audit

AUDIT COMMITTEE REPORT
CONTINUED

AUDIT EFFECTIVENESS PROCEDURE

QUESTIONNAIRES
- Questionnaires completed by members

REPORT COMPILED
- Company Secretary produces report for consideration by Committee

DECISION MADE
- Efficiency and effectiveness of the external audit 2016 was deemed satisfactory

services by the External Auditor, with the objective of ensuring that such services do not impair the independence or objectivity of the External Auditor.

The policy also sets out a number of key principles that underpin the provision of non-audit services by the External Auditor: the External Auditor should not audit its 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.

Approval of the Committee is required for any services provided by the External Auditor where the fee is likely to be in excess of £25,000. The Committee reviews all services being provided by the External Auditor annually to assess the independence and objectivity of the External Auditor, taking into consideration relevant performance and regulatory requirements, so as to ensure that these are not impaired by the provision of permissible non-audit services.

In 2016, the External Auditor performed very limited non-audit services in respect of which fees payable to the External Auditor were less than £0.1 million (2015: less than £0.1 million).

The Committee is satisfied that the independence of the External Auditor is not impaired given that the audit engagement partner is regularly changed and that the amount of non-audit fees are of a level that does not impact upon KPMG's objectivity and independence.

Audit quality and effectiveness

As part of a formal review process, external audit effectiveness questionnaires are completed by members of the Committee, the Executive Directors, other members of the Executive Board and certain members of the finance team. Based on the responses to the questionnaires, the Company Secretary produces a report for detailed consideration by the Committee.

Based on its consideration of the report, together with its own ongoing assessment, for example, through the quality of the External Auditor's reports and the audit partner's interaction with the Committee, the Committee remained satisfied with the efficiency and effectiveness of the external audit in respect of the year ended 31 December 2016.

Audit tender and new external Auditor

As indicated last year, the Committee has considered the requirements of the Code and other recent changes to the EU regulatory framework. Taking a number of factors into consideration, the Committee decided to undertake a competitive tender for external audit services. KPMG, as long-standing external auditors, were not invited to tender, but no other professional firms were precluded from participating in the process.

This tender process was managed by a senior member of the Company's finance team, and involved:

- The provision of information to all tendering firms via a shared data room;
- Individual meetings of the tendering firms with the Chairman of the Committee, executive management, and members of divisional and group finance functions;
- Written proposals; and
- A final presentation to the full Committee, chaired by the Chairman of the Committee, which was also attended by Executive Directors and the Chairman of the Group.

Following a rigorous and transparent selection process, the Committee recommended, and the Board agreed, that PricewaterhouseCoopers LLP (PwC) should be appointed, subject to Shareholders' approval at the forthcoming AGM, as the Company's new External Auditor. During the audit tender process, PwC satisfied the key selection criteria of audit quality and cultural/corporate compatibility, including by demonstrating a strong alignment with the Company's values and their ability to meet strict independence and objectivity requirements.

In order to ensure a smooth handover of the External Auditor role, PwC have "shadowed" KPMG through the 31 December 2016 year end process, and attended Committee meetings, in preparation for their formal appointment.

The Committee expresses its gratitude to KPMG for their contribution as the Company's auditors over many years.

Jane Lodge | Chairman
28 February 2017

NOMINATION COMMITTEE REPORT

Image removed

DR PAUL GOLBY CBE
Chairman

Chairman's summary statement

Dear Shareholder

The Nomination Committee (the Committee) is comprised exclusively of independent Non-Executive Directors with myself acting as Chairman. The members of the Committee and details of their attendance at Committee meetings are given on page 46 and their biographies are shown on pages 40 and 41.

MAIN ACTIVITIES DURING THE YEAR

In 2016, the Committee discharged its responsibilities by performing the following activities:

- Identifying and nominating for the Board's approval, a candidate to fill the vacancy of Chairman.
- Reviewing the overall size, structure and composition of the Board;
- Undertaking Board evaluations as detailed below;
- Receiving notifications from Directors of situations, such as proposed external appointments, in which a potential conflict of interest might arise;
- Reviewing/recommending to the Board the reappointment of those Directors who are due to offer themselves for re-election at the Annual General Meeting in accordance with the Articles of Association, following due consideration of the Board's policy on independence and the results of periodic Board performance reviews;
- Reviewing succession planning in respect of the Executive Directors and other senior employees.

Succession has been a key area of focus for the year, and on 6 April 2016 the Company announced that I would be joining the Board and succeeding David Allvey as Chairman with effect from the close of the Annual General Meeting on 5 May 2016.

My appointment followed a process, led by James Morley, Senior Independent Director. JCA Partners LLP was appointed to facilitate this process and, having no other connection with the Company, was considered to be independent. The Committee provided JCA with a full specification of the skills, experience and knowledge required. The Committee considered a number of candidates before recommending that I be appointed.

Apart from the process of appointing a new Chairman, the main focus of the Committee during the year was on reviewing the size, structure and composition of the Board and considering succession planning for both the Board and high performing individuals below Board level. This will continue to be a focus of the Committee during 2017.

Role of the Committee

The principal role of the Committee is to review the structure and composition of the Board and to identify and propose to the Board suitable candidates to fill Board vacancies.

The Committee directs the periodic Board effectiveness reviews, both internal and external, which form part of the regular evaluation and development work conducted by the Board to ensure it continues to improve its overall effectiveness. The Committee also reviews management training and succession planning arrangements in respect of the Company's senior executives. The Company Secretary is the secretary of the Committee.

Board diversity

Boardroom diversity continues to be an important area of focus for the Committee with the aim of attracting and maintaining a Board which has a broad range of skills, backgrounds and experience whilst ensuring that the best people are appointed. Within this context, and as part of the ongoing process of refreshing the Board, the Company continues to encourage and welcome interest from a wide range of candidates who will add to the Board's diversity.

The Committee notes the Hampton-Alexander Review on gender balance in FTSE leadership published in November 2016, recommending an increase in the voluntary target for women represented on FTSE 350 Boards to 33% by 2020. Also, aiming for and disclosing progress towards, women representing a minimum of 33% of the senior leadership team (being the Group Executive Board and its direct reports). Costain is fully supportive of such principles (notwithstanding that, as a member of the FTSE SmallCap Index, it is not subject to such recommendations) which is reflected in the composition of our Board and Group Executive Board, further details of which can be found on pages 40 to 41 and 42 to 43 of this Annual Report respectively.

NOMINATION COMMITTEE REPORT
CONTINUED

In the year under review, the Committee received updates from Sally Austin, the Group Human Resources Director, on the talent management processes in the Group including the progress of senior leaders.

Board evaluations

The Board has established a formal process for the evaluation of the performance of the Board and its principal Committees.

For the 2016 financial year, the Board's annual evaluation was carried out internally. It was facilitated by the Company Secretary under the direction of the Chairman. The process involved each of the Directors completing a high-level questionnaire and a comprehensive discussion between the Chairman and each of the Board members. Separately, the Senior Independent Director met with the other Non-Executive Directors, without the Chairman being present in order to appraise the Chairman's performance.

After reviewing the outcomes of the evaluation process, the Chairman prepared a summary report that was discussed by the Board. It was concluded that the Board's strength continued to be demonstrated through its composition, clarity of roles and clear focus on strategy.

The procedures, effectiveness and development of the Board will continue to be kept under review. The last externally facilitated Board review was conducted by SCT Consultants Ltd in respect of the 2014 financial year.

The next independently facilitated review is expected to take place in respect of the 2017 financial year in accordance with provision B.6.2 of the Corporate Governance Code, notwithstanding that this requirement is waived in respect of smaller companies, such as the Company, which is a member of the FTSE SmallCap Index.

The performance reviews show that each Director continues to have sufficient time, knowledge and commitment to contribute effectively to the Board and its Committees, and that the Board as a whole demonstrates good practice on the key indicators of Board effectiveness.

Succession planning

The Committee adopts a formal and transparent procedure for the appointment of new Directors to the Board.

In the year under review, the Committee received updates from Sally Austin, the Group Human Resources Director, on the talent management processes in the Group including the progress of senior leaders. The Committee also reviewed the succession for members of the Group Executive Board and other senior employees. This has involved development initiatives for senior executives, international business school training, executive coaching and non-executive director mentoring. Committee members have also participated in several diversity related initiatives throughout the year.

Dr Paul Golby CBE | Chairman
28 February 2017

DIRECTORS' REMUNERATION REPORT

Image removed

ALISON WOOD
Chairman

Chairman's summary statement

Dear Shareholder

I am pleased to present our remuneration report, on behalf of the Board, for the year ended 31 December 2016, together with details of our proposed new remuneration policy.

We have reviewed our binding remuneration policy this year as it is required to be put to shareholders at the 2017 AGM. The Committee is proposing limited changes which refine the current structure and no changes to quantum."

Alison Wood
Chairman of the Remuneration Committee

Our previous policy was adopted in 2014 and, as we are required to put the policy to shareholders every three years, we will be putting a proposed new policy to our shareholders for their approval at this year's AGM. We have used this opportunity to review the appropriateness of the policy in the context of the business environment, our continued strategy and the remuneration landscape. The Committee considers that the Company's current remuneration framework continues to effectively support the delivery of our 'Engineering Tomorrow' business strategy and the creation of shareholder value. Consequently, we are not proposing a radical overhaul of our policy. The changes proposed, which are outlined below, refine the current policy and are intended to ensure that we have sufficient flexibility to support potential changes to business needs over the next three years.

Performance and variable pay outcomes for the year ended 31 December 2016

The Company has delivered another strong result during the year, with continued growth in both revenue and profit, and has maintained a record high quality forward order book of £3.9 billion and a strong net cash position of over £140 million. The strategic nature of Costain's long-term customer relationships has once again ensured that over 90% of the order book comprises repeat business. Performance against the strategic priorities is set out on pages 19 to 23 of the Strategic report.

This year we reduced the number of measures under the 2016 AIP to simplify the plan and reinforce the messages around the key underlying measures which underpin the delivery of our 'Engineering Tomorrow' strategy. Over half is linked to EBITA and the remainder to continuing to improve our Health and Safety performance, building a profitable order book, cash management and the delivery of critical project and corporate activities which are the personal responsibility of our Executive Directors.

Based on 2016 EBITA of £41.3 million and taking into account performance in the year against the other AIP performance metrics, the Chief Executive and Finance Director will both receive 75.4% of their maximum AIP opportunity respectively. Further details are set out on page 71.

The LTIP award granted on 7 May 2014 was subject to an aggregate EPS target for the three financial years ended 31 December 2016 of 83.9 pence (15% vests) to EPS of 92.9 pence (100% vests). The origin of these targets set in 2014 was from an unusually high base point due to profit on disposals in 2013 and as a consequence and despite strong performance, particularly in 2016, the LTIP will not vest. Full details are provided on page 71.

DIRECTORS' REMUNERATION REPORT
CONTINUED

KEY CHANGES TO OUR POLICY

- At least 50% of the Annual Incentive Plan ("AIP") to be based on financial measures.
- Introduce flexibility for a greater proportion of variable pay to be based on long term performance without increasing the overall maximum variable pay opportunity.
- Shareholding guideline increased to 200% of salary for any Executive Director who is awarded an LTIP opportunity above 100% of salary.

Remuneration Policy

The following is an overview of how our remuneration policy supports the strategic priorities of the business:

Health and Safety remains our highest priority.	• AIP includes Health and Safety performance metrics.
Encourage behaviours which facilitate the delivery of innovative and sustainable solutions to increasingly complex and large-scale national needs, to ensure we remain competitive and continue to deliver shareholder value.	• Performance targets are set to reward sustainable business performance, whilst not encouraging inappropriate business risks to be taken. • AIP performance metrics aim to balance earnings growth and other key financial objectives with non-financial indicators. • One-third of any AIP award earned is deferred into shares to ensure that executives consider the longer term impacts of their decisions and the effect on the sustainability of the business. • Our LTIP captures long-term growth in earnings. An additional two years' deferral on 50% of any LTIP award which vests further supports longer term alignment between executives and shareholders.
Develop a best-in-class team.	• Our remuneration policy is designed to attract and retain high-calibre individuals in an increasingly competitive market and to remunerate executives fairly and responsibly.

Our proposed new policy is set out in full on pages 62 to 68. Our proposed amendments to our existing policy seek to support our strategy further and these changes are summarised below:

At least 50% of the Annual Incentive Plan ("AIP") to be based on financial measures

Under the current Policy 75% of AIP must be based on financial metrics. This change allows greater flexibility to ensure that the AIP measures are aligned with the key financial and strategic areas of business (such as EBITDA, Strategic Development, Cash and Health and Safety). The Committee's intention is that the majority of the AIP will continue to be based on financial metrics and the 2017 AIP metrics will be weighted 75% as regards financial metrics and 25% as regards non-financial metrics. For these purposes Health and Safety and Strategic Development metrics are non-financial metrics. Details of financial and non-financial AIP metrics, including their weighting, are disclosed in the forward looking section of the 2016 Annual Report on Remuneration.

The Committee will continue to provide detailed disclosure of AIP performance targets and the performance achieved on a retrospective basis.

Introduce flexibility for a greater proportion of variable pay to be based on long term performance without increasing the overall maximum variable pay opportunity

This is currently delivered as a maximum AIP award of 150% of salary and a maximum LTIP award of 100% of salary.

The updated policy allows flexibility to alter this balance so a greater proportion is based on long term performance which further aligns the long-term interests of executives with shareholders. The overall maximum of 250% is maintained and neither the LTIP nor the AIP can exceed 150% of salary. Subject to those limitations, the Committee may decide how the overall 250% opportunity for any year is split between AIP and LTIP. This is intended to ensure there is flexibility over the next three years to support succession planning and potential changes to business needs.

The policy will also allow up to 25% of the LTIP to vest at threshold if the Committee considers this appropriate. The ability to increase the threshold vesting under the LTIP from 15% to 25% maintains the expected value of the package if the AIP opportunity is reduced and the LTIP opportunity is increased. A threshold LTIP opportunity of up to 25% of maximum is also positioned in line with the market. There is no current intention to change the level of threshold vesting and we would only change this as part of wider changes to the structure taking into account the balance of short and long term pay, the level of stretch within targets and the overall package value.

No changes are proposed to the AIP or LTIP quantum or the level of threshold vesting for 2017.

Shareholding guideline increased to 200% of salary for any Executive Director who is awarded an LTIP opportunity above 100% of salary

No change to 100% of salary shareholding guideline for any Executive Director awarded an LTIP opportunity of up to 100% of salary.

DEFINITIONS USED IN THIS REPORT

AIP: Annual Incentive Plan

DSBP: Deferred Share Bonus Plan

EBITA: Earnings Before Interest, Tax and Amortisation as adjusted by the Remuneration Committee to take account of relevant events (such as acquisitions or disposals) and ensure that the performance measures are assessed on a consistent basis year-to-year

EPS: Earnings Per Share as adjusted by the Remuneration Committee to take account of relevant events (such as acquisitions or disposals) and ensure that the performance measures are assessed on a consistent basis year-to-year

LTIP: Long-Term Incentive Plan

SDP: Share Deferral Plan

If a higher LTIP opportunity is granted the shareholding guideline will increase to 200% of salary.

Reward for 2017

We approved salary increases for the Executive Directors of 2.5% with effect from 1 April 2017 after carefully considering their performance and the range of salary increases awarded to other employees.

No changes are proposed to the quantum or structure of the AIP for 2017, details of the performance measures are provided on page 73 and the targets with performance against them will be provided in the 2017 Remuneration Report.

For the 2017 LTIP award we are proposing to introduce a cash measure in addition to the current EPS metric, recognising that a single measure of performance does not reflect how we manage and measure our business internally and the long term behaviours we are seeking to encourage across our senior team who participate in the LTIP. The sustainable generation of cash backed profits is a key element of the future success of the Company and in enhancing value to shareholders. Consequently, the Committee is intending to grant awards with a Cash Conversion metric which accounts for 25% of the 2017 LTIP award. 75% of the 2017 LTIP will continue to be based on EPS. Full details of the 2017 LTIP performance measures and weightings are provided on pages 73 to 74.

Following a review of fees in February 2016, no further fee increase has been awarded to the Non-Executives for 2017. Fees for our new Chairman, Dr Paul Golby, who joined the Board in May 2016, were set at a level which reflected Paul's experience and breadth of skills and will remain unchanged in 2017.

Conclusion

Overall, given the Company's performance over the one and three-year periods to the end of the 2016 financial year, we believe that the remuneration of the Executive Directors in respect of 2016 continues to reflects our success in the delivery of our 'Engineering Tomorrow' strategy and the drive for profitable or sustainable long-term growth for our shareholders. The following pages describe in further detail how we have implemented our remuneration policy in respect of 2016, together with our approach for 2017.

We remain committed to a responsible approach to executive pay as I trust that this Remuneration Report demonstrates and hope that you are supportive of the proposed changes to the remuneration policy outlined above and that we can rely on your continued support at our AGM in May 2017.

Alison Wood
Chairman of the Remuneration Committee
28 February 2017

At a glance summary: Executive Directors' remuneration

- Salary increases of 2.5% per annum from 1 April 2017.
- 2016 AIP outcome of 75.4% (Chief Executive) and 75.4% (Finance Director) of maximum (see page 71).
- One-third of the amount earned under the 2016 AIP deferred in shares for two years (see page 70).
- No vesting of the 2014 LTIP award.
- Cash conversion measure introduced for the 2017 LTIP award, so that 25% driven by cash performance and 75% by EPS performance over the three years to 31 December 2019. Two year deferral of 50% of the vested award maintained. No change to quantum.

Remuneration disclosure

This report, approved by the Board, has been prepared in accordance with the provisions of the Companies Act 2006 and Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended). It also meets the requirements of the UK Listing Authority's Listing Rules and the Disclosure and Transparency Rules.

It is unaudited unless otherwise stated. In this report we describe how the principles of good governance relating to Directors' remuneration, as set out in the UK Corporate Governance Code ('the Code'), are applied in practice. The Remuneration Committee ('the Committee') confirms that throughout the financial year the Company has complied with these governance rules and best practice provisions.

The report is in two sections:

- Remuneration Policy. This section sets out the full remuneration policy for which approval is sought at the 2017 AGM under a binding vote.
- The Annual Report on Remuneration. This section sets out details of how our remuneration policy was implemented for the year ended 31 December 2016 and how we intend for the policy to apply for the year ended 31 December 2017 and is the subject of an advisory shareholder vote at the 2017 AGM.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Policy report

This report sets out the Company's policy on the remuneration of its Directors and will be put to a binding shareholder vote at the Annual General Meeting in 2017. Subject to shareholder approval the policy will take formal effect from the end of that meeting.

The remuneration policy was first approved at the Company's 2014 AGM with support from over 97% of our shareholders. As set out in the Chairman's summary statement of the Director's remuneration report on pages 59 to 61, we are not proposing a radical overhaul of our remuneration policy. The changes proposed refine the policy approved at the 2014 AGM and are intended to ensure that we have sufficient flexibility to support potential changes to business needs over the next three years. In summary the changes made are as follows:

- At least 50% of the Annual Incentive Plan ("AIP") to be based on financial measures. This change is intended to provide flexibility to ensure that the AIP measures are aligned with the key financial and strategic areas of business. For these purposes Health and Safety and Strategic Development measures are treated as non-financial measures.
- Introduce flexibility for a greater proportion of variable pay to be based on long term performance without increasing the overall maximum variable pay opportunity. Neither the AIP opportunity nor the LTIP opportunity for a year will exceed 150% of salary and the combined maximum opportunity of 250% of salary is maintained.
- To maintain the expected value of the package if the AIP opportunity is reduced and the LTIP opportunity is increased and to reflect market practice, the 2017 policy permits vesting of up to 25% of an LTIP award for threshold performance. We would only change the vesting threshold as part of wider changes to the structure taking into account the balance of short and long term pay, the level of stretch within targets and the overall package value.
- Shareholding guideline increased to 200% of salary for any Executive Director who is awarded an LTIP opportunity above 100% of salary.
- Other minor changes have been made to the policy to refine it and aid its administration. For example:
  - In line with the LTIP rules approved by shareholders, the updated policy explicitly references the ability to select long term performance measures that are aligned with the key financial and strategic areas of business.
  - In line with the rules of the Share Deferral Plan (under which the deferred element of the AIP award is granted) and the LTIP rules approved by shareholders, dividend equivalents may be earned in the period from grant to vesting on shares which vest.

Further details regarding the changes to the policy and rationale are set out in the Chairman's summary statement of the Directors' remuneration report on page 59 to 61. No changes are proposed to the AIP and LTIP quantum or the proportion of the AIP based on financial measures or the level of threshold vesting under the LTIP for 2017.

The Committee also determines the remuneration policy for the Company Secretary and such other members of the executive management team as it is designated by the Board, with the aim of promoting the long-term success of the Company. The framework has been designed as an integral part of the Company's overall business strategy. For the avoidance of doubt, although the policy for employees below the Board follows similar principles and structure to that for the Executive Directors, the remuneration policy set out below governs the policy for the Board only.

The future remuneration policy to apply from the end of the 2017 AGM, is set out below.

Element	Purpose and link to strategy	Operation	Performance metrics	Maximum opportunity
Salary	• To attract and retain high-calibre individuals. • Reflects skills, experience and performance in role. • Provides an appropriate level of basic fixed income whilst avoiding excessive risk arising from over reliance on variable income.	• Generally reviewed annually (with any change usually effective from 1 April) but exceptionally at other times of the year. • Set with reference to individual performance, experience and responsibilities. • Reflects the market rate for the individual and their role, determined with reference to remuneration levels in companies of similar size and complexity, taking into account pay levels within the Company in general. • Increases will usually be in line with average salary increases for the wider workforce (in percentage terms). • Higher increases may be appropriate in certain circumstances, which include but are not limited to, where an individual is promoted, changes role or where an individual is appointed on a below market salary with the expectation that his salary will increase with experience and performance.	• N/A	• To avoid setting expectations of future salary increases there is no maximum salary value set under the Policy.
Annual Incentive Plan ("AIP")	• To incentivise the achievement of key financial and strategic targets for the forthcoming year without encouraging excessive risk taking. • Promotes greater alignment with shareholders. • To facilitate share ownership.	• Two-thirds paid in cash. • Not pensionable. • Deferral into shares of one-third of earned AIP; this vests on the second anniversary of grant (subject, ordinarily, to continued employment and not being under notice of termination, either given or received, on the date of vesting). Deferred share awards may be granted as conditional awards or nil or nominal cost options. • The Committee may decide not to operate deferral where the amount of the bonus otherwise to be deferred would, in the opinion of the Committee be so small as to make deferral unduly administratively burdensome. Executives may, with the approval of the Committee, elect for a greater proportion of the AIP award to be deferred into shares. • Deferred share awards may include the right to receive a benefit (in cash or in shares) determined by reference to the value of dividends that would have been paid by reference to dividend record dates in the period from grant to vesting. The benefit may assume the reinvestment of dividends. • Shares provided under the AIP are typically purchased by a trust on behalf of the Group so as to not lead to any dilution of shareholder interest. • Awards may be subject to malus and clawback as described below.	• The Committee considers and approves the performance measures and targets at the start of each year and ensures they are aligned with business strategy and are sufficiently stretching. • Financial metrics will comprise at least 50% of AIP opportunity. The balance of the AIP opportunity will be based on financial metrics and/or non-financial metrics such as Health and Safety targets and personal objectives. • In setting financial parameters, the Committee takes into account the Company's internal budgets and, where applicable investors' expectations. The targets applying to financial measures are based on a sliding scale between 0% and 100%. Up to 60% of the maximum potential will be earned for on-target performance. • The Committee may amend the pay-out if the formulaic output does not reflect its assessment of overall business performance.	• Maximum: 150% of salary. • The combined AIP and LTIP maximum opportunities for any year may not exceed 250% of salary.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Element	Purpose and link to strategy	Operation	Performance metrics	Maximum opportunity
Long-Term Incentive Plan ("LTIP")	• Aligned to main strategic objectives of delivering sustainable performance which in turn should deliver enhanced returns.	• Annual grant of performance shares, half of which vest after three years subject, ordinarily, to continued service and subject to performance targets, and half of which vest after five years (the final two years being subject only to continued service). Awards may be granted as conditional awards or nil or nominal cost options. • LTIP performance will be measured over three years. • LTIP awards may include the right to receive a benefit (in cash or in shares) determined by reference to the value of dividends that would have been paid on vested shares by reference to dividend record dates in the period from grant to vesting. The benefit may assume the reinvestment of dividends. • Awards may be subject to malus and clawback as described below.	• The performance condition will be based on key metrics aligned to the business strategy, including but not limited to EPS, return measures and cash-based measures. • At least 50% of the opportunity will be subject to an EPS performance measure. • Up to 25% of the maximum is earned for threshold performance, 100% for maximum with straight line vesting usually applying between these points.	• LTIP awards with a face value of not more than 150% of salary. • The combined AIP and LTIP maximum opportunities for any year may not exceed 250% of salary.
SAYE Scheme	• Offered to all UK employees, to facilitate share ownership and provide further alignment with shareholders.	• Periodic grants which normally vest after three or five years subject to continued service. • Operated under HMRC requirements as a tax qualifying plan.	• N/A	• Participation on the same basis as all other employees.
Pension	• To aid retention and remain competitive in the market place.	• Annual pension allowance. • Paid as a cash contribution to the Defined Contribution pension scheme, personal pension arrangements and/or a cash supplement.	• N/A	• 22% of base salary.
Other Benefits	• To aid retention and be competitive in the market place. • Healthcare benefits in order to minimise business disruption.	• Company car (or car allowance) and fuel allowance. • Medical insurance. • Life assurance. • Other benefits as appropriate, for example, relocation expenses and travel and subsistence.	• N/A	• N/A
Share Ownership Guidelines	• Further alignment of interests between Costain Board and shareholders.	• Executive Directors are expected to build and maintain a shareholding worth not less than 100% of base salary (or 200% of salary should the annual LTIP opportunity exceed 100% of salary). Shares subject to LTIP awards for which the performance period has ended and which are subject, ordinarily, only to continued employment (or subject to an LTIP or SDP award where the award is exercisable but not exercised) count towards the shareholding guideline, on a net of assumed tax basis. Executive Directors are required to retain half of the shares acquired pursuant to the LTIP and SDP (after sales to cover tax) until the shareholding guideline is met.	• N/A	• N/A

Notes

Performance measures

The choice of the performance metrics applicable to the AIP reflects the Committee's aim that our annual incentives should balance the delivery of stretching financial performance with non-financial indicators, particularly Health and Safety targets, and specific individual objectives. The LTIP financial metrics capture long-term earnings performance, and if appropriate, may be extended to include return based and cash measures which we believe are closely aligned with the financial performance expected by our shareholders. LTIP measures may also include strategic measures to incentivise the behaviours needed to deliver the Company's overall strategy.

AIP and LTIP performance measures may be adjusted if an event occurs which causes the Committee to consider that it would be appropriate to amend the performance measures (e.g. a material acquisition or divestment) so that they achieve their original purpose.

Recovery provisions

The AIP (including the deferred awards delivered under the SDP) and LTIP awards are subject to "malus" and "clawback" provisions as follows.

For up to two years following the payment of the cash element of an AIP award, the Committee may require repayment of all or part of the bonus in the event of a material misstatement or error in assessing performance measures which has led to an overpayment of the bonus or in the event of dismissal due to gross misconduct in the bonus year or in the event of criminal behaviour. Some or all of a deferred share award under the SDP may be clawed back (via a cancellation of the award) prior to vesting in equivalent circumstances.

For up to two years following the vesting of an LTIP award (or part of an LTIP award) the Committee may require the repayment of all or part of the award (which may be effected by the cancellation of unvested LTIP awards) in the event of a material misstatement or error in assessing performance measures which has led to an the award vesting to a greater degree than would otherwise have been the case or in the event of dismissal due to gross misconduct.

Incentive plan operation

The Committee will operate the AIP, SDP and LTIP according to their respective rules.

Share awards under the SDP and LTIP (and any applicable performance conditions) may be adjusted in the event of a variation of the Company's share capital or a demerger, special dividend or other event which affects the market price of a share. Shares awards under the SDP and LTIP may be satisfied in cash and may vest early, in accordance with the plan rules, in the event of a change of control or other relevant event (such as a winding-up or demerger). Where an LTIP award vests early, the extent of vesting will be determined taking into account the extent to which the performance condition has been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed. A copy of the plan rules is available on request from the Company Secretary.

Illustration of application of Remuneration Policy

We estimate that the level of remuneration received by each of the two Executive Directors for 2017 under the Remuneration Policy set out above will be:

Graph removed

The chart above illustrates how the total pay opportunities for the Executive Directors vary under three performance scenarios: Minimum, On-Target and Maximum.

Assumptions:

- Maximum AIP award of 150% of salary and maximum LTIP award of 100% of salary.
- Minimum performance – fixed pay only, including salary effective 1 April 2017, 22% pension allowances and benefits as paid in 2016.
- On-Target performance – fixed pay, plus 60% of the maximum payout under the AIP (including any deferred share award under the SDP), and 50% LTIP vesting.
- Maximum performance – fixed pay, plus 100% of the maximum payout under the AIP (including any deferred share award under the SDP), and 100% LTIP vesting.

Service agreements and loss of office

The Executive Directors have service contracts that can be terminated by either party on the giving of 12 months' notice. There is no entitlement to the payment of a predetermined amount on termination of employment in any circumstances. There are no liquidated damages provisions for compensation on termination within the Executive Directors' service agreements. The Executive Directors' service agreements do contain provisions for payment in lieu of notice, but these are at the Company's sole discretion.

The Company seeks to avoid any payment for failure. The circumstances of the termination (taking into account the individual's performance) and an individual's duty and opportunity to mitigate losses are taken into account in every case. Our policy is to stop or reduce compensatory payments to former Executive Directors to the extent that they receive remuneration from other employment during the compensation period and that any such payments would be paid monthly in arrears.

It is the Committee's intention that any future service contracts will be made in accordance with the policy stated above.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Executive Directors	Date of contract	Expiry date	Termination payment	Remuneration entitlements	Compensation on termination following a change of control
Andrew Wyllie Tony Bickerstaff	25 April 2005 3 March 2006	Terminable on 12 months' notice	Base salary plus benefits paid monthly and subject to mitigation. Benefits provided in connection with termination may include for example, pension, outplacement fees, payments in respect of accrued holiday and legal fees.	No other specific entitlements are contained within our contracts.	No additional provisions other than those contained in the "Termination payment" column.

The treatment of any incentive payment on termination will be determined in accordance with the rules of the AIP, SDP or LTIP. The principal provisions of the rules are summarised below.

AIP	Ordinarily, there will be no entitlement to a bonus unless the participant is employed and not under notice at the bonus payment date. In the event of termination due to death, redundancy, injury, ill-health, disability or retirement (a "good leaver") a time pro-rated bonus may be earned. The Committee has discretion to pay the bonus following the end of the year (subject to assessment of the performance measures) or at termination (with reference to on-target measures). A good leaver will ordinarily only be entitled to a bonus calculated by reference to the proportion of his AIP award which would have been paid in cash, and not to an SDP award. However, the Committee retains discretion to pay the whole of the AIP award for the year of termination (and prior year) in cash (after assessment of performance and application of time pro-rating).
SDP	In the event of termination due to injury, disability, or any other reason at the Committee's discretion, unvested SDP awards shall continue and vest on the normal vesting date. If a participant dies, his unvested SDP awards will vest at that time. Unvested SDP awards shall lapse on termination for any other reason.
LTIP	Unvested LTIP awards will usually lapse on termination. However, in the event of termination due to injury, disability, or any other reason at the Committee's discretion, unvested LTIP awards shall continue and vest on the normal vesting date. The extent of vesting will be determined by reference to the extent to which the performance conditions are satisfied and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed at the date of cessation. If a participant dies, his unvested LTIP awards will vest at the date of cessation, with the extent of vesting determined by reference to the extent to which the performance conditions are satisfied at that date (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed at the date of cessation.

Where a new director is granted a "buy out" award as described below, the leaver provisions would be determined at the time of grant.

Recruitment remuneration

In the cases of hiring/appointing a new Executive Director, the Remuneration Committee will typically align the remuneration package with the approved Remuneration Policy. However, the Committee retains the discretion to make payments or awards which are outside the Policy to facilitate the hiring of candidates of the appropriate calibre required to implement the Group's strategy, subject to the principles and limits set out below. The individual will move over time onto a remuneration package that is consistent with the approved Policy.

The Remuneration Committee will not use its discretion to make payments or awards outside the Policy to offer a non-performance related incentive payment (for example a "guaranteed sign-on bonus").

In determining appropriate remuneration, the Remuneration Committee will take into consideration all relevant factors (including the quantum and nature of remuneration) to ensure that arrangements are in the best interests of both Costain and its shareholders. This may, for example, include (but is not limited to) the following circumstances:

- an interim appointment is made to fill an Executive Director role on a short-term basis;
- exceptional circumstances require that the Chairman or a Non-Executive Director takes on an executive function on a short-term basis;
- an Executive Director is recruited at a time in the year when it would be inappropriate to provide a bonus or long-term incentive award for that year as there would not be sufficient time to assess performance; subject to the limit on variable remuneration set out below, the quantum in respect of the months employed during the year may be transferred to the subsequent year so that reward is provided on a fair and appropriate basis;
- the Executive Director received benefits at his previous employer that the Committee considers it appropriate to recognise.

The Committee may also alter the performance measures, performance period and vesting period of the annual bonus or long-term incentive, subject to the rules of the scheme, if the Committee determines that the circumstances of the recruitment merit such alteration. The rationale will be clearly explained.

The Remuneration Committee may make an award in respect of hiring to 'buy-out' remuneration arrangements forfeited on leaving a previous employer. In doing so the Remuneration Committee will take account of relevant factors regarding the forfeited arrangements, which may include any performance conditions attached to awards forfeited (and the likelihood of meeting those conditions), the time over which they would have vested and the form of the awards (e.g. cash or shares). It will generally seek to structure buy-out awards on a comparable basis to remuneration arrangements forfeited. These payments or awards are excluded from the maximum level of variable remuneration referred to below. However, the Remuneration Committee's intention is that the value awarded would be no higher than the expected value of the forfeited arrangements. Where considered appropriate, buy-out awards will be subject to forfeiture or clawback on early departure.

Where necessary, the Company will pay appropriate relocation, travel and subsistence costs. The Remuneration Committee will seek to ensure that no more is paid than is necessary.

The maximum level of variable remuneration (excluding buy-out awards) which may be awarded to a new Executive Director is 350% of base salary. Subject to this overall maximum, variable remuneration, incentive awards may be granted within the first 12 months of appointment above the normal maximum annual award opportunities. The Remuneration Committee will ensure that such awards are linked to the achievement of appropriate and challenging performance measures and will be forfeited if performance or continued employment conditions are not met.

Any share awards referred to in this section will be granted as far as possible under the Company's existing share plans. If necessary, and subject to the limits referred to above, in order to facilitate the awards mentioned above, the Committee may adopt a new arrangement in accordance with the provisions of the Listing Rules which allow for the grant of awards to facilitate, in unusual circumstances, the recruitment of a Director.

Where a position is filled internally, any ongoing remuneration obligations or outstanding variable pay elements shall be allowed to continue according to the original terms.

Fees payable to a newly-appointed Chairman or Non-Executive Director will be in line with the fee policy in place at the time of appointment.

External directorships

The Company encourages Executive Directors to take up Non-Executive 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. Generally, no more than one such appointment may be undertaken. There must be no conflict of interest and the time devoted to the external appointment must be reasonable in relation to the individual's commitment to the Company. Fees paid for external appointments may be retained by the individual concerned.

Chairman and other Non-Executive Directors

The Non-Executive Directors have letters of appointment. The appointment of an independent Non-Executive Director can be terminated by not less than one month's notice on either side without compensation for loss of office. Each Non-Executive Director is subject to election at the first AGM following their appointment, subsequent re-election at intervals of no more than three years and re-election at each AGM if they have served on the Board for more than nine years.

The dates of each Non-Executive Director's original appointment are as follows:

Non-Executive Director	Date of original appointment	Expiry of current term	Next AGM at which the Non-Executive Director is required to be re-elected
Paul Golby[1]	05.05.2016	05.05.2019	2017 AGM
Jane Lodge	01.08.2012	01.08.2018	2019 AGM
David McManus	12.05.2014	12.05.2017	2018 AGM
James Morley[2]	09.01.2008	Close of 2017 AGM	2017 AGM
Alison Wood[3]	01.02.2014	01.02.2020	2017 AGM

1 Paul Golby is subject to election at the 2017 AGM following his appointment by the Board since the 2016 AGM.

2 James Morley is required to stand for re-election at the 2017 (and each subsequent) AGM, as he has served as a non-executive director of the Company for nine years.

3 Alison Wood is subject to re-election at the 2017 AGM in line with the Company's three year rotation policy for non-executive directors.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Remuneration Policy for Chairman and Non-Executive Directors

Element	Purpose and link to strategy	Operation	Maximum opportunity
Fees	• Attract and retain high performing individuals.	• Remuneration for Non-Executive Directors, other than the Chairman, is determined by the Board, following consultation between the Chairman and the Chief Executive. The Chairman's fee is determined by the Board following consultation between the Committee and the Chief Executive. Fees are reviewed annually and any increase is usually effective from 1 April. • Remuneration for Non-Executive Directors, other than the Chairman, comprises a basic annual fee for acting as Non-Executive Director of the Company and additional fees for the Senior Independent Director, and chairmanship of the Audit and Remuneration Committees. • Overall fees will remain within the limit set out in the Company's Articles of Association. • The Chairman and Non-Executive Directors do not participate in any variable pay or share scheme arrangement, although their fees may be paid in cash or shares. • May be entitled to benefits such as travel and subsistence and secretarial support, or other benefits as appropriate.	N/A
Share Ownership Guidelines	• Alignment of interests between Costain Board and shareholders.	• Non-Executive Directors are expected to build and maintain a shareholding worth not less than 100% of their annual fee.	N/A

Legacy arrangements
The Committee retains discretion to make any remuneration payment or payment for loss of office outside the policy in this report where the terms of the payment were agreed before the policy came into effect provided, in the case of a payment whose terms were agreed after the 7 May 2014 (the date of approval of the Company's former Directors' Remuneration Policy) and before this policy came into effect, the payment was permitted under that former policy. For these purposes, 'payment' includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted.

Consideration of employee views
There is no employee representation on the Committee. However, the Company liaises actively with employees through the Costain Ground Force employee committee and engagement surveys. The Group HR Director briefs the Board on employees' views, ensuring that the Committee's decisions are taken with appropriate insight to employees' views.

Consideration of shareholder views
- The Committee considers shareholder feedback received in relation to the AGM each year at a meeting following the AGM. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the Company's annual review of remuneration policy.
- When there are material issues relating to executive remuneration or proposed changes in policy, we engage actively with major shareholders to ensure we understand the range of their views. When significant changes are made within the policy, the Committee Chairman will inform shareholders of these.
- Details of votes cast for and against the resolution to approve last year's remuneration report and any matters discussed with shareholders during the year are set out in the Annual Report on Remuneration.

Annual Report on Remuneration

Operation of Committee

The Committee is comprised exclusively of independent Non-Executive Directors. The members of the Committee and details of their attendance at Committee meetings are given on page 46. Biographies are shown on pages 40 to 41. The Committee is chaired by Alison Wood.

Terms of reference

The Committee's terms of reference are available on the Company's website at **costain.com** or from the Company Secretary. Copies of the letters appointing the Committee's advisers can be obtained from the Company Secretary.

Remuneration Committee activity

The following table sets out the key remuneration issues which the Committee covered at each of the meetings over the course of the year.

Date	Key agenda items
12 February 2016	Approved the methodology to be used to determine the extent that EPS and operating profit performance conditions are likely to have been met with regard to the LTIP granted in 2013
	Approved the 2015 AIP annual cash bonuses subject to final audit of the 2015 accounts
	Approved the 2016 AIP performance measures and list of participants
	Reviewed the Chairman's and Non-Executive Directors' fees for 2016
	Approved the Executive Directors and Senior Executives salaries for 2016
	Approved recommendations necessitated by changes to the Pension Legislation
	Reviewed the Directors' Remuneration report
6 April 2016	Granted awards under the LTIP
	Approved the vesting of the 2013 LTIP
	Granted awards under the SDP relating to the 2015 year end AIP bonus
	Noted the vesting of the 2014 DSBP
8 September 2016	Remuneration Policy Review
19 December 2016	Reviewed the performance targets and participants in respect of the proposed 2017 LTIP
	Approved the proposed 2017 AIP performance measures and reviewed the list of participants
	Reviewed the 2017 annual salary increases for the Executive Directors, Executive Committee and the wider workforce
	Reviewed the Company's Share Ownership Guidelines

Advice provided to the Committee

Advice was sought where appropriate from a number of sources. During the course of the year, the Chief Executive, the Finance Director, the Group's Chairman, the Group HR Director, and the Legal Director and Company Secretary were invited to attend various meetings of the Committee, although none was present when their own remuneration was being discussed.

To assist the Committee in ensuring that the Company's remuneration practices take due account of market and best practice, the Committee has access to experienced specialist independent consultants. During the year, the Committee took advice, as appropriate, from Deloitte LLP (a member firm of Deloitte Touche Tohmatsu Limited).

It is the policy of the Committee to put the remuneration consultant function out to tender on a periodic basis to ensure that the Company continues to receive independent support and advice of a high standard. Following a tender process in 2014 by the Committee, Deloitte LLP was appointed in place of New Bridge Street (a trading name of Aon Hewitt Limited) to act as the Company's remuneration consultants. Deloitte LLP received fees of £37,440 for the year ended 31 December 2016.

Deloitte LLP is a founder signatory to the Remuneration Consulting Group's Code of Conduct and is considered by the Committee to be independent. During the year, Deloitte LLP also provided advice to the Company in relation to the operation of the Company's share plans.

Voting on the remuneration report at the AGM in 2016

Last year's remuneration report was approved by shareholders with a 99.68% (2015 AGM: 99.26%) vote in favour (including discretionary votes).

Voting on the remuneration policy at the AGM in 2014

The current remuneration policy was approved by shareholders with a 97.40% vote in favour (including discretionary votes) at the Company's 2014 AGM.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Implementation of Policy in the year to 31 December 2016

Single Total Figure of remuneration for each Director

This table and the associated footnotes have been audited by KPMG LLP.

	2016						2015					
	Salary & Fees £	Taxable Benefits £	Pension* £	Annual Incentive £	LTIP** £	Total £	Salary & Fees £	Taxable Benefits £	Pension £	Annual Incentive £	LTIP*** £	Total £
Executive Directors												
A Wyllie	**456,590**	**13,322**	**100,450**	**519,581**	**–**	**1,089,943**	445,426	13,346	97,994	536,446	286,068	1,379,280
A O Bickerstaff	**302,526**	**11,822**	**66,556**	**344,276**	**–**	**725,180**	295,095	11,846	64,921	357,624	190,410	919,896
Non-Executive Chairman												
P Golby[1]	**105,025**	**–**	**–**	**–**	**–**	**105,025**	–	–	–	–	–	–
Non-Executive Directors												
J A Lodge	**54,061**	**–**	**–**	**–**	**–**	**54,061**	53,046	–	–	–	–	53,046
D McManus	**44,823**	**–**	**–**	**–**	**–**	**44,823**	43,937	–	–	–	–	43,937
J Morley	**51,292**	**–**	**–**	**–**	**–**	**51,292**	50,367	–	–	–	–	50,367
A J Wood	**51,592**	**–**	**–**	**–**	**–**	**51,592**	50,367	–	–	–	–	50,367
A Samy[2] (former Director)	**–**	**–**	**–**	**–**	**–**	**–**	30,643	–	–	–	–	30,643
D P Allvey[3] (former Chairman)	**34,014**	**–**	**–**	**–**	**–**	**34,014**	136,056	–	–	–	–	136,056

* A pension contribution of £40,000 was paid to Andrew Wyllie's chosen pension arrangement and the balance was paid to him directly as a taxable benefit. The amount quoted for Anthony Bickerstaff was paid to him directly as a taxable benefit.

** The 2014 LTIP will not vest (see Note (c) below).

*** The value of the 2013 LTIP which vested in May 2016, based on the share price as at the date of vesting 9 May 2016, being 326 pence per share. In accordance with the applicable regulations, the value included in the 2015 Directors' Remuneration Report was based on the average share price over the final three months of 2015, being 366 pence per share.

1 Appointed as Non-Executive Chairman w.e.f. 5 May 2016.

2 Retired as a Non-Executive Director w.e.f. 10 September 2015.

3 Retired as Non-Executive Chairman w.e.f. 5 May 2016.

Additional Notes to the single total figure of remuneration

(a) Taxable benefits provided to Executive Directors

The main benefits available to the Executive Directors during 2016 (and their approximate values) were a car allowance of £12,000 (2015: £12,000) for Andrew Wyllie and £10,500 (2015: £10,500) for Anthony Bickerstaff, together with private medical insurance for both Executive Directors of £1,322 (2015: £1,346). This package of benefits was unchanged from 2015.

(b) Determination of the 2016 Annual Incentive

The maximum AIP opportunity for the Chief Executive and the Finance Director for the year ended 31 December 2016 remained unchanged from 2015 at 150% of base salary, with one third of the earned AIP award to be deferred into shares for a further two years and two thirds of the earned AIP award paid in cash. Grants will be made under the SDP in April 2017.

The performance measures established by the Committee for the 2016 AIP continued to align reward with the Company's 'Engineering Tomorrow' strategy whilst not encouraging inappropriate business risks to be taken. These included inter alia a maximum target of £44.6 million for Group EBITA[1].

The achievement of the performance measures has been reviewed, with appropriate input from the Audit Committee, following the end of the 2016 financial year. The maximum 2016 AIP opportunity against each of the performance measures is shown below, together with the AIP award actually achieved.

The Committee is satisfied that these measures remain aligned with the execution and delivery of the Company's strategy.

Performance measures	AIP opportunity – maximum percentage of bonus		Actual performance	AIP award – as a percentage of bonus		AIP performance measure	
	Andrew Wyllie	Anthony Bickerstaff		Andrew Wyllie	Anthony Bickerstaff	Threshold	Maximum
Group EBITA[1]	55%	55%	£41.3m	37.4%	37.4%	£36.5m	£44.6m
Group Health and Safety[2]	10%	10%	AFR 0.09	5%	5%	0.07	0.07
Order Book Contract Profit	10%	10%	£85m	10%	10%	£66.3m	£81m
Cash Balance[3]	10%	10%	£140.2m	10%	10%	£61.7m	£75.5m
Personal Performance[4]	15%	15%	See note 4	13%	13%	n/a	n/a
Total	**100%**	**100%**	**n/a**	**75.4%**	**75.4%**	**n/a**	**n/a**

1 Calculated on an adjusted basis as approved by the Committee.

2 Includes leadership of Health and Safety engagement and culture.

3 Measured pre-acquisition and investments. The cash balance for assessing AIP performance was adjusted to remove exceptional cash inflow at end of 2016.

4 Includes the strategic development of the business, e.g. increasing the number of employees in technology, advisory or design service roles to over 1,200, enhancing our technology capability through the acquisition of Simulation Systems Ltd and increasing the number of women in senior management roles.

(c) Vesting of the 7 May 2014 LTIP award

The LTIP award granted on 7 May 2014 was based on performance to the year ended 31 December 2016.

This award has the following performance condition:

Aggregate EPS for the financial years ended 31 December 2014, 2015 and 2016	Vesting level
Below 83.90 pence	0%
83.90 pence	15%
Between 83.90 pence and 92.9 pence	15% – 100% pro rata
92.9 pence or more	100%

For the purposes of the LTIP, EPS is adjusted by the Committee to take account of relevant events (such as acquisitions or disposals) and to ensure that the performance measures are assessed on a consistent basis year-to-year. Aggregate EPS for the financial years ended 31 December 2014, 2015 and 2016, calculated on an adjusted basis approved by the Committee, was 81.89 pence. As a result of which the LTIP award granted on 7 May 2014 will not vest.

(d) Pensions and life assurance

Under their terms of engagement, the Executive Directors are entitled to an annual pension allowance of 22% of base salary. Life assurance cover of four times base salary is provided through the Costain Life Assurance Scheme. The annual premiums payable in respect of life assurance for Andrew Wyllie and Anthony Bickerstaff were £2,236 (2015: £2,161) and £1,482 (2015: £1,432) respectively.

The Group offers a Group Flexible Retirement Plan which was set up in 2009 with Standard Life for employees and senior management. Neither Executive Director participated in the scheme.

(e) Chairman

Remuneration for the Chairman comprises a basic annual fee of £160,000 with effect from the date of the Chairman's appointment, being 5 May 2016 (as at 5 May 2015 the former Chairman's fee was £136,056 per annum).

(f) Non-Executive Directors

Remuneration for Non-Executive Directors, other than the Chairman, comprises a basic annual fee for acting as a Non-Executive Director of the Company and additional fees for the Senior Independent Director and chairmanship of the Audit and Remuneration Committees. The annual fees set with effect from 1 April 2016 were as follows:

2016 Fees	Basic Fee	Senior Independent Director	Audit Committee Chairman	Remuneration Committee Chairman
Fees	£45,000	£6,600	£9,400	£7,000

DIRECTORS' REMUNERATION REPORT
CONTINUED

Grants made during the year

These tables and the associated footnotes have been audited by KPMG LLP.

2016 LTIP Grant

Grants were made under the LTIP on 6 April 2016. The grant level for the Executive Directors remains at 100% of salary. Half of the award vests after three years, subject to continued service and performance conditions (as set out below), and the other half vests after five years (the final two years being subject only to continued service), thereby ensuring long-term alignment of the Executive Directors' and shareholders' interests.

Performance measures for the 2016 LTIP are as follows:

Aggregate EPS over the financial years ended 31 December 2016, 2017 and 2018	Vesting level
Below 91.7 pence	0%
91.7 pence	15%
101.7 pence or more	100%
Between 91.7 pence and 101.7 pence	Between 15% and 100% pro rata on a straight-line basis

The share awards granted under the 2016 LTIP are as follows:

	Number of shares	Face value[1]	End of performance period	Threshold vesting	Weighting (% of award)
Andrew Wyllie	132,678	£459,400	31 December 2018	15%	100%
Anthony Bickerstaff	87,913	£304,400	31 December 2018	15%	100%

1 Valued using the share price on the business day prior to the date of grant (5 April 2016), being 346.25 pence per share.

2016 SDP Grant

The Company granted awards under the Costain Share Deferral Plan to the Executive Directors during 2016, details of which are shown on page 77.

All-employee share plans

The Company granted options under the Costain SAYE scheme to the Executive Directors during 2016, details of which are shown on page 77.

Implementation of Policy in the year to 31 December 2017

Salary

For 2017, the Committee approved a 2.5% increase for the Executive Directors, effective 1 April 2017. A 2.5% salary increase budget will also be applied across the Company in 2017. The results of the salary review are set out in the table below:

	Salary 2017	Salary 2016	% change
Andrew Wyllie	**£470,847**	£459,363	2.5%
Anthony Bickerstaff	**£311,937**	£304,329	2.5%

Non-Executive Director fees

Non-Executive Directors' fees remain unchanged with effect from 1 April 2017 as follows:

2017 Fees	Basic Fee	Senior Independent Director	Audit Committee Chairman	Remuneration Committee Chairman
Fees	£45,000	£6,600	£9,400	£7,000

2017 Annual Incentive

Executive Directors and other senior management are eligible for annual bonuses under the AIP to encourage improved performance, with targets established by the Committee to align rewards with the Company strategy. The targets are clearly aligned with the delivery of our 'Engineering Tomorrow' strategy. Their achievement will be reviewed, with appropriate input from the Audit Committee, at the end of the year.

The maximum bonus opportunity for the Chief Executive and the Finance Director for the year ended 31 December 2017 will remain unchanged from 2016 at 150% of base salary, with one third of earned bonus deferred into shares for a further two years, to be awarded under the SDP, and two thirds of earned AIP paid in cash.

The performance measures for the 2017 AIP are as follows:

Performance Measures	2017 AIP Opportunity – Maximum Percentage of Bonus	
	Andrew Wyllie	Anthony Bickerstaff
Group EBITA	55%	55%
Group Health and Safety	10%	10%
Order Book percentage of target gross profit	10%	10%
Cash flow (average month end cash balances)	10%	10%
Personal Performance	15%	15%
Total	**100%**	**100%**

The Committee has chosen not to disclose in advance the performance targets for the year ended 31 December 2017, as these include items which the Committee considers commercially sensitive. The Committee will continue to provide retrospective disclosure of performance targets in next year's Annual Report on Remuneration to the extent the Committee determines these measures are not commercially sensitive.

2017 LTIP Grant

The grant level for the Executive Directors remains at 100% of salary. Subject to the achievement of performance conditions as set out below, half of the award will vest after three years and the other half will vest after five years (the final two years being subject only to continued service), thereby ensuring long-term alignment of the Executive Directors' and shareholders' interests. It is anticipated that the 2017 LTIP awards will take place in April 2017.

For the 2017 LTIP award the Committee are also proposing to introduce a cash measure in addition to the current EPS metric, recognising that a single measure of performance does not reflect how we manage and measure our business internally and the long-term behaviours we are seeking to encourage. Consequently the Committee is intending to grant awards with a Cash Conversion metric which accounts for 25% of the 2017 LTIP award; 75% of the 2017 LTIP will continue to be based on EPS.

It is proposed that the targets for the 2017 LTIP awards will be as follows:

EPS performance condition

Sum of the EPS for the financial years ending 31 December 2017, 2018 and 2019	Vesting level for awards
Below 101.4 pence	0%
101.4 pence	15%
113.6 pence or more	100%
Between 101.4 pence and 113.6 pence	Between 15% and 100% pro rata on a straight-line basis

The Committee believes that EPS remains an appropriate metric to use under the LTIP, as growth in EPS is one of the key drivers of the Company's share price. As with previous LTIP awards, EPS shall be calculated on an adjusted basis as determined by the Committee to take account of relevant events (such as acquisitions or disposals) and ensure that the performance measures are assessed on a consistent basis year-to-year.

DIRECTORS' REMUNERATION REPORT
CONTINUED

Cash Conversion performance condition

Cash conversion	Vesting level for awards
Below 80%	0%
80%	15%
100%	100%
Between 80% and 100%	Between 15% and 100% pro rata on a straight-line basis

Cash conversion is adjusted cash flow from operations (excluding cash movements in provisions and pension deficit) divided by EBITDA. It is measured as average cash flow conversion over the three year period ended 31 December 2019.

Adjusted cash flow from operations for the year ending 31 December 2017 will be adjusted to recognise exceptional cash in flows at the end of 2016.

The Committee has the discretionary power to vary these targets should circumstances change so that the original targets are no longer considered appropriate for example in the case of a material acquisition or divestment in the Group.

A clawback and malus provision is incorporated in the AIP and the LTIP (and the legacy DSBP) with regard to any material misstatement to audited accounts, an error in calculation of targets resulting in an overpayment, gross misconduct or criminal behaviour on the part of a participant.

Other information

Performance graph

The graph below shows the value, to 31 December 2016, of £100 invested in Costain Group PLC on 1 January 2009 compared with the value of £100 invested in the FTSE SmallCap Index. The Committee believes that the SmallCap Index is a more appropriate index to use than the FTSE All-Share Index as it is the index in which the Company is a constituent and comprises companies of a more similar size to Costain.

Graph removed

Change in Chief Executive's remuneration

		Year ending 31 December						
	2016	2015	2014	2013	2012	2011	2010	2009
Total remuneration	**£1,089,943**	£1,414,381	£1,329,007	£1,251,239	£1,089,337	£1,228,332	£1,603,014	£887,814
AIP (%)	**75.4%**	79.8%	71.6%	75%	55%	86%	94%	84%
LTIP vesting (%)	**nil%**	50%	50%	50%	100%	100%	96%	Nil%

Statement of change in pay of Chief Executive compared to other employees

The table below shows the movement in the remuneration for the Chief Executive between the current and previous financial year compared to the average (per head) for all employees.

	2016	2015	% change
Chief Executive			
– salary	**£456,590**	£445,426	2.5%
– benefits	**£13,322**	£13,346	0.0%
– bonus[1] (annual incentive)	**£519,581**	£469,583	10.7%
Average per employee			
– salary[2]	**£43,936**	£42,220	4.1%
– benefits[3]	**£4,735**	£4,653	1.8%
– bonus[4] (annual incentive)	**£3,148**	£3,482	-9.6%

1 Bonus figures for the Chief Executive are calculated on the basis of the combined cash bonus actually paid and the value of the share options that were granted under the AIP.

2 Average salary for employees is calculated on the basis of the annual monthly UK salary bill divided by the average number of monthly paid UK employees.

3 Employee benefits are calculated based on the total cost to the Company of private medical insurances, life assurance, company cars and car allowances, averaged per head for monthly paid employees.

4 Bonus figures earned for 2016 are calculated on the total bonus payments made to monthly paid employees in 2016.

Relative importance of spend on pay

The table below illustrates the change in expenditure by the Company on remuneration paid to all the employees of the Group and distributions to shareholders from the financial year ending 31 December 2015 to the financial year ending 31 December 2016.

	2016 £m	2015 £m	% change
Overall expenditure on pay	**216.1**	190.6	16.1%[1]
Dividend	**11.8**	10.2	15.68%

1 Including employees following the acquisition of Simulation Systems Limited in July 2016.

These matters were selected to be shown as they represent key distributions by the Group to its stakeholders.

Directors' appointment

The dates of each of the Director's original appointment and expiry of current term are as follows:

Director	Date of original appointment	Expiry of current term[1]
Andrew Wyllie	25 April 2005	Terminable on 12 months' notice
Anthony Bickerstaff	3 March 2006	Terminable on 12 months' notice
Paul Golby	5 May 2016	5 May 2019
James Morley	9 January 2008	Close of 2017 AGM
Jane Lodge	1 August 2012	1 August 2018
Alison Wood	1 February 2014	1 February 2020
David McManus	12 May 2014	12 May 2017

1 Expiry of Current Term is subject to:

(a) the appointment of a Non-Executive Director can be terminated by reasonable notice on either side (of not less than one month);

(b) election is required at the AGM following their appointment, subsequent re-election at intervals of no more than three years and, for Non-Executive Directors, re-election at each AGM if having served on the Board for more than nine years, in accordance with the Code and the Company's Articles of Association. Paul Golby, James Morley and Alison Wood are the Directors who are due to offer themselves for election/re-election at the 2017 AGM.

DIRECTORS' REMUNERATION REPORT
CONTINUED

External directorships

Andrew Wyllie was appointed as a Non-Executive Director of Scottish Water on 7 April 2009 and, in respect of the appointment for the year ended 31 December 2016, he was paid £20,400 (2015: £20,208). Anthony Bickerstaff was appointed as a Non-Executive Director and Chair of the Audit Committee of Low Carbon Contracts Company Limited and Electricity Settlements Company Limited on 11 November 2014 and, in respect of the appointment for the year ended 31 December 2016, he was paid £31,000 (2015: £31,000). The Executive Directors have retained these fees in accordance with the policy set out in the Policy report.

The following tables and the associated footnotes have been audited by KPMG LLP.

Share awards under the Long-Term Incentive Plan (LTIP)

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

Executive	Date granted	Balance at 1 January 2016	Granted during year	Share price at date of grant	Vested during year	Lapsed during year	Market price at date of exercise	Average Market price at date of sale/ retention of balance	Value of shares at date of sale/ retention of balance (excluding shares deducted to settle tax sold at market price on date of exercise)	Balance at 31 December 2016	Actual/ expected vesting date
Andrew Wyllie	07.05.13[1]	175,502*	–	241p*	87,751	87,751	328p	328p	£152,546	–	May 2016
	07.05.14[2]	164,467	–	265p	–	–	–	–	–	164,467	May 2017 May 2019
	09.03.15[3]	141,710	–	316p	–	–	–	–	–	141,710	March 2018 March 2020
	06.04.16[4]	–	132,678	346.25p	–	–	–	–	–	132,678	April 2019 April 2021
Anthony Bickerstaff	07.05.13[1]	116,817*	–	241p*	58,408	58,409	348.5p	347.24p	£107,492	–	May 2016
	07.05.14[2]	108,959	–	265p	–	–	–	–	–	108,959	May 2017 May 2019
	09.03.15[3]	93,883	–	316p	–	–	–	–	–	93,883	March 2018 March 2020
	06.04.16[4]	–	87,913	346.25p	–	–	–	–	–	87,913	April 2019 April 2021

1 50% of the award (Tier 1) was subject to an aggregate EPS target for the financial years ended 31 December 2013, 2014 and 2015 of 80.48* pence (15% vests) to EPS of 90.73 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. The remaining 50% of the award (Tier 2) was based on operating profit for the financial year ending 31 December 2015 of £35 million (15% vests) to £42 million (50% vests) to £50 million (100% vests) on a sliding scale pro rata to the operating profit actually achieved. In addition, no element of the Tier 2 award would vest unless the EPS (before pension interest) for the financial year ended 31 December 2015 was at least 33.84* pence and Tier 1 had vested in full. 50% of the target was met.

2 100% of the award is subject to an aggregate EPS target for the financial years ended 31 December 2014, 2015 and 2016 of 83.9 pence (15% vests) to EPS of 92.9 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. 50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2016, whilst the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided the individual remains an employee or officer of the Company. This award will lapse based on aggregate EPS performance during the period.

3 100% of the award is subject to an aggregate EPS target for the financial years ended 31 December 2015, 2016 and 2017 of 83.9 pence (15% vests) to EPS of 96.9 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. 50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2017, whilst the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company.

4 100% of the award is subject to an aggregate EPS target for the financial years ended 31 December 2016, 2017 and 2018 of 91.7 pence (15% vests) to EPS of 101.7 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. 50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2018, whilst the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company.

* As adjusted following the capital raising in March 2014.

The LTIP awards, which are expressed as options, have a nil exercise price. At 30 December 2016, the derived mid-market price of the ordinary shares in the Company, as advised by the Company's brokers, was 353.75 pence. The range of the share price of the ordinary shares during 2016 was 274 pence to 386 pence.

Share awards under the Share Deferral Plan (SDP)

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

Executive	Date granted	Balance at 1 January 2016	Granted during year	Share price at date of grant	Vested during year	Lapsed during year	Market price at date of exercise	Market price at date of sale/ retention of balance	Value of shares at date of sale/ retention of balance (excluding shares deducted to settle tax sold at market price on date of exercise)	Balance at 31 December 2016	Actual/ expected vesting date
Andrew Wyllie	09.03.15	48,999[1]	–	316.25p	–	–	–	–	–	48,999	March 2017[2]
	06.04.16	–	51,643[1]	346.25p	–	–	–	–	–	51,643	April 2018[2]
Anthony Bickerstaff	09.03.15	34,140[1]	–	316.25p	–	–	–	–	–	34,140	March 2017[2]
	06.04.16	–	34,428[1]	346.25p	–	–	–	–	–	34,428	April 2018[2]

1 Awards under the SDP are structured as options with a nil exercise price.

2 Awards become exercisable on or around the second anniversary of the date of grant in accordance with the Rules of the SDP and subject, ordinarily, to the continued employment of the participants. To the extent that the awards become exercisable, they will remain exercisable until the tenth anniversary of the date of grant.

Share Options under the SAYE Scheme (SAYE)

Details of the Executive Directors' SAYE options are as follows:

Executive	Date granted	Balance at 1 January 2016	Granted during year	Exercise price	Exercised during year	Lapsed during year	Market price at date of exercise	Market price at date of sale	Value of shares at date of sale	Balance at 31 December 2016	Exercised/ Exercisable from/to
Andrew Wyllie	30.09.13	1,689*	–	206.55p*	1,689	–	370p	359p	£6,064	–	Nov 2016–May 2017
	29.09.14	2,253	–	234.80p	–	–	–	–	–	2,253	Nov 2017–May 2018
	28.09.15	1,834	–	314p	–	–	–	–	–	1,834	Nov 2018–May 2019
	26.09.16	–	645	279p	–	–	–	–	–	645	Nov 2019–May 2020
Anthony Bickerstaff	30.09.13	1,689*	–	206.55p*	1,689	–	370p	359p	£6,064	–	Nov 2016–May 2017
	29.09.14	2,253	–	234.80p	–	–	–	–	–	2,253	Nov 2017–May 2018
	28.09.15	1,834	–	314p	–	–	–	–	–	1,834	Nov 2018–May 2019
	26.09.16	–	1,251	279p	–	–	–	–	–	1,251	Nov 2019–May 2020

* As adjusted following the capital raising in March 2014.

Share awards under the legacy Deferred Share Bonus Plan (DSBP)

Under the legacy DSBP, deferred bonus awards were granted in the following two forms:

i. an option with a nil exercise price over a fixed value of shares (the Combined Deferred Award), which is granted in combination with an HMRC approved market value option over a fixed number of shares (the Option) – this applies to an individual maximum of £30,000; and

ii. an option with a nil exercise price over a fixed number of shares (Deferred Award).

DIRECTORS' REMUNERATION REPORT
CONTINUED

Details of the Executive Directors' final legacy DSBP awards which became exercisable on the second anniversary of the date of grant are as follows:

Executive	Date granted	Balance at 1 January 2016	Granted during year	Share price at date of grant	Vested during year	Market price at date of vesting/ exercise	Market price at date of sale/ retention of balance	Value of shares at date of sale/ retention of balance (excluding shares deducted to settle tax sold at market price on date of exercise)	Balance at 31 December 2016	Actual vesting date
Andrew Wyllie	31.03.14	61,778[1]	–	290p	61,778[2]	355.50p	343.32p	£115,596	–	31 March 2016
Anthony Bickerstaff	31.03.14	40,928[1]	–	290p	40,928[2]	355.50p	343.32p	£76,584	–	31 March 2016

1 Number of shares under the Deferred Award.

2 In addition, Andrew Wyllie and Anthony Bickerstaff received 1,752 and 1,161 dividend shares respectively upon vesting.

Directors' shareholdings

Details of the Directors' share interests in the Company as at 31 December 2016 and, at the date of this report, are as follows:

Director	Beneficially owned	Outstanding SDP awards	Outstanding LTIP awards	Outstanding SAYE awards	Shareholding guidelines (% of salary/fee)	Actual Shareholding (% of salary/fee)
Andrew Wyllie[1]	406,508	100,642	438,855	4,732	100%	218.49%
Anthony Bickerstaff[1]	224,826	68,568	290,755	5,338	100%	180.87%
Paul Golby[2]	35,000	–	–	–	100%	69.44%
James Morley	47,111	–	–	–	100%	197.45%
Jane Lodge	22,222	–	–	–	100%	87.29%
Alison Wood	6,666	–	–	–	100%	28.84%
David McManus	0	–	–	–	100%	0%

1 Part held by persons closely associated.

2 Appointed as Non-Executive Chairman w.e.f. 5 May 2016.

The Executive Directors are expected to build and maintain a shareholding worth not less than 100% of base salary through the retention of vested share awards or through open market purchases. The Non-Executives are also expected to build and maintain a shareholding of 100% of their fee.

DIRECTORS' REPORT

The Directors submit to the members their report and accounts of the Company for the year ended 31 December 2016.

The Governance reports on pages 38 to 78 and the Strategic report on pages 01 to 37 (and in particular pages 20 and 23 with regard to information about employee involvement and greenhouse gas emissions) are also incorporated into this report by reference.

The Company has chosen to include the disclosure of likely future developments of the Company's business in the Strategic report.

Incorporation and constitution

Costain Group PLC is domiciled in England and incorporated in England and Wales under Company Number 1393773.

Profit and dividend payments

The profit after tax for the financial year ending 31 December 2016 amounted to £26.4 million (2015: £22.2 million). An interim dividend of 4.3 pence per share (2015: 3.75 pence) amounting to £4.4 million (2015: £3.9 million) was paid on 21 October 2016. A final dividend at the rate of 8.4 pence per share (2015: 7.25 pence) amounting to £8.8 million (2015: £7.4 million) will also be recommended to shareholders at the Annual General Meeting (AGM) to be held on 8 May 2017. If approved, the dividend will be paid on 19 May 2017 to shareholders registered at close of business on 7 April 2017.

Dividends and other distributions

The Company may, by ordinary resolution, from time to time declare dividends not exceeding the amount recommended by the Board. Subject to the Companies Act 2006, the Board may pay interim dividends, and also any fixed rate dividend, whenever the financial position of the Company, in the opinion of the Board, justifies its payment. If the Directors act in good faith, they are not liable for any loss that shareholders may suffer because a lawful dividend has been paid on other shares which rank equally with or behind their shares.

The Board may withhold payment of all or any part of any dividends or other monies payable in respect of the Company's shares from a person with a 0.25% interest in a class of the Company's shares if such a person has been served with a restriction notice after failure to provide the Company with information concerning interests in those shares required to be provided under the Companies Act 2006.

Share capital

The Company's share capital consists of ordinary shares with a nominal value of 50 pence each.

The issued share capital of the Company as at 31 December 2016 was £52,117,095.50, consisting of 104,234,191 ordinary shares of 50 pence each.

Further details of the share capital of the Company can be found in Note 21 on page 128.

The awards granted in May 2013 under the 2012 Long-Term Incentive Plan (LTIP) matured as at 31 December 2015 resulting in the vesting of awards in May 2016 over 598,131 ordinary shares of 50 pence each with a nil exercise price. Further details regarding the vesting of the 2013 LTIP awards can be found in the Directors' Remuneration report on page 76.

Share options granted under the Company's Save As You Earn Scheme (SAYE) in November 2011 (at an option price of 169.33p) and in November 2013 (at an option price of 206.55p) matured as at 1 November 2016, resulting in the exercise of options as at 31 December 2016 over 1,257,563 ordinary shares of 50 pence each. Further details of the SAYE Scheme can be found on page 77 of the Directors' Remuneration report.

At the 2016 AGM, shareholders approved the renewal of the scrip dividend scheme which authorises the Directors to offer and allot ordinary shares in lieu of cash dividends to those shareholders who elect to participate in the scrip dividend. This authority was granted for a period of three years (until the conclusion of the 2019 Annual General Meeting), which is in line with the guidelines of the Investment Association (IA) which requires shareholder approval to be sought to renew the Directors' authority to offer a scrip dividend scheme at least once every three years.

In May 2016, 114,972 ordinary shares of 50 pence each were allotted to shareholders in respect of the final dividend for 2015 and, in October 2016, 163,108 ordinary shares of 50 pence each were allotted to shareholders in respect of the interim dividend for 2016. Further information on the scrip dividend scheme is set out on page 138. Details about joining the scrip dividend scheme can also be found on the Company's website at **costain.com**.

Restrictions on transfer of securities

There are no restrictions on the transfer of securities in the Company, except:

- that certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws); and
- pursuant to the Company's Share Dealing Code, whereby the Directors and certain employees of the Company require the approval of the Company to deal in the Company's ordinary shares.

The Company is not aware of any agreements between holders of securities that may result in restrictions on the transfer of securities.

DIRECTORS' REPORT
CONTINUED

Major shareholders

As at 31 December 2016 the Company has been notified, under the Disclosure Guidance and Transparency Rules issued by the Financial Conduct Authority (DTR5), of the following voting interests in its ordinary share capital:

Shareholder	Number of shares/Voting rights	% of voting rights
BlackRock Inc	5,829,557	5.59
Henderson Group plc	6,250,500	6.00
JO Hambro Capital Management Group Limited	5,085,708	4.88
Miton Group plc	5,101,741	4.89

The Company did not receive any further notifications pursuant to DTR5 in the period from 31 December 2016 to the date of this Report (being a date not more than one month prior to the date of the Company's Notice of Annual General Meeting).

Rights and obligations attaching to shares

In accordance with the Articles of Association, the Company can issue shares with any rights or restrictions attached to them provided such rights or restrictions do not restrict any rights or restrictions attached to existing shares. These rights or restrictions can be decided either by ordinary resolutions passed by the shareholders or by the Directors as long as there is no conflict with any resolution passed by the shareholders. Subject to the Articles of Association, the Companies Act 2006 and other shareholders' rights, the issue of shares is at the disposal of the Board.

Authority to issue shares

The Directors may only issue shares if authorised to do so by the Articles of Association or the shareholders in general meeting. At the Company's AGM held on 5 May 2016, shareholders granted an authority to the Directors to allot ordinary shares up to an aggregate nominal amount of £17.0 million. As at 31 December 2016, the only shares that had been allotted were in order to satisfy awards under the Company's share schemes and scrip dividends.

As this authority is due to expire on 8 May 2017, shareholders will be asked to renew and extend the authority, given to the Directors at the last AGM, to allot shares in the Company, or grant rights to subscribe for, or to convert any security into, shares in the Company for the purposes of Section 551 of the Companies Act 2006. Further details on the resolution are provided in the Notice of this year's AGM.

Disapplication of Pre-emption Rights

If the Directors wish to allot new shares and other equity securities, or sell treasury shares, for cash (other than in connection with an employee share scheme) company law requires that these shares are offered first to shareholders in proportion to their existing holdings. There may be occasions, however, when the Directors need the flexibility to finance business opportunities by the issue of shares without a pre-emptive offer to existing shareholders. This cannot be done under the Companies Act 2006 unless the shareholders have first waived their pre-emption rights.

At the AGM, shareholders will be asked to pass two special resolutions to grant the Directors powers to disapply shareholders' pre-emption rights under certain circumstances. Further details on the resolutions are provided in the Notice of this year's AGM.

Power in relation to the Company buying back its own shares

The Directors may only buy back shares if authorised to do so by the Articles of Association or by a special resolution of the shareholders at a general meeting. Any shares which have been bought back may be held as treasury shares, and either be resold for cash, cancelled (either immediately or in the future), or used for the purposes of the Company's share schemes. Any cancelled treasury shares will thereby reduce the amount of the Company's issued share capital.

At the AGM authority will be sought from the shareholders to grant authority for the Company to repurchase up to 10%. of the issued share capital of the Company. Further details on the resolution are provided in the Notice of this year's AGM.

Securities carrying special rights

No person holds securities in the Company carrying special rights with regard to control of the Company. In accordance with an Undertaking entered into in October 1997, UEM Group Berhad had been entitled to appoint a Non-Executive Director as long as they held more than 7% of the aggregate nominal value of the then issued share capital of the Company, although they had not taken advantage of this option since 4 December 2009. In November 2016, UEM's holding in the Company fell below 7% and as at 31 December 2016 they no longer held any interest in the Company's shares.

Restrictions on voting

No member shall be entitled to vote at any general meeting or class meeting in respect of any share held by him/her if any call or other sum then payable by him/her in respect of that share remains unpaid or if a member has been served with a restriction notice (as defined in the Articles of Association) after failure to provide the Company with information concerning interests in those shares required to be provided under the Companies Act 2006.

The Company is not aware of any agreement between holders of securities that may result in restrictions of voting rights.

Employee Share Trust

As at 31 December 2016, ACS HR Solutions Share Plan Services (Guernsey) Limited, as Trustee of the Costain Group Employee Trust, held 0.32% of the issued share capital of the Company on trust for the benefit of those employees who exercise their share awards/options under the Company's Long-Term Incentive Plan, Deferred Share Bonus Plan, Share Deferral Plan and Save As You Earn Scheme (in respect of 'good leavers' who leave the employment of the Company before their contract matures). The Trustee does not exercise any right to vote or to receive a dividend in respect of this shareholding.

Powers of the Directors

Subject to the Company's Articles of Association, the Companies Act 2006 and any directions given to the Company by special resolution, the business of the Company will be managed by the Board, who may exercise all the powers of the Company. In particular, the Board may exercise all the powers of the Company to borrow money, to guarantee, to indemnify, to mortgage or charge any of its undertaking, property, assets (present and future) and uncalled capital and to issue debentures and other securities and to give security for any debt, liability or obligation of the Company or of any third party.

Amendment of Articles of Association

Unless expressly specified to the contrary in the Articles of Association of the Company, the Company's Articles of Association may be amended by special resolution of the Company's shareholders. A copy of the Articles of Association is available on the Company's website at **costain.com**.

Political donations

No political donations were made during the year ended 31 December 2016 (2015: nil). The Company has a policy of not making donations to political organisations. As a precautionary measure, shareholder approval is being sought at the forthcoming AGM for the Company and its subsidiaries to make donations and/or incur expenditure which may be construed as 'political' by the wide definition of that term included in the relevant legislation. Further details on the resolution are provided in the Notice of this year's AGM.

Directors' interests

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, including any changes in interests during 2016, are contained in the Directors' Remuneration report, which appears on pages 70 and 78.

Independent auditors

KPMG LLP have notified the Company that they are not seeking re-appointment as the external Auditor. It is proposed that PricewaterhouseCoopers LLP (PwC) are appointed as Auditor of the Company and that they will hold office from the conclusion of the AGM in May 2017 until the conclusion of the next general meeting at which the accounts are laid before the Company. See page 56 of the Audit Committee report and the Notice of Annual General Meeting, available on the Company's website at **costain.com**, for further details.

Significant agreements – change of control

The Directors are not aware of any significant agreements to which the Company and/or any of its subsidiaries or associates are a party that take effect, alter or terminate upon a change of control of the Company following a takeover bid, save in respect of the Facility Agreements relating to the Company's banking and surety bonding facilities, which would become terminable upon a change of control. There are no agreements between the Company and its Directors or employees providing for compensation for loss of office or employment as a result of a successful takeover bid except that provisions of the Company's share schemes and plans may cause options and awards to be granted to employees under such schemes and plans to vest on a takeover.

Research and development

The Group is involved in research and development in all the sectors in which it operates. The Group's engineers and technical staff in these named sectors seek to develop and deliver technical advances. In undertaking certain elements of this research and development work, the Group is supported by arrangements with certain British universities and various technology specialists.

Greenhouse gas emissions

The Strategic report on page 23 details the greenhouse gas emissions disclosures required by the Companies Act 2006 (Strategic report and Directors' report) Regulations 2013. This information is incorporated by reference into (and shall be deemed to form part of) this report.

Directors' indemnity

Costain Group PLC maintains liability insurance for its Directors and officers. There are no subsisting indemnities in favour of its Directors.

DIRECTORS' REPORT
CONTINUED

Appointment and replacement of Directors

Brief biographies of the present members of the Board are given on pages 40 to 41.

The Directors shall be not less than two and not more than 18 in number. The Company may by ordinary resolution vary the minimum and/or maximum number of Directors.

Directors may be appointed by the Company by ordinary resolution or by the Board. A Director appointed by the Board holds office only until the next AGM of the Company and is then eligible for reappointment.

At every AGM of the Company, any Director who has been appointed by the Board since the last AGM, or who held office at the time of the two preceding AGMs and who did not retire at either of them, or who has held office with the Company, other than employment or executive office, for a continuous period of nine years or more at the date of the meeting, shall retire from office and may offer himself/herself for reappointment by the members.

The Board, or any Committee authorised by the Board, may from time to time appoint one or more Directors to hold any employment or executive office for such period and on such terms as they may determine and may also revoke or terminate any such appointment.

The Company may by special resolution remove any Director before the expiration of his/her period of office. The office of a Director shall also be vacated under a number of situations which are set out in the Articles of Association of the Company. These include: a Director wishing to resign, being required to step down due to ill health, becoming bankrupt; or being prohibited by law from being a Director.

Employee information

The average number of employees within the Company and Group is shown in Note 5 to the financial statements on page 107.

Apart from ensuring that an individual has the ability to carry out a particular role, the Company does not discriminate in any way. The Company endeavours to retain employees if they become disabled, making reasonable adjustments to their role and, if necessary, looking for redeployment opportunities within the Group. The Company also ensures that training, career development and promotion opportunities are available to all employees irrespective of gender, race, age or disability.

The Company maintains a strong communication network and employees are encouraged to discuss with management matters of interest and issues affecting the day-to-day operations of the Group. Employees are kept informed of the financial and economic factors affecting the Company's performance, and other matters of concern to them as employees, through various means including regular updates from the Chief Executive and other senior managers and a Costain online news service. Employees also have the opportunity to provide feedback and ask questions at the annual staff road shows which take place around the country. Further details of the actions taken to introduce, maintain or develop arrangements aimed at employees are described in the Strategic review on page 20.

Essential contracts or other arrangements

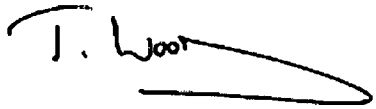
Given the scope and diversity of the Company's activities, the Company does not consider that it has contractual or other arrangements which are essential to the business of the Group and which are required to be disclosed.

Disclosure of information to auditor

The Directors confirm that, so far as they are aware, there is no relevant audit information (as defined in Section 418 of the Companies Act 2006) of which the Company's external Auditor is unaware and that each Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's external Auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

By Order of the Board



Tracey Wood | Company Secretary
28 February 2017

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration report and accounts in accordance with applicable law and regulations.

Company law requires the Directors to prepare accounts for each financial year. Under that law, the Directors are required to prepare the Group and Company accounts in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

Under Company law, the Directors must not approve the financial statements unless they are satisfied that these give a true and fair view of the state of affairs of the Group and the Company and of their profit or loss for that period.

In preparing each of the Group and the Company accounts, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the EU have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the accounts and the Director's Remuneration report comply with the Companies Act 2006 and as regards the Group accounts, Article 4 of the IAS Regulation.

They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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 also 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.

The Directors are responsible for preparing the Annual Report in accordance with applicable law and regulations. The Directors consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and the Group's position and performance, business model and strategy.

Each of the Directors of the Company confirms that, to the best of his or her knowledge:

- the Group accounts, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profits/losses of the Company (and of the Group taken as a whole); and
- the Strategic report includes a fair review of the development and performance of the business and the position of the Company (and of the Group taken as a whole), together with a description of the principal risks and uncertainties that they face.

On behalf of the Board

Dr Paul Golby CBE
Chairman
28 February 2017

Andrew Wyllie CBE
Chief Executive
28 February 2017

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COSTAIN GROUP PLC ONLY

Opinions and conclusions arising from our audit

1 Our opinion on the financial statements is unmodified

We have audited the financial statements of Costain Group Plc for the year ended 31 December 2016 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income and Expense, the Consolidated and Company Statement of Financial Position, the Consolidated and Company Statement of Changes in Equity, the Consolidated and Company Cash Flow Statement and related notes. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement, in decreasing order of audit significance, that had the greatest effect on our audit were as follows *(2015: Contract accounting estimates and Accounting for acquisitions):*

Contract accounting estimates (risk vs 2015):
Refer to page 54 (Audit Committee Report) and pages 101 – 102 (accounting policies).

- *The Risk:* The Group recognises revenue and profit in accordance with IAS 11 based on the proportion of contract costs incurred for the work performed to the balance sheet date, relative to the estimated total forecast costs of the contract at completion. The recognition of revenue and profit therefore relies on estimates in relation to the forecast total costs on each contract. Cost contingencies may also be included in these estimates to take account of specific uncertain risks, or disputed claims against the Group, arising within each contract. These contingencies are reviewed by the Group on a regular basis throughout the contract life and adjusted where appropriate. The revenue on contracts may also include compensation events, variations and claims. Compensation events, variations and claims are recognised on a contract-by-contract basis. This occurs when the Group's negotiations with the customer indicate that for compensation events and variations it is probable that they will be agreed and for claims that they have reached an advanced stage such that it is probable that the customer will accept the claim and in all cases when the amount can be measured reliably. In certain circumstances recoveries from insurers are also included in forecasts where legal entitlement has been established and receipt is deemed to be probable. Therefore there is a high degree of risk and associated management judgement in estimating the amount of revenue and associated profit to be recognised by the Group up to the balance sheet date and changes to these estimates could give rise to material variances.
- *Our Response:* Using a variety of quantitative and qualitative criteria we selected a sample of contracts to assess and challenge the most significant and complex contract estimates. We obtained the detailed project management review papers from the Group to support the estimates made and challenged the judgements underlying those papers with senior operational, commercial and financial management. Procedures varied across projects depending on the risks identified, they included:
  - evaluating the financial performance of contracts against budget and historical trends;
  - completing site visits to certain higher risk or larger value contracts and identifying areas of complexity through observation and discussion with site personnel;
  - challenging the Group's judgement in respect of forecast contract out-turn, contingencies, settlements and the recoverability of contract balances via agreement to third party certifications and confirmations and with reference to our own assessments, historical outcomes and industry norms;
  - analysing correspondence with customers around compensation events, variations and claims and considering whether this information is consistent with the estimates made by the Group;
  - analysing correspondence with insurers around recognised insurance claims, challenging management on the issues raised and considering whether this information supports the recoverability of recognised amounts;
  - inspecting selected contracts for key clauses; identifying relevant contractual mechanisms such as pain/gain shares, design bonuses, liquidated damages and success fees and assessing whether these key clauses have been appropriately reflected in the amounts recognised in the financial statements;
  - taking into account the risks and opportunities on each contract, assessing whether the amounts recognised in the financial statements resulting from the estimates and assumptions made are appropriate and in accordance with the recognition and measurement requirements of IAS 11: Construction Contracts; and
  - considering the adequacy of the Group's disclosures in respect of contract accounting and the key risks relating to these amounts.

Carrying value of Natural Resources goodwill £38,600,000 (2015: £38,300,000) (risk vs 2015) *(New risk)*
Refer to page 54 (Audit Committee Report) and pages 101 – 102 (accounting policies).

- *The Risk:* The Group has previously recognised goodwill of £38.3 million allocated to the Natural Resources cash generating unit (CGU). In accordance with IAS 36, the Group is required to assess goodwill for impairment on an annual basis. There is inherent uncertainty involved in forecasting and discounting future cash flows, which are the basis of the assessment of recoverability. Our assessment of the risk to this balance has increased in the year due to the trading performance of the division and, accordingly, this year we highlight this as a significant risk in our audit report.
- *Our Response:* Our audit procedures over the carrying value of the goodwill for the Natural Resources CGU included the following procedures:
  - testing the mathematical accuracy of the Group's discounted cash flow model by recalculating each year's net present value and the terminal value using management's inputs;
  - comparing the cash flows used in the impairment model to the output of the Group's budgeting process and against the understanding we obtained about the business areas through our audit;
  - assessing the historical accuracy of the forecasts used in the Group's impairment model by considering actual performance against prior year budgets;
  - using external data, such as forecast growth rates, and our own internal valuation specialists to evaluate the key inputs and assumptions for growth and discount rates;
  - performing sensitivity and break-even analysis for the key inputs and assumptions; and
  - evaluating the adequacy of the Group's disclosures related to the judgements and assumptions over recoverability of goodwill in note 11.

Risks determined to no longer be significant
In 2015 we identified accounting for the acquisition of the Rhead Group Limited as a significant audit risk. We continue to perform procedures over accounting for acquisitions. However, the acquisition completed during 2016 was less significant than the acquisition completed in 2015. Accordingly, we have not assessed this as one of the risks that had the greatest effect on our audit and, therefore, it is not separately identified in our audit report this year.

3 Our application of materiality and an overview of the scope of our audit

Materiality	amount	£1.49 million (2015: £1.45 million)
	basis	4.8% of Group profit before taxation (2015: 4.9% of Group profit before taxation and finance charges)
Range of component materialities		£0.73 million to £1.49 million (2015: £0.75 million to £1.45 million)
Threshold for reporting corrected or uncorrected differences to the Audit Committee		£74,500 (2015: £72,500) plus any lesser differences if warranted on qualitative grounds

In 2016 we changed our benchmark for determining materiality from Group profit before taxation and finance charges to Group profit before taxation as Group profit before taxation is considered the industry standard benchmark.

Audits for Group reporting purposes were performed by component auditors at the key reporting components in Spain, Aberdeen and by the Group audit team at the Group's head offices. These procedures covered 99% of total Group revenue (2015: 99%), 96% (2015: 99%) of total Group profit before tax and 99% (2015: 99%) of total Group assets. The segment disclosures in Note 3 set out the individual significance of specific countries.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COSTAIN GROUP PLC ONLY CONTINUED

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' Viability Statement on page 28, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to 31 December 2019; or
- the disclosures in Note 2 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements and the part of the Directors' Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statements, set out on page 28 in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on page 39 relating to the Company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 83, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Andrew Marshall (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
15 Canada Square
London E14 5GL

28 February 2017

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CONSOLIDATED INCOME STATEMENT

YEAR ENDED 31 DECEMBER

		2016			2015		
	Notes	Before other items £m	Other items £m	Total £m	Before other items £m	Other items £m	Total £m
Continuing operations							
Revenue including share of revenue of joint ventures and associates	3	**1,658.0**	–	**1,658.0**	1,316.5	–	1,316.5
Less: Share of revenue of joint ventures and associates	13	**(84.3)**	–	**(84.3)**	(52.9)	–	(52.9)
Group revenue		**1,573.7**	–	**1,573.7**	1,263.6	–	1,263.6
Cost of sales		**(1,497.7)**	–	**(1,497.7)**	(1,196.9)	–	(1,196.9)
Gross profit		**76.0**	–	**76.0**	66.7	–	66.7
Administrative expenses before other items		**(34.9)**	–	**(34.9)**	(33.5)	–	(33.5)
Amortisation of acquired intangible assets		–	**(4.6)**	**(4.6)**	–	(3.2)	(3.2)
Employment related and other deferred consideration		–	**(1.6)**	**(1.6)**	–	(0.4)	(0.4)
Group operating profit		**41.1**	**(6.2)**	**34.9**	33.2	(3.6)	29.6
Share of results of joint ventures and associates	13	**0.2**	–	**0.2**	(0.1)	–	(0.1)
Profit from operations	3	**41.3**	**(6.2)**	**35.1**	33.1	(3.6)	29.5
Finance income	7	**0.6**	–	**0.6**	0.8	–	0.8
Finance expense	7	**(4.4)**	**(0.4)**	**(4.8)**	(4.0)	(0.3)	(4.3)
Net finance expense		**(3.8)**	**(0.4)**	**(4.2)**	(3.2)	(0.3)	(3.5)
Profit before tax	3/4	**37.5**	**(6.6)**	**30.9**	29.9	(3.9)	26.0
Taxation	8	**(5.1)**	**0.6**	**(4.5)**	(4.4)	0.6	(3.8)
Profit for the year attributable to equity holders of the parent		**32.4**	**(6.0)**	**26.4**	25.5	(3.3)	22.2
Earnings per share							
Basic	9	**31.5p**	**(5.8)p**	**25.7p**	25.1p	(3.3)p	21.8p
Diluted	9	**30.7p**	**(5.7)p**	**25.0p**	24.4p	(3.2)p	21.2p

The impact of business disposals in either year was not material and, therefore, all results are classified as arising from continuing operations.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME AND EXPENSE

YEAR ENDED 31 DECEMBER

	2016 £m	2015 £m
Profit for the year	**26.4**	22.2
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of foreign operations	**4.2**	(1.3)
Net investment hedge – net loss	**(3.7)**	–
Cash flow hedges:		
Effective portion of changes in fair value during year	**1.9**	–
Net changes in fair value transferred to the income statement	**–**	–
Total items that may be reclassified subsequently to profit or loss	**2.4**	(1.3)
Items that will not be reclassified to profit or loss:		
Remeasurement of defined benefit obligations	**(49.8)**	(3.3)
Tax recognised on remeasurement of defined benefit obligations	**7.6**	0.7
Total items that will not be reclassified to profit or loss	**(42.2)**	(2.6)
Other comprehensive expense for the year	**(39.8)**	(3.9)
Total comprehensive (expense)/income for the year attributable to equity holders of the parent	**(13.4)**	18.3

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER

	Notes	2016 £m	2015 £m
Assets			
Non-current assets			
Intangible assets	11	**65.9**	52.3
Property, plant and equipment	12	**42.2**	37.3
Investments in equity accounted joint ventures	13	**0.3**	0.4
Investments in equity accounted associates	13	**0.6**	0.5
Loans to equity accounted associates	13	**1.7**	1.7
Other	14	**7.7**	8.2
Deferred tax	8	**14.9**	10.6
Total non-current assets		**133.3**	111.0
Current assets			
Inventories		**3.6**	2.9
Trade and other receivables	14	**299.1**	271.8
Cash and cash equivalents	15	**210.2**	146.7
Total current assets		**512.9**	421.4
Total assets		**646.2**	532.4
Equity			
Share capital	21	**52.1**	51.1
Share premium		**8.8**	6.2
Foreign currency translation reserve		**2.3**	1.8
Hedging reserve		**1.9**	–
Retained earnings		**34.5**	61.5
Total equity attributable to equity holders of the parent		**99.6**	120.6
Liabilities			
Non-current liabilities			
Retirement benefit obligations	20	**73.5**	36.7
Other payables	18	**1.0**	2.8
Interest bearing loans and borrowings	16	**30.1**	–
Provisions for other liabilities and charges	19	**0.4**	0.1
Total non-current liabilities		**105.0**	39.6
Current liabilities			
Trade and other payables	18	**397.2**	329.0
Taxation	8	**3.4**	2.7
Interest bearing loans and borrowings	16	**39.9**	38.5
Provisions for other liabilities and charges	19	**1.1**	2.0
Total current liabilities		**441.6**	372.2
Total liabilities		**546.6**	411.8
Total equity and liabilities		**646.2**	532.4

The financial statements were approved by the Board of Directors on 28 February 2017 and were signed on its behalf by:

A Wyllie
Director

A O Bickerstaff
Director

Registered number: 1393773

COMPANY STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER

	Notes	2016 £m	2015 £m
Assets			
Non-current assets			
Investments in subsidiaries	13	**105.4**	102.5
Total non-current assets		**105.4**	102.5
Current assets			
Trade and other receivables	14	**134.4**	98.5
Cash and cash equivalents	15	**–**	0.1
Total current assets		**134.4**	98.6
Total assets		**239.8**	201.1
Equity			
Share capital	21	**52.1**	51.1
Share premium		**8.8**	6.2
Other reserves		**19.5**	16.6
Retained earnings		**59.7**	59.8
Total equity attributable to equity holders of the parent		**140.1**	133.7
Liabilities			
Non-current liabilities			
Interest bearing loans and borrowings	16	**30.0**	–
Provisions for other liabilities and charges	19	**1.1**	1.1
Total non-current liabilities		**31.1**	1.1
Current liabilities			
Trade and other payables	18	**27.2**	26.2
Taxation	8	**1.5**	1.5
Interest bearing loans and borrowings	16	**39.9**	38.5
Provisions for other liabilities and charges	19	**–**	0.1
Total current liabilities		**68.6**	66.3
Total liabilities		**99.7**	67.4
Total equity and liabilities		**239.8**	201.1

The financial statements were approved by the Board of Directors on 28 February 2017 and were signed on its behalf by:

A Wyllie
Director

A O Bickerstaff
Director

Registered number: 1393773

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital £m	Share premium £m	Translation reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
At 1 January 2015	50.6	5.5	2.8	–	51.9	110.8
Profit for the year	–	–	–	–	22.2	22.2
Other comprehensive expense	–	–	(1.3)	–	(2.6)	(3.9)
Issue of ordinary shares under employee share option plans	0.4	–	–	–	(0.4)	–
Transfer	–	–	0.3	–	(0.3)	–
Shares purchased to satisfy employee share schemes	–	–	–	–	(1.0)	(1.0)
Equity-settled share-based payments	–	–	–	–	1.9	1.9
Dividends paid	0.1	0.7	–	–	(10.2)	(9.4)
At 31 December 2015	51.1	6.2	1.8	–	61.5	120.6
At 1 January 2016	**51.1**	**6.2**	**1.8**	**–**	**61.5**	**120.6**
Profit for the year	–	–	–	–	**26.4**	**26.4**
Other comprehensive income/(expense)	–	–	**0.5**	**1.9**	**(42.2)**	**(39.8)**
Issue of ordinary shares under employee share option plans	**0.9**	**1.9**	–	–	**(0.3)**	**2.5**
Shares purchased to satisfy employee share schemes	–	–	–	–	**(1.4)**	**(1.4)**
Equity-settled share-based payments	–	–	–	–	**2.3**	**2.3**
Dividends paid	**0.1**	**0.7**	–	–	**(11.8)**	**(11.0)**
At 31 December 2016	**52.1**	**8.8**	**2.3**	**1.9**	**34.5**	**99.6**

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

Details of the nature of the above reserves are set out below.

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.

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.

COMPANY STATEMENT OF CHANGES IN EQUITY

	Share capital £m	Share premium £m	Other reserve £m	Retained earnings £m	Total equity £m
At 1 January 2015	50.6	5.5	14.2	67.5	137.8
Comprehensive income	–	–	–	2.9	2.9
Issue of ordinary shares under employee share option plans	0.4	–	–	(0.4)	–
Equity-settled share-based payments granted to employees of subsidiaries	–	–	2.4	–	2.4
Dividends paid	0.1	0.7	–	(10.2)	(9.4)
At 31 December 2015	51.1	6.2	16.6	59.8	133.7
At 1 January 2016	**51.1**	**6.2**	**16.6**	**59.8**	**133.7**
Comprehensive income	–	–	–	**12.0**	**12.0**
Issue of ordinary shares under employee share option plans	**0.9**	**1.9**	–	**(0.3)**	**2.5**
Equity-settled share-based payments granted to employees of subsidiaries	–	–	**2.9**	–	**2.9**
Dividends paid	**0.1**	**0.7**	–	**(11.8)**	**(11.0)**
At 31 December 2016	**52.1**	**8.8**	**19.5**	**59.7**	**140.1**

Details of the nature of the above reserves are set out below.

Other reserve

The Company grants certain of its subsidiaries rights to its equity instruments as part of its share-based payment plan incentive schemes. The impact is recognised within this non-distributable reserve.

CONSOLIDATED CASH FLOW STATEMENT

YEAR ENDED 31 DECEMBER

	Notes	2016 £m	2015 £m
Cash flows from operating activities			
Profit for the year		**26.4**	22.2
Adjustments for:			
Share of results of joint ventures and associates	13	**(0.2)**	0.1
Finance income	7	**(0.6)**	(0.8)
Finance expense	7	**4.8**	4.3
Taxation	8	**4.5**	3.8
Depreciation of property, plant and equipment	4	**6.4**	2.9
Amortisation of intangible assets	4	**5.2**	3.9
Employment related and other deferred consideration		**1.6**	0.4
Shares purchased to satisfy employee share schemes		**(1.4)**	(1.0)
Share-based payments expense	5	**2.9**	2.4
Cash from operations before changes in working capital and provisions		**49.6**	38.2
(Increase)/decrease in inventories		**(0.7)**	0.1
Increase in receivables		**(24.0)**	(37.7)
Increase in payables		**61.1**	26.7
Movement in provisions and employee benefits		**(14.7)**	(9.1)
Cash from operations		**71.3**	18.2
Interest received		**0.4**	0.8
Interest paid		**(2.4)**	(2.7)
Taxation paid		**(2.2)**	(0.6)
Net cash from operating activities		**67.1**	15.7
Cash flows from/(used by) investing activities			
Dividends received from joint ventures and associates	13	**0.2**	–
Additions to property, plant and equipment	12	**(7.0)**	(2.0)
Additions to intangible assets	11	**(0.1)**	(0.2)
Proceeds of disposal of property, plant and equipment		**0.1**	0.1
Additions to cost of investments	13	**–**	(1.0)
Acquisition related deferred consideration	17	**(2.0)**	(5.4)
Acquisition of subsidiaries (net of acquired cash and cash equivalents)	25	**(16.3)**	(30.0)
Net cash used by investing activities		**(25.1)**	(38.5)
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**2.5**	–
Ordinary dividends paid	10	**(11.0)**	(9.4)
Drawdown of loans	16	**90.1**	38.5
Repayment of loans	16	**(60.0)**	(8.1)
Net cash from financing activities		**21.6**	21.0
Net increase/(decrease) in cash, cash equivalents and overdrafts		**63.6**	(1.8)
Cash, cash equivalents and overdrafts at beginning of the year	15	**146.7**	148.5
Effect of foreign exchange rate changes		**(0.1)**	–
Cash, cash equivalents and overdrafts at end of the year	15	**210.2**	146.7

COMPANY CASH FLOW STATEMENT

YEAR ENDED 31 DECEMBER

	Notes	2016 £m	2015 £m
Cash flows from operating activities			
Profit for the year		**12.0**	2.9
Adjustments for:			
Finance income		**(13.0)**	(2.0)
Finance expense		**2.3**	–
Cash from operations before changes in working capital and provisions		**1.3**	0.9
Increase in receivables		**(34.5)**	(37.8)
Increase/(decrease) in payables		**1.0**	(1.3)
Movement in provisions		**(0.1)**	(0.1)
Cash used by operations		**(32.3)**	(38.3)
Interest received		**0.5**	0.1
Interest paid		**(2.3)**	(2.5)
Net cash used by operating activities		**(34.1)**	(40.7)
Cash flows from investing activities			
Dividends received		**12.5**	1.5
Net cash from investing activities		**12.5**	1.5
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**2.5**	–
Ordinary dividends paid	10	**(11.0)**	(9.4)
Drawdown of revolving credit facility	16	**90.0**	38.5
Repayment of loans	16	**(60.0)**	–
Net cash from financing activities		**21.5**	29.1
Net decrease in cash and cash equivalents		**(0.1)**	(10.1)
Cash and cash equivalents at beginning of the year	15	**0.1**	10.2
Cash and cash equivalents at end of the year	15	**–**	0.1

NOTES TO THE FINANCIAL STATEMENTS

1 General information

Costain Group PLC (the Company) is a public limited company incorporated in the UK. The address of its registered office and principal place of business is disclosed on page 138 of this Annual Report. The principal activities of the Company and its subsidiary undertakings (collectively referred to as 'the Group') are described in the Strategic report.

The consolidated financial statements of the Company for the year ended 31 December 2016 comprise the Group and the Group's interests in associates, joint ventures and joint operations. 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 28 February 2017.

2 Summary of significant accounting policies

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) and their related interpretations. On publishing the parent Company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements.

Basis of preparation

These financial statements are presented in pounds sterling, rounded to the nearest hundred thousand. The financial statements are prepared on the historical cost basis, except that financial assets and derivative financial instruments are stated at their fair value.

The preparation of financial statements in conformity with 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 IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed later in this Note.

Going concern

The Group's business activities and the factors likely to affect its future development, performance and position are set out in the Strategic report. The financial position of the Group, its cash flows, liquidity position, borrowing and bonding facilities, use of financial instruments and hedging activities, exposure to credit risk and its objectives, policies and processes for managing its capital and financial risk are described in the Financial review section of these financial statements and in Note 17.

The Group's principal business activity involves long-term contracts with a number of customers, virtually all in the UK. To meet its day-to-day working capital requirements, it uses cash balances provided from shareholders' capital and retained earnings and its borrowing facilities. As part of its contracting operations, the Group may be required to provide performance and other bonds. It satisfies these requirements by utilising its committed bonding facilities from banks and surety companies. These facilities have financial covenants that are tested quarterly.

The Directors have acknowledged the guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' published by the Financial Reporting Council in October 2009. The Directors have considered these requirements, the Group's current order book and future opportunities and its available bonding facilities. Having reviewed the latest projections, including the application of reasonable downside sensitivities, the Directors believe that the Group is well-placed to manage its business risks successfully despite the current uncertain economic outlook. Accordingly, they continue to adopt the going concern basis in preparing these financial statements.

Accounting policies

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

The following standards and interpretations are effective for the year ended 31 December 2016:

- 'Accounting for Acquisitions of Interests in Joint Operations' (Amendments to IFRS 11).
- 'Clarification of Acceptable methods of Depreciation and Amortisation' (Amendments to IAS 16 and IAS 38).
- 'Equity Method in Separate Financial Statements' (Amendments to IAS 27).
- 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture' (Amendments to IFRS 10 and IAS 28).
- Annual Improvements to IFRSs 2012-2014 Cycle.
- Disclosure Initiative (Amendments to IAS 1).
- 'Agriculture: Bearer Plants' – Amendments to IAS 16 and IAS 41.
- 'Investment entities: Applying the Consolidation Exception' – Amendments to IFRS 10, IFRS 12 and IAS 28.

The impact of these standards is limited to minor disclosure changes and alignment of accounting policies has not necessitated any prior year restatements.

2 Summary of significant accounting policies continued

Basis of consolidation

(a) The Group's financial statements include the financial statements of the Company and its subsidiaries. Subsidiaries are entities controlled by the Group and control exists when the Group is exposed to, or has the rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. 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 power exists 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.

(c) Joint ventures are those joint arrangements where control is shared with another entity, and where the Group has rights to the net assets of the arrangement. Joint ventures are accounted for using the equity method from the date that the joint venture commences until the date that joint control of the entity ceases.

(d) The presentation of investments in associates and joint ventures in the statement of financial position restricts the minimum carrying value to £Nil. Where the cost of investment would be negative, due to losses incurred, then an amount up to the value of the negative position is applied to any outstanding loan balance with the investment or, where future funding commitments exist, a provision is made up to the value of the commitment. Any such transfers of excess losses from the carrying value of investments are shown within reclassifications in Note 13.

(e) Joint operations are those joint arrangements over which joint control exists, established by contractual agreement, which are not legal entities and where the parties have rights to the assets and obligations for the liabilities relating to the arrangement. Where a joint operation exists, then the Group entity involved records the assets it controls, the liabilities and expenses it incurs and its share of income. Such joint operations are reported in the consolidated financial statements on the same basis. Transactions between Group companies and joint operations eliminate on consolidation.

(f) Intra-group balances and transactions together with any unrealised gains arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates, joint ventures and joint operations are eliminated to the extent of the interest in the entity or operation. Unrealised losses are 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 exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to pounds sterling at the exchange rate ruling at the statement of financial position date. Foreign exchange differences arising on translation are recognised in the income statement.

The assets and liabilities of foreign operations are translated to pounds sterling at exchange rates ruling at the statement of financial position date. The revenues and expenses of foreign operations are translated to pounds sterling at rates approximating to the 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, to the extent that the hedge is effective, are recognised directly in equity and those that have arisen since 1 January 2004, the date of transition to IFRS, are presented as a separate component of equity. Any remaining differences are recognised in profit or loss. Cumulative exchange differences are released into the income statement upon disposal. Translation differences that arose before the date of transition to 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 share of revenue of joint operations. Over 95% of the Group's revenue arises from long-term contracts.

(a) Long-term contracts

Revenue arises from increase in the value of work performed and the value of services provided during the year. Where the outcome of a long-term 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 statement of financial position 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.

Compensation events, 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 long-term 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.

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

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

2 Summary of significant accounting policies continued

Revenue recognition continued

Contract 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. Cost includes all expenditure related directly to specific projects and an appropriate allocation of fixed and variable overheads based on normal operating capacity. Amounts valued and billed to customers are included in trade receivables. Where cash received from customers exceeds the value of work performed, the amount is included in credit balances on long-term contracts.

(b) Other revenue
Revenue from other services contracts is recognised when the service is provided.

Revenue from the sale of land is recognised when the significant risks and rewards of ownership have been transferred 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.

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.

Income statement presentation – Other items

In order to aid understanding of the underlying and overall performance of the Group, certain amounts are shown in the consolidated income statement in a separate column headed 'Other items'. Items are included under this heading where the Board considers them to be of a one-off and unusual nature or related to the accounting treatment of acquisitions, this includes amortisation of acquired intangibles and employment related and other deferred consideration. These are adjusted because they are not long term in nature and, hence, will not reflect the long-term performance of the Group.

Pre-contract costs

Costs associated with bidding for contracts are written off as incurred.

Research and development

Research and development activities are usually directly attributable to a project and accounted within project costs.

Goodwill and other intangible assets

Goodwill arising on acquisitions represents the excess of the fair value of the consideration over the identifiable assets, liabilities and contingent liabilities of the acquired entity and goodwill arising on the acquisition of subsidiaries is included in non-current assets. The attributable costs of acquisitions are expensed to the income statement.

Goodwill is reviewed annually for impairment and is carried at cost less accumulated impairment losses. Goodwill is included when determining the profit or loss on subsequent disposal of the business to which it relates.

Other intangible assets comprise acquired intangible assets (customer relationships, order book, brand and intellectual property) and computer software. Customer relationships and other intangibles acquired are measured at the present value of cash flows attributable to the relationship less an appropriate contributory asset charge. Computer software is carried at cost; subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates, otherwise expenditure is expensed as incurred.

Amortisation begins when an asset is acquired or, in the case of computer software, available for use and is amortised over the following periods:

Brands	– on a straight-line basis up to three years
Order book	– in line with expected profit generation up to three years
Customer relationships	– on a straight-line basis up to seven years
Other intangibles	– on a straight-line basis up to five years

Property, plant and equipment

Property, plant and equipment is carried at cost less accumulated depreciation and impairment losses.
Where parts of an item of property, plant and 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 and 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 and equipment	– remaining useful life (generally 3 to 10 years)
Marina (Alcaidesa)	– concession period (20 years remaining)
Golf courses (Alcaidesa)	– 50 years

The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at each statement of financial position date.

2 Summary of significant accounting policies continued

Investments – Company

Company investments in subsidiaries are carried at cost less provisions for impairment.

Impairment of non-financial assets

For the purposes of impairment testing, goodwill is allocated to each of the cash generating units expected to benefit from the synergies of the combination. Cash generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

The carrying amounts of other assets, except inventories and deferred tax assets, are reviewed at each statement of financial position 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 (other than in relation to goodwill) 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.

Provisions

A provision is recognised in the statement of financial position when there is 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 from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

Taxation

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

The tax currently payable is based on the taxable profit for the year. Taxable profit differs from profit before tax 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 liability for current tax is calculated using tax rates and laws that have been enacted or substantively enacted by the statement of financial position 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 statement of financial position 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 future taxable profits will be available against which deductible temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each statement of financial position 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 arrangements, 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 statement of financial position 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.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

2 Summary of significant accounting policies continued

Leases
Leases principally comprise 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.

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

Share capital
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Dividends
Dividends are recognised as distributions in the period in which they are declared. Dividends proposed but not declared are not recognised but are disclosed in Note 10 to the financial statements.

Share-based payments
These comprise equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant and the fair value is expensed over the vesting period, based on the estimate of awards that will eventually vest. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each statement of financial position date. Fair value is measured by the use of a Black-Scholes option pricing model.

Where options are granted over shares in the Company to employees of subsidiaries, the Company recognises in its 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.

Retirement benefit obligations
A defined benefit pension scheme is operated in the UK, which provides benefits based on pensionable salary. The details are included in Note 20. 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 statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligations less the fair value of scheme assets at the statement of financial position date.

Administration costs of the scheme are recognised in the income statement. The interest cost on the scheme's net liabilities is included in finance expense. Remeasurements of the net liability are recognised in the consolidated statement of comprehensive income.

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

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

(a) Financial assets
Financial assets are classified as loans and receivables. The classification depends on the nature and purpose of the financial asset and is determined at the time of initial recognition.

A financial asset is derecognised only when the contractual rights to the cash flows from that asset expire, or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

Loans and receivables
Loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables and 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.

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

Impairment of financial assets
Estimated recoverable amounts are based on the ageing of the outstanding receivable and provisions against individual receivables are recognised when management deems the amounts are not collectible.

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.

2 Summary of significant accounting policies continued

(b) 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. Where borrowings are the hedged item in an effective fair value hedge relationship, the carrying value is adjusted to reflect the fair value movements associated with the hedged risk. Financial liabilities are derecognised only when the obligations are discharged, cancelled or expire.

Trade payables
Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

(c) Derivative financial instruments

Derivative financial instruments are used to manage risks arising from changes in foreign exchange rates, interest rates and inflation and are measured at their fair value. The fair value of forward exchange contracts is their quoted market value at the statement of financial position date.

Certain derivative financial instruments are designated as cash flow hedges in line with established risk management policies and classified as follows:

- Fair value hedges that hedge the exposure to changes in the fair value of a recognised asset or liability; or
- 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 adjusted against the carrying amount of the hedged item.

For cash flow hedges, the portion of the gain or 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 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 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.

Fair value measurement

When measuring the fair value of a financial or non-financial asset or liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the hierarchy as the lowest level input that is significant to the entire measurement.

Significant areas of judgement and estimation

The estimates and underlying assumptions used in the preparation of these financial statements 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 most critical accounting policies and significant areas of judgement and estimation arise from the accounting for long-term contracts under IAS 11 'Construction Contracts', the carrying value of goodwill and acquired intangible assets and the assumptions used in the accounting for defined benefit pension schemes under IAS 19 'Employee benefits'.

Long-term contracts
The majority of the Group's activities are undertaken via long-term contracts and these contracts are accounted for in accordance with IAS 11, which requires estimates to be made for contract costs and revenues. In many cases, these contractual obligations span more than one financial period. Both cost and revenue forecasts may be affected by a number of uncertainties that depend on the outcome of future events and may need to be revised as events unfold and uncertainties are resolved. Cost forecasts take into account the expectations of work to be undertaken on the contract. Revenue forecasts take into account compensation events, variations and claims to the extent that the amounts the Group expects to recover can be reliably estimated and the receipt is probable.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

2 Summary of significant accounting policies continued

Significant areas of judgement and estimation continued

Management bases its judgements of costs and revenues and its assessment of the expected outcome of each long-term contractual obligation on the latest available information, this includes detailed contract valuations, progress on discussions over compensation events, variations and claims with clients and forecasts of the costs to complete and, in certain limited cases, assessments of recoveries from insurers. The estimates of the contract position and the profit or loss earned to date are updated regularly and significant changes are highlighted through established internal review procedures. The impact of any change in the accounting estimates is then reflected in the financial statements.

Management believes it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year could require material adjustment. Given the pervasive impact of judgements and estimates on revenue, cost of sales and related balance sheet amounts, it is difficult to quantify the impact of taking alternative assessments on each of the judgements above.

Carrying value of goodwill and intangible assets
Reviewing the carrying value of goodwill and intangible assets recognised on acquisition requires judgements, principally, in respect of growth rates and future cash flows of cash generating units, the useful lives of intangible assets and the selection of discount rates used to calculate present values are set out in Note 11.

Defined benefit pension schemes
Defined benefit pension schemes require significant judgements in relation to the assumptions for inflation, future pension increases, investment returns and member longevity that underpin the valuation. Each year in selecting the appropriate assumptions, the Directors take advice from an independent qualified actuary. The assumptions and resultant sensitivities are set out in Note 20.

IFRSs not applied

The following IFRSs having been endorsed, will be applicable as stated below:

- IFRS 9 'Financial Instruments' – Published in July 2014 and replacing the existing guidance in IAS 39 'Financial Instruments: Recognition and Measurement.' IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

  The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 9.

- IFRS 15 'Revenue from Contracts with Customers' was issued in May 2015 and will be effective for Costain Group PLC for accounting periods beginning on or before 1 January 2018. We will adopt IFRS 15 in both our half-year and full-year 2018 accounts and at that time we will restate the 2017 results as required.

  IFRS 15 replaces existing revenue recognition standards: IAS 11 'Construction Contracts' and IAS 18 'Revenue', and moves away from the 'risks and rewards' concept of revenue recognition used by IAS 18 to a concept of 'transfer of control'. Its core principle is that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer.

  The Group is currently assessing the impact of these and other accounting changes that will arise under IFRS 15. It is important to remember that, while IFRS 15 may affect the timing of revenue recognition over the life of individual long-term contracts (without changing the total amount of revenue recognised), there will be no changes to the treatment of cash flows and cash will still be collected in line with the contractual terms.

  Based on the work, which we have undertaken to date, the areas we expect that could be most affected by the adoption of IFRS 15 include:

  - The timing of recognition of variable revenue, *including pain/gain agreements, incentives, claims and* liquidated damages;
  - Framework contract performance obligations;
  - The timing of recognition of revenue for work on uninstalled off-site components.

  Further work is required to fully evaluate the impact and to prepare for adoption in 2018 including:

  - finalisation of methodology for recognition of revenue on contracts including, for example, the impact on risk and revenue sharing agreements;
  - modelling the detailed impact on our historical results and to determine the actual transition adjustments;
  - finalisation of the procedures required to operate under the new requirements;
  - completion of the evaluation and implementation for all businesses.

The following IFRS has yet to be endorsed by the EU:

- IFRS 16: 'Leases' will apply for the year ended 31 December 2019. IFRS 16 will bring the net present value of future lease liabilities and an equivalent right of use asset onto the balance sheet for all leases (with the exception of small value and short-term leases). It also changes the profile of income statement charges for current operating leases from the current straight-line model to one which is forward loaded to reflect the financing component of leases. We are at an early stage of quantifying the impact.

3 Operating segments

The Group has two core business segments: Natural Resources and Infrastructure plus Alcaidesa in Spain. The core segments are strategic business units with separate management and have different core customers or offer different services. This information is provided to the Chief Executive who is the chief operating decision maker. The segments are discussed in the Strategic report section of these financial statements.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. The Group evaluates segment performance on the basis of profit or loss from operations before interest and tax expense before and after other items. The segment results that are reported to the Chief Executive include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Intersegment sales and transfers are not material.

2016	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Segment revenue					
External revenue	361.9	1,207.2	4.6	–	1,573.7
Share of revenue of joint ventures and associates	15.4	68.9	–	–	84.3
Total segment revenue	377.3	1,276.1	4.6	–	1,658.0
Segment profit/(loss)					
Operating profit/(loss)	(8.6)	56.6	(0.7)	(6.2)	41.1
Share of results of joint ventures and associates	0.2	–	–	–	0.2
Profit/(loss) from operations before other items	(8.4)	56.6	(0.7)	(6.2)	41.3
Other items:					
Amortisation of acquired intangible assets	(2.8)	(1.8)	–	–	(4.6)
Employment related and other deferred consideration	(1.4)	(0.2)	–	–	(1.6)
Profit/(loss) from operations	(12.6)	54.6	(0.7)	(6.2)	35.1
Net finance expense					(4.2)
Profit before tax					30.9
Segment profit/(loss) is stated after charging the following:					
Depreciation	3.6	1.7	1.1	–	6.4
Amortisation (including acquired intangible assets)	3.2	1.9	0.1	–	5.2
Segment assets					
Reportable segment assets	185.3	200.4	34.2	1.2	421.1
Unallocated assets:					
Deferred tax					14.9
Cash and cash equivalents					210.2
Total assets					646.2

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

3 Operating segments continued

2016	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Expenditure on non-current assets					
Property, plant and equipment	**6.0**	**0.6**	**0.4**	**–**	**7.0**
Intangible assets	**0.1**	**–**	**–**	**–**	**0.1**
Segment liabilities					
Reportable segment liabilities	**127.8**	**244.2**	**3.4**	**24.3**	**399.7**
Unallocated liabilities:					
Retirement benefit obligations					**73.5**
Borrowings					**70.0**
Taxation					**3.4**
Total liabilities					**546.6**

2015	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Segment revenue					
External revenue	298.8	962.9	1.9	–	1,263.6
Share of revenue of joint ventures and associates	18.8	33.2	0.9	–	52.9
Total segment revenue	317.6	996.1	2.8	–	1,316.5
Segment profit/(loss)					
Operating profit/(loss)	(11.1)	50.9	(0.5)	(6.1)	33.2
Share of results of joint ventures and associates	0.3	–	(0.4)	–	(0.1)
Profit/(loss) from operations before other items	(10.8)	50.9	(0.9)	(6.1)	33.1
Other items:					
Amortisation of acquired intangible assets	(2.2)	(1.0)	–	–	(3.2)
Employment related and other deferred consideration	(0.4)	–	–	–	(0.4)
Profit/(loss) from operations	(13.4)	49.9	(0.9)	(6.1)	29.5
Net finance expense					(3.5)
Profit before tax					26.0
Segment profit/(loss) is stated after charging the following:					
Depreciation	1.2	1.2	0.5	–	2.9
Amortisation (including acquired intangible assets)	2.7	1.2	–	–	3.9
Segment assets					
Reportable segment assets	172.1	171.4	30.5	1.1	375.1
Unallocated assets:					
Deferred tax					10.6
Cash and cash equivalents					146.7
Total assets					532.4

3 Operating segments continued

2015	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Expenditure on non-current assets					
Property, plant and equipment	0.3	1.5	0.2	–	2.0
Intangible assets	0.2	–	–	–	0.2
Segment liabilities					
Reportable segment liabilities	103.0	218.5	2.1	10.3	333.9
Unallocated liabilities:					
Retirement benefit obligations					36.7
Borrowings					38.5
Taxation					2.7
Total liabilities					411.8

Geographical information

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets and exclude deferred tax assets.

2016	**External revenue £m**	**Share of revenue of JVs and associates £m**	**Total segment revenue £m**	**Non-current assets £m**
UK	**1,564.4**	**84.3**	**1,648.7**	**86.9**
Spain	**4.6**	**–**	**4.6**	**31.4**
Rest of the World	**4.7**	**–**	**4.7**	**0.1**
	1,573.7	**84.3**	**1,658.0**	**118.4**

2015	External revenue £m	Share of revenue of JVs and associates £m	Total segment revenue £m	Non-current assets £m
UK	1,260.7	52.0	1,312.7	72.6
Spain	2.0	0.9	2.9	27.7
Rest of the World	0.9	–	0.9	0.1
	1,263.6	52.9	1,316.5	100.4

Customers accounting for more than 10% of revenue

Three customers (2015: three) in the Infrastructure segment accounted for revenue of £1,028.2 million (2015: £761.3 million).

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4 Other operating expenses and income

	2016 £m	2015 £m
Profit before tax is stated after charging:		
Amortisation of intangible assets (Note 11)	**5.2**	3.9
Depreciation of property, plant and equipment (Note 12)	**6.4**	2.9
Hire of plant and machinery	**48.4**	64.5
Rent of land and buildings	**5.2**	4.4
and after crediting:		
Income from sub-leases of land and buildings	**0.1**	0.5

Auditor's remuneration

	2016 £m	2015 £m
Fees payable to the Group's auditor for the audit of the annual financial statements	**0.1**	0.1
Fees payable to the Group's auditor and its associates in respect of:		
– Audit of financial statements of subsidiaries of the Company	**0.4**	0.4
	0.5	0.5

Amounts paid to the Company's auditor and its 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 instead to be disclosed on a consolidated basis.

5 Employee benefit expense

	2016 £m	2015 £m
Group		
Wages and salaries	**216.1**	190.6
Social security costs	**23.5**	20.9
Pension costs (Note 20)	**8.5**	7.7
Share-based payments expense (Note 20)	**2.8**	2.4
	250.9	221.6

	2016 Number	2015 Number
Average number of persons employed		
Natural Resources	**1,555**	1,438
Infrastructure	**2,545**	2,514
Alcaidesa	**64**	27
Central	**26**	26
	4,190	4,005

Of the above employees, 104 were employed overseas (2015: 49).

Company
The Company does not employ any personnel, except for the Directors considered in Note 6.

6 Remuneration of Directors

Details of the Directors' remuneration, pension entitlements, interest in the Long-Term Incentive Plans, Annual Incentive Plans, Deferred Share Bonus Plans and share options are included in the Directors' Remuneration report.

For the purpose of the disclosure required by Schedule 5 to the Companies Act 2006, the total aggregate emoluments of the Directors in respect of 2016 and 2015 are detailed below.

	2016 £m	2015 £m
Remuneration	**1.7**	1.7
Post-employment benefits	**0.2**	0.2
Gains made on the exercise of share-based plans	**0.3**	0.8
	2.2	2.7

7 Net finance expense

	2016 £m	2015 £m
Interest income from bank deposits	**0.3**	0.5
Interest income on loans to related parties	**0.3**	0.3
Finance income	**0.6**	0.8
Interest payable on bank overdrafts, interest bearing loans, borrowings and other similar charges	**(3.3)**	(2.7)
Unwind of discount on deferred consideration	**(0.4)**	(0.3)
Interest cost on the net liabilities of the defined benefit pension scheme (Note 20)	**(1.1)**	(1.3)
Finance expense	**(4.8)**	(4.3)
Net finance expense	**(4.2)**	(3.5)

Interest income on loans to related parties relates to shareholder loan interest receivable from investments in equity accounted joint ventures and associates.

NOTES TO THE FINANCIAL STATEMENTS
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8 Taxation

	2016 £m	2015 £m
On profit for the year		
UK corporation tax at 20% (2015: 20.25%)	**(2.8)**	(2.4)
Adjustment in respect of prior years	**–**	–
Current tax charge for the year	**(2.8)**	(2.4)
Deferred tax charge for current year	**(1.7)**	(1.7)
Adjustment in respect of prior years	**–**	0.3
Deferred tax charge for the year	**(1.7)**	(1.4)
Tax expense in the consolidated income statement	**(4.5)**	(3.8)

	2016 £m	2015 £m
Tax reconciliation		
Profit before tax	**30.9**	26.0
Taxation at 20% (2015: 20.25%)	**(6.2)**	(5.3)
Share of results of joint ventures and associates at 20% (2015: 20.25%)	**0.1**	–
Disallowed expenses and amounts qualifying for tax relief	**(0.3)**	0.1
Utilisation of previously unrecognised temporary differences	**0.1**	0.3
Research and Development tax relief for current year	**0.5**	0.7
Rate adjustment relating to deferred taxation and overseas profits and losses	**1.3**	0.1
Adjustments in respect of prior years, mainly Research and Development tax relief claims	**–**	0.3
Tax expense in the consolidated income statement	**(4.5)**	(3.8)
Effective rate of tax	**14.6%**	14.6%

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

The current tax liabilities of £3.4 million (2015: £2.7 million) for the Group and £1.5 million (2015: £1.5 million) for the Company represent the amount of tax in respect of all outstanding periods.

Accumulated tax losses carried forward in the UK were £5.1 million (2015: £5.1 million).

Accumulated tax losses carried forward in Spain were £55.9 million (2015: £47.0 million); these losses have various expiry dates to 2031.

	2016 £m	2015 £m
Deferred tax asset recognised at 19.0% (2015: 20.0%)		
Accelerated capital allowances	**2.0**	1.6
Short-term temporary differences	**(4.3)**	(1.7)
Retirement benefit obligations	**14.0**	7.3
Tax losses	**3.2**	3.4
Deferred tax asset	**14.9**	10.6

The Company had no deferred tax asset at either year-end.

8 Taxation continued

	2016 £m	2015 £m
Analysis of deferred tax movements		
At 1 January	**10.6**	9.2
Deferred tax relating to business combinations		
Transfer in respect of acquired intangible assets	**(1.1)**	(1.2)
Transfer in respect of acquired business combinations	**–**	3.6
Currency realignment	**0.5**	0.2
	(0.6)	2.6
Deferred tax in consolidated income statement		
Accelerated capital allowances	**0.4**	(0.2)
Short-term temporary differences	**(1.1)**	0.9
Trading tax losses	**–**	(0.4)
Retirement benefit obligations	**(1.0)**	(1.7)
	(1.7)	(1.4)
Deferred tax in other comprehensive income and expense statement		
Retirement benefit obligations	**7.6**	0.7
Deferred tax recognised directly in the consolidated statement of changes in equity		
Short-term temporary differences	**(1.0)**	(0.5)
At 31 December	**14.9**	10.6

Factors that may affect future tax charges

The rate of UK corporation tax reduces to 17% with effect from 1 April 2020. If the deferred tax asset as at 31 December 2016 were reduced to reflect rate of 17%, the effect would be a tax credit of £1.6 million through the consolidated income statement and a charge of £3.2 million through the consolidated statement of comprehensive income and expense.

The Group and Company have potential deferred tax assets in their UK operations that have not been recognised at the year-end on the basis that their future economic benefits were not assured at the statement of financial position date.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

8 Taxation continued

Gross deferred tax assets not recognised at the statement of financial position date were as follows:

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Accelerated capital allowances	**2.2**	2.7	**–**	–
Short-term temporary differences	**19.9**	20.6	**–**	–
Trading tax losses	**4.9**	5.1	**–**	–
Temporary differences	**27.0**	28.4	**–**	–
In addition to the above temporary differences, the following gross deferred tax assets are available.				
Management expenses and charges incurred by parent Company	**55.6**	55.6	**55.6**	55.6
Spanish tax losses carried forward	**39.2**	33.0	**–**	–
Capital losses	**275.0**	275.0	**241.0**	241.0

The current year tax effect, at 20%, of claiming short-term temporary differences and trading tax losses was £0.1 million (2015: £0.3 million) as shown in the tax reconciliation above.

There are no expiry dates associated with the deferred tax assets, recognised and not recognised, save for the various expiry dates relating to Spanish tax losses and tax relief will be obtained if suitable profits arise in the future.

9 Earnings per share

The calculation of earnings per share is based on profit of £26.4 million (2015: £22.2 million) and the number of shares set out below.

	2016 Number (m)	2015 Number (m)
Weighted average number of ordinary shares in issue for basic earnings per share calculation	**102.8**	101.7
Dilutive potential ordinary shares arising from employee share schemes	**2.6**	2.8
Weighted average number of ordinary shares in issue for diluted earnings per share calculation	**105.4**	104.5

At 31 December 2016, 0.7 million options were excluded from the weighted average number of ordinary shares calculation as they were anti-dilutive (2015: 0.7 million options were excluded).

10 Dividends

	Dividend per share pence	**2016 £m**	2015 £m
Final dividend for the year ended 31 December 2014	6.25	**–**	6.3
Interim dividend for the year ended 31 December 2015	3.75	**–**	3.9
Final dividend for the year ended 31 December 2015	7.25	**7.4**	–
Interim dividend for the year ended 31 December 2016	4.30	**4.4**	–
Amount recognised as distributions to equity holders in the year		**11.8**	10.2
Dividends settled in shares		**(0.8)**	(0.8)
Dividends settled in cash		**11.0**	9.4

A final dividend in respect of the year ended 31 December 2016 of 8.4 pence per share, amounting to a dividend of £8.8 million, is to be proposed at the Annual General Meeting. If approved, the dividend is expected to be paid on 19 May 2017 to shareholders registered at the close of business on 7 April 2017 and a scrip dividend alternative will be offered. These financial statements do not reflect the final dividend payable.

11 Intangible assets

Group	Goodwill £m	Customer relationships £m	Other acquired intangibles £m	Other intangibles £m	Total £m
Cost					
At 1 January 2015	22.3	8.6	5.5	7.7	44.1
Acquired through business combinations	18.5	4.0	1.7	0.8	25.0
Additions	–	–	–	0.2	0.2
Disposals	–	–	–	(0.1)	(0.1)
At 31 December 2015	40.8	12.6	7.2	8.6	69.2
At 1 January 2016	**40.8**	**12.6**	**7.2**	**8.6**	**69.2**
Currency realignment	–	–	–	**0.1**	**0.1**
Acquired through business combinations	**13.3**	**2.8**	**2.5**	–	**18.6**
Additions	–	–	–	**0.1**	**0.1**
Disposals	–	–	–	**(0.7)**	**(0.7)**
At 31 December 2016	**54.1**	**15.4**	**9.7**	**8.1**	**87.3**
Amortisation					
At 1 January 2015	–	4.1	3.3	5.7	13.1
Provided in year	–	1.5	1.7	0.7	3.9
Disposals	–	–	–	(0.1)	(0.1)
At 31 December 2015	–	5.6	5.0	6.3	16.9
At 1 January 2016	–	**5.6**	**5.0**	**6.3**	**16.9**
Provided in year	–	**2.3**	**2.3**	**0.6**	**5.2**
Disposals	–	–	–	**(0.7)**	**(0.7)**
At 31 December 2016	–	**7.9**	**7.3**	**6.2**	**21.4**
Net book value					
At 31 December 2016	**54.1**	**7.5**	**2.4**	**1.9**	**65.9**
At 31 December 2015	40.8	7.0	2.2	2.3	52.3
At 1 January 2015	22.3	4.5	2.2	2.0	31.0

The net book value of other acquired intangible assets includes £1.3 million (2015: £2.1 million) relating to order book.

Goodwill has been allocated to the applicable cash generating units of the Infrastructure segment (£15.5 million) and the Natural Resources segment (£38.6 million).

As described in Note 2, the Group reviews the value of goodwill and in the absence of any identified impairment risks, tests are based on internal value in use calculations of the cash generating unit (CGU). The key assumptions for these calculations are: discount rates, growth rates and expected changes to revenue and direct costs during the period.

Discount rates have been estimated based on pre-tax rates that reflect current market assessments of the Group's weighted average cost of capital and the risks specific to the CGU. The rate used to discount the forecast cash flows for the Infrastructure CGU was 9.2% and for the Natural Resources CGU was 10.3%.

The value in use calculations utilise the Group's three-year cash flow forecasts, which are based on the expected revenues of each CGU taking into account the current level of secured and anticipated orders, extrapolated for future years by the expected growth applicable to each CGU as follows:

Growth rates	Infrastructure %	Natural Resources %
Years 3-4	2.5	2.5
Year 5	1.5	2.5
Long-term average	1.5	1.5

At 31 December 2016, based on the internal value in use calculations, management concluded that the recoverable value of the cash generating units exceeded their carrying amount.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

11 Intangible assets continued

There is substantial headroom on goodwill for both CGUs. Sensitivity analysis has been performed on the goodwill in relation to each CGU by changing the key assumptions applicable to each CGU. In respect of the Natural Resources segment, which has the smaller headroom, the assumptions would have to change as follows for any single assumption change to bring headroom down to £nil:

- Discount rate – increase from 10.3% to 14.3%;
- Growth rate – reduce from positive 2.5% to a negative value;
- Underlying operating margin – reduce by 3%.

12 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Total £m
Group			
Cost			
At 1 January 2015	0.9	20.7	21.6
Currency realignment	1.0	0.1	1.1
Additions	0.3	1.7	2.0
Acquired through business combinations	23.8	3.5	27.3
Disposals	–	(1.3)	(1.3)
At 31 December 2015	26.0	24.7	50.7
At 1 January 2016	**26.0**	**24.7**	**50.7**
Currency realignment	**4.2**	**0.5**	**4.7**
Additions	**0.2**	**6.8**	**7.0**
Acquired through business combinations (Note 25)	**–**	**0.1**	**0.1**
Disposals	**(0.5)**	**(0.4)**	**(0.9)**
At 31 December 2016	**29.9**	**31.7**	**61.6**
Depreciation			
At 1 January 2015	0.7	10.9	11.6
Currency realignment	0.1	–	0.1
Provided in year	0.5	2.4	2.9
Disposals	–	(1.2)	(1.2)
At 31 December 2015	1.3	12.1	13.4
At 1 January 2016	**1.3**	**12.1**	**13.4**
Currency realignment	**0.3**	**0.1**	**0.4**
Provided in year	**0.9**	**5.5**	**6.4**
Disposals	**(0.5)**	**(0.3)**	**(0.8)**
At 31 December 2016	**2.0**	**17.4**	**19.4**
Net book value			
At 31 December 2016	**27.9**	**14.3**	**42.2**
At 31 December 2015	24.7	12.6	37.3
At 1 January 2015	0.2	9.8	10.0

The £5.5 million provided in the year for plant and equipment includes an impairment of £1.4 million relating to a tunnel boring machine.

13 Investments and loans in subsidiaries, equity accounted joint ventures and associates

	Investments		Loans	
	Joint ventures £m	Associates £m	Associates £m	Total £m
Group				
Cost or fair value				
At 1 January 2015	56.1	0.1	1.7	57.9
Currency realignment	(3.7)	–	–	(3.7)
Additions	1.0	–	–	1.0
Disposal	(39.0)	–	–	(39.0)
At 31 December 2015	14.4	0.1	1.7	16.2
At 1 January 2016	**14.4**	**0.1**	**1.7**	**16.2**
At 31 December 2016	**14.4**	**0.1**	**1.7**	**16.2**
Share of post-acquisition reserves				
At 1 January 2015	(30.6)	0.2		(30.4)
Currency realignment	1.4	–		1.4
Disposals	15.5	–		15.5
(Loss)/profit for the year	(0.3)	0.2		(0.1)
At 31 December 2015	(14.0)	0.4		(13.6)
At 1 January 2016	**(14.0)**	**0.4**		**(13.6)**
Dividends	**(0.1)**	**(0.1)**		**(0.2)**
Profit for the year	**–**	**0.2**		**0.2**
At 31 December 2016	**(14.1)**	**0.5**		**(13.6)**
Net book value				
At 31 December 2016	**0.3**	**0.6**	**1.7**	**2.6**
At 31 December 2015	0.4	0.5	1.7	2.6
At 1 January 2015	25.5	0.3	1.7	27.5

NOTES TO THE FINANCIAL STATEMENTS
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13 Investments and loans in subsidiaries, equity accounted joint ventures and associates continued

Analysis of Group share of joint ventures and associates revenue, income and assets and liabilities

	2016			2015		
	Joint ventures £m	Associates £m	Total £m	Joint ventures £m	Associates £m	Total £m
Revenue	83.4	0.9	84.3	49.8	3.1	52.9
Profit/(loss) before tax	–	0.3	0.3	(0.3)	0.2	(0.1)
Taxation	–	(0.1)	(0.1)	–	–	–
Profit/(loss) for the year	–	0.2	0.2	(0.3)	0.2	(0.1)
Non-current assets	–	–	–	0.1	–	0.1
Current assets	15.7	2.5	18.2	13.0	2.7	15.7
Current liabilities	(15.4)	(0.6)	(16.0)	(12.7)	(0.9)	(13.6)
Non-current liabilities	–	(1.3)	(1.3)	–	(1.3)	(1.3)
Investments in joint ventures and associates	0.3	0.6	0.9	0.4	0.5	0.9
Dividends received by Group	0.1	0.1	0.2	–	–	–

Net interest payable by joint ventures and associates in 2016 was £Nil (2015: £0.3 million). The applicable interest rates during the year are income of 0.2% to 6.5% per annum (2015: 0.2% to 6.5%) and expense of 11.5% per annum (2015: 6.0% to 11.5%).

Analysis of the total revenue, income, assets and liabilities of joint ventures and associates

	2016			2015		
	Other joint ventures £m	Associates £m	Total £m	Other joint ventures £m	Associates £m	Total £m
Revenue	242.9	2.2	245.1	140.5	7.7	148.2
Profit/(loss) before tax	–	0.8	0.8	(0.7)	0.7	–
Taxation	–	(0.1)	(0.1)	–	(0.1)	(0.1)
Profit/(loss) for the year	–	0.7	0.7	(0.7)	0.6	(0.1)
Non-current assets	0.2	–	0.2	0.2	–	0.2
Current assets	44.9	6.1	51.0	37.9	6.9	44.8
Current liabilities	(44.2)	(1.4)	(45.6)	(37.2)	(2.4)	(39.6)
Non-current liabilities	–	(3.3)	(3.3)	–	(3.4)	(3.4)
Equity	0.9	1.4	2.3	0.9	1.1	2.0

Details of the subsidiary undertakings, joint ventures, joint operations and associates are shown in Note 24.

There is no other comprehensive income/(expense) in respect of joint ventures and the associates.

13 Investments and loans in subsidiaries, equity accounted joint ventures and associates continued

Company	
Investments in subsidiaries	£m
Cost	
At 1 January 2015	369.3
Additions	2.4
At 31 December 2015	371.7
At 1 January 2016	**371.7**
Additions	**2.9**
At 31 December 2016	**374.6**
Amounts written off	
At 1 January 2015	(269.2)
At 31 December 2015	(269.2)
At 1 January 2016	**(269.2)**
At 31 December 2016	**(269.2)**
Net book value	
At 31 December 2016	**105.4**
At 31 December 2015	102.5
At 1 January 2015	100.1

Additions relate to the increase in the cost of investments in subsidiaries by the equivalent amount of the equity-settled share-based payment charge in relation to employees of subsidiaries included in the income statement.

Details of the subsidiaries in which the Company has an interest are set out in Note 24.

14 Trade and other receivables

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Amounts included in current assets				
Trade receivables	**101.8**	83.5	**–**	–
Other receivables	**44.3**	36.3	**–**	–
Amounts due from customers for contract work	**125.2**	133.6	**–**	–
Prepayments and accrued income	**24.2**	16.9	**1.0**	1.1
Amounts owed by joint ventures and associates	**3.6**	1.5	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**133.4**	97.4
	299.1	271.8	**134.4**	98.5
Amounts included in non-current assets				
Other	**7.7**	8.2	–	–

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

14 Trade and other receivables continued

At 31 December 2016, amounts due from customers for contract work falling due within one year include retentions of £27.1 million (2015: £25.6 million) relating to long-term contracts in progress. Other receivables falling due after more than one year include retentions of £7.1 million (2015: £7.7 million) relating to long-term contracts in progress.

With respect to trade receivables that are neither impaired nor past due, there are no indications at the reporting date that the payment obligations will not be met. The Directors consider that the carrying amount of trade, other receivables and amounts owed by joint ventures and associates approximates to their fair value.

The average credit period within trade receivables on amounts billed for contract work and on sales of goods is 35 days (2015: 34 days). The analysis of the due dates of the trade receivables was £82.4 million (2015: £61.1 million) due within 30 days, £19.3 million (2015: £18.8 million) due between 30 and 60 days and £0.1 million (2015: £3.6 million) due after 60 days.

These balances include receivables, with a carrying amount of £5.6 million (2015: £5.3 million), which are past due at the reporting date and for which no provision has been made as there has been no significant change in credit quality and the amounts are considered recoverable. No collateral is held over these balances. The analysis of the overdue amounts was £1.0 million (2015: £1.7 million) overdue by less than 30 days, £0.7 million (2015: £1.0 million) overdue by between 30 and 60 days and £3.9 million (2015: £2.6 million) overdue by more than 60 days.

The provision for impairment of trade and other receivables is £0.3 million (2015: £7.1 million).

The aggregate amount of costs incurred plus recognised profits, less recognised losses, for all contracts in progress at the statement of financial position date was £3,776.3 million (2015: £3,103.1 million). Progress billings and advances received from customers under open contracts amounted to £3,672.0 million (2015: £2,997.7 million). Advances for which work has not started, and billings in excess of costs incurred and recognised profits are included in credit balances on long-term contracts.

15 Cash and cash equivalents

Cash and cash equivalents are analysed below, and include the Group's share of cash held by joint operations of £68.1 million (2015: £42.7 million).

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Cash and cash equivalents	**210.2**	146.7	**–**	0.1
Cash and cash equivalents in the cash flow statement	**210.2**	146.7	**–**	0.1

16 Interest bearing loans and borrowings

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Current				
Revolving Credit Facility	**39.9**	38.5	**39.9**	38.5
Non-current				
Term Loan	**30.0**	–	**30.0**	–
Other loans	**0.1**	–	**–**	–
	30.1	–	**30.0**	–

The Group's borrowings facilities are described in Note 17.

17 Financial instruments – Fair values and risk management

a) Risk management

The Group's centralised treasury function manages financial risk, principally arising from liquidity and funding risks and movements in foreign currency rates, interest rates and inflation rates, in accordance with policies agreed by the Directors.

The Group does not enter into speculative transactions.

The Company does not have any forward foreign currency contracts or other derivatives.

i) Capital management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern and to provide resources to grow the business, in order to provide returns for shareholders and other stakeholders. The current capital base of the Group is driven by equity capital from shareholders and retained earnings. The Board of Directors ('Board') continues to seek to strengthen the Group by growing the business and improving profitability; the Strategic report describes the Group's strategy and its operations. It is the Board's policy to progressively increase dividends paid to shareholders based on growth in underlying earnings per share after taking account of the investment and capital needs of the business. There were no changes in the Board's approach to capital management during the year.

ii) Liquidity and funding risk

Ultimate responsibility for liquidity and funding risk rests with the Board, which has put in place a monitoring and reporting framework to manage funding requirements.

Liquidity risk is managed by monitoring actual and forecast short-and medium-term cash flows and the maturity profile of financial assets and liabilities and by maintaining adequate cash reserves and bank facilities. The nature and timing of the contract cash flows causes the cash balances to vary over the month with the balance usually highest at month end.

The average month end net cash balance during the year was £69.1 million (2015: £103.7 million).

Customers awarding long-term contracting work may, as a condition of the award, require the contractor to provide performance and other bonds. Consequently, the Group is reliant on its ability to secure bank and surety bonds. It has facilities in place to provide these bonds and monitors the usage and regularly updates the forecast usage of these facilities.

At 31 December 2016, the Group had banking and bonding facilities, including a £125.0 million (2015: £125.0 million) Revolving Credit Facility and a £30.0 million Term Loan, extending to 25 June 2021. The facilities, which were increased by the Term Loan and extended by one year during 2016, have financial covenants based on interest cover and leverage measured quarterly.

Unsecured bonding facilities

	Group and Company	
	2016 £m	2015 £m
Expiring between one and five years*	**400.0**	400.0
* Element of above facilities available for borrowings	**2.5**	2.5

At 31 December 2016, the utilisation of these bonding facilities amounted to £78.7 million (2015: £154.9 million).

iii) Credit risk

The Group focuses on major blue-chip private sector and large public sector customers. It uses an external credit scoring system to assess a potential customer's credit quality and will enter into a contract only if that assessment is satisfactory. Deposits in the UK are placed with the bank facility providers or, in joint operations, with banks agreed by the partners. Overseas deposits are placed with major banks operating in those countries. Transactions involving derivative financial instruments are with bank or insurance company counterparties with high credit ratings that are monitored regularly and with whom there are signed netting agreements. Given the high credit ratings of the banks and insurance companies used, management does not expect any counterparty will fail to meet its obligations.

At the year-end date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amounts of each financial asset, including derivative financial instruments, and the individual constituents of amounts due from customers for contract work in the statement of financial position. Further information on the exposure to credit risk is set out in Note 14.

NOTES TO THE FINANCIAL STATEMENTS
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17 Financial instruments – Fair values and risk management continued

a) Risk management continued

iv) Interest rate risk

The Group has cash balances in the UK and overseas and bank borrowings in the UK. The largest constituents are UK balances denominated in pounds sterling. A 1% rise in interest rates would have increased the annual interest income on net cash balances by £0.7 million (2015: £1.0 million).

During the year and at 31 December 2016, there was no interest rate hedging undertaken by the Group.

v) Foreign currency risk

Transactional currency exposures arise from sales or purchases by operating companies in currencies other than their functional currency. The current strategy is to hedge 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. The Group only enters into forward contracts when a contractual commitment exists in respect of the foreign currency transaction and the Group's policy is to negotiate the terms of the hedge derivative to match the terms of the hedged item to maximise hedge effectiveness.

The Group's subsidiary, Alcaidesa Holding SA, a company based in Spain is denominated in euro. At the year-end, the net carrying value of the assets was £26.3 million (2015: £23.4 million). A 10% strengthening in the euro would have adversely impacted the results by £0.1 million (2015: £0.2 million).

The Group's investment in Alcaidesa Holding SA is hedged by euro currency contracts (6 sale contracts (2015: 6 sale contracts)) which mitigate the foreign currency risk arising from the subsidiary's net assets. The fair value of the forward sales at 31 December 2016 was €30.5 million (2015: €32.0 million). No ineffectiveness was recognised from the net investment hedge. The Group's investments in other subsidiaries are not hedged.

As a consequence, a 10% strengthening in the euro would have no impact on the statement of financial position (2015: £Nil).

b) Cash flow hedges

Forward currency contracts that hedge forecast transactions are classified as cash flow hedges and stated at fair value based on a Level 2 valuation method, using quoted forward exchange rates. The terms of the foreign currency contracts match the terms of the commitments.

At 31 December 2016, the Group had foreign currency contracts (16 sale contracts (2015: 5) and 52 purchase contracts (2015: 51)) designated as cash flow hedges of future transactions and summarised below. The 2015 figures have been reclassified to exclude the net investment hedge. The carrying value represents the fair value of the contract; the contractual cash flows represent the pounds sterling commitments. There were no ineffective hedges at the year-end (2015: none).

Foreign exchange contracts

	2016				2015			
	Carrying amount £m	**Contractual cash flows £m**	**Within one year £m**	**Between one and five years £m**	Carrying amount £m	Contractual cash flows £m	Within one year £m	Between one and five years £m
Purchases	**2.8**	**(29.6)**	**(19.7)**	**(9.9)**	0.3	(21.7)	(4.1)	(17.6)
Sales	**(0.1)**	**11.8**	**8.6**	**3.2**	(0.3)	1.4	0.9	0.5
	2.7	**(17.8)**	**(11.1)**	**(6.7)**	–	(20.3)	(3.2)	(17.1)

The expected impact on the income statement of the foreign exchange contracts is £1.7 million in 2017.

17 Financial instruments – Fair values and risk management continued

c) Financial assets and liabilities

The Group has grouped its financial instruments into 'classes'. Although IFRS 7 does not define 'classes', as a minimum instruments measured at amortised cost should be distinguished from instruments measured at fair value.

i) Currency and maturity of financial assets

Financial assets not measured at fair value

	2016				2015			
	Total £m	**Within one year £m**	**Between one and five years £m**	**After five years £m**	Total £m	Within one year £m	Between one and five years £m	After five years £m
Cash and cash equivalents:								
Pounds sterling	**205.4**	**205.4**	**–**	**–**	142.2	142.2	–	–
Other	**4.8**	**4.8**	**–**	**–**	4.5	4.5	–	–
	210.2	**210.2**	**–**	**–**	146.7	146.7	–	–
Loans to joint ventures and associates:								
Pounds sterling	**1.7**	**0.1**	**0.4**	**1.2**	1.7	0.1	0.3	1.3
Trade, other receivables and amounts owed by joint ventures and associates:								
Pounds sterling	**156.1**	**148.4**	**7.7**	**–**	127.8	119.6	8.2	–
Other	**1.3**	**1.3**	**–**	**–**	1.7	1.7	–	–
	157.4	**149.7**	**7.7**	**–**	129.5	121.3	8.2	–
Total financial assets not measured at fair value	**369.3**	**360.0**	**8.1**	**1.2**	277.9	268.1	8.5	1.3

The Group has not disclosed the fair values for short-term trade receivables and amounts due from joint ventures and associates within financial assets, because their carrying amounts are a reasonable approximation of fair values. The fair values of loans carrying interest rates above 10% may be higher than their carrying values of £1.7 million (2015: £1.7 million), but not by a material amount.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

17 Financial instruments – Fair values and risk management continued

c) Financial assets and liabilities continued

Financial assets measured at fair value

The Group does not have any financial assets measured at fair value.

ii) Currency and maturity of financial liabilities

Financial liabilities not measured at fair value

	2016			2015		
	Total £m	Within one year £m	Between one and five years £m	Total £m	Within one year £m	Between one and five years £m
Term Loan – pounds sterling	**30.0**	**–**	**30.0**	–	–	–
Revolving Credit Facility:						
Pounds sterling	**30.0**	**30.0**	**–**	30.0	30.0	–
Euro	**9.9**	**9.9**	**–**	8.5	8.5	–
Other loans – euro	**0.1**	**–**	**0.1**	–	–	–
	70.0	**39.9**	**30.1**	38.5	38.5	–
Trade and other payables:						
Pounds sterling	**211.3**	**210.5**	**0.8**	152.2	150.1	2.1
Other	**2.6**	**2.6**	**–**	2.4	2.4	–
	213.9	**213.1**	**0.8**	154.6	152.5	2.1
Total financial liabilities not measured at fair value	**283.9**	**253.0**	**30.9**	193.1	191.0	2.1

The Group has not disclosed the fair values for short-term trade and other payables and bank overdrafts within financial liabilities, because their carrying amounts are a reasonable approximation of fair values.

Financial liabilities measured at fair value

	2016			2015		
	Total £m	Within one year £m	Between one and five years £m	Total £m	Within one year £m	Between one and five years £m
Deferred consideration – pounds sterling	**1.8**	**1.6**	**0.2**	1.8	1.1	0.7

The deferred consideration is valued at a Level 3 valuation method. The fair value is the same as the carrying value. See (d) 'Measurement of fair value' below.

iii) Reconciliation of trade and other receivables and trade and other payables to the statement of financial position

	2016		2015	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other receivables (as above)	**149.7**	**7.7**	121.3	8.2
Amounts due from customers	**125.2**	**–**	133.6	–
Prepayments and accrued income	**24.2**	**–**	16.9	–
	299.1	**7.7**	271.8	8.2

17 Financial instruments – Fair values and risk management continued

c) Financial assets and liabilities continued

	2016		2015	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other payables (as above)	**213.1**	**0.8**	152.5	2.1
Deferred consideration (as above)	**1.6**	**0.2**	1.1	0.7
Credit balances on long-term contracts	**5.0**	**–**	2.7	–
Accruals and deferred income	**177.5**	**–**	172.7	–
	397.2	**1.0**	329.0	2.8

iv) Effective interest rates of financial assets and liabilities

	2016	2015
Financial assets		
Cash and cash equivalents	**0.0% to 0.4%**	0.0% to 0.5%
Loans to joint ventures and associates	**10.0% to 11.5%**	10.0% to 11.5%

Financial liabilities

The Group has overdraft facilities, a Revolving Credit Facility (RCF) and a Term Loan. The £30.0 million Term Loan and £39.9 million of the RCF was drawn at the year-end (2015: £38.5 million of the RCF was drawn). These are unsecured and carry interest at floating rates at a margin over Base, LIBOR or EURIBOR.

The Company's financial assets comprised cash at bank of £Nil (2015: £0.1 million) and trade and other receivables of £133.4 million (2015: £97.4 million) with 123.1 million (2015: £88.8 million) denominated in pounds sterling and £10.3 million (2015: £8.6 million) denominated in euros and all maturing within one year.

The Company's financial liabilities comprise trade and other payables of £27.2 million (2015: £26.2 million) denominated in pounds sterling, the £30.0 million Term Loan (denominated in pounds sterling) and the RCF of £39.9 million (2015: £38.5 million) with £30.0 million (2015: £30.0 million) denominated in pounds sterling and £9.9 million (2015: £8.5 million) denominated in euro. All liabilities mature within one year other than the Term Loan which is between one and five years.

d) Measurement of fair value

Valuation techniques and significant unobservable inputs

The following tables show the valuation techniques used in measuring Level 3 and Level 2 fair values, as well as the significant unobservable inputs used. There are no financial instruments whose value could be determined under Level 1.

Financial instruments measured at fair value

Type	Valuation technique	Significant unobservable inputs	Inter relationship between significant unobservable inputs and fair value measurement
Deferred consideration	Discounted cash flows: The valuation models consider the present value of the contractual payments, discounted using a risk-adjusted discount rate.	Risk-adjusted discount rate (12.5%).	The estimated fair value would increase (decrease) if the risk-adjusted discount rate were lower (higher).
Cash flow hedges	Market comparison technique: The fair values are based on broker quotes. Similar contracts are traded in an active market and quotes reflect the actual transactions in similar instruments.	Not applicable.	Not applicable.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

17 Financial instruments – Fair values and risk management continued

d) Measurement of fair value continued

Financial instruments not measured at fair value

Type	Valuation technique	Significant unobservable inputs
Other financial liabilities (as above)	Discounted cash flow.	Not applicable.
Revolving Credit Facility	Discounted cash flow.	Not applicable.
Term Loan	Discounted cash flow.	Not applicable.

Level 3 fair values

The following table shows a reconciliation from the opening to closing balances for Level 3 fair values:

	Deferred consideration £m
At 1 January 2015	6.5
Addition charged to income statement (including unwind of discount)	0.7
Payments	(5.4)
At 31 December 2015	1.8
At 1 January 2016	**1.8**
Addition charged to income statement (including unwind of discount)	**2.0**
Payments	**(2.0)**
At 31 December 2016	**1.8**

There were no transfers out of Level 3 other than the payments made during the year.

Sensitivity analysis

For the fair value of the £0.2 million non-current deferred consideration, possible changes at the reporting date to the risk adjusted discount rate would have effects to profit or loss as set out in the table below. The amount payable is contractual and not dependent on performance.

	Profit/(Loss)	
	Increase £m	Decrease £m
Risk-adjusted discount rate (10.0% movement)	**0.1**	**(0.1)**

The fair value of the current deferred consideration will not change.

18 Trade and other payables

	Group		Company	
	2016 £m	2015 £m	**2016 £m**	2015 £m
Current liabilities				
Trade payables	**175.1**	128.8	**–**	–
Other payables	**30.8**	16.7	**–**	–
Social security	**7.1**	7.0	**–**	–
Credit balances on long-term contracts	**5.0**	2.7	**–**	–
Accruals and deferred income	**177.5**	172.7	**0.3**	–
Deferred consideration	**1.6**	1.1	**–**	–
Amounts owed to joint ventures and associates	**0.1**	–	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**26.9**	26.2
	397.2	329.0	**27.2**	26.2
Non-current liabilities				
Other payables	**0.8**	2.1	**–**	–
Deferred consideration	**0.2**	0.7	**–**	–
	1.0	2.8	**–**	–

Accruals and deferred income include subcontract liabilities (not yet payable), subcontract retentions and other accruals and deferred income.

The Directors consider that the carrying amount of trade payables, other payables, social security and amounts owed to joint ventures and associates approximates to their fair value.

Financial risk management policies are in place that seek to ensure that all payables are paid within their credit timeframes.

19 Provisions for other liabilities and charges

Group	Property £m	Other £m	Total £m
Current			
At 1 January 2015	0.3	1.2	1.5
Provided	0.9	–	0.9
Utilised	–	(0.3)	(0.3)
Released	(0.1)	–	(0.1)
At 31 December 2015	1.1	0.9	2.0
At 1 January 2016	**1.1**	**0.9**	**2.0**
Provided	–	**0.2**	**0.2**
Utilised	**(0.4)**	**(0.4)**	**(0.8)**
Released	**(0.3)**	**–**	**(0.3)**
At 31 December 2016	**0.4**	**0.7**	**1.1**

Non-current			
At 1 January 2015	–	0.1	0.1
At 31 December 2015	–	0.1	0.1
At 1 January 2016	**–**	**0.1**	**0.1**
Provided	**0.3**	–	**0.3**
At 31 December 2016	**0.3**	**0.1**	**0.4**

NOTES TO THE FINANCIAL STATEMENTS
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19 Provisions for other liabilities and charges continued

Company	Funding obligations £m
Current	
At 1 January 2015	–
Reclassified from non-current	0.2
Utilised	(0.1)
At 31 December 2015	0.1
At 1 January 2016	**0.1**
Utilised	**(0.1)**
At 31 December 2016	**–**
Non-current	
At 1 January 2015	1.3
Reclassified to current	(0.2)
At 31 December 2015	1.1
At 1 January 2016	**1.1**
At 31 December 2016	**1.1**

Group
Property provisions relate to costs of vacant properties and will be utilised over the next two years.

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

Company
Provisions in the Company relate to funding obligations to a non-trading overseas subsidiary, which eliminates on consolidation.

20 Employee benefits

(a) Pensions
A defined benefit pension scheme is operated in the UK and a number of defined contribution pension schemes are in place in the UK and overseas. Contributions are paid by subsidiary undertakings and, to the defined contribution schemes, by employees. The total pension charge in the income statement was £12.1 million comprising £11.0 million included in operating costs plus £1.1 million included in net finance expense (2015: £11.2 million, comprising £9.9 million in operating costs plus £1.3 million in net finance expense).

The Company does not operate a pension scheme.

Defined benefit scheme
The defined benefit scheme was closed to new members on 31 May 2005 and from 1 April 2006 future benefits were calculated on a Career Average Revalued Earnings basis. The scheme was closed to future accrual of benefits to members on 30 September 2009. A full actuarial valuation of the scheme was carried out as at 31 March 2013 and this was updated to 31 December 2016 by a qualified independent actuary. At 31 December 2016, there were 2,820 retirees and 3,234 deferred members. The weighted average duration of the obligations is 17.3 years.

	2016 £m	2015 £m	2014 £m
Present value of defined benefit obligations	**(827.5)**	(687.4)	(701.0)
Fair value of scheme assets	**754.0**	650.7	659.3
Recognised liability for defined benefit obligations	**(73.5)**	(36.7)	(41.7)

20 Employee benefits continued

(a) Pensions continued

Movements in present value of defined benefit obligations

	2016 £m	2015 £m
At 1 January	**687.4**	701.0
Interest cost	**25.5**	24.6
Remeasurements – demographic assumptions	**–**	7.9
Remeasurements – financial assumptions	**153.0**	(13.9)
Remeasurements – experience adjustments	**(6.8)**	–
Benefits paid	**(31.6)**	(32.2)
At 31 December	**827.5**	687.4

Movements in fair value of scheme assets

	2016 £m	2015 £m
At 1 January	**650.7**	659.3
Interest income	**24.4**	23.3
Remeasurements – return on assets	**96.4**	(9.3)
Contributions by employer	**14.3**	10.0
Administrative expenses	**(0.2)**	(0.4)
Benefits paid	**(31.6)**	(32.2)
At 31 December	**754.0**	650.7

Expense recognised in the income statement

	2016 £m	2015 £m
Administrative expenses paid by the pension scheme	**(0.2)**	(0.4)
Administrative expenses paid directly by the Group	**(2.3)**	(1.8)
Interest cost on the net liabilities of the defined benefit pension scheme	**(1.1)**	(1.3)
	(3.6)	(3.5)

Fair value of scheme assets

	2016 £m	2015 £m
UK equities	**116.2**	89.3
Overseas equities	**95.9**	73.2
Multi-credit fund	**87.1**	75.5
Index linked gilts	**311.0**	266.1
PFI investments	**51.6**	51.6
Property	**22.3**	22.6
Absolute return fund	**68.4**	71.7
Cash	**1.5**	0.7
	754.0	650.7

All equities are listed. The multi-credit fund invests in a portfolio of primarily floating rate debt of non-investment grade or unrated borrowers. The PFI investments is the portfolio of interests in ten PFI investments transferred by the Group to The Costain Pension Scheme in 2010, 2012 and 2014. The absolute return fund targets a lower volatility return by investing primarily in long/short equity strategies.

The investment portfolio comprises 41% index linked gilts, which are targeted to hedge inflation risk, plus a portfolio of other assets targeted, as a whole, to generate a higher return over the long-term than the cost of the liabilities.

NOTES TO THE FINANCIAL STATEMENTS
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20 Employee benefits continued

(a) Pensions continued

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

The multi-credit fund is valued by reference to the most recently available price of the underlying investments. The PFI investments are valued using a level 3 valuation method based on the future cash flows of the individual investments. The property investments are valued by an independent third party.

Principal actuarial assumptions (expressed as weighted averages)

	2016 %	2015 %	2014 %
Discount rate	**2.70**	3.80	3.60
Future pension increases	**3.10**	2.95	2.85
Inflation assumption	**3.20**	3.00	2.90

Weighted average life expectancy from age 65 as per mortality tables used to determine benefits at 31 December 2016 and 31 December 2015 is:

	2016		2015	
	Male (years)	Female (years)	Male (years)	Female (years)
Currently aged 65	**22.2**	**24.7**	22.2	24.7
Non-retirees currently aged 45	**24.1**	**26.7**	24.0	26.6

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 defined benefit scheme:

	Pension liability £m	Pension cost £m
Increase discount rate by 0.25%, decreases pension liability and reduces pension cost by	**34.7**	**1.2**
Decrease inflation, pension increases by 0.25%, decreases pension liability and reduces pension cost by	**30.7**	**1.2**
Increase life expectancy by one year, increases pension liability and increases pension cost by	**28.1**	**2.8**

In accordance with the pension regulations, a triennial actuarial review of the Costain defined benefit pension scheme was carried out as at 31 March 2016. In February 2017, the valuation and an updated deficit recovery plan were agreed with the scheme Trustee resulting in cash contributions of £10.0 million for the 12 months to 31 March 2017 and then £9.6 million per annum (increasing annually with inflation) until the deficit is cleared, which would be in 2031 on the basis of the assumptions made in the valuation and agreed recovery plan.

In addition, as previously implemented, the Group will continue to make an additional contribution so that the total deficit contributions match the total dividend amount paid by the Company each year. Consequently, the total amount of contribution is anticipated to be at a similar level to that under the previous plan. Any additional payments in this regard would have the effect of reducing the recovery period in the agreed plan. The Group will also pay the expenses of administration in the next financial year.

Any surplus of deficit contributions to the Costain Pension Scheme would be recoverable by way of a refund, as the Group has the unconditional right to any surplus once all the obligations of the Scheme have been settled. Accordingly, the Group does not expect to have to make provision for these additional contributions arising from this post balance sheet agreement in future accounts.

Defined contribution schemes

Several defined contribution pensions are operated. The total expense relating to these plans was £8.5 million (2015: £7.7 million).

20 Employee benefits continued

(b) Share-based payments

The Company operates a number of share-based payment plans as described below.

Long-Term Incentive Plan (LTIP)
Shareholders approved a new Long-Term Incentive Plan at the 2014 AGM that allows for conditional awards with a maximum face value of up to 100% of base salary to be awarded. Performance conditions such as those based on earnings per share, are determined by the Remuneration Committee of the Board at the time of grant.

Annual Incentive Plan (AIP)
Executive Directors and other senior management are eligible to participate in the Company's Annual Incentive Plan, under which one third of the award is payable in shares. The total AIP award of up to 150% of base salary has performance conditions based on adjusted EBIT (Earnings before interest, tax and other items) (at least 50% of the award) and other measures.
The share award element vests on the second anniversary of the date of grant and will be satisfied by shares purchased by a trust on behalf of the Group. It will not lead to any dilution of shareholder interest. Participants must be in employment with the Company and not under notice of termination (either given or received) on the date of vesting.

Deferred Share Bonus Plan (DSBP)
Prior to 2014, Executive Directors and other senior management were eligible to participate in the Company's Deferred Share Bonus Plan which allowed for conditional awards with a face value of up to 50% of base salary with a performance condition based on adjusted EBIT (Earnings before interest, tax and other items). The deferred bonus award was satisfied by shares purchased by a trust on behalf of the Group, so did not dilute shareholder interests. The last grant under the DSBP was made in 2014 and vested on 31 March 2016.

Save As You Earn Plans (SAYE)
The Company operates a SAYE scheme that is open to all eligible employees who pay a fixed amount from salary into a savings account each month and elect to save over three or five years. At the end of the savings period, employees have six months in which to exercise their options (after which the options expire) using the funds saved. If employees decide not to exercise their options, they may withdraw the funds saved. Exercise of options is subject to continued employment within the Group (except where permitted by the rules of the scheme).

Share-based payment expense
The amounts recognised in the income statement, before tax, for share-based payment transactions with employees was £2.8 million (2015: £2.4 million); the entire charge relates to subsidiaries.

Options outstanding at the end of the year
The outstanding LTIPs (exercise price £1 per individual grant), AIP (Nil-cost option) and DSBPs (Nil-cost option), which arrange for the grant of shares to Executive Directors and senior management, and the outstanding SAYE schemes are shown below.

	LTIP	DSBP	AIP	SAYE	
	Number (m)	Number (m)	Number (m)	Number (m)	Weighted average exercise price (p)
Outstanding at 1 January 2015	2.4	0.8	0.5	2.9	218.6
Forfeited during the year	–	–	–	(0.2)	224.8
Exercised during the year	(0.9)	(0.3)	(0.2)	(0.1)	201.8
Granted during the year	0.7	–	0.5	1.1	314.0
Outstanding at 31 December 2015	2.2	0.5	0.8	3.7	246.9
Adjusted during the year	–	–	(0.1)	–	–
Forfeited during the year	(0.2)	–	–	(0.3)	273.5
Exercised during the year	(0.6)	(0.4)	–	(1.4)	209.9
Granted during the year	0.6	–	0.5	1.1	279.0
Outstanding at 31 December 2016	**2.0**	**0.1**	**1.2**	**3.1**	**271.9**
Exercisable at the end of the period	**0.1**	**–**	**–**	**0.2**	**207.7**

Share options outstanding at the end of the year had a weighted average remaining contractual life of 5.4 years (2015: 6 years).

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

20 Employee benefits continued

(b) Share-based payments continued

The fair value of options granted is calculated using the Black-Scholes option pricing model. The aggregate fair value of options granted during the year was £3.8 million (2015: £3.4 million). The assumptions used in valuing the grants were:

	2016	2015
Expected volatility	**20%**	20%
Expected life (years)	**2.7 – 5.0**	2.7 – 5.0
Risk-free interest rate	**2.6%**	2.6%
Expected dividend yield	**2.8%**	2.8%

The expected volatility is based on the historical share price volatility over a term matching the expected life. The expected life is based on management's best estimate having regard to the effect of non-transferability, exercise restrictions and behavioural considerations.

21 Share capital

	2016		2015	
	Number (m)	Nominal value £m	Number (m)	Nominal value £m
Issued share capital				
Shares in issue at beginning of year – ordinary shares of 50p each, fully paid	**102.1**	**51.1**	101.2	50.6
Issued in year (see below)	**2.1**	**1.0**	0.9	0.5
Shares in issue at end of year – ordinary shares of 50p each, fully paid	**104.2**	**52.1**	102.1	51.1

The Company's issued share capital comprised 104,234,191 ordinary shares of 50 pence each as at 31 December 2016.

On 9 May 2016, the Company issued 598,131 shares in respect of the exercise of options granted under the 2013 LTIP.

On 20 May 2016, pursuant to the Scrip Dividend Scheme, shareholders elected to receive 114,972 ordinary shares of 50 pence each in the Company in lieu of cash in respect of all or part of their final dividend for the year ended 31 December 2015, and shareholders elected to receive a further 163,108 ordinary shares on 21 October 2016 in lieu of cash in respect of all or part of their interim dividend for the year ended 31 December 2016.

During 2016, the Company issued 829,716 shares on exercise of options granted under the 2013 3-year SAYE scheme.

During 2016, the Company issued 427,847 shares on exercise of options granted under the 2011 5-year SAYE scheme.

All shares rank pari passu regarding entitlement to capital and dividends.

The share options outstanding at the year-end are detailed in Note 20. Details of the performance conditions and the options granted to Executive Directors are given in the Directors' Remuneration report.

22 Contingent liabilities

Group

There are contingent liabilities in respect of:

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

It is not anticipated that any material liabilities will arise from the contingent liabilities other than those provided for (Note 19).

Company

The Company has guaranteed the obligations of the subsidiary companies that are participating employers of The Costain Pension Scheme, the defined benefit pension scheme in the UK. At 31 December 2016, the potential liability was £73.5 million (2015: £36.7 million) on an IAS 19 basis and is included in these financial statements as disclosed in Note 20.

23 Other financial commitments

Group

Operating lease commitments

	2016		2015	
Leases as lessee	Land and buildings £m	Other operating leases £m	Land and buildings £m	Other operating leases £m
Future aggregate minimum lease payments under non-cancellable leases:				
Within one year	**4.3**	**4.6**	4.2	3.9
Between one and five years	**11.9**	**4.6**	12.4	4.5
Later than five years	**3.9**	**–**	5.8	–
	20.1	**9.2**	22.4	8.4

The Group has various offices under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases vehicles and computers under non-cancellable operating leases. None of the leases include contingent rents.

Company

The Company does not have any other financial commitments (2015: £Nil).

24 Subsidiary undertakings, joint ventures, associates and joint operations

	Activity	Percentage of equity held	Registered office / principal place of business
Principal subsidiary undertakings			
Alcaidesa Holding SA	Golf Course and Marina Operations	100	(5)
Costain Ltd	Engineering, Construction and Maintenance	100	(1)
Costain Engineering & Construction Ltd	Holding and Service Company	100	(1)
Costain Integrated Services Ltd	Professional Services	100	(1)
Costain Integrated Technical Solutions Ltd	Technology Integration	100	(1)
Costain Oil, Gas & Process Ltd	Process Engineering	100	(1)
Costain Upstream Ltd	Engineering and Design Services	100	(2)
Richard Costain Ltd	Service Company	100	(1)

	Activity	Issued share capital £m	Percentage of equity held	Registered office / principal place of business	Reporting date
Principal joint ventures					
ABC Electrification Ltd	Rail Electrification	–	33.3	(11)	31 March
Brighton & Hove 4Delivery Ltd	Civil Engineering	–	49	(3)	31 March
4Delivery Ltd	Civil Engineering	–	40	(3)	31 March
Principal associates					
Integrated Bradford LEP Ltd	Development and Delivery of Schools	–	40	(10)	31 December
Lewisham Schools for the Future LEP Ltd	Development and Delivery of Schools	0.1	40	(1)	31 March

The equity capital of the above are held by subsidiary undertakings with the exception of Richard Costain Limited and Costain Engineering & Construction Ltd.

All undertakings operate mainly in the country of incorporation. See Key to registered office / principal place of business at the bottom of this note.

All holdings are of ordinary shares except Richard Costain Ltd, where Costain Group PLC holds 100% of the ordinary and preference shares.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

24 Subsidiary undertakings, joint ventures, associates and joint operations continued

	Activity	Percentage interest	Country of business
Major joint operations			
Alstom-Babcock-Costain Joint Venture – Edinburgh to Glasgow Rail Improvement Programme	Rail Engineering	33.3	UK
Alstom-Costain C644 Joint Venture – Traction power – Crossrail	Rail Engineering	32.5	UK
Alstom-Costain C650 Joint Venture – HV power supply – Crossrail	Rail Engineering	32.5	UK
A-one+ Integrated Highway Services – MAC 12	Engineering & Maintenance	33.3	UK
A-one+ Integrated Highway Services – MAC 14	Engineering & Maintenance	33.3	UK
A-one+ Integrated Highway Services – MAC 7	Engineering & Maintenance	33.3	UK
A-one+ Joint Venture – ASC area 12 – Highways England	Engineering & Maintenance	33.3	UK
A-one+ Joint Venture – ASC area 4 – Highways England	Engineering & Maintenance	33.3	UK
ATC Joint Venture – C610 – Crossrail	Rail Engineering	32.5	UK
Balfour Beatty-BmJV-Carillion-Costain Joint Venture – National Major Projects – Highways England	Civil Engineering	22	UK
CH2M-Costain Joint Venture – Area 14 M&R contract	Engineering & Maintenance	50	UK
Costain-CH2M UK – ESCC JV – East Sussex highway maintenance	Engineering & Maintenance	50	UK
Costain-Atkins-Black & Veatch Joint Venture – Thames Water AMP6	Engineering	70	UK
Costain-Carillion Joint Venture – M1 Widening and A5/M1 Link	Civil Engineering	50	UK
Costain-Galliford Try Joint Venture – M1 smart motorways	Civil Engineering	70	UK
Costain-Laing O'Rourke Joint Venture – Bond Street station	Civil Engineering	50	UK
Costain-MWH Joint Venture – Southern Water AMP6	Civil Engineering	50	UK
Costain-Skanska C360 Joint Venture – Eleanor Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska C405 Joint Venture – Paddington – Crossrail	Civil Engineering	50	UK
Costain-Skanska C412 Joint Venture – Bond Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska – HS2 Enabling works	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A14 Cambridge to Huntingdon Improvement Scheme	Civil Engineering	50	UK
Costain-Skanska Joint Venture – NGT Tunnels, London	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Paddington Station Bakerloo Line Link Project	Civil Engineering	50	UK
Costain-Vinci Construction Joint Venture – Shieldhall	Civil Engineering	50	UK
Costain-Vinci Joint Venture – M4 corridor around Newport	Civil Engineering	50	UK
CVB Joint Venture – Thames Tideway Tunnel East	Civil Engineering	40	UK
Educo UK Joint Venture – Bradford Schools	Building	50	UK
Galliford-Costain-Atkins Joint Venture – United Utilities	Engineering	42.5	UK
Lagan-Ferrovial-Costain – A8	Civil Engineering	45	UK
The ASP Batch Joint Venture – Severn Trent – Large capital schemes outside AMP6	Engineering	33.3	UK

24 Subsidiary undertakings, joint ventures, associates and joint operations continued

In accordance with Section 409 of the Companies Act 2006 a full list of subsidiaries, associates, joint ventures and joint arrangements is required:

	Status	Percentage of equity held	Registered office / principal place of business
Other subsidiaries owned directly by Costain Group PLC			
C.G. Nominees Limited	Dormant	100	(1)
Costain Civil Engineering Limited	Holding Company	100	(1)
Costain Investments Limited	Dormant	100	(13)
Costain USA Inc.	Holding Company	100	(6)
County & District Properties Limited	Trading	100	(1)
Renown Investments (Holdings) Limited	Trading	100	(1)
Lysander Services Limited	Trading	100	(1)
Other subsidiaries owned indirectly by Costain Group PLC			
AB Rhead & Associates Limited	Trading	100	(1)
Alcaidesa Golf SA	Trading	100	(5)
Alcaidesa Servicios SA	Trading	100	(5)
Alway Associates (International) Limited	Dormant	100	(1)
Alway Associates (London) Limited	Trading	100	(1)
Alway Associates Limited	Dormant	100	(1)
Alway IT Limited	Dormant	100	(1)
Brunswick Infrastructure Services Limited	Trading	100	(1)
Calvert & Russell Limited	Trading	100	(1)
C-in-A Limited	Trading	100	(1)
CLM Engineering (Overseas) Limited	Dormant	100	(1)
COGAP (Middle East) Limited	Holding Company	100	(1)
COGAP Limited	Dormant	100	(1)
Construct Safe Limited	Dormant	100	(1)
Construction Study Centre Limited	Trading	100	(1)
Costain Abu Dhabi Co WLL	Trading	49	(14)
Costain Alcaidesa Limited	Holding Company	100	(1)
Costain America Inc.	Holding Company	100	(6)
Costain Building & Civil Engineering Ltd	Holding Company	100	(1)
Costain Construction (Botswana) (Pty) Ltd	Dormant	100	(7)
Costain Construction Limited	Dormant	100	(1)
Costain de Venezuela CA	Dormant	100	(23)
Costain Energy Solutions Limited	Trading	100	(1)
Costain Engineering & Construction (Overseas) Limited	Holding Company	100	(1)
Costain Engineering Services Inc	Dormant	100	(6)
Costain Holdings (Botswana) (Pty) Limited	Holding Company	100	(7)
Costain Holdings (Malaysia) Sdn Bhd	Dormant	100	(8)
Costain International Limited	Dormant	100	(1)
Costain (Malaysia) Sdn Bhd	Dormant	100	(8)
Costain Management Design Limited	Dormant	100	(1)
Costain Minerals Inc.	Dormant	100	(6)
Costain Mining Services Inc.	Dormant	100	(6)
Costain Oil, Gas & Process (Malaysia) Sdn Bhd	Dormant	100	(8)

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

24 Subsidiary undertakings, joint ventures, associates and joint operations continued

	Status	Percentage of equity held	Registered office / principal place of business
Other subsidiaries owned indirectly by Costain Group PLC continued			
Costain Oil, Gas & Process (Nigeria) Limited	Dormant	95	(24)
Costain Oil, Gas & Process (Overseas) Limited	Dormant	100	(1)
Costain Process Construction Limited	Dormant	100	(1)
EPC Offshore Limited	Dormant	100	(2)
F & P Consulting Limited	Dormant	100	(1)
Integrated Care Solutions Limited	Dormant	100	(1)
International Commercial and Project Solutions Pty Limited	Trading	100	(19)
JBCC Rhead PTE Limited	Trading	100	(17)
L.R.R. Holdings Limited	Holding Company	100	(1)
National Road Operators Limited	Dormant	100	(1)
Promanex (Civils & Industrial Services) Limited	Dormant	100	(1)
Promanex (Construction & Maintenance Services) Limited	Dormant	100	(1)
Promanex Group Holdings Limited	Holding Company	100	(1)
Promanex Group Limited	Dormant	100	(1)
Promanex (Total FM & Environmental Services) Ltd	Trading	100	(1)
RG Bidco Limited	Holding Company	100	(1)
Rhead Group Holdings Ltd	Holding Company	100	(1)
Rhead Group Holdings (Australia) Pty Limited	Holding Company	100	(18)
Rhead Group Pty Limited	Trading	100	(20)
Rhead Holdings Limited	Holding Company	100	(1)
Southview Holdings (Private) Limited	Trading	100	(12)
Southview Investments (Private) Limited	Trading	100	(12)
Sunland Mining Corporation (II)	Dormant	100	(6)
Westminster Plant Co. Limited	Dormant	100	(1)
Other joint ventures or associates owned indirectly by Costain Group PLC			
ACM Health Solutions Limited	Dormant	33.3	(4)
Budimex & Costain SP ZO.O	Dormant	50	(22)
China Harbour-Costain Mexico S de RL de CV	Dormant	50	(21)
Costain Petrofac Limited	Dissolved	50	(1)
Gravitas Offshore Limited	Trading	45	(9)
Integrated Bradford LEP FIN Co One Limited	Trading	40	(10)
Integrated Bradford PSP Limited	Holding Company	50	(10)
Jalal Costain WLL	Dormant	49	(15)
L21 Lewisham PSP Limited	Holding Company	50	(1)
Nesma-Costain Process Co. Limited	Dormant	50	(16)

Costain Abu Dhabi Co WLL has been treated as a subsidiary undertaking due to Costain having power to influence and control the composition of the Board of Directors and the beneficial right to all the net income.

24 Subsidiary undertakings, joint ventures, associates and joint operations continued

	Activity	Percentage interest	Country of business
Other joint operations, including completed			
ACTUS Joint Venture – Trawsfynydd nuclear power station active waste retrieval	Civil Engineering	25	UK
Amec-Costain-Jacobs Joint Venture – Magnox ILW Management Programme	Civil Engineering	33.3	UK
A-one+ Integrated Highway Services – MAC 10	Engineering & Maintenance	25	UK
Bachy Soletanche-Costain-Skanska Joint Venture – CTRL 240 – Stratford Box	Civil Engineering	33.3	UK
Black & Veatch-Costain Joint Venture – Margate & Broadstairs UWWTD Scheme – Southern Water	Civil Engineering	62	UK
Costain-Dalekovod Joint Venture – National Grid HV Overhead Line System	Engineering	60	UK
Costain-Hochtief Joint Venture – Reading station	Civil Engineering	50	UK
Costain-John Mowlem-Skanska Joint Venture – A2/M2 widening (Cobham to Jct.2)	Civil Engineering	30	UK
Costain-Lafarge Joint venture – East and South East Framework	Civil Engineering	50	UK
Costain-Lafarge Joint venture – Midlands Framework	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – Farringdon station	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – King's Cross Eastern Range Refurbishment	Civil Engineering	50	UK
Costain-Skanska C411 Joint Venture – Bond Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A14 Ellington to Fen Ditton	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A43 Silverstone	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Crossrail Civils Framework Enabling Works	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Kings College Hospital, London	Building	50	UK
Costain-Skanska Joint Venture – Lower Precinct Shopping Centre, Coventry	Building	50	UK
Costain-Skanska Joint Venture – The new Met Office	Building	50	UK
Costain-Taylor Woodrow Joint Venture – King's Cross re-development & Phase II Northern works	Civil Engineering	50	UK
Costain-VWS Joint Venture – Mersey Valley Processing Centre (Shell Green) Extension Project Stage 2	Engineering	50	UK
The e5 Joint Alliance Severn Trent Framework	Engineering	25	UK
TSIF-ILW Joint Venture – Trawsfynydd nuclear power station decommissioning	Civil Engineering	33.3	UK

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

24 Subsidiary undertakings, joint ventures, associates and joint operations continued

Key to registered office / principal place of business

(1) Costain House, Vanwall Business Park, Maidenhead, Berkshire, SL6 4UB, England
(2) Salvesen Tower, Blaikies Quay, Aberdeen, AB11 5PW, Scotland
(3) 210 Pentonville Road, London, N1 9JY, England
(4) Carillion House, 84 Salop Street, Wolverhampton, West Midlands, WV3 0SR, England
(5) Avda. Pablo Cerezo, s/n, Club de Golf Alcaidesa, 11360 – San Roque-Cádiz, Spain
(6) The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801 (New Castle County), USA
(7) Plot 67978, Mokolwane House, First Floor, Fairgrounds Office Park, Gaborone, Botswana
(8) Suite 16-10, Level 16, Wisma UOA II, No. 21 Jalan Pinang, 50450 Kuala Lumpur, Malaysia
(9) Whitehill House, Windmill Hill Business Park, Whitehill Way, Swindon, SN5 6PE, England
(10) The Sherard Building, Edmund Halley Road, Oxford, Oxfordshire, OX4 4DQ, England
(11) 8th Floor, The Place, High Holborn, London, WC1V 7AA, England
(12) 10th Floor, Club Chambers Building, Corner Nelson Mandela Avenue / 3rd Street, Harare, Zimbabwe
(13) P.O.Box N-7768, Bank Lane, Nassau, Bahamas
(14) Building 4F, Corniche Road, Ground floor, Office 1, Mussafah Industrial Area, 3069, Abu Dhabi, UAE
(15) Flat 33, Building 232, Road 18, Block 321, Manama, Bahrain
(16) P.O.Box, 6967, 21452, Jeddah, Saudi Arabia
(17) Peninsula Plaza #27-01, 111 North Bridge Road, 179098, Singapore
(18) 10-12 Laramie Road, Narre Warren South, Victoria 3805, Australia
(19) BGC Centre, Mezzanine level, 28 The Esplanade, Perth, WA 6000, Australia
(20) 737 Burwood Road, Hawthorn Road, Melbourne, Victoria 3122/3123, Australia
(21) Calle Delfines No. 268 – 2, Frac. Playa Ensenada, Ensenada, B.C., CP. 22880, Mexico
(22) Marszałkowska 82, Warsaw, Mazowieckie, 00-517, Poland
(23) Dormant company – Venezuela, no record of address
(24) Dormant company – Nigeria, no record of address

25 Acquisitions

On 5 July 2016, the Group purchased the share capital of Simulation Systems Limited (now Costain Integrated Technology Solutions Limited). The business is based in the UK and provides innovative technology based solutions, primarily in the highways sector.

The initial consideration was £17.6 million. A further payment of £1.5 million was deferred over three years. This is dependent on continued future service and, in accordance with IFRS 3, will be expensed to the income statement.

Costain's strategy is to focus on major customers spending billions of pounds addressing national needs in energy, water and transportation. These customers are consolidating their supply chains and seeking an increasingly integrated service offering from their service providers through larger, longer-term collaborative contracts. The Group believes the acquisition will further enhance its technology capability as part of its focus on delivering a broad range of innovative integrated services.

The contributions to revenue and operating profit before amortisation of acquired intangibles and employment related consideration within the Group's results of this acquisition was revenue £11.5 million, operating profit £0.5 million, including integration costs.

The proforma figures as required by IFRS 3, assuming that the acquisition had been part of the Group throughout the year, were revenue £19.0 million and operating profit before amortisation of acquired intangibles of £0.7 million.

The acquisition had the following effect on the Group's assets and liabilities:

	£m
Cash consideration	17.6
Acquired intangible assets – Customer relationships	2.8
Acquired intangible assets – Other	2.5
Property, plant and equipment	0.1
Cash	1.6
Other current assets	2.6
Other current liabilities	(3.9)
Deferred tax	(1.1)
Fair value of assets acquired and liabilities recognised	4.6
Goodwill arising on acquisitions	13.0

Based on the provisional assessment of the recognised values of assets and liabilities, the goodwill arising on the acquisition is expected to be £13.0 million.

Costs of £0.4 million were incurred by the Group in relation to the acquisition and have been expensed in administrative expenses within the income statement.

The acquisition of Rhead Group Holdings Limited, acquired in July 2015, was adjusted by £0.3 million with a corresponding increase in the goodwill. There was no change to the acquisition fair values of Alcaidesa Holding SA, the joint venture that became a wholly-owned subsidiary in 2015, following a reorganisation in which the assets were split between the two partners.

NOTES TO THE FINANCIAL STATEMENTS
CONTINUED

26 Related party transactions

Group
A related party relationship exists with its major shareholders, subsidiaries, joint ventures and associates, joint operations, The Costain Pension Scheme and with its Directors and executive officers.

Sales of goods and services

	2016			2015		
	Joint ventures and associates £m	**Joint operations £m**	**Total £m**	Joint ventures and associates £m	Joint operations £m	Total £m
Services of Group employees	**32.6**	**133.9**	**166.5**	17.1	95.5	112.6
Construction services and materials	**0.2**	**28.4**	**28.6**	0.4	20.2	20.6
	32.8	**162.3**	**195.1**	17.5	115.7	133.2

There were no sales of goods and services to major shareholders during the year (2015: £Nil).

Balances with joint ventures and associates are disclosed in Notes 14 and 18. Balances with joint operations are eliminated on consolidation.

Major shareholders
UEM Group Berhad is regarded as a related party of the Company.

The Costain Pension Scheme
Details of transactions between the Group and The Costain Pension Scheme are included in Note 20.

Transactions with key management personnel
Disclosures related to the remuneration of key personnel as defined in IAS 24 'Related Party Disclosures' are given in Note 6. Key management personnel, as defined under IAS 24 'Related Party Disclosures', have been identified as the Board of Directors as the controls operated by the Group ensure that all key decisions are reserved for the Board.

The Directors of the Company and their immediate relatives control 742,333 ordinary shares in Costain Group PLC, which expressed as a percentage of the issued share capital is 0.71% (2015: 0.64%) of the voting shares of the Company.

In addition to their salaries, in respect of the Executive Directors and executive officers, the Group provides non-cash benefits and contributes to defined contribution pension plans. Executive Directors and executive officers also participate in the Group's LTIP, AIP, DSBP and SAYE plans, which are detailed in Note 20.

The compensation of key management personnel, including the Directors, is as follows:

	Group	
	2016 £m	2015 £m
Directors' emoluments	**2.0**	2.3
Executive officers' emoluments	**2.3**	1.8
Post-employment benefits	**0.2**	0.3
Share-based payments	**1.6**	1.2
	6.1	5.6

The above amounts are included in employee benefit expense (Note 6).

Nigel Curry, Director of Costain Limited and Costain Integrated Services Limited and Andrew Ferguson, Director of Costain Integrated Services Limited are beneficiaries of a pension scheme that owns and leases a property to a Costain subsidiary under a lease dated 17 September 2012. The duration of the lease is 10 years with a break clause after five years. The rent is £0.2 million per annum.

Louis Thompson, who until 5 July 2016 was a director of Simulation Systems Limited (now Costain Integrated Technology Solutions Limited), is a beneficiary of a pension scheme that owns and leases certain properties to a Costain subsidiary under three leases dated between 2007 and 2013. The lease terms are seven, ten and 25 years and the 25-year lease has a break option period between 18 and 36 months following the acquisition by the Group. The aggregate rent is under £0.1 million per annum.

Company
The Company has no transactions with related parties other than the charge in relation to share-based payments (Note 20) (2015: none).

FIVE-YEAR FINANCIAL SUMMARY

	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Revenue and profit					
Revenue (Group and share of joint ventures and associates)	**1,658.0**	1,316.5	1,122.5	960.0	934.5
Less: Share of joint ventures and associates	**(84.3)**	(52.9)	(50.7)	(74.8)	(86.1)
Group revenue	**1,573.7**	1,263.6	1,071.8	885.2	848.4
Group operating profit before other items	**41.1**	33.2	28.7	27.4	21.7
Other items:					
Exceptional transaction costs	**–**	–	–	(3.7)	–
Amortisation of acquired intangible assets	**(4.6)**	(3.2)	(3.0)	(1.8)	(1.7)
Employment related and other deferred consideration	**(1.6)**	(0.4)	(2.2)	(2.8)	(1.7)
Group operating profit	**34.9**	29.6	23.5	19.1	18.3
Profit on sales of interests in joint ventures and associates	**–**	–	4.0	9.1	10.5
Share of results of joint ventures and associates	**0.2**	(0.1)	(1.3)	(11.3)	(1.4)
Profit from operations	**35.1**	29.5	26.2	16.9	27.4
Finance income	**0.6**	0.8	0.7	0.7	1.0
Finance expense	**(4.8)**	(4.3)	(4.3)	(4.7)	(3.7)
Net finance expense	**(4.2)**	(3.5)	(3.6)	(4.0)	(2.7)
Profit before tax	**30.9**	26.0	22.6	12.9	24.7
Taxation	**(4.5)**	(3.8)	(1.6)	(0.4)	(1.6)
Profit for the year attributable to equity holders of the parent	**26.4**	22.2	21.0	12.5	23.1
Earnings per share – basic*	**25.7p**	21.8p	22.2p	17.6p	32.9p
Earnings per share – diluted*	**25.0p**	21.2p	21.7p	16.9p	31.8p
Dividends per ordinary share					
Final	**4.30p**	7.25p	6.25p	7.75p	7.25p
Interim	**8.40p**	3.75p	3.25p	3.75p	3.50p
Summarised consolidated statement of financial position					
Intangible assets	**65.9**	52.3	31.0	33.0	18.7
Property, plant and equipment	**42.2**	37.3	10.0	7.9	9.1
Investments in equity accounted joint ventures and associates	**2.6**	2.6	27.5	32.1	40.4
Other non-current assets	**22.6**	18.8	41.0	31.8	34.9
Total non-current assets	**133.3**	111.0	109.5	104.8	103.1
Current assets	**512.9**	421.4	346.9	276.5	290.6
Total assets	**646.2**	532.4	456.4	381.3	393.7
Current liabilities	**441.6**	372.2	299.3	296.1	303.1
Retirement benefit obligations	**73.5**	36.7	41.7	37.2	51.9
Other non-current liabilities	**31.5**	2.9	4.6	4.7	6.9
Total liabilities	**546.6**	411.8	345.6	338.0	361.9
Equity attributable to equity holders of the parent	**99.6**	120.6	110.8	43.3	31.8

* The earnings per share figures for 2012 to 2013 have been restated for the bonus element in the 2014 capital raise.

FINANCIAL CALENDAR AND OTHER SHAREHOLDER INFORMATION

Financial calendar[1]

Full year results	1 March 2017
Annual Report mailing	17 March 2017
Ex-dividend date for final dividend	6 April 2017
Final dividend record date	7 April 2017
Annual General Meeting	8 May 2017
Final dividend payment date[2]	19 May 2017
Half-year end	30 June 2017
Half-year results 2017	23 August 2017
Ex-dividend date for interim dividend	14 September 2017
Interim dividend record date	15 September 2017
Interim dividend payment date	20 October 2017
Financial year end	31 December 2017

1 The financial calendar may be updated from time to time throughout the year. Please refer to our website **costain.com** for up-to-date details.

2 Subject to shareholder approval at the Annual General Meeting to be held on 8 May 2017.

Scrip dividend scheme

A scrip dividend scheme will be offered in respect of the final dividend. Those shareholders who have already elected to join the scheme will automatically have their dividend sent to them in this form.

Shareholders wishing to join the scheme for the final dividend (and all future dividends) should return a completed mandate form to the Registrar, Equiniti, by 27 April 2017. Copies of the mandate form and the scrip dividend brochure can be downloaded from the Company's website at **costain.com** or obtained from Equiniti by telephoning 0371 384 2268* or +44 (0)121 415 7173 if calling from outside the UK.

Analysis of shareholders

as at 1 March 2017

	Accounts	Shares	%
Institutions, companies, individuals and nominees:			
Shareholdings 100,000 and more	114	92,208,857	88.40
Shareholdings 50,000-99,999	46	3,184,131	3.05
Shareholdings 25,000-49,999	50	1,869,021	1.79
Shareholdings 5,000-24,999	343	3,402,520	3.26
Shareholdings 1-4,999	8,642	3,640,337	3.49
Totals	**9,195**	**104,304,866**	**100.00**

Secretary

Tracey Wood

Registered Office

Costain House, Vanwall Business Park, Maidenhead, Berkshire SL6 4UB

Telephone 01628 842 444
costain.com
info@costain.com
Company Number 1393773

Registrar

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

Telephone 0371 384 2250* or +44 (0)121 415 7047 if calling from outside the UK.

* Lines are open Monday to Friday 08.30am to 05.30pm, excluding UK bank holidays.

Dividend mandate

Shareholders can arrange to have their dividends paid directly into their bank or building society account, by completing a bank mandate form. The advantages of using this service are:

- the payment is more secure as you can avoid the risk of cheques getting lost in the post;
- it avoids the hassle of paying in a cheque; and
- there is no risk of lost, stolen or out-of-date cheques.

A mandate form can be obtained from the Company's website, or by contacting Equiniti on 0371 384 2250* (+44 (0) 121 415 7047 if calling from outside the UK) who will be pleased to assist you and can also be obtained via the shareholder website at **shareview.co.uk** (see below for further details). Alternatively, you will find one attached to the 'dividend tax confirmation' of your last dividend payment. Overseas shareholders can arrange for their dividends to be paid in their local currency and more information can be obtained from **shareview.com/overseas**

Shareview service

The Shareview service from our Registrar, Equiniti, allows shareholders to manage their shareholding online, giving:

- direct access to data held on their behalf on the share register including recent share movements and dividend details; and
- the ability to change their address or dividend payment instructions online.

To sign up for Shareview you need the 'shareholder reference' printed on your proxy form or dividend stationery. There is no charge to register.

When you register with the site, you can register your preferred format (post or email) for shareholder communications. If you select email as your mailing preference, you will be notified of various shareholder communications, such as annual results, by email instead of post.

If you have your dividends paid straight to your bank account, and you have selected email as your mailing preference, you can also collect your 'dividend tax confirmation' electronically. Instead of receiving the paper 'dividend tax confirmation', you will be notified by email with details of how to download your electronic version. Visit the website at **shareview.co.uk** for more details.

Details of software and equipment requirements are given on the website.

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 29
LON20771
London W1E OZT

Further guidance on this issue can also be found on the Company's website at **costain.com**

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 at **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.

* Lines are open Monday to Friday 08.30am to 05.30pm, excluding UK bank holidays.

CONTACT US

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For shareholder information, please contact:

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Legal Director and Company Secretary
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For corporate communications, please contact:

Sara Lipscombe
Group Communications Director
info@costain.com

We welcome your views

Costain is committed to engaging in dialogue with all its stakeholders. We are actively encouraging feedback on our Annual Report and would welcome any views you may have.

Useful links

costain.com

costain.com/investors

costain.com/our-culture

costain.com/annual-report-2016

costain.com/news

Disclaimer
The purpose of this document is to provide information to the members of Costain Group PLC. This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding our intentions, beliefs or current expectations and those of our officers, directors and employees concerning, amongst other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the business we operate. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this document and unless otherwise required by applicable law the Company undertakes no obligation to update or revise these forward-looking statements. Nothing in this document should be construed as a profit forecast. The Company and its Directors accept no liability to third parties in respect of this document save as would arise under English law.

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