Engineering *Tomorrow*

Costain Group PLC Annual Report 2012

COSTAIN

Who we are

At Costain we are continually progressing our business to become the engineering solutions provider of choice.

Our customers demand a seamless world-class service – from initial consultancy and advice to construction and engineering solutions, and long-term asset care and maintenance support.

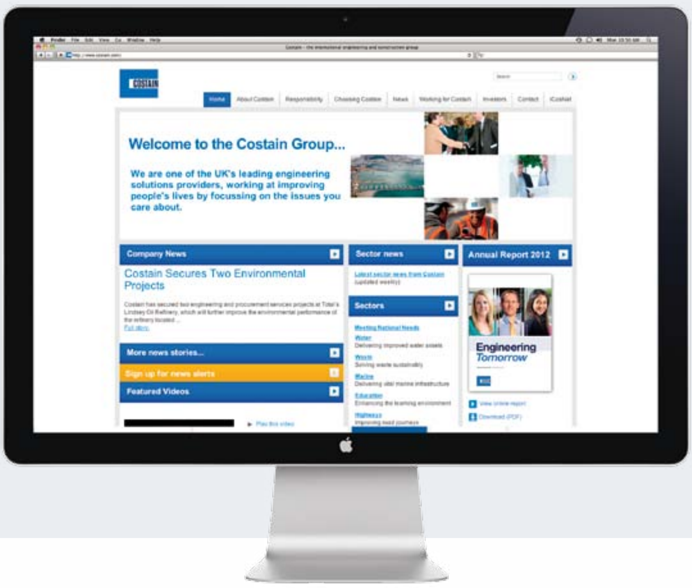
We can never stand still. Throughout our history of almost 150 years we have been driven by the need to seek continually new and innovative ways to meet the challenges of delivering ever more complex solutions.

Our vision
Our vision is to be one of the UK's top engineering solutions providers. We must be the best for technical, innovative expertise and sustainable solutions.

What we do
We focus on intelligent solutions to meet national needs. As a Tier One engineering solutions provider, we provide front-end engineering consultancy, construction and ongoing care and maintenance services across market sectors including water, waste, power, rail, hydrocarbons and chemicals, highways and nuclear process.

How we operate
We are committed to operating our business both sustainably and responsibly. We are focused on one simple but powerful message – 'Costain Cares'. This is not a slogan: it is an attitude of mind. It is integral to everything we do and a touchstone against which we can evaluate and measure our performance. Costain Cares about relationships, our environment and the future.

How we create value
Our 'Choosing Costain' strategy is designed to meet national needs by upgrading and maintaining the UK's infrastructure and aiding economic recovery and growth. Value is created by our drive for innovation and we are committed to a constant quest for improvement. We are confident that our robust business model and our strategic focus will continue to deliver shareholder value in the years ahead.



Find us online
Our Annual Report 2012 is available in both printed form and within the 'Investors' section of the Costain website at **www.costain.com/investors**. Effective communication with our shareholders is vital to our continued success and we would welcome feedback on either or both versions of this Annual Report – contact us at **info@costain.com**

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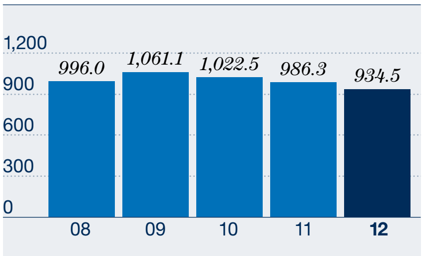
2012 highlights

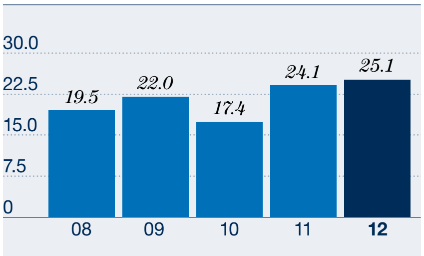
Strategy delivering results

Financial highlights

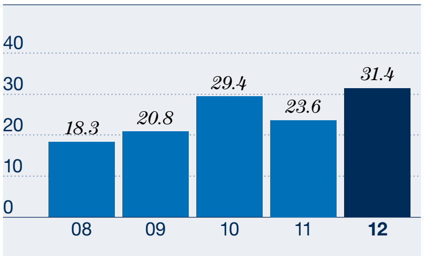
Revenue[1]
£m



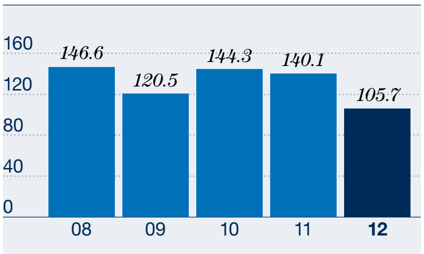
Underlying operating profit[2]
£m



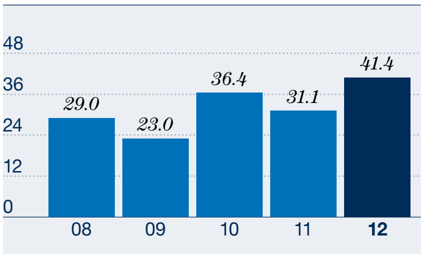
Adjusted profit from operations[3]
£m



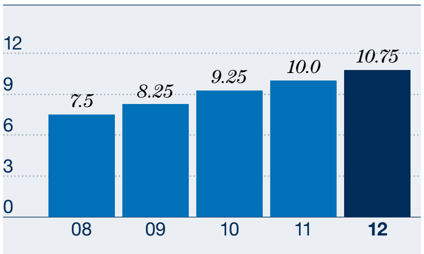
Net cash balance
£m



Adjusted earnings per share[3]
Pence



Dividends per share
Pence



Year ended 31 December	2012	2011
Revenue[1]	**£934.5m**	£986.3m
Operating profit		
Underlying[2]	**£25.1m**	£24.1m
Profit from operations		
Adjusted[3]	**£31.4m**	£23.6m
Reported	**£28.0m**	£22.0m
Profit before tax		
Adjusted[3]	**£29.5m**	£25.5m
Reported	**£26.1m**	£23.9m
Basic earnings per share		
Adjusted[3]	**41.4p**	31.1p
Reported	**37.1p**	29.2p
Net cash		
Year-end cash balance	**£105.7m**	£140.1m
Average month-end cash balance	**£103.4m**	£130.4m
Dividend per share	**10.75p**	10.0p

1 Including share of joint ventures and associates.

2 Underlying operating profit (before amortisation of acquired intangible assets and employment related acquisition consideration of £3.4 million) in 2012 excludes the £2.8 million one-off costs resulting from pension scheme liability actions.

3 Results stated before amortisation of acquired intangible assets and employment related acquisition consideration and after £10.5 million profit arising from transfer of PFI assets into the Group's pension scheme and £2.8 million one-off costs resulting from pension scheme liability actions.

Find out more:

Operational highlights

- Underlying operating profit[2] up 4% to £25.1 million (2011: £24.1 million)
- Increase of 16% in adjusted profit before tax[3] to £29.5 million (2011: £25.5 million)
- Adjusted basic earnings per share[3] up 33% to 41.4 pence (2011: 31.1 pence), reflecting increased profits and a non-recurring tax timing benefit
- £105.7 million year-end net cash balance (2011: £140.1 million) and average month-end cash balance of £103.4 million (2011: £130.4 million)
- High quality forward order book of £2.4 billion, in excess of 90% from repeat orders including new awards and extensions to existing contracts (2011: £2.5 billion)
- Increase to over £700 million of revenue secured for 2013 as at 31 December 2012 (2011: over £650 million secured for 2012)
- Recommended increase in final dividend for the sixth successive year, taking the total for the year to 10.75 pence, a 7.5% increase on the prior year

A8 Belfast to Larne underway

The Northern Ireland Minister for Regional Development, Danny Kennedy MLA, has signalled the start of the A8 Belfast to Larne Dualling (a Costain joint venture project) by cutting the first sod of the £102 million scheme.

The Minister said: "These works, which will take 34 months to complete, are of significant importance to the economic development of Northern Ireland."

Started in August 2012, the works are expected to be completed in spring 2015.

It is estimated that 55,000 tonnes of concrete, 1,300 tonnes of steel reinforcement and 310,000 tonnes of bituminous material will be used for the scheme, which will lead to an increase in demand for local suppliers of construction material.

Costain appointed to £288 million Magnox framework contract

Magnox has awarded a framework contract worth around £288 million for the delivery of construction, infrastructure and maintenance projects across all ten sites which are operated by Magnox on behalf of the Nuclear Decommissioning Authority.

Major milestones reached at London Power Tunnels

Costain has reached a number of significant milestones in the construction of three deep level tunnels as part of the London Power Tunnels contract for National Grid.

Evelyn dug its way to its first destination, a pre-prepared shaft deep below National Grid's Channel Gate Road offices, after beginning its journey from Willesden Substation earlier this year.

Cleopatra is digging the other 13km of the route and is approximately a kilometre away from her launch site in Haringey. Tunnelling work is scheduled for completion in 2014.

David Luetchford, National Grid's Head of Cable Tunnels, said: "The breakthrough represents another major step towards the completion of this vital project. Our breakthrough at Channel Gate Road is just one part of a much bigger story which involves us deploying the best talent and technology available to help ensure the lights stay on."

One million man-hours injury-free

The Costain Carillion JV reached another major safety milestone on the M1 Junctions 10-13 project. The project, which has an inducted workforce of over 4,000 people, has again achieved one million man-hours injury free. It is the fourth time the project has reached this milestone since work began on the project in 2009, and to celebrate the team decided to donate £500 to Leagrave Primary School in Luton.

The new managed motorway scheme, which aims to relieve congestion by using technology to vary the speed limit, went live between Junctions 10 and 11 in July 2012.

Overview

2012 highlights
continued

Focused on our responsibilities

Environmental and social highlights

Platinum status

Costain's commitment to being a responsible business was underlined by the retention of Platinum status in Business in the Community's ('BITC's') 2012 Corporate Responsibility ('CR') Index.

"I congratulate Costain on achieving Platinum in the 2012 BITC Corporate Responsibility Index. The CR Index has helped to highlight clearly those best practice examples that bring to life in a powerful way what integrated responsible practice really looks like. As we celebrate ten years of our CR Index it has given me great pleasure to witness each company's responsible business journey and the transformations they are making both within their businesses and the impact they have in our communities."

Stephen Howard
Chief Executive
Business in the Community

£171,142

Donated to charitable causes in 2012, including £22,000 to Great Ormond Street Hospital

Costain donated over £22,000 to Great Ormond Street Hospital's 'Raising the Roof' appeal, which will go towards upgrading the hospital's world-renowned neuroscience centre.

Earlier this year, Costain instigated an enhanced transfer value offer and a pension increase exchange offer to members of The Costain Pension Scheme. This aimed to offer scheme members greater choice and flexibility regarding their pension entitlement and gave Costain the opportunity to reduce the overall pension liabilities and risk remaining within the scheme.

Costain considered it important that all members fully understood the offer and that they sought financial advice. The Company decided to make a donation of £10 to Great Ormond Street Hospital for each member who contacted the appointed independent financial adviser, Oval Financial Services Limited. During the offer period, 2,246 members contacted Oval, generating a donation of over £22,000.

Costain's Sarah Barton, Lisa Bravery and Martin Hunter presented a cheque to Great Ormond Street Hospital's Christina Panayiotou (second from right).

93%

Waste diverted from landfill

27%

Reduction in measured carbon emissions over the last four years

38

RoSPA Awards

Costain's Health and Safety performance was recognised by the achievement of Health and Safety Awards. The Group received 38 RoSPA Awards, including two Orders of Distinction, one President's Award, five Gold Medals and 19 Gold Awards.

Costain receives accreditation for carbon footprint

Costain has received independent accreditation for reducing its carbon footprint, following an external audit by Achilles to the Certified Emissions Measurement and Reduction Scheme ('CEMARS').

Accreditation to CEMARS means Costain's commitment over the last three years to accurately report and reduce its carbon emissions has been officially recognised. The CEMARS standard includes a yearly review to ensure the Company continues to meet its reduction goals.

Costain's target is to achieve a 55% reduction in emission intensity by 2020 against a 2009 baseline, by actively engaging with its employees, customers and supply chain.

CEEQUAL award for Crossrail project

In October, the C330 Royal Oak Portal contract in west London, for which a Costain Skanska joint venture ('CSJV') was the contractor, won Crossrail's first 'Whole Project Award' under the Civil Engineering Environmental Quality Assessment and Award Scheme ('CEEQUAL').

CEEQUAL is the assessment and award scheme for improving sustainability in civil engineering and the public realm. It aims to demonstrate the commitment of the civil engineering industry to environmental quality and social performance.

CSJV Project Manager Dr Vicknayson Thevendran said examples of sustainability on the project included recycling aggregates for temporary and permanent works, using rainwater for the wheel-wash for vehicles leaving the site, and installing solar panels to power monitoring equipment.

Costain launches supply chain academy

In September, Costain officially opened its supply chain academy, a new initiative that aims to support and develop small to medium-sized enterprises.

The Company welcomed 15 suppliers on 3 September 2012 to attend the first of 19 modules covering business administration, commercial and financial best practice, insurance, Health and Safety, behavioural safety and quality.

The academy has been launched to align the Company's supply chain partners with the high standard of training and development adopted across the Group.

Costain Annual Report wins Investor Relations Society Award

In November, Costain was recognised at a prestigious investor relations award ceremony in London for its 2011 Annual Report.

Costain won the 'Most Effective Overall Annual Report (Printed and Online) Award', in the SmallCap & AIM category at the Investor Relations Society's ('IRSs') Best Practice Awards held at The Pavilion, Tower of London, on 20 November.

Now in their 12th year, the IRS Best Practice Awards recognise and reward best practice in investor communications, both online and in print.

The awards, which were attended by approximately 450 people from across the investor relations and corporate communications industry, were compered and presented by former Conservative cabinet minister Michael Portillo.

The IRS is the professional body for those involved in investor relations and is the focal point for investor relations in the UK.

The awards' winners are determined through a robust, three-part review process. All entries are reviewed and scored against a checklist, based on the IRS's best practice guidelines and the specific criteria for each award, set out in the awards entry form.

Commenting on the award, the judges said: "Costain Group presented a clear and easy-to-navigate report with the Remuneration Committee content being a particular feature."

Investor relations is a strategic management function that incorporates finance, communication, marketing and strict compliance with Stock Exchange listing rules to enable the most effective two-way communication between a company, its shareholders and stakeholders, and the financial community.

Costain started to integrate its financial and corporate responsibility reporting into its Annual Report five years ago.

This allowed shareholders and other stakeholders to better gauge how the company performed financially and, through the successful implementation of the Costain Cares initiative launched in May 2011, to see how it conducted its business in the communities in which it operated.

Directors' Report – Business review

Chairman's statement

Delivering excellent results

David Allvey
Chairman

Overview & Strategic Update

Costain has delivered another strong performance.

As a result of the implementation of our 'Choosing Costain' strategy, the Group is one of the UK's leading engineering solutions providers, delivering integrated consulting, project delivery and operations and maintenance services to major blue-chip customers in targeted market sectors.

Our success is the direct result of our focus on major customers who are continuing to invest billions of pounds in capital, operations and maintenance contracts to address essential national infrastructure requirements across the transport, energy, water and waste sectors.

During 2012, we increased the proportion of revenues from support service related activities to 29%. To meet the demands of major customers for an increasingly integrated service, we must continue to enhance and broaden the range of services we offer. The ongoing drive to develop our services particularly across engineering consultancy, and operations and maintenance will remain a key priority in 2013.

The spending plans of our customers provide a major opportunity to grow the business further. With a strong cash position, robust balance sheet and banking and bonding facilities in place, we have the resources to continue to grow the business organically and by acquisition.

Performance

Revenue, including the Group's share of joint ventures and associates, for the year was £934.5 million (2011: £986.3 million). Our focus on higher margin activities led to an increase of 4% in Group underlying operating profit of £25.1 million (2011: £24.1 million). Adjusted profit before tax increased by 16% to £29.5 million (2011: £25.5 million). Adjusted basic earnings per share were up 33% to 41.4 pence (2011: 31.1 pence), reflecting increased profits and a non-recurring tax timing benefit.

As a result of the Group's ongoing strategic focus on major blue chip customers who increasingly utilise a target cost based form of contract, our net cash position includes a lower level of advanced payments typically paid on lump sum contracts. Additionally, our increasing emphasis on support service related activities and changing industry cash flow trends, together with the cash flow timing implication of a delayed contract completion, accounted for the reduction in net cash to £105.7 million (2011: £140.1 million). We expect these trends will continue to be reflected in a lower average net cash position.

“Costain has delivered another strong performance in 2012, and our confidence in the Group’s future is reflected in the Board’s recommendation to increase the final dividend for the sixth successive year.”

The Group has flexible financing in place with total banking and bonding facilities of £465 million with a maturity date of 30 September 2015.

We were successful in securing a number of major new contract awards and extensions to existing contracts. Consequently, the order book, as at 31 December 2012, was £2.4 billion (2011: £2.5 billion). We have increased to over £700 million the revenue secured for 2013 (2011: over £650 million secured for 2012) and it is encouraging to have started the new financial year with such long-term visibility.

Dividend

Reflecting another successful year and our continuing confidence in the long-term prospects for the Group, the Board is recommending a 7.4% increase in the final dividend, the sixth successive year of increase. If approved, the 7.25 pence per share (2011: 6.75 pence) final dividend will be paid on 24 May 2013 to shareholders on the register as at the close of business on 19 April 2013. This would bring the total dividend for the full year to 10.75 pence per share (2011: 10.00 pence), an increase of 7.5% over the prior year.

Board & Staff

The Board was pleased to announce the appointment of Jane Lodge as a Non-Executive Director with effect from 1 August 2012. Jane has also been appointed Chair of the Audit Committee, succeeding James Morley who became Senior Independent Director. James succeeded John Bryant who retired from the Board at the end of 2012 after nearly 11 years as a Board member. We would like to thank John for his considerable contribution over that time.

There were a number of operational management changes and these are covered in the Chief Executive’s Review.

On behalf of the whole Board, I would like to place on record our recognition and appreciation of the excellent colleagues we have at Costain who continue to play a major role in our success.

Group Pension Scheme

The deficit on the Group’s legacy Costain Pension Scheme (‘CPS’) at 31 December 2012 was £40.0 million net of deferred tax (2011: £39.7 million). The assumptions and sensitivities used in the valuation of the pension scheme are set out in the notes to the financial statements.

Costain has in place a deficit recovery plan based on the latest actuarial position as at 31 March 2010, agreed with the Pension Scheme Trustee, expected to eliminate the deficit over a period of less than ten years and continues to take various decisive actions in that regard. Additionally, in February 2012, the Group announced two further actions being taken to manage the obligations in the CPS (further detail is provided within the Financial Review). In accordance with the requirement for a tri-ennial review, another full actuarial valuation of the CPS will be carried out as at 31 March 2013.

Summary & Outlook

Costain has delivered another strong performance in 2012, and our confidence in the Group’s future is reflected in the Board’s recommendation to increase the final dividend for the sixth successive year.

Our progress in recent years, despite challenging economic conditions, is a reflection of the Group’s strategic focus on meeting the complex needs of customers by ensuring that Costain provides integrated consulting, project delivery and operations and maintenance capability.

The Group believes that, driven by innovation, the strategic development of the business will be accelerated as we work with customers on their future programmes.

With a robust balance sheet, positive net cash position and banking and bonding facilities in place, we have the resources to continue to grow the business organically and by acquisition.

David Allvey
Chairman

6 March 2013

Consulting

Designing intelligent solutions

The depth and breadth of Costain's expertise enables the Company to develop innovative solutions across its business sectors. These range from concrete gravity bases for offshore wind turbines, or completely redeveloping an operational railway station, to a study – with partners – of a new treatment for the UK's 100,000 tonnes of irradiated graphite from decommissioned nuclear power stations.

Reading is one of the busiest railway stations outside London, handling 17 million passengers annually. A Costain/Hochtief Joint Venture is undertaking an £80 million project to redevelop and expand it.

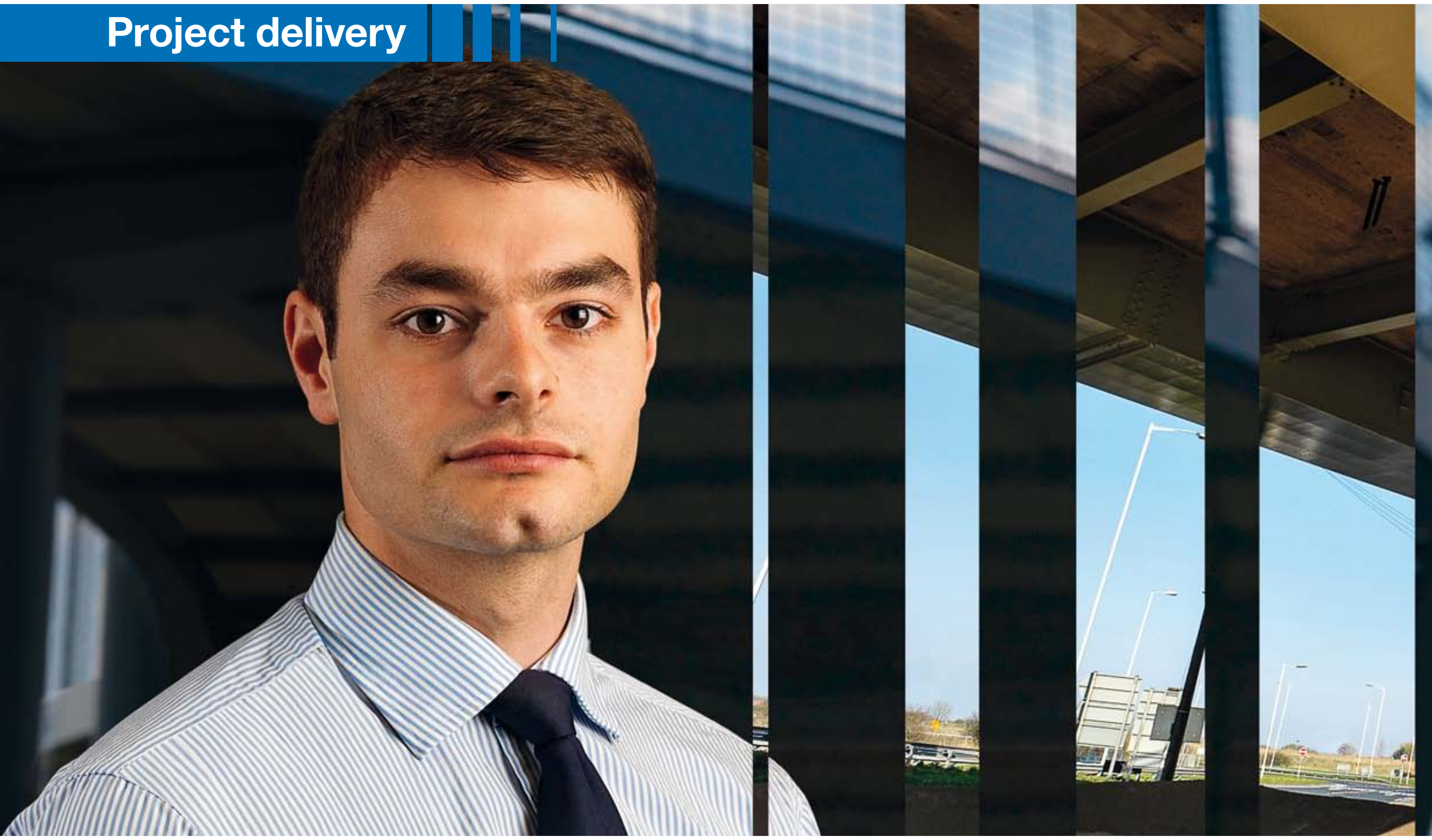
This includes increasing the number of platforms from ten to 15, roofing the station and installing a new 'transfer deck' across the tracks. The latter involves replacing the existing footbridge and stairs with a higher capacity structure complete with escalators down to the platforms. The project has been designed to allow all this to take place while rail services through the station continue uninterrupted.

The new 100-metre transfer deck was constructed in three sections at a site beside the tracks. The first 50-metre section was pushed 28 metres out over the railway over four nights in July 2012, while the second section was jacked into position over five nights in the period between the Olympic and Paralympic Games. It took two nights to slide the second section 18 metres over the track, then a further three nights to lower it just 100mm into its final position.

The 1,100-tonne section was lowered 25mm at a time in a series of steps to ensure it fitted exactly onto its bearings.

This particular part of the project was carried out over an operational railway rather than during a possession when rail services are suspended. "This demonstrated both Network Rail and First Great Western's confidence in the team after the earlier bridge slide," commented Site Agent Dave Forbes.

Project delivery



Delivering programme excellence

Construction involves much more than simply building an asset accurately and efficiently to plan. Costain has to understand clients' requirements and work collaboratively with them to create the most effective solution to balance performance for users with long-term maintenance requirements. During construction it means having teams with the right levels of competence and leadership to pull together extensive supply chains and negotiate complicated interfaces.

Bidston Moss Viaduct is a 3.7km-long structure carrying the M53 motorway over a railway line and major roundabout on the Wirral peninsula. It is a 37-span box girder bridge built in the late 1960s and, by the early 'noughties', like many structures of that vintage and construction method, structural deterioration had set in.

The viaduct had laboured under weight restrictions from 2005 and was under threat of closure if structural weaknesses were not addressed. It carries 63,000 vehicles daily, including 5,000 HGVs – closure would have had a severe effect on the economic life of the Wirral.

Costain, as principal contractor, installed 400 tonnes of reinforcement steel within the hollow box girder structure – all while traffic flow was maintained overhead.

Much of the structure had not been opened up since 1969. This meant Costain and its subcontractors had to create or improve access into 602 individual box girder compartments. Costain had to co-ordinate multiple trades working together in extremely confined spaces.

A lean engineering team was set up, using techniques similar to those in the car industry, to ensure the work was undertaken with maximum efficiency.

The viaduct's concrete piers were also strengthened and refurbishment of the deck and carriageway was undertaken as part of the £89.9 million contract for the Highways Agency.

The viaduct was restored to full structural capacity three months ahead of deadline. The project won a plethora of awards for excellence in both construction and safety standards.

Care

Maximising whole-life value

Over the past decade, Costain has greatly expanded the services it offers clients. As well as its long-established project delivery expertise in construction and engineering, it now provides whole-life services, from consultancy and design work at the start of a project to the post-construction operation, maintenance and eventual decommissioning of assets.

Water, nuclear and highways are three areas where this change has been most apparent.

Under Asset Management Programme ('AMP') contracts being undertaken with several of the UK's largest water utilities, for example... Costain is advising upfront, doing the work and supplying ongoing support and maintenance. Costain also provides maintenance services for approximately a third of England's motorways and major trunk routes under Managing Agent Contractor arrangements with the Highways Agency.

In nuclear, as the UK's first-generation Magnox nuclear reactors close down, Costain is helping care for the sites as they enter the lengthy decommissioning process. A £288 million framework contract lasting up to ten years is emblematic of the emphasis the Company is placing on creating value beyond its traditional activities.

Costain is also handling enabling works at the Berkeley and Trawsfynydd sites, installing infrastructure that will allow decommissioning to proceed. This includes the reconfiguration of buildings and access roads, plus creation of facilities for the decommissioning workforce. Additionally, Costain is also designing and constructing plant to deal with radiological waste and assembling the team to operate it.

On the roads, Costain has worked with the Highways Agency to retro-fit a more efficient service delivery system to existing contracts. The modified contracts are based around what actually needs to be done to keep the network functioning as opposed to the previous, prescriptive level of intervention where Costain delivered a suite of works to a pre-set budget.

Directors' Report – Business review

Chief Executive's review

Engineering value is our business

Andrew Wyllie
Chief Executive

Our business model

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3. **Our market focus**
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Against a backdrop of changing industry dynamics and ongoing challenging economic conditions, 2012 was another year of progress at Costain.

Our focus on providing innovative and cost effective solutions to increasingly complex and large-scale national needs, along with our partnership approach, is enabling Costain to build new and extend existing long-term relationships with a range of major customers. As a result, during the year we secured new contracts and extensions of some £900 million and our year-end total order book stood at £2.4 billion.

Reflecting the increasing quality of our customer relationships, over 90% of that order book now comprises repeat orders. The order book also provides good long-term visibility with over £700 million of revenue secured for 2013, and in excess of a further £1.7 billion of revenue secured for 2014 and beyond. In addition, the Group has maintained a strong preferred bidder position of over £400 million.

Trends & Developments

During the year we saw a continuing trend amongst our major customers to consolidate their supply chains, as they seek to derive business benefits by working in a much more strategic and collaborative manner with a reduced number of preferred Tier One service providers who have the ability to deliver the entirety of their service needs.

"Our progress in recent years, despite economic conditions, is a reflection of the Group's strategic focus on meeting the complex needs of customers by ensuring the Costain provides integrated consulting, project delivery and operations and maintenance capability."

David Allvey
Chairman

As a consequence, our customers are rapidly changing their procurement approach, consolidating a broader range of services across consulting, project delivery and operations activities into larger, longer-term contracts. As examples of this trend, in 2012 we were appointed by Magnox as one of two service providers under a 10-year framework contract that now covers all ten of their UK nuclear sites, and we were appointed by the Oil & Pipelines Agency on a 3-year operations and maintenance contract that now covers the whole of their estate.

In this changing and competitive environment, it is essential that Costain is able to demonstrate that it has the scale, skills, experience and financial strength necessary to secure, and then deliver, a strong performance on these increasingly large and complex contracts. The Costain Group has been transformed in recent times to meet our customers' evolving requirements.

We now deliver Engineering services across the full asset life-cycle, from advisory and design to operations and maintenance. Developed both organically and by acquisition, 29% of our revenue in 2012 was derived from support service activities.

The provision of an increasing range of skills and services, along with the recognised capability of our team, our acknowledged engineering expertise and reputation for reliable safe delivery has enabled us to secure large, integrated and complex projects: the contract from Network Rail for the London Bridge Redevelopment, a key part of the Thameslink programme; the Evaporator D project, one of the largest nuclear decommissioning projects in the UK, where we are utilising innovative modularisation techniques used in our oil and gas operations to deliver units to site; the Greater Manchester Waste project, one of Western Europe's largest waste PFI contracts; and with the Highways Agency, whose own assessment rates Costain as a leading supply chain partner.

During the year, we secured our first highways technology framework contract for the Welsh Government, an important contract given the increased levels of investment in technology expected in the highways sector. We also recently secured, in joint venture, our first rail electrification contract for Network Rail, with electrification forming a key part of their £37 billion investment programme.

Costain's growing in-house ability to design, procure and deliver projects is being utilised by Centrica for the delivery of its gas plant at Easington to serve the York field in the North Sea. As a result of successful delivery on the new plant, we have just been appointed by Centrica to develop the Front End Engineering design ('FEED') for a similar project at Barrow. The Aberdeen based ClerkMaxwell specialist oil and gas FEED consultancy, acquired by Costain in 2011, has almost doubled in size since acquisition.

Directors' Report – Business review
Chief Executive's review
continued

Engineering value is our business

'Engineering Tomorrow'

Engineering excellence runs through our DNA and 'Engineering Tomorrow' is the Costain commitment to identifying, developing and implementing innovative solutions to major national needs.

Our customers are increasingly looking to their preferred supply chain partners such as Costain for innovative products and services that will shorten lead times, enhance the quality of project delivery and, above all, provide cost-effective solutions. To remain a preferred Tier One supplier, we need to stay one step ahead of our peer group.

We have increased our investment in Research and Development, and have introduced the Costain Start-Up initiative to encourage and support entrepreneurial members of staff to develop their ideas into business opportunities. The 'Mario' asset management tool was one such idea, which is now being sold commercially to rail and highways customers as an addition to Costain's range of services.

We are currently undertaking consulting projects to develop Plasma Vitrification and Graphite Gasification technologies as potential solutions for addressing the treatment and storage of intermediate level nuclear waste. We are also undertaking work on behalf of the Energy Technology Institute to develop a prototype process for carbon capture.

'Costain Cares'

One of our competitive advantages is the recognition some time ago of the increasing importance customers were placing on the "good citizen" credentials of their supply-chain partners. Failure to embrace and deliver on what our customers regard as vital components of corporate and social responsibility means non qualification for tender lists. We passionately share these values and Costain believes that investment in corporate social responsibility capital is a vital investment in the Group's future success.

Core to our transformation and our value proposition to customers is our 'Costain Cares' programme which places responsible, effective and collaborative stakeholder relationships at the core of everything we do.

We received a Platinum award from Business in the Community, recognising our proactive commitment to mitigating the environmental and social aspects of our operations.

Costain places the highest priority on the effective management of Safety, Health and Environment. Further progress was made in the year and we again recorded an improved Group Accident Frequency Rate ('AFR') reducing from 0.11 to a new record low of 0.09, which continues to compare favourably with our major Tier One peer group. We also received 19 Gold Awards from RoSPA and two prestigious Orders of Distinction.

Teamwork

The results generated by Costain in 2012 were delivered by an outstanding team. During the year, we increased our training and development programmes across the organisation so that we have the requisite skills and resources. There was a further increase in the number of apprentices across the Group.

There were also a number of adjustments to the senior executive team. Mark Rogerson MBE, who joined the Group in June from Serco in the new role of Chief Development Officer, has since been appointed Managing Director of the new Natural Resources division. Mark has a track record of successfully managing and growing support service businesses. The Infrastructure division will continue to be led by Managing Director Darren James.

Alan Kay, previously Managing Director of the Environment Division, and who recently completed the Advanced Management Programme at Harvard Business School, was appointed in November to the new role of Group Technical & Operations Director on the Executive Board to drive innovation, operational and engineering excellence across the Group.

Tim Bowen, previously Highways Sector Director, was appointed to the Executive Board to develop our consulting and operations activities for major customers in the Middle East. The senior management team was further strengthened by the appointment of Fiona Ware as Human Resources Director.

A New Structure

One of the strengths of Costain is the ability to focus group-wide resources to meet specific customer requirements, address opportunities and optimise returns for the Company as a whole irrespective of divisional structure.

In November, the Group announced the formation of the new Natural Resources operating division, encompassing the Water, Hydrocarbons & Chemicals, Nuclear Process and Waste sectors, combining most of the existing Energy & Process and Environment Divisions and some support service activities previously in Infrastructure. This new divisional structure will enable the Group to align itself more closely with its customers' evolving requirements and to combine further its front end process engineering, project delivery, and operations capability into an integrated service for customers.

The Natural Resources division will operate alongside the Infrastructure division which will now also include all power activities as well as the Group's activities in the highways, rail, and airports sectors. The new divisional structure took effect from 1 January 2013.

The Future

Costain has delivered another strong performance and demonstrated again that it has the right strategy to drive profitable growth even through the most challenging of economic conditions.

We entered 2013, having already secured over £700 million of work for the year and we continue to benefit from a strong pipeline and high levels of tendering activity.

Looking forward, we expect the rate of change in Costain to accelerate as we take further steps to broaden our services and enhance our product range. We believe that we will continue to be successful by further increasing the agility of the business to react to customer's changing requirements and by driving innovation and new technology across all of our operations in line with our commitment to 'Engineering Tomorrow'.

I look forward to reporting on further progress during the year.

Andrew Wyllie
Chief Executive

6 March 2013

Directors' Report – Business review

Business model

Creating value through our customer-focused strategy

1 Engineering solutions to meet national needs

2 Focusing on the needs of major blue-chip customers

Health and Safety

Our focus on safety remains our highest priority. We achieve this by providing a safe working environment where the health and wellbeing of our people are protected and actively promoted.

Intelligent solutions

Providing solutions that are agile and responsive to the needs of our customers remains essential in our chosen markets. Our experience and knowledge in the application of the right solutions remain critical to informing decisions at all stages of the asset life-cycle.

Cost-competitiveness

In a challenging global economy, businesses continue to come under pressure to drive down costs. We concentrate not just on solutions that deliver the best value for customers but also on how we deliver these solutions. This requires an unrelenting focus on our customers' costs and our own operating procedures.

Corporate Responsibility

Our commitment to delivering services responsibly and sustainably is vitally important to the Group. We believe that responsible business is central to delivering greater value to our customers and all other stakeholders.

Innovation and technology

Today's environment requires businesses to innovate at a faster rate than ever before. The need to continually innovate and apply new technology in creating solutions to meet national and customer needs is now a base requirement of operating in this market place. We focus on developing intelligent solutions and providing the latest technology in all activities that we undertake.

Partnering and collaboration

Partnering and collaboration form a central part of an approach which has become essential to deliver complex engineering and services. Our customers and suppliers value the importance of this partnership approach and we often work in collaboration to deliver required projects and services.

3 Our market focus

The markets we operate in remain robust and aligned to planned investment programmes underpinned by regulated spend and national needs.
Targeting £billions worth of committed spend (based on estimated annual industry spend).

£11bn

Water

Committed spend continues in the UK water market as a result of rising environmental standards and continued threat of water scarcity. The sixth asset management plan cycle, proposed £4.1 billion London super-sewer project and legislation-driven £3 billion water retail markets are examples of the growth in this market.

£5.4bn

Nuclear process

In addition to the Nuclear Decommissioning Authority’s £49.5 billion investment in cleaning up the UK’s nuclear legacy, generating new nuclear power is seen as vital to UK energy security, with an estimated investment of circa £60 billion to build up to 16GW of capacity.

£9.5bn

Waste

Environmental and legislative obligations continue to shape the UK waste management sector, which is predicted to grow around 3% by 2014. The market continues to be transformed to focus on reuse, recycling and recovery of waste. This reflects the UK’s ambition to achieve a zero-waste economy and to divert waste from landfills, estimated to be circa 50% of all local authority collected waste.

£17bn

Rail

The national infrastructure plan sets out a robust plan for investment in the UK rail network. This is a priority area for the Government to stimulate economic growth, and to meet future demands for an additional 225 million passengers and 355,000 more trains per year. £37.5 billion is set to be invested over five years on national rail networks in areas including electrification, track and network upgrades and the proposed High Speed 2 (‘HS2’).

£8bn

Highways

UK road networks are under pressure, with longer average delays and increases in traffic volumes year on year. Congestion is predicted to cost the economy £22 billion a year by 2025 if road networks are not upgraded. To overcome these challenges, billions of pounds are being spent improving road networks, including plans to invest £9.7 billion to extend the life and quality of the UK strategic road network.

£9.5bn

Power

The UK’s challenge is to secure its energy future while meeting carbon reduction commitments and coping with an ageing infrastructure. This will be underpinned by investment in cleaner and more reliable sources of energy and bigger and smarter infrastructure, including renewables, nuclear power and fossil fuels with Carbon Capture Storage (‘CCS’) technology. Around £110 billion of investment is anticipated by 2020.

£23bn

Hydrocarbons and chemicals

Significant activity in the UK upstream market is expected to continue. This will be primarily driven by investment of over £10 billion in offshore deep drilling and the optimisation of mature assets in the North Sea. In addition, rising energy demands, unstable oil prices and cheaper energy sources are boosting investment in gas exploration.

£6bn

Airports

The UK is recognised as one of the world’s leading business centres. However, there is growing pressure on the UK to increase capacity within its aviation infrastructure to accommodate economic growth. It is estimated that a lack of capacity at Heathrow is costing the UK economy £14 billion a year.

Directors' Report – Business review

Business model

continued

Creating value through our customer-focused strategy

4 Our 'Choosing Costain' strategy

We continue to develop our strategy by broadening our offer and focusing on developing solutions to meet the needs of our customers.

Our focus is in our target markets of highways, rail, power, airports, waste, water, nuclear process and hydrocarbons and chemicals. Our geographical focus remains primarily in the UK whilst developing international consultancy services through strategic partnerships in the Middle East.

Having successfully pursued this approach for the last two years we are strengthening our market position and delivering engineering solutions across the entire asset life-cycle.

We provide advisory and design services designing intelligent solutions, complex engineering delivering programme excellence and operations and maintenance maximising whole-life value.

Costain's ambition remains to double profits in the medium term.

5 Strategic priorities and progress in 2012

Customer focus

Broadening our services across the asset life-cycle, enhancing the quality of our earnings and the value to our customers and the end user.

Progress

- 90% repeat business in 2012
- 47% of new order book through existing contract arrangements

Developing a best-in-class management team

Providing new solutions through insight and innovation requires a leadership team at all levels of the business closely aligned to our customers' needs and our ability to deliver these solutions.

Progress

- 51 new recruits in senior positions, including nine key senior-level recruits (six external, three internal)
- Two new appointments to the Executive Board

Operational efficiency

To meet our customers' needs we continue to focus on our cost base, ensuring that we are providing best value through implementing a 'lean' strategy throughout the business.

Progress

- Appointment of Group Technical & Operations Director to the Board
- Reduction in operational overhead

Innovation

We continue to invest significantly in innovation, research and technology that will provide new services to customers and address national needs where new markets are emerging.

Progress

- 36 patents and patents pending to improve customers' business performance
- Over £2 million deployed annually to solve technical challenges and bring innovative solutions to market
- Directly over £8 million of government investment

Operating responsibly

In contributing to the sustainable development of the UK's infrastructure, it is important that we approach our business in a responsible way. Corporate Responsibility ('CR') is core to our business. We are committed to delivering projects and services responsibly and sustainably, ensuring that we meet our customers' and society's needs while managing the social, environmental and economic impacts of our business.

Progress

- Retained Platinum status in Business in the Community's 2012 CR Index
- Please see pages 30 to 39 for further details of our progress in 2012

Partnerships

In a market where collaboration continues to deliver value, Costain focuses on developing strategic partnerships to support the development of broader services and technology.

Progress

- Alstom Babcock Costain joint venture wins first electrification project

6 Our business divisions

In November 2012, we announced a restructuring of our business divisions by creating a new Natural Resources operating division as part of the further transformation of the Costain Group.

We now have two operating divisions: Natural Resources and Infrastructure.

The new division will encompass the water, hydrocarbons and chemicals, nuclear process and waste sectors by combining the existing Energy & Process and Environment divisions. The division will enable Costain to combine further its front-end processing engineering, project delivery and operations capability into an integrated service for customers.

Natural Resources

The Natural Resources division delivers engineering solutions in water, nuclear process, waste and hydrocarbons and chemicals, whilst also delivering legacy projects in education.

Water

A leading provider of capital framework and maintenance framework programmes under the current AMP 5 arrangements. Providing water services to commercial and industrial customers.

Nuclear process

Major frameworks and capital schemes delivered across a number of the UK's strategic assets.

Waste

Delivering major waste schemes across the UK.

Hydrocarbons and chemicals

Developing and implementing solutions for the upstream and downstream oil and gas and chemical sectors in the UK and Middle East.

Infrastructure

The Infrastructure division delivers engineering solutions for principal infrastructure providers in rail, highways, power and airports.

Rail

A leading provider of multi-disciplinary projects for Network Rail, Crossrail and LUL. Currently delivering major projects principally focused on transportation hubs, most recently at London Bridge, Reading and Bond Street.

Highways

Delivering major programmes for the Highways Agency, Welsh Government and local authorities. Maintenance under the current MAC contracts and Early Contractor Involvement works.

Power

Focusing on thermal generation, new nuclear, offshore wind, transmission and distribution. Currently delivering major tunnelling works for National Grid.

Airports

Delivering programmes of work across airport assets at Heathrow, Gatwick and Manchester.

Find out more on pages 26-28

Directors' Report – Business review

Business model

continued

Creating value through our customer-focused strategy

7 Our business architecture

Consulting

Advisory and design

Pre-investment advisory

- Investment appraisals and business cases
- Feasibility and concept design
- Intelligent infrastructure solutions
- Optioneering and value management

Complex programme advisory

- Programme management and governance
- Performance assurance and controls
- Risk and opportunity management
- Contractual consultancy services
- Commercial controls
- Asset commissioning planning

Operational excellence

- Lean engineering
- Cost planning and reduction
- Procurement and supply chain solutions
- Asset management and optimisation
- Decommissioning and reclamation

Sustainability and energy advisory

- Engineering consultancy, advice and support across the asset life-cycle

Design

- Concept outline through to detailed design
- Front-end engineering studies
- Feasibility and options

Construction

Complex programme delivery

Programme leadership

- Detailed design management and control
- Construction methodology and strategy
- Planning and programme management
- Resource allocation and optimisation
- Construction management

Sustainable delivery

- Behavioural safety and environmental assurance
- Quality assurance management
- Energy and waste management
- Community engagement and liaison

Asset operation integration

- Network management system
- Network technology integration
- Service assurance
- Stakeholder management

Construction and engineering compliance

- Risk control management
- CDM standards and control management
- Construction systems and process assurance
- People development and communication

Care

Operations and maintenance

Infrastructure network management

- Control centre staffing
- Call centre operations
- Live 'on network' emergency
- Sustainable operational excellence

Asset management and maintenance

- Asset knowledge acquisition
- Asset monitoring, testing and inspection
- Planned preventative maintenance
- 'Non-scheduled' defect solutions
- Life-expired asset renewal
- Decommissioning

Facilities management

- Building fabric maintenance and renewal
- Mechanical and electrical repair and renewal
- Support service staffing and resourcing
- Commercial cleaning, catering and security
- Grounds maintenance

Compliance services

- Behavioural and process safety
- Fire systems maintenance
- HVAC installation and maintenance
- Water hygiene and monitoring
- Energy efficiency management

Find out more:

8 Operating effectively and responsibly

Relationships

We encourage open, honest and respectful communication. We believe in strong, long-lasting relationships that are mutually beneficial.

We will:

- provide a safe working environment free from harm;
- provide a healthy working environment for all our people;
- support the local communities in which we operate, ensuring we leave a lasting legacy;
- provide sustainable solutions and the highest standards of service for our customers;
- attract, retain and develop the best people for the Costain Group; and
- operate a collaborative, responsible supply chain where our partners support us in delivering efficient, innovative and sustainable solutions.

Find out more on pages 30-36

Our Environment

We operate in the built environment, where we meet national needs for strategic investment in infrastructure. We compete in the economic environment, where we must deliver value for customers and shareholders. We have to deliver responsibly to the natural environment for the benefit of everyone.

We will:

- work with our customers and supply chain to, where possible:
  - reduce our impact on climate change;
  - conserve natural resources through effective waste management, minimising water consumption and sustainably sourcing materials; and
  - protect and enhance the environment.

Find out more on pages 37-38

The Future

We play an important role in the provision of infrastructure vital for the UK economy. The benefits of investment in infrastructure today will be felt for many years to come.

We will:

- be one of the UK's top engineering solutions providers;
- provide a sustainable return on investment for our shareholders;
- invest in innovation to provide solutions for tomorrow's challenges;
- work with our customers and supply chain to develop skills to respond to future needs within our sector; and
- contribute to economic growth by supporting our supply chain, including small and medium-sized enterprises.

Find out more on page 39

Directors' Report – Business review

Business model

continued

Creating value through our customer-focused strategy

9 Investing in...

Health and Safety

Ensuring that we provide a safe working environment where the health and wellbeing of our people is protected and actively promoted.

Find out more on pages 30-32

Our people

Attract, retain and develop the best people and, in doing so, support the delivery of our strategy. A focus on key roles to deliver our broadening offer into our chosen markets.

Find out more on pages 33-35

Developing customer insight

Developing customer relationships through a greater focus on business development and early project engagement.

Additional capability

Strategic acquisitions to support the 'Choosing Costain' strategy in our chosen markets.

Find out more on pages 14-17

Work-winning

Maximising our return on investment through focus and developing relationships with key partners to extend our offer to our customers. Providing greater capability, service and technology solutions.

Innovation and technology

Delivering intelligent solutions through the effective deployment of direct investment, research funding and customer-led innovation.

Responsible business and sustainability

Building a longer-term sustainable business that creates economic, environmental and social value.

Providing sustainable solutions and the highest standards of service for our customers.

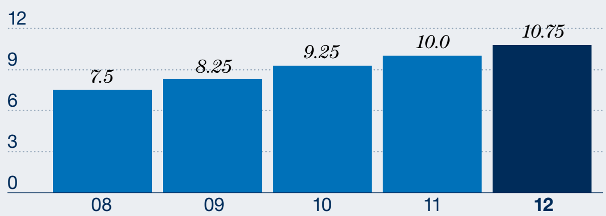
Find out more on pages 29-39

10 Delivering shareholder value

Reflecting another successful year and our continuing confidence in the long-term prospects for the Group, the Board is recommending a 7.4% increase in the final dividend, the sixth successive year of increase.

David Allvey
Chairman

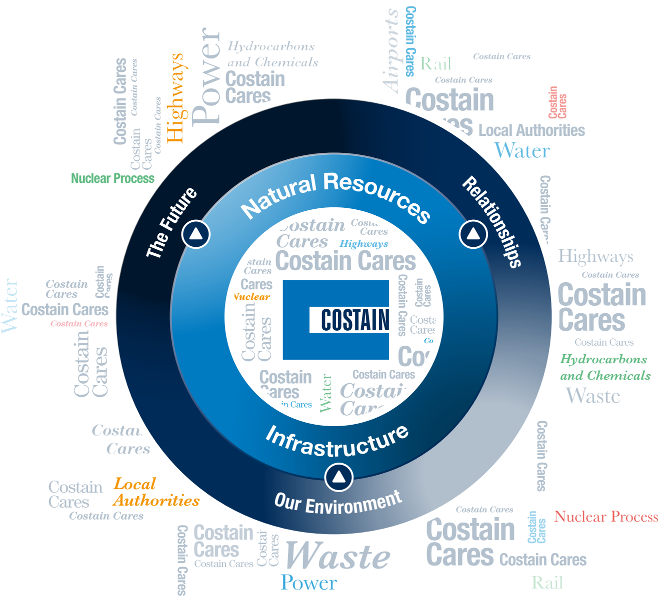
Dividends per share
Pence



Performing responsibly

is integral to our success and sustainability

This is the fifth year we have combined our Financial and Corporate Responsibility ('CR') reporting, demonstrating that responsible business is core to our Company. Our aim is to deliver a totally integrated approach to our reporting.



Our operational reporting framework

Natural resources

The Natural Resources division delivers engineering solutions in water, nuclear process, waste and hydrocarbons and chemicals, whilst also delivering legacy projects in education.

Water
Nuclear process
Waste
Hydrocarbons and chemicals

Infrastructure

The Infrastructure division delivers engineering solutions for principal infrastructure providers in rail, highways, power and airports.

Rail
Highways
Power
Airports

Our CR reporting framework

Relationships

We encourage open, honest and respectful communication. We believe in strong, long-lasting relationships that are mutually beneficial.

Our Environment

We operate in the built environment, where we meet national needs for strategic investment in infrastructure. We compete in the economic environment, where we must deliver value for customers and shareholders. We have to deliver responsibly to the natural environment for the benefit of everyone.

The Future

We play an important role in the provision of infrastructure vital for the UK economy. The benefits of investment in infrastructure today will be felt for many years to come.

Directors' Report – Business review

Performing responsibly
continued

Divisional performance

Infrastructure

The Infrastructure division, which incorporated activities in the highways, rail, and airports sectors, had a very successful year in which revenue (including share of joint ventures and associates) increased to £562.3 million (2011: £466.0 million) as investment in business development enabled the Group to take advantage of a number of major opportunities in the market. As a result, adjusted profit from operations rose to £26.1 million (2011: £10.2 million). The significantly improved profit performance reflects strong operating returns and additional gains on successfully completed and final accounted projects. The order book for the division has grown to £1.6 billion (2011: £1.5 billion) and the level of tendering activity remains high.

In Rail, during the period, the Group, in joint venture, secured its fifth contract with Crossrail for the construction and fit out of the intermediate shafts and headhouses at Eleanor Street and Mile End Park in London, along with the connecting adits to the main running tunnels. Work is also progressing well on the major London Bridge Station redevelopment project for Network Rail, in which Costain is providing integrated services including design, construction, logistical and environmental operations whilst ensuring the station remains open throughout.

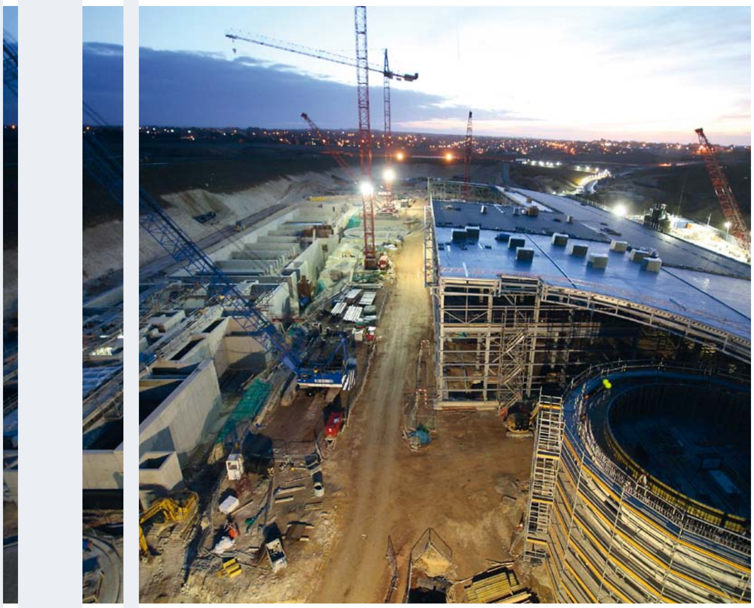
Costain continues to be a leading supplier to the Highways Agency and significant progress is being made with the large portfolio of professional services, construction and maintenance contracts in which it is engaged for this customer. New contract awards during the period under review include the upgrade of the A8 Belfast to Larne carriageway for the Northern Ireland Roads Service, appointment to both lots of the Highways Agency Asset Support Framework and a four-year technology contract awarded by the Welsh Government for the maintenance of Road Network Communications and Tunnel Systems across Wales, involving the maintenance and fault repair of complex technology systems such as CCTV cameras, variable messaging signs ('VMS'), emergency telephones and traffic signals along major strategic routes.

The Riverside Resource Recovery Energy from Waste facility at Belvedere is now fully operational and the final account has been agreed.

New wastewater infrastructure brings cleaner seas to Sussex

A new wastewater treatment works, two pumping stations, an 11-kilometre sewer tunnel and a 2.5-kilometre-long sea outfall for client Southern Water is bringing cleaner seas to the Sussex coast.

The project is being delivered by 4Delivery, a consortium made up of Costain, Veolia Water and MWH. A new sewer tunnel, bored through the local chalk, takes wastewater from Peacehaven, Telscombe, Saltdean, Rottingdean, Ovingdean and Brighton and Hove to a new wastewater treatment works. Located on the edge of the South Downs National Park, the works nestle in a dry valley and is covered by one of the largest green roofs in the UK, blending it into the surrounding landscape. Once fully operational the works will treat 95 million litres of wastewater each day to the latest EU standards.



Find out more:

2012 highlights	pages 02-05
Business model	pages 18-24
Our Corporate Responsibility framework and approach	pages 29-39

Improving the flow and efficiency of the M1

Costain is heavily involved in maximising the capacity of one of the UK's biggest infrastructure assets, the M1 motorway.

When the Managed Motorways scheme is complete in spring 2013, motorists travelling on a 15-mile stretch of the motorway between Junctions 10 and 13 will, when signs indicate, be able to use the hard shoulder as a traffic lane during busy periods – increasing capacity and improving journey times.

Costain has also recently been awarded similar contracts for Junctions 28 to 32 and Junctions 32 to 35.

Costain is involved in every stage of the programme. With a position in the Managed Motorways programme office, it manages development of the schemes, takes them through public inquiries, physically reconfigures and rehabilitates these 1950s/60s/70s assets, then provides aftercare for the carriageways.

Environment

The Environment division focused on the water and waste markets as well as the specific requirements of a number of long term customers. Customer spend in this market is underpinned by regulatory and legislative requirements and we expect this to grow over the medium and long term as the market in the UK undergoes major change.

Revenue (including share of joint ventures and associates) in the division for the year was £232.6 million (2011: £375.4 million), with profit from operations, including the profit on PFI transfers, of £15.0 million (2011: £17.5 million). The reduction in revenue has been influenced by our strategic priority on other activities in the Group. Operating profits in this division declined significantly in the period following the one-off margin benefits from successful close-out of a number of legacy issues well within our allowances in the comparative period and as a result of additional costs to complete a project. The division finished the year with a forward order book of £0.6 billion (2011: £0.8 billion), with the reduction again reflecting the Group's strategic focus on other opportunities.

In the water sector, the Group is making good progress on the AMP5 framework contracts with Northumbrian Water, Severn Trent, Southern Water, United Utilities and Welsh Water. During the period the Group was also awarded a contract by Severn Trent Water to replace its largest covered service reservoir sited near Ambergate in Derbyshire.

Costain's position in the water sector gives the Group a strong platform to win new contracts and extensions as the water sector prepares for the next regulatory review period, commencing in 2014.

In the waste sector, the Group is completing the PFI contract for the Greater Manchester Waste Disposal Authority. The majority of the facilities on the scheme, which utilises a range of sophisticated waste management technologies, have been handed over with the remainder in an extended commissioning phase and commercial discussion regarding completion continuing.

Directors' Report – Business review

Performing responsibly

continued

Divisional performance

Energy & Process

The Energy & Process division undertook work in the hydrocarbons and chemicals, nuclear process and power sectors.

Revenue (including share of joint ventures and associates) in the division for the year was £137.7 million (2011: £143.4 million) with adjusted profit from operations of £2.5 million (2011: £4.7 million). During the year, the profits in the division have been impacted by the reduced revenue, higher business development costs, restructuring costs and additional costs to complete on two projects. The division finished the year with a forward order book of £178 million (2011: £215 million).

In Hydrocarbons & Chemicals, the Group is continuing to carry out projects for a number of customers both in the UK and overseas. We have benefitted greatly from ClerkMaxwell, acquired in 2011, which is enabling us to take advantage of a number of exciting opportunities in the high growth upstream oil and gas service sector.

During the period the Group also secured a three-year £60 million asset support contract, awarded by the Oil and Pipelines Agency for the operation and maintenance of the Government Pipeline and Storage System. The additional support services capabilities afforded the Group by the acquisition of Promanex in August 2011, were instrumental in securing this contract and demonstrates the value in enhancing existing capabilities through targeted acquisition.

In Nuclear Process, we continued to make good progress during the course of the year in our various projects across the UK, including Evaporator D at Sellafield, one of the UK's largest nuclear decommissioning projects, which has seen the delivery of further modules to site during the period. The Group was also appointed, as one of two suppliers, to the Magnox framework contract, for the delivery of construction, infrastructure and maintenance projects across all ten sites which are operated by Magnox on behalf of the Nuclear Decommissioning Authority. The project work which Costain will deliver includes: the design, construction and maintenance of permanent buildings and structures, infrastructure maintenance and extension works incorporating construction, civil engineering structures and ground works projects.

In Power, the Group continues its work with the Energy Technologies Institute, developing carbon dioxide reduction technology for use in coal fired power stations, a critical factor in the UK's ability to meet its stated climate change targets.

Land Development

Our non-core Land Development activity in Spain continued to be subject to challenging market conditions. Revenue was £1.9 million (2011: £1.5 million) and the loss after tax was £2.3 million (2011: £2.0 million). As anticipated, no significant land sales were completed in the year and we continue our moratorium on development activity on our land-bank until the market improves and maximum shareholder value can be secured for the assets. Our activities during the year have been focused on our leisure businesses of golf courses and our 600-berth yacht marina adjacent to Gibraltar which has reported increased levels of activity during the year.

Our Corporate Responsibility framework and approach

Our approach

We are committed to delivering projects and services responsibly and sustainably, ensuring that we meet our customers' and society's needs while managing the social, environmental and economic impacts of our business.

We recognise that by working with our customers, supply chain partners, employees and other stakeholders we can make a greater contribution to a more sustainable society.

The Board is responsible and the Executive Board is accountable for all aspects of Corporate Responsibility ('CR'), including setting policy and strategy and providing leadership to drive our CR programme. We have established CR champions, consisting of directors and senior managers with direct responsibility for key aspects of our CR performance. Every employee is expected to work in a responsible and sustainable way.

Listening to our stakeholders

We have a wide range of stakeholders, including customers, joint venture partners, supply chain partners, employees, investors, regulators, government, community and environmental groups and other interested parties. The views of our stakeholders inform and guide our policies and reporting. For more information on how we engage and respond to our stakeholders, please see our website **www.costain.com**

Your comments are important to us and we would welcome your feedback. Please visit our website and complete a short online survey at **www.costain.com/responsibility**, or, email us at **corporate.responsibility@costain.com**

Key responsibilities

There is a wide range of social, environmental and economic issues that impact our business, either directly or through our supply chain. Through stakeholder engagement and by assessing our impacts and level of influence, we have identified issues that are material to our business. In 2011 we launched Costain Cares, our Corporate Responsibility strategy and vision to build a longer-term sustainable business that creates economic, environmental and social value. Costain Cares is based on three fundamental pillars:

Relationships

We encourage open, honest and respectful communication. We believe in strong, long-lasting relationships that are mutually beneficial.

Our Environment

We operate in the built environment, where we meet national needs for strategic investment in infrastructure. We compete in the economic environment, where we must deliver value for customers and shareholders. We have to deliver responsibly to the natural environment for the benefit of everyone.

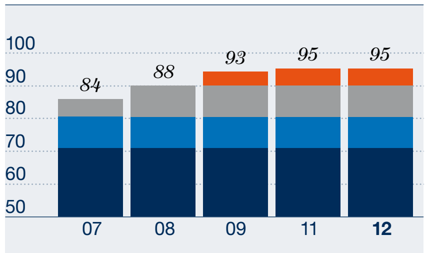
The Future

We play an important role in the provision of infrastructure vital for the UK economy. The benefits of investment in infrastructure today will be felt for many years to come.

Measuring our performance

We measure our performance and benchmark ourselves against our peers and other companies in the wider marketplace by participating in Business in the Community ('BITC') CR Index. The CR Index illustrates how companies integrate responsible business at strategic and operational levels. In June 2012, we received the results of the BITC CR Index 2012 and are proud to have retained Platinum status, achieving 95%. Our BITC CR Index feedback report is available to download on our website.

Business in the Community Responsibility Index performance and band thresholds
%



■ Bronze ≥ 70.00%
■ Silver ≥ 79.76%
■ Gold ≥ 89.76%
■ Platinum ≥ 94.76%

In 2011, BITC renamed the CR Index 2010 as CR Index 2011 to reflect the year the results were published.

Directors' Report – Business review

Performing responsibly

continued

Costain Cares

Relationships

We encourage open, honest, respectful communications. We believe in strong, long-lasting relationships that are mutually beneficial.

BeSafe

Health and Safety: providing a safe working environment free from harm

The Health and Safety of our workforce are of paramount importance. We are committed to providing a safe working environment, where the health and wellbeing of our people are both protected and actively promoted.

In 2012, we achieved an Accident Frequency Rate ('AFR') of 0.09, which represents a reduction of 18% over the previous year and a 47% reduction over the last five years.

We are dedicated in our drive towards zero accidents and incidents. We focus this drive on the following three areas: compliance, competence and culture.

Group annual Accident Frequency Rate

Number of reportable accidents per 100,000 man-hours

0.09

Group AFR, a 47% reduction in the last five years

Compliance

Health and Safety management

Our Health and Safety management system is accredited to BS OHSAS 18001. This provides our stakeholders with the reassurance they need that our system meets and exceeds the requirements of all relevant Health and Safety legislation, codes of practice and guidelines.

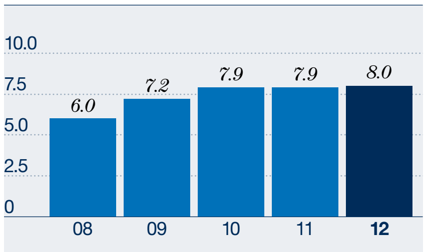
Our standards are maintained by continually monitoring compliance to systems and benchmarking performance through an established audit and inspection regime, undertaken by both external parties and our own Health and Safety professionals. All findings are reviewed at the highest level and where necessary changes are made to our policies or procedures, or innovations captured and implemented Company-wide in the spirit of continual improvement.

In March, Costain was prosecuted in respect of an accident that occurred on the A2/M25 site on 8 April 2008. The Company pleaded guilty to breaching Section 2(1) of the Health and Safety at Work Act 1974 and was fined £250,000 plus £45,000 costs. Following the judgement, work stopped on all sites to enable a safety stand-down to be conducted with a view to disseminating the lessons learnt across the Costain business to try to ensure that a similar situation is never experienced again on one of our sites. The stand-down focused on raising awareness of behavioural issues, and in particular the impact of behaviours on our safety, health and environment ('SHE') performance. In addition the managing director for the Infrastructure division and the Group SHE director undertook a series of briefings at various Costain forums to reinforce the message to all operational management.

In October, a Prohibition Notice was served on Costain relating to confined space working on our Tier 1 COMAH site at Purton in contravention of Section 3(1) of the Health and Safety at Work Act 1974 and Regulation 4 of the Confined Spaces Regulations 1997. Immediately following the notice, all works ceased on the site concerned to enable our procedures to be reviewed and strengthened. Suitable control measures were subsequently implemented at Purton and all other sites within the framework and the notice was lifted six days later when work recommenced under the new safe system of work.

Group average score in monthly SHE scored inspection

Score



8.0

Group average SHE performance score

Process safety management

In 2012, we reviewed and strengthened our process safety management systems which now align to the industry-recognised Energy Institute framework. In addition members of our PLC and Executive Boards attended process safety awareness training sessions.

Find out more:

2012 highlights	pages 02-05
Business model	pages 18-24

Relationships continued

Management of road risk
An enhanced procedure for the management of road risk was drawn up in 2012. This included the launch of an online drivers' risk assessment tool in June. Under the new regime all Costain personnel who are engaged to drive on Company business are required to undertake a risk assessment and, dependent on the resultant risk rating, may be required to agree a course of action with their line manager to control the degree of risk that may exist while driving.

In 2013 we will continue to develop our systems and processes relating to transport logistics and will be launching a minimum standard for specific types of vehicle that access our sites.

Competence

A safe site is one where all workers are qualified to carry out the tasks to which they are assigned. For this reason we insist on a fully qualified workforce and provide ongoing training and development for both our own employees and those of our supply chain partners.

The role of front-line supervisors is a key factor in improving Health and Safety performance, and in September we dedicated a week-long campaign to supervision in the workplace. A total of 562 front-line supervisors, across the Group, took part in the event. The aim of the initiative was to achieve a premier standard of front-line supervision performance through the use of a number of techniques including workshops, assessments and feedback sessions.

Culture

We promote a culture where our managers are expected to lead by example and our people are expected to demonstrate personal leadership in Health and Safety. Our values of teamwork and accountability actively encourage our workforce to engage and interact with their colleagues, customers and supply chain partners alike so that we learn from one another, explore different methods of working and promote best practice and innovation.

During 2011–2012, 127 directors and senior managers attended a two-day 'Leading Safety, Health and Environment in Costain' course. All attendees subsequently developed an individual leadership action plan by assessing their own leadership performance against the criteria set out in the Institute of Directors safety leadership guidance.

Our ongoing drive to improve the Health and Safety culture within the Group continued during 2012 with the development and delivery of a bespoke Health and Safety course aimed at middle management. Further courses are planned for 2013 as we continue to cascade our Health and Safety leadership principles throughout our business.

In 2012, all Costain operational directors were required to carry out a minimum of six engagement tours, the primary focus of which was to enter into discussions with the workforce regarding site Health and Safety issues while also checking physical conditions on site. In 2013, we have set a target for all our operational directors to receive 360-degree feedback from their direct reports on their leadership style. Subsequent personal leadership improvement plans will be developed.

Following third-party accreditation in 2011, we continued to promote our Costain Behavioural Safety Programme ('CBS') during 2012. The aim is to significantly influence the delivery of sustained safety improvements which focus on safety leadership and the development of a culture where the people who work for us do the right things 'because they want to'.

Building on the internal success of CBS, we have developed a behavioural safety and management consultancy and are currently engaged with a number of external clients in supporting them to deliver their own behavioural safety programmes.

In 2013, we will be using the behavioural science principles of our CBS programme to develop and enhance our approach to and delivery of our business and quality systems.

We continue to build on our already well-established links with our supply chain, which we consider to be fundamental to the smooth running and safe delivery of all our operations. In 2012, biannual Health and Safety meetings were held with our preferred subcontractors in seven different disciplines. These meetings have provided an effective forum for an exchange of views and the sharing of best practice and lessons learnt with our strategic partners.

Directors' Report – Business review

Performing responsibly

continued

Costain Cares

Relationships continued

BE HEALTHY

Health: providing a healthy working environment for all our people

The health and wellbeing of our people remained a key focus area during 2012. Our ongoing 'Be Healthy' campaign was enhanced in the spring with the development of a logo which now appears on all health-related documentation.

Our vision is to provide a working environment which impacts positively on the health of our workers. Our health management system is focused on the prevention of work-related ill-health and the protection of workers with existing health conditions. In addition, the wellbeing and good health of the workforce is actively promoted and maintained.

We continued to offer voluntary wellbeing medicals to all staff during the year, and have introduced a monthly wellbeing clinic in our head office, which is open to employees working in local sites as well as all head office staff. The take-up of these medicals increased during the year as employees recognised the value and benefits of regular health checks.

Our proactive approach to health promotion was maintained in 2012 with the introduction of blood pressure testing kits at all sites and offices to enable all members of the workforce (including our subcontractors) to regularly test their own blood pressure. In addition, we ran a skin cancer awareness/summer working campaign Company-wide with support from Macmillan Cancer Support.

Furthermore, Costain signed up to the Public Health Responsibility Deal, a Department of Health initiative which taps into the potential for businesses and other organisations to improve public health and tackle health inequalities through their influence over food, physical activity, alcohol and health in the workplace. As a Responsibility Deal partner, we have signed up to five core commitments and supporting pledges and have made an individual pledge within the Health at Work category which relates to health checks for staff.

During 2013, we will continually review the management of health and wellbeing in the workplace as we strive to raise standards further. Our proactive stance with regard to health promotion in the workplace will continue with the delivery of regular themed campaigns, for example the issuing of pedometers which are aimed at encouraging our workers to exercise and thereby improve health and fitness in a sociable and enjoyable way. We will also continue to work closely with external organisations such as the UK Contractors Group and the Rail Safety and Standards Board with a view to sharing best practice and raising standards.

In December, Costain organised a STEM event which gave over 240 pupils an insight into civil engineering, pictured are pupils from St James Junior School who took part in the Bridges to Schools event.

Find out more:
2012 highlights pages 02-05
Business model pages 18-24

Relationships continued

Communities: supporting the local communities in which we operate, ensuring we leave a lasting legacy

We recognise that our work affects the communities in which we operate. How we manage our relationships and work together with these communities and other stakeholders is vital. We are committed to developing and maintaining excellent relations with local communities.

We strive to minimise the negative aspects of our work, such as noise and disruption, and our goal is to have a greater positive impact, by focusing on the following key areas:

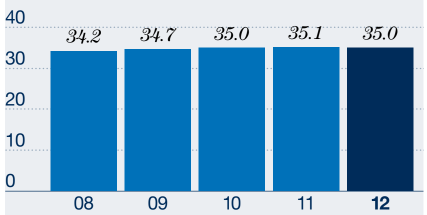
- Community engagement
- Local employment and skills
- Charitable giving and volunteering.

Community engagement

In 2012, 86% of our projects developed and implemented community engagement plans, which identify specific socio-economic issues associated with the local community, note the positive impacts that Costain makes, and develop an action plan to work in partnership with the local community.

As an associate member of the Considerate Constructors Scheme, we are committed to the principles set out in the Considerate Constructors Code of Considerate Practice. In 2012, the Group achieved an average score of 35 out of 40. The average score of all sites registered with the scheme is approximately 33.2 (December 2012). In addition, our performance was recognised by the receipt of 17 Awards from the Considerate Constructors Scheme: four Gold Awards, four Silver Awards and nine Bronze Awards.

Considerate Constructors Scheme performance
Group average score



35
Average score in the Considerate Constructors Scheme

Local employment and skills

We work with a range of partners and organisations to offer employment and training opportunities in the communities in which we work. We are a patron of The Prince's Trust, the youth charity that helps change young lives, and a member of the Trust's Construction and Business Services Leadership Group. The Trust works with 13 to 30-year-olds who have struggled academically, have been in care, are long-term unemployed or have been in trouble with the law.

Proud to be a Patron of **The Prince's Trust**

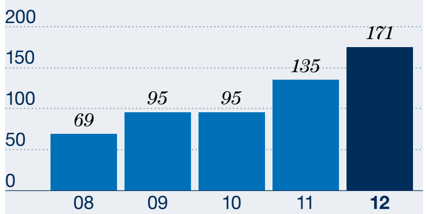
In 2012 Costain, in collaboration with CITB-ConstructionSkills, the National Skills Academy for Construction and The Prince's Trust, secured Employee Ownership of Skills ('EOS') funding, matched to the value of £600,000 over two years. With this matched funding, Costain will provide 100 opportunities for individuals to undertake a three-week 'Get Into Construction' programme during 2013–2014.

Charitable giving and volunteering

We continue to support various charities both corporately and through local donations given by our project teams. In 2012, we donated £171,142 to worthy causes, including a donation of £22,000 to Great Ormond Street Hospital's 'Raising the Roof' appeal, which went towards upgrading the hospital's world-renowned neuroscience centre.

Through our employee volunteering policy, we provide our employees with the opportunity to develop and share skills while making a visible and sustainable difference to local communities. In 2012, our employees volunteered a total of 27 days and we are committed to continuing this support in 2013.

Group charitable donations
£000



£171,142
Donated to charitable causes in 2012

Our People: attracting, retaining and developing the best people for the Costain Group

Costain Group continues to grow and now employs 3,740 people in the UK and 1,026 people in the Middle East. We have a relatively stable workforce, with 49% of staff having been with us for over five years and our voluntary staff turnover for 2012 was 7.37%. We filled 154 vacancies last year, 56% of them through internal placements, ensuring a mix of employee career progression and bringing new employees into the organisation.

Directors' Report – Business review

Performing responsibly

continued

Costain Cares

Relationships continued

Employee (voluntary) turnover rate[1]

%

[1] UK employees

7.37%

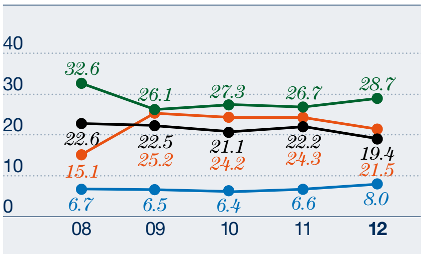
Employee (voluntary) turnover rate

Building a diverse workforce

We recognise the value of a diverse workforce and ensure that all people activities continue to be inclusive and that we provide fair access to and participation in training, promotions, reward and recognition. We have monitored our diversity profile over the last five years. This year, our statistics include acquisitions, which have resulted in a slight decrease in the proportion of female employees to 19.4% (construction industry female average: 13%, UK Contractors Group ('UKCG') average female: 16%) and an increase in Black, Asian and Minority Ethnic ('BAME') employees to 8.0% (construction industry BAME average: 5%, UKCG average BAME: 6%). While these figures compare favourably to the industry average, we are not satisfied with this and our focus for 2013 will be on encouraging more women and BAME people to join Costain. In 2012, Costain became a member of Business in the Community's 'Opportunity Now' campaign, to share ideas with other industries to improve the attraction and retention of women in the workplace. Opportunity Now empowers employers to accelerate change for women in the workplace.

Diversity profile[1]

% employees



Female
BAME
Over 50
Under 30
[1] UK employees

19.4%

Of our people are female, 8.0% are BAME

Developing talent

We continue to invest in training and development for all our staff, delivering a total of 7,988 training days in 2012, covering technical and behavioural skills and a range of qualification levels. In October, over 120 leaders at all levels within the Company, from the Board to front-line supervisors and trainees, attended a Costain leadership development day, creating an opportunity to engage and develop common leadership styles across the Group.

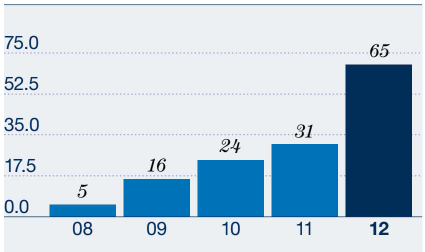
Costain is now actively working with four sector skills academies, covering rail, power, nuclear and construction. We are working with the academies to develop skills and competencies to ensure we can meet the evolving needs of our customers.

In 2012, we expanded our commitment to the Costain Project Management Academy, accredited by the Association of Project Management ('APM'), supporting 20 of our project managers who are targeting registered project professional status with the APM. Costain is currently one of only four organisations with ten or more registered project professionals in the UK.

Part of our ongoing strategy is to increase employment opportunities for young people, and we continue to invest in our graduate and apprentice programmes. During 2012, we welcomed 38 new graduates from eight discipline areas, bringing our current scheme total to 120. This year we have placed increased focus on our apprentice schemes and have seen a doubling in the number of apprentices. We currently have 65 apprentices on Level 3 frameworks across 11 disciplines, including new areas such as track and signalling, tunnelling operation, business administration and accounting.

Apprentice totals

Number of Costain apprentices



65

Apprentices on our apprenticeship programme

We are aware of the need to encourage young people to take an interest in science, technology, engineering and math ('STEM') skills and we are encouraging all our graduates and apprentices to become STEM ambassadors and to use their volunteer days to go into schools and encourage young children to take an interest in these subjects. Please see page 39 for more information on our work developing skills for the future.

Find out more:

2012 highlights	pages 02-05
Business model	pages 18-24

Relationships continued

Employee engagement

Engaging effectively with our people is crucial to the success of our business. The views of our employees are extremely important and we want our people to feel valued, listened to and rewarded. We run a biennial employee engagement survey to understand the opinions of our employees, gain feedback and target areas where improvements can be made. In 2012, we continued to act on the results of our 2011 survey.

Our employees told us we needed to improve some forms of communication across the business. As a result we have updated our methods of communication, embracing social media (for example Twitter) and implementing internal online networking forums, where employees are encouraged to share their ideas and ask for or offer support.

Feedback from employees also identified performance management as an area for further improvement. In 2011 and 2012 we provided performance management and leadership training to over 150 managers. As a direct result of this training there was a shift in our performance review scoring, demonstrating that our managers are improving their performance appraisal skills. We surveyed the direct reports of the managers who received the training and were pleased that their overall engagement scores increased by 6%.

Our next employee engagement survey will take place in 2013.

Reward and recognition

In the last 12 months, we have recognised 293 employees through formal promotion and have facilitated the career development of a further 447 employees through implementing cross-project and cross-sector transfers to enable them to broaden their experience and capabilities. We have been developing career paths and benchmarking roles externally to ensure that we have a robust career and grading structure in place, in order to improve visibility of career progression and to ensure we are rewarding our employees competitively in the current marketplace. The career paths will be rolled out during 2013.

In February 2013, we hosted our Achieving Excellence Awards to recognise and celebrate the outstanding performance and contributions of individuals.

Customers: providing sustainable solutions and the highest standards of service for our customers

Our aim is to provide sustainable, innovative solutions and the highest standards of service to our customers. We constantly strive to improve our performance and actively seek feedback from our customers.

We undertake regular customer satisfaction surveys, where we ask our customers to rate our performance against core values such as safety, health and environment, quality, delivery, subcontract management and relationships. In 2012 we achieved an average score of 84%.

Customer satisfaction score
%

84%
Group average customer satisfaction score

Supply chain: operating a collaborative, responsible supply chain where our partners support us in delivering efficient, innovative and sustainable solutions

We understand the impact of our procurement activities and are committed to the responsible management of our supply chain and the economic, environmental and social issues within it. We ask our suppliers to share our values and standards and to support us in delivering efficient, innovative, sustainable solutions. In turn, Costain is committed to engaging and supporting its supply chain to ensure compliance, continuous improvement and the achievement of mutual goals.

Costain celebrates the achievements and outstanding performance of its people at its Achieving Excellence Awards 2012.

Directors' Report – Business review

Performing responsibly

continued

Costain Cares

Relationships continued

Supply chain management

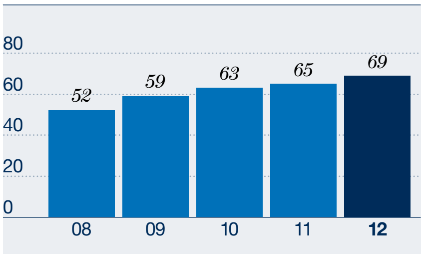
During 2012, our focus was to strengthen the supply chain, ensuring that the identified companies were sustainable businesses procured in a uniform and responsible manner, particularly in relation to industry-recognised social and ethical trading standards/initiatives. In 2011, Costain introduced an accreditation scheme for assessing the capabilities and values of a supplier. During 2012, the percentage of our strategic and preferred supplier base accredited to the scheme increased to 90%, from 59% in 2011. An added benefit of implementing the scheme is the facility to track and analyse the percentage of suppliers that have achieved specific standards.

Effective engagement and two-way feedback are essential to ensure that we perform as one team. We monitor and measure our own performance biannually via 360-degree feedback reviews requested from the elected Top 100 supply chain. The results are analysed to identify the formation of trends or cultures, which are addressed accordingly. In 2012, 203 reviews were received, which collectively gave Costain a feedback review score of 79.7%.

We undertake regular performance reviews with our supply chain, discussing issues such as supervision, competency, communication, teamwork, cost, quality, innovation, safety and environmental performance. Suppliers and project management are encouraged to conduct the performance review jointly to ensure the performance of our supply chain is accurately represented. This allows both parties to have an input. During 2012, 1,160 performance reviews were conducted on our Top 100 and other business-critical supply chain members, resulting in an average score across the Group of 69% (2011: 65%). We were pleased to note that the number of suppliers achieving the 'Costain Blue' standard (a minimum score of 80% in an individual performance review) increased to 171 from 115 in 2011.

Supply chain performance

%



33%

Increase in supply chain performance over the last five years

Supply chain engagement

In April 2012, we held our third supply chain conference at Warwick University, attended by 160 senior representatives of our supply chain partners and 50 of Costain's senior management. The conference offered a chance for suppliers to hear about the future of working with Costain and to participate in a Q&A session with a panel consisting of Costain senior management.

Responsible procurement

Responsible procurement for Costain means leading socially, environmentally and economically responsible procurement to deliver value and benefits to stakeholders.

We have adopted the UK Government's Flexible Framework as the method through which we will develop our approach and measure our progress. We have set a target to achieve Level 3 of the Flexible Framework in 2013 and Level 5 by 2015.

In 2013, we will identify five key sustainability focus areas that we will promote within our Top 250 suppliers, setting timescales for them to meet a required standard in these areas.

To ensure our procurement staff approach responsible procurement in a uniform manner, our commitment in 2013 is to deliver responsible procurement training to all our procurement personnel.

In September, we launched the Costain supply chain academy, a new initiative that aims to support and develop small to medium-sized enterprises ('SMEs'). The Company welcomed 15 suppliers to the academy, where representatives attended 19 learning modules covering business administration, commercial and financial best practice, insurance, Health and Safety, behavioural safety and quality.

Find out more:

2012 highlights	pages 02-05
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Overview
Business review
Corporate Governance
Financial statements
Other information

Our Environment

We have to deliver responsibly to the natural environment for the benefit of everyone.

Our Environmental Management System ('EMS') is accredited to the international standard of environmental management ISO 14001:2004. The Group Environmental Policy Statement outlines our intention to ensure we manage all our work and its impacts effectively, prevent pollution and continuously improve the operation and environmental management of our activities.

Our commitment is to work with our customers and supply chain to, where possible:

- reduce our impact on climate change;
- conserve natural resources through effective waste management, minimising water consumption and sustainably sourcing materials; and
- protect and enhance the environment.

Climate change

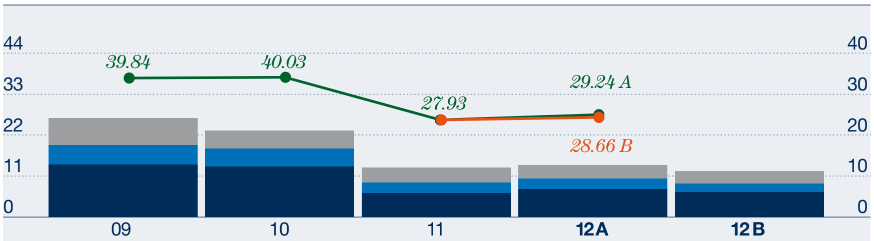
We remain committed to reducing our measured carbon emissions and, in 2012, demonstrated significant improvements in the management of climate change and our overall performance. We achieved external accreditation to the Achilles Certified Emissions Measurement and Reduction Scheme ('CEMARS'), accrediting our data from 2009 to 2011. This highlights our ongoing dedication to accurate carbon emissions reporting and disclosure, in addition to reducing our emissions. The CEMARS standard includes independent verification of our data and a yearly review to ensure we continue to deliver reductions in emissions. Our method of reporting is in accordance with, and certified against, ISO 14064-1:2006 and is also in line with the Carbon Reduction Commitment Energy Efficiency Scheme reporting guidelines.

As a result of this verification and increased accuracy in our data we have reviewed and updated our climate change strategy and associated targets. Our restated target is to achieve a 55% reduction in carbon emission intensity by 2020, compared with 2009, and to work with our customers to provide them with low-cost low-carbon solutions.

In 2012, we demonstrated a reduction in our absolute emissions compared with 2009. We further expanded our carbon footprint and associated boundaries to include 2011 acquisitions, their associated activities and turnover. As can be seen from the graph below, this has increased both our emissions intensity and our absolute emissions compared with 2011. While the intensity figures are normalised against turnover, the activities are different and, therefore, an increase is reported. In 2013, we will further expand our footprint to include joint ventures and international operations.

In 2012, we continued to engage the business on climate change, raising awareness among our employees through dedicated energy awareness weeks, sustainable transport plans for offices and projects, and the promotion of case studies.

Costain certified CO_2 emissions by scope and emissions intensity
'000 tCO_2e/tCO_2e per £m turnover



■ Scope 3 – Indirect emissions such as employee business travel (not included in Scope 1), emissions from water usage and waste disposed of at landfill
■ Scope 2 – Indirect emissions such as electricity
■ Scope 1 – Direct emissions such as fuel combustion, company owned or leased vehicles
■ Emissions intensity (tCO_2e/£M1) – 2012 A carbon footprint: new reporting boundary including 2011 acquisitions
■ Emissions intensity minus acquisitions (tCO_2e/£M1) – 2012 B carbon footprint: 2011 reporting boundary

Figures are reported in accordance with ISO14064-1:2006 and reflect UK operations within Costain's direct operational control.

27%

Reduction in measured emissions intensity, compared with 2009

Directors' Report – Business review

Performing responsibly

continued

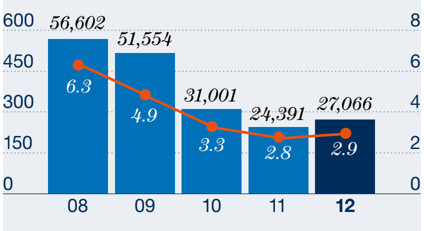
Costain Cares

Our Environment continued

Natural resources

We continue to focus on waste management and the reduction of waste produced from all our activities.

Construction waste removed from site
'000 tonnes of waste/ tonnes per £100,000 turnover

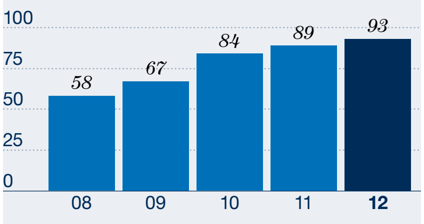


Tonnes of waste removed from site
Tonnes per £100,000 turnover

Figures are reported in accordance with WRAP Waste Measurement and Reporting Guidance. Turnover figure reflect operations reporting waste. 2008–2011 figures relate to UK operations excluding MAC joint ventures and 2011 acquisitions. 2012 figures reflect all operations but exclude our MAC 10 joint venture and Alcaidesa operations and the associated turnover.

53%
Reduction in construction waste, compared with 2008

Waste diverted from landfill
%



Figures are reported in accordance with WRAP Waste Measurement and Reporting Guidance. Turnover figure reflect operations reporting waste. 2008–2011 figures relate to UK operations excluding MAC joint ventures and 2011 acquisitions. 2012 figures reflect all operations but exclude our MAC 10 joint venture and Alcaidesa operations and the associated turnover.

93%
Waste diverted from landfill

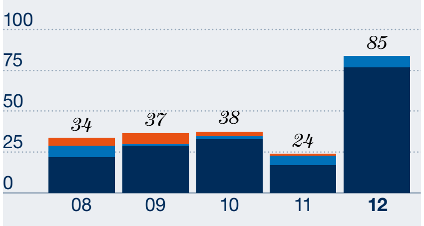
We successfully met our 2012 target, increasing the waste diverted from landfill to 93%. In 2008, the Group pledged its support to the Waste & Resources Action Programme ('WRAP') 'Halving Waste to Landfill' commitment, setting a target to achieve a 50% reduction in the total tonnage of construction, demolition and excavation waste we sent to landfill by 2012. By 2012, we had vastly exceeded this target by reducing the total tonnes of waste we send to landfill by 92% compared with 2008.

We continue to train key personnel in environmental management, in particular responsible procurement, materials procurement and waste and materials management. This training provides advice, guidance and knowledge to individuals dealing with waste and materials on a day-to-day basis.

Obtaining a greater understanding of our water consumption continues to be a key focus for the Group. Water monitoring and measurement have commenced on a number of our projects and we continue to develop our reporting process to improve the capture of information across the business, so that we are able to report on our water consumption in 2013.

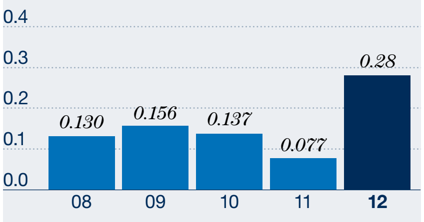
Protecting the environment

Environmental incidents
Number of incidents



Number of major incidents
Number of significant incidents
Number of minor incidents
As defined by Costain.

Environmental incident frequency rate
Number of environmental incidents per 1,000,000 man hours



We are committed to minimising our impact on the environment by ensuring, where possible, that our activities do not result in damage and that we reduce our overall environmental incidents year on year. We ensure that all environmental incidents are reported and investigated to capture lessons learnt and prevent recurrence.

Our reported environmental incidents and the associated environmental incident frequency rate ('EIFR') have increased in 2012. In 2011, we reviewed our definition of environmental incidents to align our reporting procedure with that of our customers and the regulator, and have continued to strongly promote the reporting of incidents. While our reported EIFR has increased in 2012 compared with 2011, we attribute this to an increased awareness and reporting of incidents. No major incidents have been reported in 2012, compared with one in 2011, and no environmental prosecutions, cautions or notices were received.

To improve environmental awareness across the industry, Costain contributed to the development of an industry environmental awareness course, the Site Environmental Awareness Training Scheme ('SEATS'), for supervisors and managers. The scheme will be launched in 2013 and will be formally accredited to CITB-ConstructionSkills.

Find out more:

2012 highlights	pages 02-05
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The Future

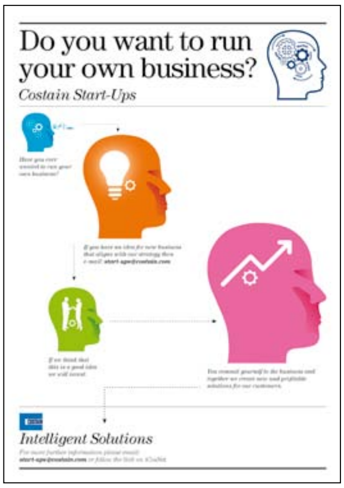
We play an important role in the provision of infrastructure vital for the UK economy. The benefits of investment in infrastructure today will be felt for many years to come.

Developing skills for the future

We recognise the importance of engaging with schools, colleges and universities to ensure we attract young talent into our organisation, build a sustainable pipeline of talent for the future and support local communities where we operate.

Through our Engineering Futures programme, we aim to raise the awareness and aspirations of young people to find out more about careers in engineering and related industries. We have numerous ambassadors across the Group who volunteer their time to go into schools to inspire young people in STEM subjects. In addition, we offer inspirational work experience to young people, aiming to make their experience of the world of work more accessible and meaningful. In 2012, we supported over 90 work placement opportunities and were delighted to be rewarded by being voted 24th in the National Placement and Internship Awards 2012. We have set a target to increase the number of work experience placements we offer across the Group in 2013.

We continue to grow and expand our apprenticeship programme, with 65 apprentices on Level 3 frameworks across 11 disciplines. In 2012, we also undertook a campaign to promote apprentices within our supply chain, setting a target of 150 apprentices within Costain and our supply chain by the end of the year. We have achieved a total of 169 apprentices across the Group and within our supply chain.



Innovation

Innovation underpins our strategy and will contribute to our growth, productivity and competitiveness. We are committed to providing intelligent solutions to our customers that will help them achieve their ambitions and aspirations.

In June, we launched Costain Start-ups, a new initiative which creates and supports innovative business ideas from across the Company. Employees are invited to submit their innovative business idea; if it is chosen, the Company will invest in their idea and provide the necessary resources to make it a reality. That could mean help with finance, HR and legal issues as well as the technical advice needed to bring the idea to life. If successful, the candidate will be given the opportunity to work on their idea on a full-time basis in order to develop it and get it off the ground.

Contribute to economic growth supporting our supply chain, including small and medium-sized enterprises ('SMES')

We are committed to ensuring that our supply chain is accessible to a diverse supplier base, including SMEs, and that we support SMEs within our supply chain, empowering them to achieve their potential.

In recognition and support of this aim, in September Costain opened its supply chain academy, a new initiative that aims to support and develop SMEs and to align the Company's supply chain partners with the high standard of training and development adopted across the Group. The Company welcomed 15 suppliers to the first academy, where representatives attended 19 learning modules covering business administration, commercial and financial best practice, insurance, Health and safety, behavioural safety and quality. A further two intakes are planned for 2013.

Costain Cares: our vision for 2014

In 2011, we launched our Corporate Responsibility strategy, Costain Cares, which sets out our vision for 2014, and 2012 targets against which we measure our performance and drive continual improvement. We achieved 76% of the 2012 targets and have developed targets for 2013 to drive further improvements and deliver our 2014 vision.

For more information and to download a copy of our Costain Cares vision, please visit our website at **www.costain.com**

76%

CR targets achieved in 2012

Directors' Report – Business review
Principal risks

Managing risk

Strategic and Financial Risk

Risk and Impact	Mitigation
Economic outlook The uncertain outlook for the UK and global economy continues. The extent of any changes to government and international regulation, taxation and interest rates, may also impact the Group's ability to win work and deliver forecast returns. The uncertain economic outlook also affects our customers' ability and confidence to place orders, potentially impacting the Group's level of opportunities.	The Group regularly monitors the pipeline of opportunities available and develops relationships with customers across a range of markets in both the private and public sectors. The Group has set out a clear strategy to target customers whose spending plans are driven by national need, regulatory commitments or essential maintenance requirements. The Group continues to broaden its offer in its key sectors.
Change of Government Policy on spending Certain of the Group's operations are dependent on government policy with regard to improving public infrastructure and services. Any reduction in government investment and funding would be likely to affect the Group's future revenues and profitability adversely.	Key factors that may affect Group strategy are kept under regular review by senior management and action taken where potential future workload shortfalls are identified. The Group continues to liaise with government bodies, showcasing a wide range of innovative ideas to demonstrate the business as a solution provider.
Competition The failure by the Group to compete effectively, resulting in a failure to win work in a competitive market, could reduce the Group's revenue, profitability and cash flow.	The Company's strategy of targeting customers with committed long-term capital and operational spending plans will enable us to continue to pursue and win work less affected by the downturn. The Company's ongoing drive, both organically and by acquisition, to broaden its services across engineering consultancy, construction and operations and maintenance, and to provide innovative cost-effective solutions, will also provide it with a competitive edge.
Pension liabilities The Group operates a defined benefit scheme which was closed to new members from 1 June 2005 and was closed to future accrual on 30 September 2009. The current deficit on the scheme is £51.9 million net of deferred tax. If the market value of the scheme's assets decline in relation to its assessed liabilities, the Group may be required to increase its cash contributions to cover funding shortfalls which could have an adverse impact on the Group's operational results.	The valuation under IAS 19 for the scheme as at 31 December 2012 valued the scheme's assets at £558.8 million and liabilities of £610.7 million. An actuarial valuation of the scheme as at 31 March 2010 was concluded during 2010 and Costain agreed a deficit recovery plan with the Trustee. The next actuarial valuation is due on 31 March 2013. The value of the deficit recognised in the Group's balance sheet pursuant to IAS 19 is dependent on certain critical assumptions, including mortality rates, pension increases, investment returns and inflation and is likely to vary from year to year. The Company reviews the options regarding what actions Costain can take to mitigate its long-term risk and consults professional advisers as necessary.
Acquisitions 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.	Full due diligence is carried out before any acquisition is made. Integration plans are put in place and managed by a dedicated team.

Find out more:

Chairman's statement	pages 06-07
Chief Executive's review	pages 14-17
Group Finance Director's review	pages 44-47
Corporate Governance	pages 50-76

Operational Risk

Risk and Impact	Mitigation
Operational delivery Failure to follow best practice guidelines could mean that projects are not delivered to time, cost, quality or appropriate Health and Safety and environmental standards and therefore do not meet customers' expectations. Failure to follow Company standards, policies, procedures and guidelines could adversely affect the Group's reputation and/or expose the Group to financial liabilities and adversely affect the operational, financial and share price performance.	To mitigate the cost risk, experienced and qualified staff are used to prepare bids, which are subject to internal review and approval before submission. During the life of the contract, regular project manager's report meetings and end forecast meetings take place to discuss safety, progress, quality, cost, financial performance, risk, etc. Work on site is audited by in-house specialists and reports 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. The senior executive is also responsible for reviewing and updating our procedures in line with the changing business. Regular Health and Safety visits and on site training take place to reduce the risk of human error. Any breaches in procedures are reported quickly and acted upon as appropriate. Employees are encouraged to take responsibility for safety in their work areas.
Loss of IT systems/Key Documentation Failure of IT systems, inability to manage and/or to integrate IT systems, as well as the failure to store key documentation securely, could cause financial loss to the Group and expose the Company to breaches of legislation and fines.	A senior executive is responsible for the IT systems and has a suitably qualified team in support. Critical areas are subject to testing and include rapid recovery as well as sound data backup procedures. Online security training is provided for safe usage and storage of documentation.
Subcontractor/supply chain and customer failure If a subcontractor, joint venture partner or supplier of goods or services fails financially or is responsible for late or inadequate delivery or low quality work, it could damage the Group's reputation and/or cause it to suffer financial losses. If a customer fails financially, the Group could suffer financial losses.	The Company seeks to ensure that it is not over-reliant on any one subcontractor, supplier or joint venture partner. In addition, the Company maintains a list of preferred subcontractors and suppliers which is reviewed regularly. The Company also undertakes financial monitoring of subcontractors and suppliers and endeavours to maintain a dialogue with them in order to identify any issue or cause for concern. The Company has in use an external audit system to ensure compliance by our preferred and strategic suppliers. The Company focuses on targeting and working with blue-chip customers in sectors whose spending activity is underpinned by strategic national need, regulatory commitments or essential maintenance requirements.
People Failure to attract, develop and retain highly skilled management or personnel may limit the Group's ability to grow the business as anticipated.	The Company has in place a well-developed succession planning process which is regularly monitored. This process includes carrying out 'talent reviews' and encouraging ongoing development at all levels. The Company seeks to actively engage with employees through engagement surveys and its Employee Consultative Committee. Pay and conditions of employment are also regularly reviewed against the prevailing market and benchmarked against competitors to ensure that the Company remains competitive at all levels.

Directors' Report – Business review

Key performance indicators

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

The Board considers that the following Non-financial and Financial key performance indicators ('KPIs') are the most effective measures for monitoring its objectives:

Non-financial KPIs

Accident Frequency Rate ('AFR')

Target:
To continually improve safety performance with a zero tolerance approach

2012	2011	2010
0.09	*0.11*	*0.15*

Safety is the number one priority. Within the Company there is both a corporate and individual responsibility to ensure that operations are managed in a safe, healthy and environmentally controlled manner. The common measure in the construction sector for measuring safety performance is the Accident Frequency Rate ('AFR') which measures the number of serious workplace accidents reportable under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 per 100,000 of hours worked. The further improvement achieved in 2012 reflects the continued attention given to all areas of safety and represents upper-quartile safety performance in the construction sector.

Staff turnover

Target:
To provide initiatives and working conditions in order to retain key staff

2012	2011	2010
7.4%	*7.0%*	*5.1%*

The retention of staff is fundamental in delivering a quality service to customers. The Group undertakes a number of important initiatives to retain key staff, including actively facilitating their career development. Clear action plans are in place to address issues such as Health and Safety, reward, training and development and job satisfaction. The Group uses a 'voluntary leavers' turnover rate to monitor staff retention. In 2012, staff retention was very strong compared to long-term industry norms.

Supply chain performance

Target:
Average key supplier performance score of greater than 50%

2012	2011	2010
69%	*65%*	*63%*

The Group has a number of key suppliers and is reliant on their performance in carrying out its business. Consequently, an internal performance measurement tool is used to assess the performance of key suppliers on a regular basis against a number of indicators including Health and Safety, programme, commercial and quality performance. The result of the assessment is shown as a percentage score which allows comparison against previous scores and other suppliers. The assessment and results are then used as a basis for discussion with each strategic and preferred supplier of their performance and to put in place, where necessary, actions to improve performance or, if appropriate, reduce the amount of work performed by a supplier.

In 2012, the average key supplier performance score continued to improve. The objective is to ensure that all key suppliers have a performance score of at least 50%. The Group has also implemented an external accreditation system called Achilles (Building Confidence) for its strategic and preferred supply chain members.

Find out more:

Our Corporate Responsibility framework and approach	page 29
Costain Cares	pages 30-39
Group Finance Director's review	pages 44-47

Financial KPIs

Underlying operating profit

Target:
In line with business plan

2012	2011	2010
£25.1m	£24.1m	£17.4m

The level of underlying operating profit (before acquisition related other items and pension liability management costs) is a key measure of performance for the Group. The measure represents the results of the operating elements of the Group's performance and excludes sale of assets and joint ventures. The Group's operating profit in 2011 and 2012 increased as a result of the strong performance in the Group during the year.

Adjusted profit from operations

Target:
In line with business plan

2012	2011	2010
£31.4m	£23.6m	£29.4m

The level of adjusted profit from operations (before acquisition related other items) is a key measure of performance across all areas and divisions of the Group. The profit from operations for each segment of the business is reported in detail in the Business review section of the Annual Report. The Group's profit from operations in 2012 increased compared to 2011 due to the significant profit of £10.5 million from the transfer of assets into The Costain Pension Scheme in 2012.

Adjusted profit before tax

Target:
In line with business plan

2012	2011	2010
£29.5m	£25.5m	£27.9m

Adjusted profit before tax is a key measure for the Group and incorporates the interest from cash deposits held and the IAS 19 pension interest. The reported profit before tax in 2012 included the significant profit of £10.5 million from the transfer of assets into The Costain Pension Scheme.

Order book

Target:
To build a strong order book in line with strategy

2012	2011	2010
£2.4bn	£2.5bn	£2.4bn

The level of secured orders on which work is to be carried out is a key measure for achieving continued profitability and growth. At the end of 2012 the order book for the Group has decreased from the level at the start of the year.

Net cash balance

Target:
Maintain a net cash balance at an appropriate level to suit the business requirements

2012	2011	2010
£105.7m	£140.1m	£144.3m

The Group has a positive net cash balance and close monitoring and measurement of cash resources is carried out as part of the performance measurement process. The reduction in the 2012 year-end cash balance compared to 2011 reflects the transition to target cost based contracts with blue chip customers. The average month-end cash balance for the Group during 2012 was £103.4 million compared to £130.4 million in 2011.

Directors' Report – Business review

Group Finance Director's review

Focused on a strong financial position

Tony Bickerstaff
Group Finance Director

Costain delivered another year of good financial performance.

The Group generated a 4% increase in underlying[1] operating profit for the year to £25.1 million (2011: £24.1 million). Profit from operations, before other items[2], for the year was £31.4 million (2011: £23.6 million).

Group revenue, including share of joint ventures and associates, was £934.5 million for the twelve months to 31 December 2012 (2011: £986.3 million). The increased profitability, on reduced revenue, reflects the Group's focus on higher margin work.

During the year the Group transferred two PFI investments into The Costain Pension Scheme ('CPS') at an agreed value of £20.3 million which resulted in a profit on the transfer of £10.5 million. In addition the Group implemented an Enhanced Transfer Value and Pension Increase Exchange offers to the members of the CPS which resulted in a one-off accounting cost of £2.8 million in the year.

Profit before tax, before other items[2], for the year ended 31 December 2012 increased to £29.5 million (2011: £25.5 million). Basic earnings per share, before other items[2], amounted to 41.4 pence (2011: 31.1 pence per share), reflecting increased profits and a non-recurring tax timing benefit. Reported basic earnings per share were 37.1 pence (2011: 29.2 pence).

During the year the Group secured a number of new contracts and extensions and the Group's order book stood at £2.4 billion (31 December 2011: £2.5 billion).

As a result of the Group's ongoing strategic focus on major blue chip customers who increasingly utilise a target cost based form of contract, our net cash position includes a lower level of advanced payments typically paid on lump sum contracts. Additionally, our increasing emphasis on support service related activities, changing industry cash flow trends, together with the cash flow timing implication of a delayed contract completion, accounted for the reduction in net cash to £105.7 million (2011: £140.1 million). We expect these trends will continue to be reflected in a lower average net cash position.

1 Underlying operating profit is before amortisation of acquired intangible assets and employment related acquisition consideration and excludes the one-off costs relating from pension scheme liability actions.

2 Other items are the amortisation of acquired intangible assets of £1.7 million (2011: £0.9 million) and employment related acquisition consideration of £1.7 million (2011: £0.7 million).

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

Interest

Net finance expense amounted to £1.9 million (2011: £1.9 million income). The interest payable on bank overdrafts and other similar charges was £1.8 million (2011: £1.7 million) and the interest income from bank deposits and other loans and receivables amounted to £1.0 million (2011: £1.8 million). In addition, the net finance expense included the difference between the expected return on the pension scheme's assets of £26.3 million (2011: £32.3 million) and the interest cost on the present value of the pension scheme's liabilities of £27.4 million (2010: £30.5 million) being a net expense of £1.1 million (2011: £1.8 million income).

In accordance with IAS 19, the pension scheme deficit position was reassessed as at 31 December 2012. As a consequence of the new requirements of IAS 19, requiring a change in the method of calculation, the net pension interest expense will increase in 2013 to £2.1 million.

Tax

The Group's effective rate of tax was 7.3% of the profit before tax (2011: 21.8%). The lower than normal rate of tax arose owing to tax relief on the transfer of PFI assets to The Costain Pension Scheme, Research and Development tax relief claims, the utilisation of brought forward tax losses, timing differences and capital allowances, not previously recognised as deferred tax assets, and the effect on the brought forward deferred tax balances of the reduced rate of corporation tax of 23% from 1 April 2013.

Dividend

The Board has recommended a final dividend for the year of 7.25 pence per share (2011: 6.75 pence per share) to bring the total for the year to 10.75 pence per share (2011: 10.0 pence per share), an increase of 7.5%.

As in previous years, the Group will make an additional cash contribution to the pension scheme equal to the amount of dividend paid to shareholders.

Shareholders' Equity

Shareholders' equity increased in the year to £31.8 million (2011: £30.8 million). The profit for the year amounted to £24.2 million and other comprehensive expenses to £19.1 million. The movements are detailed in the consolidated statements of comprehensive income and expense and changes in equity in the financial statements. The most significant element was the actuarial loss on the Group's defined benefit pension scheme.

Pensions

As at 31 December 2012, the Group's pension scheme deficit in accordance with IAS 19, net of deferred tax, was £40.0 million (2011: £39.7 million). The scheme deficit position has increased primarily as a result of a reduction in the discount rate, based on corporate bond yields, used to calculate the liabilities.

In February 2012, the Group announced two further actions being taken to manage the obligations in the CPS. The first of these was the transfer of the Group's interest in two PFI investments into the CPS at an agreed value of £20.3 million which was completed on 22 February 2012 and resulted in an accounting profit on the transfer of £10.5 million. The second action was the implementation of Enhanced Transfer Value ('ETV') and Pension Increase Exchange ('PIE') offers to the members of the CPS. The ETV and PIE exercises have resulted in a reduction in the scheme liabilities and assets of approximately £35 million and have resulted in a one-off accounting cost of £2.8 million expensed in 2012.

A full actuarial valuation of the CPS was last performed by the Scheme Actuary as at 31 March 2010 and a recovery plan agreed with the Trustee of the Scheme. In accordance with the requirement for a tri-ennial review, another full actuarial valuation of the CPS will be carried out as at 31 March 2013.

Cash Flow and Borrowings

The Group has a positive net cash balance, which was £105.7 million as at 31 December 2012 (2011: £140.1 million) and included £1.7 million of borrowings (2011: £1.6 million) and cash held by jointly controlled operations of £29.6 million (2011: £33.6 million).

As set out in the consolidated cash flow statement, during the year, the Group had an operating cash outflow, together with outflows for payment of dividends and matching pension deficit contributions. The average month-end cash balance during 2012 was £103.4 million (2010: £130.4 million).

The cash position is affected by monthly and contract specific cycles and in order to accommodate these cyclical flows, the Group seeks to maintain a base cash balance.

Directors' Report – Business review

Group Finance Director's review

continued

Focused on a strong financial position

	2012	2011	2010	2009	2008
Revenue	**£934.5m**	£986.3m	£1,022.5m	£1,061.1m	£996.0m
Underlying operating profit	**£25.1m**	£24.1m	£17.4m	£22.0m	£19.5m
Profit from operations	**£28.0m**	£22.0m	£29.4m	£20.8m	£18.3m
Profit before tax	**£26.1m**	£23.9m	£27.9m	£18.1m	£23.1m
Earnings per share – basic	**37.1p**	29.2p	36.4p	23.0p	29.0p
Net cash	**£105.7m**	£140.1m	£144.3m	£120.5m	£146.9m
Dividends per ordinary share	**10.75p**	10.00p	9.25p	8.25p	7.50p

Key Risks and Uncertainties

The principal risks and uncertainties of the business, and the factors which mitigate these risks, are set out in the Group's Annual Report and include the economic outlook, change of government policy on spending, competition, pension liabilities, acquisition integration, operational delivery, loss of IT systems, supply chain and customer failure and people retention. The Board continuously assesses and monitors these risks and the Chairman's Statement, Chief Executive's Review and business and operations review in these financial statements include consideration of uncertainties affecting the Group.

Accounting policies and significant areas of judgment and estimation

A summary of the significant accounting policies of the Group is set out in the Notes to the financial statements. There has been no significant change to the accounting policies in the year and there is no material effect on the Financial statements of new accounting standards adopted in the period.

The Notes to the financial statements also include the significant areas of judgment and estimation used in preparation of the financial statements.

The most critical accounting policies and significant areas of judgment and estimation arise from the accounting for defined benefit pension schemes under IAS 19 Employee benefits, the accounting for long-term contracts under IAS 11 and assessments of the carrying value of land, property, goodwill and intangible assets.

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. The Group has contract bonding and banking facilities of £465 million with a maturity date of 30 September 2015 with its relationship banks and surety companies.

Going Concern

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 the Group's financial requirements, its 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, the Group continues to adopt the going concern basis in preparing these financial statements.

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.

“With a robust balance sheet, positive net cash position and banking and bonding facilities in place, we have the resources to continue to grow the business organically and by acquisition.”

David Allvey
Chairman

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 and retained profits. 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 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.

Transaction exposure: the Group has a small transactional currency exposure arising from subsidiaries’ commercial activities overseas and, 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 holds relatively minor financial instruments for two main purposes: to finance its operations and, currently only within its PFI investments, to manage the interest rate risks arising from its operations and its sources of finance. Various financial instruments (for example, trade receivables and trade payables) arise directly from the Group’s operations.

With the Group’s cash balances and low level of borrowings, 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. Within the investments in joint ventures and associates, interest rate movements will affect the value of swaps classified as cash flow hedges and this will impact the Group’s equity.

Tony Bickerstaff
Group Finance Director

6 March 2013

Directors' Report – Business review
Board of Directors

Experienced leadership

David P. Allvey (67)
FCA, ATII [3]
Non-Executive Chairman

Appointment: November 2001

Skills and experience: David Allvey was appointed Chairman in January 2008 prior to which he was Chairman of the Audit Committee. With a career that started in civil engineering and subsequently as a Chartered Accountant, his previous roles include Group Finance Director for BAT Industries plc, Barclays Bank plc and Chief Operating Officer for Zurich Financial Services, member of the UK Accounting Standards Board, member of the International Accounting Standards Insurance Group, Non-Executive Director of Thomas Cook plc (2007–2012), Senior Non-Executive Director of Intertek Group plc (2002–2011), Senior Non-Executive Director of William Hill plc (2002–2011), Senior Independent Director of Friends Life FPG Limited (formerly Friends Provident Group plc) (2009–2011) and Chairman of Arena Coventry Ltd (2006–2012).

External appointments: Senior Independent Director of Friends Life Group plc, Non-Executive Director of Clydesdale Bank plc and National Australia Group Europe Limited.

Andrew Wyllie (50)
FREng, MBA, BSc, CEng, FICE, CCMI
Chief Executive

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.

External appointments: Non-Executive Director of Scottish Water.

Anthony O. Bickerstaff (48)
FCCA
Group Finance Director

Appointment: June 2006

Skills and experience: Tony Bickerstaff is Group Finance Director, Costain Group PLC and has been since 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 the Group's PFI projects.

Former Director
Mr John Bryant retired as a Non-Executive Director with effect from 31 December 2012.

Notes
[1] Member of the Remuneration Committee
[2] Member of the Audit Committee
[3] Member of the Nomination Committee

James Morley (64)
BSc, FCA [1,2,3]
Senior Independent Director

Appointment: January 2008

Skills and experience: James Morley served as Chairman of the Audit Committee from January 2008 until the end of October 2012 and was appointed as the Senior Independent Director at the start of January 2013. 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 WS Atkins plc (2001–2009), Non-Executive Director of Trade Indemnity Group plc (1991–1996) and Non-Executive Chairman of Acumus Ltd (2011–2012).

External appointments: Non-Executive Director of The Innovation Group plc, Clarkson plc, Speedy Hire plc, BMS Group Ltd and BMS Associates Ltd.

Samer G. Younis (51)
BSc, Grand Officer of the Order of the Star of Italian Solidarity [3]
Non-Executive Director

Appointment: June 2009

Skills and experience: Samer Younis was appointed as a Non-Executive Director in June 2009. He is Vice Chairman and Managing Director of Kharafi National Group; Board Member of ABJ Engineering and Contracting Co KSCC (Kuwait), Utilities Development Company (Kuwait), Kuwait Jordanian Holding Company (Jordan), SSH Consultants (Kuwait), Global Clearing House Systems (Kuwait), Emirates Utilities Company Holding (UAE) and Heavy Engineering Industries & Shipbuilding Co (HEISCO) (Kuwait); and a Trustee of the Arab Forum for Environment and Development.

Jane A. Lodge (57)
FCA, BSc [1,2,3]
Independent Non-Executive Director

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.

External appointments: Non-Executive Director and Chair of the Audit Committee, Devro Plc, Non-Executive Director, Black Country Living Museum Trust Ltd and Non-Executive Director and Chair of the Audit Committee, DCC plc.

Michael R. Alexander (65)
BSc, MSc, FIChem.E, FIET, FIGM, CEng, CSci [1,2,3]
Independent Non-Executive Director

Appointment: July 2007

Skills and experience: Mike Alexander has extensive experience of the energy market. Previous roles include Chief Executive of British Energy plc (2003–2005), Managing Director of British Gas Trading, Chief Operating Officer and Executive Director of Centrica plc (1994–2003), Non-Executive Chairman of Goldfish Bank Ltd (2002–2003), Chairman of TGE Marine AG (2007–2010), Chairman of the Association of Train Operators (2008–2009) and Non-Executive Director of the Energy Saving Trust Ltd (1994–2001).

External appointments: Independent Non-Executive Director of Payments Council Ltd.; Executive Director of Lexican Ltd and Lexican Associates Ltd., member of the European Advisory Board for Landis & Gyr, Special Adviser at EGS Energy Ltd and Deputy Chairman and Senior Independent Director of Russian Platinum PLC.

Tracey A. Wood (43)
LLB
Legal Director and Company Secretary

Appointment: June 2011

Skills and experience: Tracey Wood joined the Company in February 2006. She has a construction and commercial law background and was formerly a partner at Hammonds. She has responsibility for legal, secretariat and human resources.

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. It consists of the executive directors and other senior managers and is chaired by **Andrew Wyllie, Chief Executive**. The members of the Executive Board are:

Andrew Wyllie
Chief Executive

Tony Bickerstaff
Group Finance Director

Tim Bowen
Regional Development Director

Patrick Bruce
Group Commercial Director

Martin Hunter
Group Financial Controller

Darren James
Managing Director – Infrastructure

Alan Kay
Group Technical and Operations Director

Mark Rogerson
Managing Director – Natural Resources

Alex Vaughan
Corporate Development Director

Tracey Wood
Legal Director and Company Secretary

Corporate Governance

This section explains our Corporate Governance and decision-making processes. We detail the committees and our accountability and audit procedures.

Directors' Report – Corporate Governance

"The Board is committed to achieving the highest standards of governance. This overview sets out our approach to effective leadership and best practice."

David Allvey
Chairman

Dear Shareholder

We believe that great companies are built on the foundation of trust. Trust is earned by providing open and transparent information, together with strong compliance with both the spirit and letter of the law, and by managing the business in a responsible and sustainable way.

At Costain, we are committed to robust corporate governance practices and accountability. The Company considers that the principles set out in the UK Corporate Governance Code are central to the effective management of the business and to maintaining the confidence of the investors.

Our Board is responsible for providing strong leadership to the Costain Group. Effective leadership is realised through collaboration between the Board and the executive team and my role as Chairman is to ensure that we harness the experience and knowledge of the Directors and drive a culture of continual improvement in standards, decision-making, policies and accountability.

Governance goes well beyond the boardroom. At Costain, we operate with diligence and discipline across the whole business and believe it is important to assess continually how we do things. Encouraging dialogue with stakeholders helps to guide and shape our approach to governance and risk management.

We continually monitor the composition of the Board to ensure we have the right level of skills and expertise. The Directors have a deep understanding of our business and sector and bring valuable insight and experience to the table.

Our Board is ultimately responsible for the success of Costain and we are committed to the highest standards of corporate governance to enable us to achieve our vision of becoming one of the UK's top engineering solutions providers.

The way in which the Costain Board and its various committees operates and delivers effective corporate governance is detailed in the following Corporate Governance statement.

David Allvey
Chairman

Directors' Report – Corporate Governance

Corporate Governance statement

The Board of Directors of Costain Group PLC is committed to achieving the highest standards of Corporate Governance and to managing operations in accordance with the principles set out in the UK Corporate Governance Code (the 'Code')[1] to which the Company is subject.

These principles are considered to be central to the effective management of the business and to maintaining the confidence of investors.

Responsibilities

The Board has adopted a schedule of matters specifically reserved to the Board for its approval.[2]

The principal matters reserved to the Board include:

- reviewing the environmental and health and safety performance of the Group;
- setting Group strategy;
- approving the annual operating and capital expenditure budgets and material changes to them;
- reviewing performance in light of the Group strategy, objectives, business plans and budgets and ensuring that any necessary corrective action is taken;
- supervising the Group's operations and financial performance;
- approving major acquisitions and divestments;
- reviewing the Group's systems of financial control and risk management;
- ensuring that appropriate management development and succession plans are in place;
- approving appointments to the Board and Executive Board and the appointment of the Company Secretary;
- approving policies relating to executive directors' remuneration and the severance of executive directors' service agreements; and
- ensuring that a satisfactory dialogue takes place with shareholders.

[1] A copy of the Code is publicly available at **www.frc.org.uk**
[2] A copy of the schedule is available on the Company's website at **www.costain.com**

Achievements of 2012

What has the Board done during the year?
Set out below is a summary of the key matters undertaken by the Board in 2012:

Strategic discussions and investment	The Board continued to undertake wide-ranging discussions on key strategic issues which included a number of Board workshops attended by members of the Executive Board and third-party advisers. Discussions were focused on formulating a strategy to achieve a step-change in the underlying profit of the business and included the ongoing consideration of potential acquisitions and investments. A business plan for 2013–2015 was approved in December 2012 based on the 'Choosing Costain' strategy.
Monitoring risk	The Board has continued to assess the effectiveness of the Group's reporting controls and has ensured that the Group's risk profile reflects the Company's strategic objectives.
Visits	The Board attended senior leadership team gatherings and visited a number of sites across the country to ensure the directors maintain an understanding of the operational issues that affect the Group.
Training	The Board has overseen the updating of the Company's Competition Law Compliance Policy. All Board members also undertook training in this area and in the area of process safety leadership.
Evaluation	The Board reviewed the results of an externally facilitated independent Board evaluation. Further details of the external evaluation can be found on page 55. Following due consideration of the composition and competencies of the Board, Jane Lodge was appointed as a Non-Executive Director in August 2012.
Corporate Responsibility ('CR')	The Board receives reports from the Company's dedicated CR Director and monitors progress on a regular basis.

Board and Committees

The role of the Board

The Group is controlled through its Board. The Board's main role is to create long-term value for shareholders by providing entrepreneurial and prudent leadership of the Company, setting the Company's strategic aims, ensuring that the necessary financial and other resources are available and that the appropriate controls are in place to deliver these objectives.

Who is on the Board?

The Board currently comprises two executive directors and five non-executive directors of whom one is the Chairman, three are independent non-executive directors (one being the Senior Independent Director) and one is a nominee non-executive director. The nominee non-executive director is nominated by our major shareholder, Mohammed Abdulmohsin Al-Kharafi & Sons Co. W.L.L.

A list of the individual directors and their biographies are set out on pages 48 to 49. 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 of the non-executive directors, which are depicted in the chart on page 54.

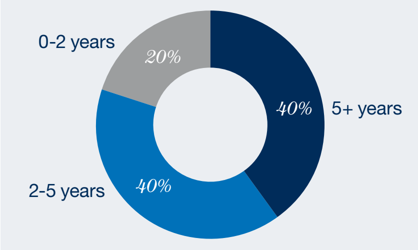
The Board recognises the importance of greater diversity (not just gender specific) in the boardroom and throughout the business. The Board aims to have a broad range of skills, backgrounds and experience whilst following a policy of ensuring we appoint the best people. Within this context, and as part of the ongoing process of refreshing the Board, the Company will continue to encourage and welcome interest from candidates drawn from a diverse background, who will add to the Board's diversity. With effect from August 2012 Jane Lodge was appointed as a Non-Executive Director and appointed Chair of the Audit Committee with effect from the end of October 2012. Having spent 25 years as an audit partner at Deloitte LLP (UK), Jane brings considerable experience to her role and enhances the skill-set of the Board as a whole.

Directors' Report – Corporate Governance

Corporate Governance statement

continued

Length of Service: Non-Executive Directors
as at 31 December 2012



Independence

The Board considers each of its independent 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.

The Nomination Committee continues to review succession on a regular basis.

At the time of his original appointment in January 2008, the Chairman of the Company was considered independent by the Board. However, in accordance with the Code, 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 are members of the FTSE SmallCap Index.

Conflicts

The Company has procedures in place for managing conflicts 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. The Board requires directors to declare all appointments which could result in a possible conflict of interests and has adopted appropriate processes to manage and, if appropriate, approve any such conflict.

Appointments to the Board and retirement of directors

The membership of the Board and biographical details of the executive and non-executive directors are given on pages 48 to 49.

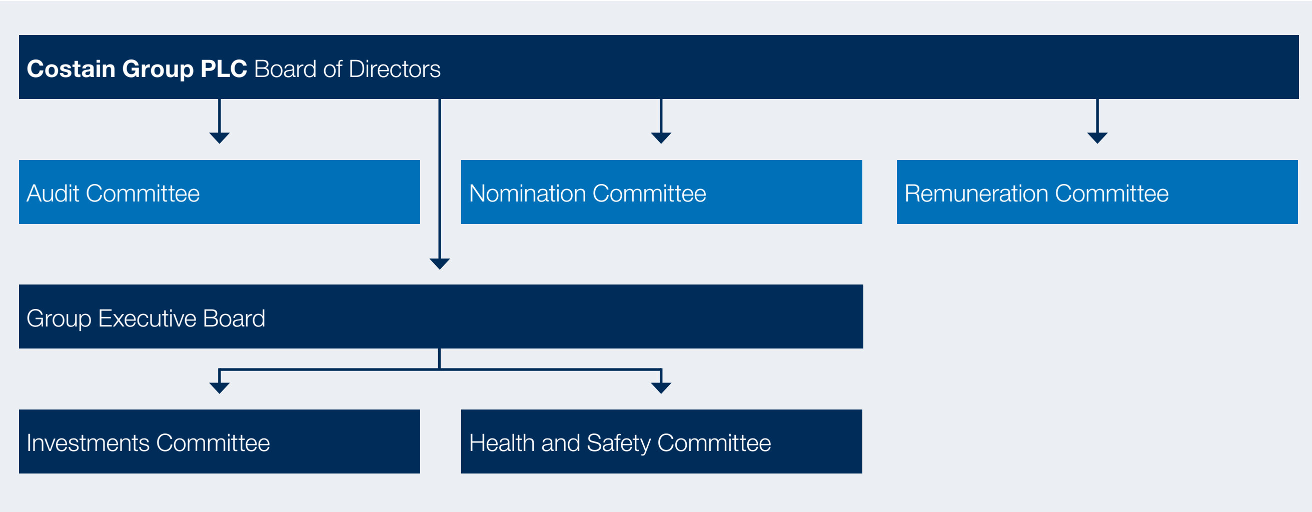
Jane Lodge was appointed to the Board in August 2012 and became Chair of the Audit Committee at the end of October 2012, replacing James Morley who became the Senior Independent Director at the end of December 2012 upon the retirement from the Board of John Bryant.

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, including nominee non-executive directors, should be subject to election by shareholders at the first opportunity after their appointment and to re-election thereafter at intervals of no more than three years. 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.

In accordance with the Company's Articles of Association and provision B.7.1 of the Code, David Allvey, Tony Bickerstaff, Samer Younis and Jane Lodge will offer themselves for re-election at the next Annual General Meeting. Having due regard to the results of the independently facilitated review of the Board's performance conducted towards the end of 2011 and to the periodic internal evaluations, the Board confirms that it is of the opinion that each of the directors standing for re-election continues to make an effective and valuable contribution to the Board and should therefore be re-elected at the forthcoming Annual General Meeting.

The Chairman and independent non-executive directors all have terms and conditions of appointment, which are available for inspection during normal business hours at the Company's registered office. An independent non-executive director's appointment is for an initial period of three years, at the expiry of which time the appointment is reviewed to determine whether the appointment should continue. Mohammed Abdulmohsin Al-Kharafi & Sons Co. W.L.L. and the other major shareholder UEM Builders Berhad are each entitled to appoint a non-executive director for so long as these shareholders each hold 7% of the aggregate nominal value of the then issued ordinary share capital of the Company. UEM Builders Berhad has not taken advantage of this option since 4 December 2009. In consequence, the Company did not comply with provision B.2.3 of the Code, which requires that all non-executive directors should be appointed for a specific term.

Board and Executive Committee structure



How often does the Board meet?

The Board holds scheduled meetings throughout the year and meets on an ad hoc basis both physically and by telephone conference as required. During 2012, the Board met formally on seven occasions. Details of the attendance at Board meetings in 2012 are given in the table below:

Board meetings

Director	A	B
D P Allvey	7	7
A Wyllie	7	7
A O Bickerstaff	7	7
J Morley	7	7
M R Alexander	7	7
J A Lodge*	4	4
S G Younis	7	4
J M Bryant**	7	7

A Maximum number of meetings the director could have attended
B Number of meetings the director actually attended
* appointed to the Board with effect from 01 August 2012
** retired from the Board with effect from 31 December 2012

Samer Younis attended four out of the seven scheduled Board meetings throughout the year due to other work commitments. Samer Younis regularly attended board meetings held on an ad hoc basis.

How do we make sure our Board is effective?

The Board has established a formal process for the evaluation of the performance of the Board and its principal committees. Towards the end of 2011, in accordance with best practice, the Board commissioned an externally facilitated Board and committee review. The review was conducted by SCT Consultants Ltd (who, having no other connection with the Company, are considered to be independent) and each director completed a questionnaire and was interviewed individually on a confidential basis. This independent external review formed part of the regular and on-going evaluation and development work conducted by the Board, during which consideration is given to a number of key issues including overall effectiveness and Board diversity. The outputs of the 2011 external Board and committee evaluation have informed the Board's action planning for 2012–2013. The next independently facilitated review is due to commence towards the end of 2013.

During the year, David Allvey met with the non-executive directors without the executive directors being present and, as part of the process to appraise David Allvey's performance, the Senior Independent Director met with the non-executive directors without the Chairman being present.

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.

Directors' Report – Corporate Governance

Corporate Governance statement

continued

In order to discharge their duties, the directors are provided with full and timely access to papers prior to Board meetings and the directors are free to seek any further information they consider necessary. In addition, between Board meetings, non-executive directors have access to the Chief Executive, Group Finance Director and Company Secretary in order to progress the Company's business. The non-executive directors also receive a weekly report from the Chief Executive, monthly management accounts, internal audit reports and regular management reports and information, which enable them to scrutinise the Group's and its management's performance against agreed objectives.

All Board members have access to all information relating to the Group and have access to the advice and services of the Company Secretary (who is responsible for ensuring that Board procedures 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 Group.

The Group's organisation and 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 on page 55. The Board has established committees which are responsible for audit, remuneration 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. 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 membership and activities of each of the Board committees is detailed in the following sections.

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.

Audit Committee

Members

Director	A	B
J A Lodge* (Committee Chair)	2	2
J Morley	5	5
M R Alexander	5	5
J M Bryant**	5	5

A Maximum number of meetings the director could have attended
B Number of meetings the director actually attended
* appointed to the Committee with effect from 20 August 2012
** retired from the Board with effect from 31 December 2012

Details of the attendance at Audit Committee meetings in 2012 are given in the table above. The Committee's terms of reference are available from the Company Secretary and are published on the Company's website. The meetings of the Committee are normally also attended by the Chairman, the Chief Executive, the Group Finance Director, the external auditors, the Head of Internal Audit and the Group Financial Controller. The Audit Committee regularly meets privately with the external auditors and Head of Internal Audit. The Company Secretary is the Secretary to the Audit Committee.

Biographies of the members of the Committee are shown on page 49. The Company considers that it has in Jane Lodge, as Chair of the Audit Committee, an appropriate person possessing what the Financial Reporting Council's ('FRC') guidance on audit committees describes as recent and relevant financial experience.

Prior to joining the Costain Board, Jane Lodge, a chartered accountant, 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. Jane Lodge was senior partner of the Birmingham office and the Deloitte UK Manufacturing Industry Sector.

Role of the Audit Committee

In accordance with its terms of reference, the Audit Committee is responsible for:

- monitoring the integrity of the Group's financial statements and any formal announcement relating to the Group's performance;
- monitoring the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, re-appointment and remuneration of the external auditors;
- ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services and fees;
- reviewing 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; and
- 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.

Main activities during the year

In 2012, the Audit Committee discharged its responsibilities placed on it by provisions of the Code by performing the following activities:

- reviewing the Group's draft financial statements, preliminary and interim results prior to Board approval and reviewing the external auditors' detailed reports thereon. Significant issues that the Committee considered included key contract judgements, internal controls, cash flow and financial covenant compliance;
- reviewing the appropriateness of the Group's accounting policies;
- reviewing the external auditors' plan for the audit of the Group's financial statements;

- reviewing and monitoring the external auditors' independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements, together with the quality control processes operated by the auditors. The Committee concluded that this remained of a satisfactory standard;
- reviewing/approving the external auditors' engagement letter, together with their audit and non-audit fees;
- reviewing the internal audit function's work programme, internal audit reports and quarterly reports on its work during the year;
- reviewing the Group's system of internal controls and its effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- monitoring the process for formally identifying, evaluating and managing any significant risks and opportunities within the business;
- reviewing and monitoring the Group's commercial and financial IT systems; and
- undertaking an internal review of the effectiveness of the Committee and the internal audit function.

Audit services

The Company's external auditors are KPMG Audit Plc. The Senior Statutory Auditor (who has signed the Audit Report on behalf of KPMG on page 76) is Mr Stephen Bligh, who has been the Company's audit director since 2010.

Non-audit services

The Audit Committee monitors the non-audit services being provided to the Group by its external auditors, and has developed a formal policy on the provision of non-audit services by the external auditors with the objective of ensuring that such services do not impair their independence or objectivity. The policy also sets out a number of key principles that underpin the provision of non-audit services by the external auditors: the auditors should not audit their own firm's work; make management decisions for the Group; have a mutuality of financial interest with the Group; or be put in the role of advocate for the Group.

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

In 2012, KPMG performed non-audit services in respect of potential acquisitions and the provision of tax services. KPMG were selected as the most cost-effective and efficient supplier to undertake these services based on their thorough understanding of the Group and their particular expertise. The Audit Committee approved the provision of these services and were satisfied that the non-audit services would not impact upon KPMG's objectivity and independence.

The services of two other accounting firms, PwC and Ernst & Young, were also employed in respect of due diligence on potential acquisitions during the course of 2012.

Nomination Committee

Members

Director	A	B
D P Allvey (Committee Chair)	1	1
J A Lodge*	1	1
J Morley	1	1
M R Alexander	1	1
S G Younis	1	0
J M Bryant**	1	1

A Maximum number of meetings the director could have attended
B Number of meetings the director actually attended
* appointed to the Committee with effect from 20 August 2012
** retired from the Board with effect from 31 December 2012

Details of the attendance at Nomination Committee meetings in 2012 are given in the table above. The Committee's terms of reference are available from the Company Secretary and are published on the Company's website.

Role of the Nomination Committee

The principal role of the Nomination 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 Nomination Committee directs the Board effectiveness reviews and also reviews management training and succession planning arrangements in respect of senior management. The Company Secretary is the Secretary of the Nomination Committee.

Main activities during the year

In 2012, the Nomination Committee discharged its responsibilities by performing the following activities:

- reviewing the results of the external review of Board effectiveness which took place towards the end of 2011;
- reviewing recruitment of non-executive directors;
- receiving notifications from directors of situations, such as proposed external appointments, in which a potential conflict of interest may arise;
- recommending to the Board the re-appointment 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; and
- reviewing succession planning in respect of the Company's senior management.

Directors' Report – Corporate Governance

Corporate Governance statement

continued

Remuneration Committee

Members

Director	A	B
M R Alexander (Committee Chair)	6	6
J A Lodge*	2	2
J Morley	6	5
J M Bryant**	6	6

A Maximum number of meetings the director could have attended
B Number of meetings the director actually attended
* appointed to the Committee with effect from 20 August 2012
** retired from the Board with effect from 31 December 2012

Details of the attendance at Remuneration Committee meetings in 2012 are given in the table above. The Committee's terms of reference are available from the Company Secretary and are published on the Company's website.

Role of the Remuneration Committee

The role and operation of the Remuneration Committee is set out in the Director's remuneration report on pages 65 to 74.

Relationship with institutional investors and private investors

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 **www.costain.com**. In addition, there are meetings with analysts, financial journalists and institutional investors throughout the year.

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 concerns that have not been, or cannot be, addressed through the Chairman.

The Company obtains feedback from its brokers, Investec, 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 Annual General Meeting as an important opportunity to communicate directly with shareholders. Board members, including the Chairs of the Remuneration, Nomination and Audit Committees, attended the 2012 meeting and propose attending the 2013 meeting where they will be available to answer questions.

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

Internal controls and risk management

Review of internal controls

The Board is responsible for the Group's system of internal controls and for reviewing its effectiveness. 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. Management of the Group is delegated to the Chief Executive, who is assisted by members of the Executive Board. The Chief Executive has full authority to act subject to the matters reserved to the Board and to the requirements of Group policies.

The Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, which has been in place for the year under review and up to the date of approval of the Annual Report. This process extends not only to projects undertaken solely by subsidiaries of the Group but also to projects undertaken in joint arrangements and by joint ventures and associates.

This process is reviewed by the Audit Committee on behalf of the Board and accords with the Financial Reporting Council's ('FRC') guidance on internal control.

The Audit Committee has reviewed the effectiveness of the system of internal controls. The review covered all controls, including financial, operational and compliance controls and risk management.

Risk management

The Company has various procedures for identifying and managing risk, including a pre-qualification and pre-tender review for obtaining approval to bid for a project from the Investments Committee and a specific project risk management procedure which involves a continuous review of risks by the project manager and commercial manager of the project following contract award.

The Company has established a Corporate Risk and Opportunity Register, as well as, sector business Risk Registers, which are monitored and updated regularly. The Board and Audit Committee receive reports on the Company's main corporate risks and opportunities. As recommended by the Code, the Board has determined the nature and extent of the significant risks it is willing to take in achieving its strategic objectives.

For the duration of a contract, the Risk and Opportunity Register is updated on a monthly basis and the top five risks and opportunities reviewed by Group senior management. Internal Audit conducts site reviews and circulates reports with further follow-up actions and inspections.

The risk management strategy is regularly reviewed and the Group's risks and opportunities compared against those of other blue-chip companies. Internal Audit provides independent assurance that risks inherent to the Company's business processes are reasonably controlled and assists management in assessing those risks and how effectively they are managed by internal controls. Internal Audit also promotes best practice in risk management processes to ensure delivery of corporate objectives.

In 2012, Internal Audit conducted project and departmental reviews to appraise and report on the effectiveness of the risk management processes. All reviews carried out were subject to appropriate follow-up action to provide assurance that accepted recommendations have been implemented effectively. The overall assessment is that a strong risk management culture is continuing to develop within the Group.

The Board also assesses the effectiveness of the Company's reporting controls to ensure that the Group's risk profile reflects its strategic objectives.

Operational controls

Controls and procedures are detailed in Group policy statements, procedure manuals and other written instructions, which are reviewed and updated regularly.

The Company has developed operational management systems that are accredited to ISO 9001:2008 which are designed to support management in providing safe quality management processes across the entire business. In addition, the Company operates information security processes certified to ISO 27001:2005. Implementation and compliance with the systems are monitored and audited by Internal Audit. In order to maintain the Company's accreditation, external audits of the management systems are undertaken biannually by the British Standards Institution.

Each project manager completes monthly reports, which include information on safety, health and environmental statistics, cash flow, value, cost and profit, claims and variations, risk management, progress and staffing levels. All projects operate within a controlled framework of best practice, safety, health and environmental guidelines. The project management team monitors and the safety, health and environmental advisers audit, compliance with and execution of the guidelines.

The Board and Executive Board receive regular reports on safety, health and environmental performance and significant operational matters. The Executive Board is responsible for ensuring compliance with Company procedures. The Chief Executive is the Board member responsible for Health and Safety.

Financial controls

There is a comprehensive annual budgeting system, linked to the annual strategy review, for each business 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 in December.

The Company produces a monthly rolling forecast update for the current year which is compared with the annual budget. Each operation'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. The Group Treasurer and Group Taxation Manager report to the Audit Committee, via the Group Finance Director, on any issues of significance to the Group.

Compliance

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, for example the Bribery Act 2010. The Company expects the highest standards from all employees and key suppliers.

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, and reviewed by, the Board. Significant legal and regulatory changes are notified to the appropriate staff and training given where necessary.

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

Compliance with the Code

Throughout the year ended 31 December 2012 the Company complied with all the applicable principles and provisions of the UK Corporate Governance Code (the 'Code'), except for provision B.2.3 of the Code, which requires non-executive directors to be appointed for a specific term because the Company's two major shareholders are entitled to appoint a non-executive director for so long as they each hold 7% of the then issued ordinary share capital of the Company, as detailed on page 54 of this Corporate Governance statement.

Directors' Report – Corporate Governance

Other statutory information

The directors submit to the members their Report and Accounts of the Company for the year ended 31 December 2012.

The Directors' Report of the Company for the year ended 31 December 2012, prepared in accordance with the Auditing Standards Board's ('ASB's') Reporting Statement on Operating and Financial Review, is set out on pages 06 to 75.

Activities

The principal activities of the Group are engineering consultancy, construction and operations and maintenance. The Group also has a share in a land development and marina joint venture in southern Spain. The progress and prospects of the Group's businesses and the main factors which could affect the future development and performance of the Group are set out in the Business review (pages 06 to 44).

Fixed assets

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

Profit and dividends

The profit after tax for the financial year ending 31 December 2012 amounted to £24.2 million (2011: £18.7 million). An interim dividend of 3.50 pence per share (2011: 3.25 pence) amounting to £2.3 million (2011: £2.2 million) was paid on 26 October 2012. The directors recommend payment of a final dividend at the rate of 7.25 pence per share (2011: 6.75 pence) amounting to £4.7 million (2011: £4.4 million). If approved, the dividend will be paid on 24 May 2013 to shareholders registered at close of business on 19 April 2013.

Going concern

The directors believe, after due and careful enquiry, that the Group has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the 2012 financial statements as discussed on page 46 of the Group Finance Director's review and Note 2 to the financial statements.

Forward looking statements

This Annual Report contains forward-looking statements. These forward-looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors that may cause actual results to differ from any future results or developments expressed or implied by the forward-looking statements. Each forward-looking statement speaks only as of its particular date.

Directors and directors' interests

Brief biographies of the present members of the Board are given on pages 48 and 49.

In accordance with Article 78 of the Company's Articles of Association and the Code, David Allvey, Tony Bickerstaff, Samer Younis and Jane Lodge, being eligible, will offer themselves for re-election at the 2013 Annual General Meeting. David Allvey, having been in office for a continuous period in excess of nine years, is required to stand for re-election on an annual basis. Tony Bickerstaff and Samer Younis, having served on the Board at the time of the two preceding Annual General Meetings without retiring, are required to stand for re-election at the 2013 Annual General Meeting. Jane Lodge, having been appointed as a director of the Company since the last Annual General Meeting, is required to stand for re-election at the 2013 Annual General Meeting. David Allvey and Jane Lodge have letters of appointment with the Company and Tony Bickerstaff has a service contract with the Company, details of which are set out in the Directors' remuneration report.

With regard to the re-election of David Allvey, Tony Bickerstaff, Samer Younis and Jane Lodge, the Board is of the opinion that they each continue to perform effectively and demonstrate commitment of time for Board and committee meetings and other respective duties.

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 2012, are contained in the Directors' remuneration report, which appears on pages 65 to 74.

Related party transactions

Details of transactions with related parties undertaken by the Group during the year are disclosed in Note 25 to the financial statements on page 119.

Incorporation and constitution

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

Costain Group PLC's Articles of Association are available on the Company's website at **www.costain.com**

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 2012 was £32,772,153, consisting of 65,544,306 ordinary shares of 50 pence each.

Details of the share capital of the Company can be found in Note 20 on page 116.

The awards granted in April 2009 under the 2002 Long-Term Incentive Plan (the '2002 LTIP') matured as at 31 December 2011 resulting in the vesting of awards in March 2012 over 634,767 ordinary shares of 50 pence each with an exercise price of £1 per exercise. Further details with regard to the vesting of these LTIP awards can be found in the Directors' remuneration report on page 73.

At the 2008 Annual General Meeting, the Company obtained shareholder approval to offer a 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. In May 2012, 133,133 ordinary shares of 50 pence each were allotted to shareholders in respect of the final dividend for 2011, and 65,681 ordinary shares of 50 pence each were allotted to shareholders in October 2012 in respect of the interim dividend for 2012. Further information on the scrip dividend scheme is set out on page 122. Shareholders' approval to renew the authority for the directors to offer a scrip dividend scheme will be sought at the 2013 Annual General Meeting as the current approval will expire at that time (being the fifth anniversary of the passing of the shareholders resolution). Details about joining the scrip dividend scheme can also be found on the Company's website at **www.costain.com**

Major shareholders
As at 04 March 2013, the Company had been notified, including under the Disclosure and Transparency Rules issued by the Financial Services Authority ('DTR5'), of the following voting interests in its ordinary share capital:

UEM Builders Berhad[(i)]	13,810,850	21.07%
Mohammed Abdulmohsin Al-Kharafi & Sons Co. W.L.L.[(i)]	13,789,490	21.04%
Henderson Global Investors[(ii)]	3,642,742	5.56%
Legal & General Investment Management[(ii)]	2,564,056	3.91%

(i) Shares are held by nominees on behalf of these beneficial owners.
(ii) Fund managers holding shares on behalf of a number of beneficial owners.

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 Listing Rules of the Financial Services Authority whereby 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.

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.

Powers in relation to the Company issuing or buying back its own shares
The directors may only issue and buy back shares if authorised to do so by the Articles of Association or the shareholders in general meeting. At the Company's Annual General Meeting held on 8 May 2008, shareholders granted an authority to the directors to allot ordinary shares up to an aggregate nominal amount of £10.47 million. As this authority is due to expire on 7 May 2013, shareholders' approval will be sought to renew the directors' authority to allot ordinary shares at the 2013 Annual General Meeting, up to an aggregate nominal amount of £10,924,051. As at 31 December 2012, the only shares that had been allotted were in order to satisfy awards under employee share schemes and the scrip dividends. The directors did not request authority to buy back any of the Company's shares at the last Annual General Meeting in 2012 and they do not propose to do so at this year's Annual General Meeting.

Securities carrying special rights
No person holds securities in the Company carrying special rights with regard to control of the Company.

Corporate Responsibility
The section on performing responsibly is on pages 25 to 39.

Directors' Report – Corporate Governance

Other statutory information

continued

Employee involvement

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 in various ways. These include regular updates from the Chief Executive and other senior managers, a Costain online news service, personal briefings and emails. Senior managers also visit sites and discuss with employees matters of current interest and concern to them and the business. Employees also have the opportunity to provide feedback and ask questions at the annual staff road-shows which take place around the country.

The Company also organised a staff engagement survey in 2011, allowing it to understand how employees feel about Costain and will be organising a further survey during the course of 2013. In December 2011, the Company also launched '**ask.costain.com**', enabling employees to get involved in two-way communication with the Company.

The Company has an established Employee Consultative Committee which convenes three times a year and on an ad hoc basis throughout the year, to discuss matters impacting the business, in order that the views of employees can be taken into account in making decisions likely to affect their interests.

Share schemes are an established part of our reward package, encouraging and supporting employee share ownership; in particular, employees currently participate in the Company's Save As You Earn Scheme.

Diversity and inclusion

The Company is an inclusive employer and promotes equality and inclusion from recruitment and selection, through training and development, to promotion and retirement. We are fully committed to the elimination of unlawful and unfair discrimination and we value the differences that a diverse workforce brings to the organisation. It is Company policy that people with disabilities should have full and fair consideration for all vacancies. Wherever possible, we endeavour to interview those people with disabilities who fulfil the minimum criteria, and to retain employees in the workforce if they become disabled during employment and to provide specialist training where appropriate. We support our supply chain and encourage their active commitment to our approach on equality and inclusion.

Our customers are looking to us to provide local employment and skills, and to facilitate inclusion in our projects. We continue to work with the UK Contractors Group to deliver an equality and diversity action plan across Costain and to apply local solutions to diversity issues on projects. We assist our customers in their employment and skills agenda by delivering an apprentice development programme and through establishing National Skills Academies.

Policy and practice on payment of suppliers

As a result of the nature of the Group's business, its contractual relationships with suppliers of goods and services and with subcontractors vary according to circumstances and type of supplier or subcontractor. It is the Group's policy to enter into an appropriate form of contractual agreement on payment terms when agreeing the terms of each transaction and to pay according to those terms. The Group enters into an appropriate form of contractual agreement on payment terms with its suppliers and subcontractors on an individual basis rather than following a code or standard on payment practice. The Group's policy is to make every effort to abide by these agreed terms when it can be confirmed that the supplier has provided the goods or services in accordance with the contract terms and conditions.

The amount for trade creditors of the major subsidiary trading companies represents 47 (2011: 46) days of average daily purchases. The Company has no trade creditors (2011: none).

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 terminate 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 that occurs because of a 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.

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.

Research and development

The Group is involved in research and development in all sectors in which it operates, but specifically in highways, rail, airports, nuclear, hydrocarbons and chemicals, waste and water. The Group's engineers and technical staff in these named sectors develop and deliver technical advances, processes and innovations in an effort to achieve practical, integrated solutions that incorporate the most advanced technologies, while taking account of the broader regulatory perspective and seeking to resolve all scientific and technological uncertainties. In undertaking certain elements of this research and development work, the Group is supported by arrangements with certain British universities and various technology specialists.

Donations

Charitable donations of £171,142 (2011: £135,424) were made by the Group during the year, principally to industry-related charities serving the communities in which the Group operates.

No political donations were made during the year ended 31 December 2012 (2011: none). The Company has a policy of not making donations to political organisations.

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

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

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

Directors' responsibilities
The directors' responsibilities for the financial statements contained within this Annual Report and the directors' confirmations required under DTR 4.1.12 are set out on page 75.

Voting rights
Every member and every duly appointed proxy present at a general meeting or class meeting has, upon a show of hands, one vote and every member present in person or by proxy has, upon a poll, one vote for every share held by him/her. In the case of joint holders of a share, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders and, for this purpose, seniority shall be determined by the order in which the names stand in the register in respect of the joint holding.

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.

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.

Variation of rights
Subject to the Companies Act 2006, rights attached to any class of shares may be varied with the written consent of the holders of not less than three-fourths in nominal value of the issued shares of that class (calculated excluding any shares held as treasury shares), or with the sanction of a special resolution passed at a separate general meeting of the holders of those shares. At every such separate general meeting (except an adjourned meeting), the quorum shall be one or more persons holding or representing by proxy not less than one-third in nominal value of the issued shares of the class (calculated excluding any shares held as treasury shares). The rights conferred upon the holders of any shares shall not, unless otherwise expressly provided in the rights attaching to those shares, be deemed to be varied by the creation or issue of further shares ranking pari passu with them.

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 a special resolution of the Company's shareholders.

Appointment and replacement of directors
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.

A director shall not be required to hold any shares in Costain Group PLC but is encouraged to do so under the Company's share ownership guidelines. 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 Annual General Meeting of the Company and is then eligible for reappointment. 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.

Directors' Report – Corporate Governance

Other statutory information

continued

At every Annual General Meeting of the Company, any director who has been appointed by the Board since the last Annual General Meeting, or who held office at the time of the two preceding Annual General Meetings 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 Company may by special resolution remove any director before the expiration of his/her period of office. The office of a director shall be vacated if: (i) he/she resigns or offers to resign and the Board resolves to accept such offer; (ii) his/her resignation is requested by all of the other directors and all of the other directors are not less than three in number; (iii) he/she is or has been suffering from mental or physical ill health and the Board resolves that his/her office be vacated; (iv) he/she is absent without the permission of the Board from meetings of the Board (whether or not an alternate director appointed by him/her attends) for six consecutive months and the Board resolves that his/her office is vacated; (v) he/she becomes bankrupt or compounds with his creditors generally; (vi) he/she is prohibited by a law from being a director; (vii) he ceases to be a director by virtue of the Companies Act 2006; or (viii) he/she is removed from office pursuant to the Company's Articles of Association.

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.

Rights under the employee share schemes

ACS HR Solutions Share Plan Services (Guernsey) Limited (formerly Excellerate HRO Share Plan Services (Guernsey) Limited), as Trustee of the Costain Group Employee Trust, holds 0.77% of the issued share capital of the Company as at 31 December 2012 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 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.

Annual General Meeting ('AGM')

The AGM of the Company will be held in The More Suite, 2nd Floor, Dexter House, No 2 Royal Mint Court, Tower Hill, London EC3N 4QN on Wednesday 8 May 2013 at 11.00am.

The Notice of Annual General Meeting will be sent in paper form to all shareholders and will also be available on the Company's website at **www.costain.com**. This 2012 Annual Report will also be available on the Company's website. Those shareholders who have elected to receive paper copies of shareholder information will receive a copy of this Annual Report with the Notice of Annual General Meeting.

Jane Lodge, the Chair of the Audit Committee and Michael Alexander, the Chairman of the Remuneration Committee, will be available at the Annual General Meeting, together with the Chairman of the Board and the Senior Independent Director.

By Order of the Board

Paul Starkey
Joint Company Secretary

6 March 2013

Directors' remuneration report

This report, approved by the Board, has been prepared in accordance with the requirements of the UKLA listing rules, the Companies Act 2006, the UK Corporate Governance Code and best practice guidelines.

Remuneration Committee

Operation of Committee

The Remuneration Committee is comprised exclusively of independent non-executive directors. The members of the Committee are Michael Alexander (Chairman), Jane Lodge and James Morley. John Bryant was also a member of the Committee until his retirement from the Board at the end of December 2012. In 2012, the Committee met six times and details of the attendance at those meetings are as follows:

Director	A	B
M R Alexander (Committee Chair)	6	6
J A Lodge*	2	2
J Morley	6	5
J M Bryant**	6	6

A Maximum number of meetings the director could have attended
B Number of meetings the director actually attended
* appointed to the Committee with effect from 20 August 2012
** retired from the Board with effect from 31 December 2012

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 New Bridge Street (a trading name of Aon Hewitt Limited). This included advice on the appropriate targets for the initial award under the 2012 Long-Term Incentive Plan and the benchmarking of senior executive remuneration.

New Bridge Street is a founder signatory to the Remuneration Consulting Group's Code of Conduct. Neither New Bridge Street, nor any other part of Aon plc, provided other services to the Company during the year and, having no other connection with the Company, New Bridge Street is considered to be independent. Following the undertaking of a tender process during the course of 2012 by the Committee, New Bridge Street was re-appointed to act as the Company's remuneration consultants. 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. New Bridge Street received fees of circa £123,000 for the year ended 31 December 2012, split between circa £58,000 relating to advice given to the Committee and circa £65,000 relating to the implementation of such advice (including in relation to the introduction of the new 2012 LTIP and SAYE Scheme).

In addition, advice was sought where appropriate from other sources. During the course of the year, the Chief Executive, the Group Finance Director, the Company's Chairman and the HR and Legal Director were invited to attend various meetings of the Committee, although none was present when their own remuneration was being discussed. The Company Secretary acts as secretary to the Committee.

Terms of Reference

The Committee's terms of reference are available on the Company's website at **www.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
4 January 2012	• Reviewed the Long-Term Incentive Plan ('LTIP') performance targets for the 2012 awards
9 February 2012	• Reviewed proposed new LTIP and Save As You Earn Scheme ('SAYE') Rules • Approved 2011 annual cash bonuses subject to final audit of the 2011 Accounts • Reviewed senior executives' salaries • Approved the 2012 annual cash bonus targets • Approved the Deferred Share Bonus Plan ('DSBP') performance targets for the 2012 base year • Reviewed the Chairman's fee • Reviewed the Directors' remuneration report
4 April 2012	• Approved the vesting of the 2009 LTIP • Granted awards under the DSBP for the 2011 base year • Approved the notification of participants for the DSBP 2012 base year
9 May 2012	• Granted awards under the 2012 LTIP
2 October 2012	• Reviewed market update on remuneration packages (prepared by New Bridge Street), together with measurements and targets
11 December 2012	• Approved changes to participants in the LTIP/DSBP • Reviewed LTIP performance targets for 2013 awards • Approved the 2013 annual cash bonus targets • Approved the 2013 annual salary review

A resolution to approve the Directors' remuneration report will be proposed at the AGM. Last year's remuneration report was approved by shareholders with a 96.86% vote in favour (including discretionary votes).

Directors' Report – Corporate Governance

Directors' remuneration report

continued

Policy Report

The Committee determines the remuneration policy for executive directors, the Chairman and other senior management with the aim of attracting, motivating and retaining executives of the appropriate calibre and expertise, so that the Company is managed successfully for the benefit of its stakeholders. The following table sets out the main elements of the remuneration policy for the year ending 31 December 2013. Each year, the Committee reviews the remuneration policy, taking into account both the external market (including environment, social and corporate governance issues) and the Company's strategic objectives over the short and the medium term. The framework has been designed as an integral part of the Company's overall business strategy.

Element	Purpose and Link to Strategy
Salary	• To attract and retain high-calibre individuals by providing an appropriate level of basic fixed income whilst avoiding excessive risk arising from over reliance on variable income • The basic salary reflects the market rate for the individual, their role, skills and experience
Annual Cash Bonus	• To incentivise the achievement of key financial and strategic targets for the forthcoming year without encouraging excessive risk taking
Deferred Share Bonus Plan	• To incentivise the delivery of annual profit • Promotes greater alignment with shareholders • To facilitate share ownership
Long-Term Incentive Plan ('LTIP')	• Aligned to main strategic objectives of delivering sustainable profit growth which in turn should deliver enhanced returns • To facilitate share ownership
SAYE Scheme	• To facilitate share ownership and provide further alignment with shareholders
Pension	• To aid retention and remain competitive in the market place
Other Benefits	• To aid retention and be competitive in the market place • Healthcare benefits in order to minimise business disruption
Share Ownership Guidelines	• Further alignment of interests with shareholders

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How operated	Maximum potential value	Performance targets	Changes from prior policy
• Generally reviewed annually (with any change effective 1 April) but exceptionally at other times of the year • Set with reference to individual performance, experience and responsibilities • Broadly takes into account the median position in light of remuneration generally within the Company and other companies in the UK-based construction sector • Higher increases may be appropriate where an individual is promoted, changes role or where any individual is appointed on a below market salary with the expectation that his/her salary will increase with experience and performance	• N/A	• N/A	• No change in policy • Salary changes are set out on page 68
• The Committee considers and approves the measures and targets at the start of each year and ensures they are aligned with business strategy and are sufficiently stretching • 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 • Paid in cash • Not pensionable	• Up to 100% of base salary	• Group underlying earnings before interest, tax, amortisation and employment related acquisition consideration but excluding any PFI transfer into the pension scheme and pension risk management costs ('EBITA') (80%) • Health and safety targets (10%) • Personal objectives (10%) • The weightings are determined at the start of the year and reflect business priorities	• No change in policy
• Any bonus earned is deferred in shares which vest on the second anniversary of grant (subject to continued employment and not being under notice of termination, either given or received, on the date of vesting) • Shares are purchased by a trust on behalf of the Group and so do not lead to any dilution of shareholder interest	• Up to 50% of base salary	• Group underlying earnings before interest, tax, amortisation and employment related acquisition consideration but excluding any PFI transfer into the pension scheme and pension risk management costs ('EBITA') • Targets disclosed retrospectively	• No change in policy
• Annual grant of shares which normally vest after three years subject to continued service and satisfaction of performance targets	• LTIP awards with a face value of up to 100% of base salary	• Portion of LTIP award worth up to 50% of salary: Sum of EPS for the next three consecutive financial years • For executive directors, the portion of LTIP award in excess of 50% of salary: Operating Profit for the financial year ending three years post-grant • LTIP performance measured over three years	• No change in policy
• Periodic grants which normally vest after three or five years subject to continued service	• Executive directors are eligible to participate in the 2012 SAYE Scheme on the same terms as other employees	• N/A	• No change in policy
• For executive directors, an annual pension allowance of 22% of base salary	• N/A	• N/A	• No change in policy
• Company car or car allowance • Fuel • Medical insurance • Life assurance	• N/A	• N/A	• No change in policy
• Executive directors are required to build and maintain a shareholding worth not less than 100% of base salary (for non-executives, not less than 100% of their annual fee) through the retention of vested share awards or through open market purchases	• N/A	• N/A	• No change in policy

Directors' Report – Corporate Governance
Directors' remuneration report
continued

Salary
For 2013, the Committee approved a 2.5% increase for executive directors (effective 1 April 2013), resulting in a base salary of £426,564 for Andrew Wyllie and £282,599 for Tony Bickerstaff. A 2.5% salary increase budget will also be applied across the Company for 2013.

Pensions
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 Tony Bickerstaff were £1,904 (2011: £1,867) and £1,262 (2011: £1,237) 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 participates in the scheme.

Annual cash bonus
Executive directors and other senior management are eligible for annual cash bonuses to encourage improved performance, with targets established by the Committee to align rewards with the Company strategy. The targets are set at the beginning of the year by the Committee and are reviewed with appropriate input from the Audit Committee at the end of the year. For the year ended 31 December 2012, the Chief Executive and the Group Finance Director each had a maximum bonus opportunity of 100% of base salary.

For the year ended 31 December 2013, the maximum annual cash bonus potential for the Chief Executive and the Group Finance Director remains unchanged, with the same basic approach to target-setting (i.e. 80% relating to key financial targets, 10% relating to Health and Safety targets and 10% relating to personal goals).

Deferred Share Bonus Plan
Executive directors and other senior management are eligible to participate in the Company's Deferred Share Bonus Plan ('DSBP') which promotes greater alignment with shareholders through the award of deferred shares. Under the DSBP, any bonus earned is deferred in shares which vest on the second anniversary of grant, subject to continued employment and not being under notice of termination (either given or received) at the date of vesting. Shares to satisfy the deferred bonuses are purchased by a trust on behalf of the Group and so do not lead to any dilution of shareholder interest.

For the year ended 31 December 2013, the maximum potential DSBP award for the executive directors remains unchanged. The Committee will disclose on a retrospective basis the EBITA measure (defined as underlying earnings before interest, tax, amortisation of acquired intangible assets and employment-related acquisition consideration but excluding any PFI transfer into the pension and pension risk management costs) for 2013 in next year's report.

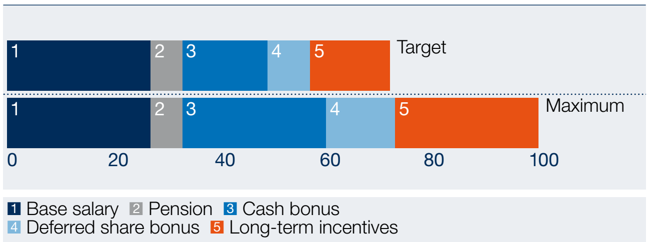
Long-Term Incentive Plan
The Company's 2002 Long-Term Incentive Plan (the '2002 LTIP'), approved by shareholders at the 2002 AGM, reached the end of its ten-year life in 2012 and shareholders gave their approval for the introduction of a new Long-Term Incentive Plan (the '2012 LTIP') at the 2012 Annual General Meeting.

The 2012 LTIP allows for conditional awards over shares to be granted to a participant with a market value of up to 100% of base salary at the date of grant of the award. The vesting of awards are subject to performance conditions set by the Committee. For the year ended 31 December 2013, the maximum grant under the 2012 LTIP for the Chief Executive and the Group Finance Director remains unchanged, with the same basic approach to target-setting to be applied.

For 2012 onwards, the Committee introduced a clawback provision incorporated into the annual cash bonus, the LTIP and the 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.

Fixed versus variable pay mix
The chart below illustrates the average mix between the fixed and variable (performance-related) elements of remuneration of the executive directors at target and maximum performance. Target performance assumes target payouts of cash and DSBP and an expected value of LTIP awards. Maximum performance assumes all bonuses and long-term incentive awards vest in full. The chart demonstrates the weighting of the package towards variable pay, particularly at maximum performance. The Committee considers the mix between fixed and variable pay to be appropriate. During the year, the Committee reviewed the executive remuneration arrangements from a risk perspective and concluded that they do not encourage undue risk and that the arrangements, as a whole, provide an appropriate balance.

Fixed versus variable pay mix
% of maximum remuneration



All-employee Share Plan

The Company's 2002 Save As You Earn Scheme approved by shareholders at the 2002 AGM (the '2002 SAYE Scheme') also reached the end of its ten-year life in 2012 and shareholders gave their approval for the establishment of a new Save As You Earn Scheme at the 2012 Annual General Meeting (the '2012 SAYE Scheme').

The Company intends to make its first grant of options under the 2012 SAYE Scheme during the six-week period following the announcement of its half-year results for the year ending 31 December 2013. No grants were made under either the 2002 SAYE Scheme or the 2012 SAYE Scheme during the course of 2012.

Service agreements and letters of appointment

The executive directors have service contracts that can be terminated by either party on the giving of 12 months' notice. There is no provision for payment of predetermined compensation in case of wrongful termination by the Group and the duty to mitigate loss applies.

Andrew Wyllie's service agreement is dated 25 April 2005 and Tony Bickerstaff's is dated 3 March 2006.

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.

Andrew Wyllie was appointed a Non-Executive Director of Scottish Water on 7 April 2009 and in respect of the appointment for the year ended 31 December 2012 he was paid £19,872 (2011: £19,872). He has retained these fees in accordance with the above policy.

Chairman and other non-executive directors

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 and recommended to the Board following consultation between the Committee and the Chief Executive. Fees are reviewed annually and any increase is effective from 1 April.

Remuneration for non-executive directors, other than the Chairman, comprise 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. As reported last year, following a review in 2012, it was decided to increase the basic annual fees and the additional fees, reflecting the increased time commitment expected of non-executive directors and the expertise that they bring to the Company. The annual fees are as follows:

Year	Basic fee	Senior Independent Director(1)	Audit Committee Chair(2)	Remuneration Committee Chairman
2013	£42,865	£6,273	£8,887	£6,273
2012	£41,820	£6,120	£8,670	£6,120

(1) James Morley was appointed as the Senior Independent Director at the end of December 2012 upon the retirement of John Bryant.
(2) Jane Lodge was appointed as Chair of the Audit Committee at the end of October 2012, succeeding James Morley.

For the year ended 31 December 2012, the Chairman was paid fees of £128,875. He does not receive any additional fees for committee memberships. With effect from 1 April 2013, he will receive an annual fee of £132,096 (2012: £129,500).

The independent non-executive directors have letters of appointment. The appointment of an independent non-executive director can be terminated by reasonable notice on either side. David Allvey, Michael Alexander, Jane Lodge and James Morley are not entitled to compensation for loss of office.

Nominee non-executive directors (as indicated in the Corporate Governance Statement on page 54), hold office for as long as the shareholder nominating them holds a specific percentage of the issued share capital. Nominee non-executive directors are required to stand for re-election in the usual way and are not entitled to compensation for loss of office. Currently, only one of the two major shareholders has appointed a nominee non-executive director to sit on the Board.

The dates of each non-executive director's original appointment are as follows:

Non-executive director	Date of original appointment	Expiry of current term*
David P Allvey	01.11.2001	Close of 2013 AGM
Michael R Alexander	25.07.2007	Close of 2014 AGM
Jane A Lodge	01.08.2012	Close of 2013 AGM
James Morley	09.01.2008	Close of 2014 AGM
Samer G Younis	23.06.2009	Close of 2013 AGM

* Subject to re-election at the AGM following their appointment, subsequent re-election at intervals of no more than three years and re-election at each AGM if having served on the Board for more than nine years, in accordance with the UK Corporate Governance Code and the Company's Articles of Association.

Directors' Report – Corporate Governance

Directors' remuneration report

continued

Implementation Report

Annual bonus

For the year ended 31 December 2012, 80% of the executive directors' annual bonus metrics were set as measurable key financial targets, being Group underlying earnings before interest, tax, amortisation and employment related acquisition consideration but excluding any PFI transfer into the pension scheme and pension risk management costs ('EBITA'). The remaining 20% was linked to: 10% for health and safety targets, relating to Group Accident Frequency Rate ('AFR') and site scored inspections, and 10% to personal goals, relating to building and developing the executive team and the talent pool within the organisation.

The total bonus payment for the executive directors for the year ended 31 December 2012 amounted to 52% of salary for Andrew Wyllie and 51% of salary for Tony Bickerstaff. Of this total payment, 32% related to measurable financial targets ('EBITA'), 10% to health and safety targets (including the achievement of an AFR of 0.09% against a target of 0.12%) and 10% and 9% related to personal goals for Messrs. Wyllie and Bickerstaff respectively (which included the implementation and development of a newly constituted Executive Board and management team to reflect the re-structuring of the business into two divisions: Infrastructure and Natural Resources).

Deferred Share Bonus Plan

For the year ended 31 December 2012, both executive directors had a maximum DSBP opportunity of 50% of base salary. The performance measure was EBITA, as described in the table below:

Group EBITA for 2012	Percentage of Relevant Maximum Award
£21.2 million or less	0%
Between £21.2 million and £23.5 million	Between 0% and 60% on a straight-line basis
£23.5 million	60%
Between £23.5 million and £28.2 million	Between 60% and 100% on a straight-line basis
£28.2 million or more	100%

The EBITA for the year ended 31 December 2012 was £23.7 million and, accordingly, 62% of the maximum DSBP award opportunity will vest. The number of shares to which a participant in the DSBP will be entitled will be calculated on the basis of the monetary value of the deferred bonus divided by the middle-market quotation of a share at the date of the deferred award. The grant of the deferred bonus award is due to be made in the six weeks following the preliminary announcement of the results for the financial year ended 31 December 2012.

The DSBP includes a mechanism to allow the Company to deliver a combined arrangement at no additional cost to the Company by delivering to participants a combination of HM Revenue & Customs ('HMRC') tax-approved market value share Options (with an exercise price determined at the time of grant) over a fixed number of shares, together with non tax-approved Combined Deferred Awards with a nil exercise price over a fixed value of shares. The tax-approved and non tax-approved options/awards are linked, in terms of value and exercise and mirror the same commercial terms as the Deferred Awards.

Long-Term Incentive Plan

The performance conditions applying to the initial awards made under the 2012 LTIP for the executive directors depends upon the quantum of the award. For the portion of awards made over shares worth up to 50% of salary (Tier 1), the performance condition is based on an aggregate EPS target over a period of three financial years. For the portion of awards made over shares in excess of 50% of salary (Tier 2), the performance condition is based on stretching operating profit targets for the 2014 financial year.

The targets for the 2012 LTIP awards are as follows:

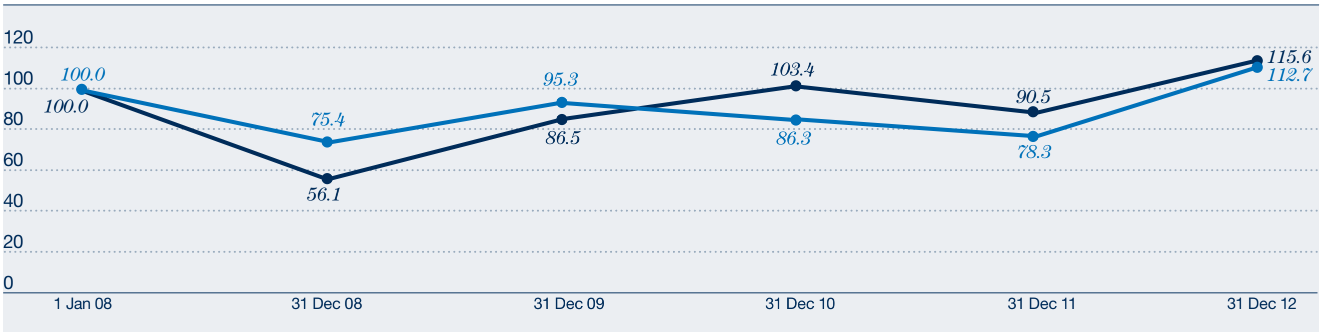
Tier 1

Sum of the EPS for the financial years ending 31 December 2012, 2013 and 2014	Vesting level for awards up to 50% of salary
Below 90 pence	0%
90 pence	15%
100 pence or more	100%
Between 90 pence and 100 pence	Pro-rata between 15% and 100%

Tier 2

Operating Profit for the financial year ending 31 December 2014	Vesting level for awards in excess of 50% of salary
£29.6 million or below	0%
£37 million	50%
Between £29.6 million and £37 million	Pro-rata between 0% and 50%
£44.4 million or more	100%
Between £37 million and £44.4 million	Pro-rata between 50% and 100%

Total shareholder return (from 1 January 2008)
£



■ Costain Group PLC ■ FTSE SmallCap Index
Source: Thomson Reuters

Consequently, for this Tier 2 to vest in full, operating profit must have more than doubled over four years from 2010 levels.

In addition, no element of the Tier 2 award will vest unless the EPS (before pension interest) for the financial year ending 31 December 2014 is at least 35.5 pence and Tier 1 has vested in full.

The Committee believes that EPS and operating profit are the most appropriate metrics to use for the 2012 LTIP, as growth in EPS and operating profit are two of the key drivers of the Company's share price. As with previous LTIP awards, EPS for the award made in 2012 is calculated before pension interest (itself calculated under IAS 19) whilst operating profit is defined as underlying profit before interest, tax, amortisation and employment-related acquisition consideration, but excluding any private finance initiative ('PFI') transfer into the pension scheme and pension risk management costs.

The Remuneration Committee is committed to the concept of creating a genuine alignment of interests between investors and the Costain Board. The Committee therefore welcomed the continuing substantial increases in Andrew Wyllie's and Tony Bickerstaff's shareholdings during 2012 which accords with the Company's share ownership guidelines introduced during 2011. The guidelines seek to align the interests of the Company and investors by encouraging the executive directors to build up and maintain a shareholding worth not less than 100% of base salary (and in the case of non-executive directors 100% of their annual fee) and for other senior executives a shareholding worth no less than 50% of base salary. Executive directors and other senior executives are also encouraged to retain up to 50% of the net number of shares received under any 2012 LTIP or DSBP awards until the target under these guidelines is satisfied.

For 2012 onwards, the Committee introduced a clawback provision incorporated into the annual cash bonus, the LTIP and the 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.

Performance graph

The graph above shows the value, by 31 December 2012, for £100 invested in Costain Group PLC on 1 January 2008 compared with the value of £100 invested in the FTSE SmallCap Index. The Committee believes that the SmallCap Index is an appropriate Index to use as it is the Index in which the Company is a constituent and comprises companies of a more similar size to Costain than the FTSE All-Share.

Directors' Report – Corporate Governance

Directors' remuneration report

continued

The following sections have been audited by KPMG Audit Plc.

Directors' emoluments

The aggregate directors' remuneration for the year ended 31 December 2012 was £1,404,342 (2011: £1,584,800).

	Salary/Fee £	Bonus £	Benefits £	**2012 Total £**	2011 Total £	**2012 Pension* £**	2011 Pension* £
Executive directors							
A Wyllie	414,120	216,403	13,394	**643,917**	766,310	**91,106**	89,320
A O Bickerstaff	274,354	140,610	11,894	**426,858**	510,740	**60,358**	59,175
Non-executive directors							
D P Allvey	128,875	–	–	**128,875**	125,250	**–**	–
M R Alexander	47,705	–	–	**47,705**	46,500	**–**	–
J A Lodge[(i)]	18,870	–	–	**18,870**	–	**–**	–
J Morley[(ii)]	48,797	–	–	**48,797**	49,000	**–**	–
S G Younis	41,615	–	–	**41,615**	40,500	**–**	–
J M Bryant[(iii)]	47,705	–	–	**47,705**	46,500	**–**	–
Former directors	–	–	–	**–**	–	**–**	–
Total	**1,022,041**	**357,013**	**25,288**	**1,404,342**	**1,584,800**	**151,464**	**148,495**

* Pension contributions in excess of £50,000 paid as a cash supplement.
(i) Jane Lodge was appointed as a Non-Executive Director with effect from 1 August 2012 and became Chair of the Audit Committee at the end of October 2012, succeeding James Morley.
(ii) James Morley became the Senior Independent Director at the end of December 2012.
(iii) John Bryant retired as a Non-Executive Director with effect from 31 December 2012.

Directors' share interests

(i) Beneficial holdings

	As at 1 January 2012 Number of Ordinary Shares	As at 31 December 2012 Number of Ordinary Shares
A Wyllie	142,016	200,452
A O Bickerstaff	79,833	117,198
D P Allvey	5,250	5,250
M R Alexander	17,533	18,364
J A Lodge[(i)]	–	–
J Morley[(ii)]	23,000	27,000
S G Younis	–	–
J M Bryant*[(iii)]	15,028	15,028

* All shares held by spouse through a nominee account.
(i) Jane Lodge was appointed as a Non-Executive Director with effect from 1 August 2012 and became Chair of the Audit Committee at the end of October 2012, succeeding James Morley.
(ii) James Morley became the Senior Independent Director at the end of December 2012.
(iii) John Bryant retired as a Non-Executive Director with effect from 31 December 2012.

There continued to be a significant increase in shareholding during 2012 following the introduction of the Company's share ownership guidelines in 2011.

(ii) Deferred Share Bonus Plan awards

Under the DSBP, deferred bonus awards can be 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').

Overview
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Corporate Governance
Financial statements
Other information

Details of the executive directors' DSBP share awards are as follows:

	Date granted	As at 1 Jan 2012	Granted during the year	Lapsed during the year	Exercisable during the year[4]	As at 31 Dec 2012	Exercise price	Exercisable from
A Wyllie	19.04.10	25,800[1]	–	–	25,800	–	–	April 2012-2020
	19.04.10	12,377	–	–	12,377	–	–	April 2012-2020
		(£29,999.91)[2]						
	19.04.10	12,377[3]	–	12,377	–	–	£2.42p	April 2012-2020
	12.04.11	82,644[1]	–	–	–	82,644	–	April 2013-2021
	04.04.12	–	78,258[1]	–	–	78,258	–	April 2014-2022
A O Bickerstaff	19.04.10	12,180[1]	–	–	12,180	–	–	April 2012-2020
	19.04.10	12,377	–	–	12,377	–	–	April 2012-2020
		(£29,999.91)[2]						
	19.04.10	12,377[3]	–	12,377	–	–	£2.42p	April 2012-2020
	12.04.11	54,752[1]	–	–	–	54,752	–	April 2013-2021
	04.04.12	–	51,846[1]	–	–	51,846	–	April 2014-2022

1 Number of shares under the Deferred Award.
2 Maximum number and value of shares under the Combined Deferred Award.
3 Number of shares under the Option.
4 On 27 April 2012, Andrew Wyllie exercised a total of 38,177 DSBP share awards (and thereby also received 1,151 in Dividend Shares) and Tony Bickerstaff exercised a total of 24,557 share awards (and thereby also received 543 Dividend Shares). The market price of the Company's shares on 27 April 2012 was £2.19. The gain (before tax and national insurance) received by these executive directors was £86,128 for Andrew Wyllie and £54,969 for Tony Bickerstaff.

The value of the shares under the Combined Deferred Award and the Option are equal. The Combined Deferred Award and the Option must normally be exercised at the same time. When calculating the maximum value of the shares under a Deferred Award that may be granted under the terms of the Plan, the value of the shares under the Option is not counted.

All of the awards will become exercisable on the second anniversary of the date of grant subject to the continued employment of the participant. The value of the shares delivered under the Combined Deferred Award on exercise is the same as the value of the shares under that award at the time of grant. The number of shares under the Deferred Award and Option at grant will be delivered to the participants on exercise.

To the extent that all or any part of an award becomes exercisable, it remains, subject to the DSBP Rules, exercisable until the tenth anniversary of the date of grant.

(iii) Long-Term Incentive Plan awards
Details of the executive directors' LTIP share awards are as follows:

	Date granted	As at 1 Jan 2012	Granted during the year	Lapsed during the year	Vested during the year[5]	As at 31 Dec 2012	Exercisable from
A Wyllie	07.04.09[1]	82,417	–	–	82,417	–	March 2012
	14.04.10[2]	81,632	–	–	–	81,632	March 2013
	12.04.11[3]	169,294	–	–	–	169,294	March 2014
	09.05.12[4]	–	207,044	–	–	207,044	March 2015
A O Bickerstaff	07.04.09[1]	52,747	–	–	52,747	–	March 2012
	14.04.10[2]	54,081	–	–	–	54,081	March 2013
	12.04.11[3]	112,157	–	–	–	112,157	March 2014
	09.05.12[4]	–	137,167	–	–	137,167	March 2015

1 EPS for the financial year ended 31 December 2011 of 21.0p (15% vests) to EPS of 27.5p (100% vests) on a sliding scale between 15% and 100% pro-rata to the EPS actually achieved. The EPS target was 100% met.
2 EPS for the financial year ended 31 December 2012 of 21.0p (15% vests) to EPS of 27.5p (100% vests) on a sliding scale between 15% and 100% pro-rata to the EPS actually achieved. The EPS target was 100% met.
3 50% of the award is subject to an aggregate EPS for the financial years ended 31 December 2011, 2012 and 2013 of 102p (15% vests) to EPS of 113p (100% vests) on a sliding scale between 15% and 100% pro-rata to the EPS actually achieved. The remaining 50% of the award will be based on an EPS for the financial year ended 31 December 2013 of 47p (0% vests) to EPS of 56p (100% vests) on a sliding scale between 0% and 100% pro-rata to the actual EPS achieved. (EPS targets rounded as appropriate).
4 50% of the award (Tier 1) is subject to an aggregate EPS target for the financial years ended 31 December 2012, 2013 and 2014 of 90p (15% vests) to EPS of 100p (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) is based on operating profit for the financial year ending 31 December 2014 of £37 million (50% vests) to £44.4 million (100% vests) on a sliding scale between £29.6 million and £44.4 million pro-rata to the operating profit actually achieved. In addition, no element of the Tier 2 award will vest unless the EPS (before pension interest) for the financial year ended 31 December 2014 is at least 35.5p and Tier 1 has vested in full.
5 On 05 April 2012, Andrew Wyllie exercised 82,417 share options and Tony Bickerstaff exercised 52,747 share options. The market price of the Company's shares on 05 April 2012 was £2.3187. The gain (before tax and national insurance) received by these executive directors was £191,100 for Andrew Wyllie and £122,304 for Tony Bickerstaff.

Directors' Report – Corporate Governance

Directors' remuneration report

continued

Notes

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

(b) The average closing middle-market price of ordinary shares of 50p each in the Company for the dealing day immediately preceding the date of grant for the 2009 award was 227p, for the 2010 award 245p, for the 2011 award 241p and for the 2012 award 201p.

(c) The total number of ordinary shares of 50p each still outstanding and subject to the 2009 award is 25,186 (2011: 620,262), the 2010 award: 605,533 (2011: 606,550), the 2011 award: 736,504 (2011: 761,402) and the 2012 award: 860,378.

(d) At 31 December 2012, the derived mid-market price of the ordinary shares in the Company, as advised by the Company's brokers, was 254p. The range of the share price of the ordinary shares during 2012 was 184.87p to 254p.

(iv) Save As You Earn scheme awards

Details of the executive directors' SAYE options are as follows:

	Date granted	As at 1 Jan 12	Granted during year	Lapsed during year	Exercised during year	As at 31 Dec 12	Exercise price	Exercisable from
A Wyllie	11.10.11	1,633	–	–	–	1,633	205p	Nov 2014-May 2015
A O Bickerstaff	11.10.11	1,633	–	–	–	1,633	205p	Nov 2014-May 2015

On behalf of the Board

Michael R Alexander

Chairman of the Remuneration Committee

6 March 2013

Directors' Report – Corporate Governance

Directors' responsibilities statement

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

Company law requires the directors to prepare the Group and parent company financial statements for each financial year. Under that law, they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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 parent company and of their profit or loss for that period.

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

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

We confirm that to the best of our knowledge:

- the financial statements for the year ended 31 December 2012, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' Report, the Business review, the Principal risks and Key performance indicators and the Group Finance Director's review sections of this report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

On behalf of the Board

David Allvey
Chairman

Andrew Wyllie
Chief Executive

6 March 2013

Directors' Report – Corporate Governance

Independent Auditor's report

to the members of Costain Group PLC

We have audited the financial statements of the Costain Group PLC for the year ended 31 December 2012 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Statement of Comprehensive Income, the Consolidated and Parent Company Statement of Financial Position, the Consolidated and Parent Company Statements of Changes in Equity, the Consolidated and Parent Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS's') as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ('APB's') Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at **www.frc.org.uk/auditscopeukprivate**

Opinion on financial statements

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 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with 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.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- information given in the Corporate Governance statement with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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' statement, set out in the Directors' Report, in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on directors' remuneration.

Stephen Bligh

Stephen Bligh
Senior Statutory Auditor

for and on behalf of KPMG Audit Plc, Statutory Auditor, Chartered accountants
15 Canada Square
London E14 5GL

6 March 2013

Financial statements

This section contains the detailed financial statements and other information that our stakeholders find useful, including the financial calendar and shareholder services.

Financial statements
Consolidated income statement
Year ended 31 December

		2012			2011		
	Notes	Before other items £m	Other items £m	Total £m	Before other items £m	Other items £m	Total £m
Continuing operations							
Revenue	3	**934.5**	**–**	**934.5**	986.3	–	986.3
Less: Share of revenue of joint ventures and associates	13	**(86.1)**	**–**	**(86.1)**	(117.8)	–	(117.8)
Group revenue		**848.4**	**–**	**848.4**	868.5	–	868.5
Cost of sales		**(794.2)**	**–**	**(794.2)**	(818.8)	–	(818.8)
Gross profit		**54.2**	**–**	**54.2**	49.7	–	49.7
Administrative expenses		**(29.1)**	**–**	**(29.1)**	(25.6)	–	(25.6)
Pension liability management		**(2.8)**	**–**	**(2.8)**	–	–	–
Amortisation of acquired intangible assets		**–**	**(1.7)**	**(1.7)**	–	(0.9)	(0.9)
Employment related deferred consideration		**–**	**(1.7)**	**(1.7)**	–	(0.7)	(0.7)
Group operating profit		**22.3**	**(3.4)**	**18.9**	24.1	(1.6)	22.5
Profit on sale of non-consolidated subsidiary	4	**–**	**–**	**–**	0.5	–	0.5
Profit on sales of interests in joint ventures and associates	4	**10.5**	**–**	**10.5**	0.3	–	0.3
Share of results of joint ventures and associates	13	**(1.4)**	**–**	**(1.4)**	(1.3)	–	(1.3)
Profit from operations	3	**31.4**	**(3.4)**	**28.0**	23.6	(1.6)	22.0
Finance income	7	**27.3**	**–**	**27.3**	34.1	–	34.1
Finance expense	7	**(29.2)**	**–**	**(29.2)**	(32.2)	–	(32.2)
Net finance (expense)/income		**(1.9)**	**–**	**(1.9)**	1.9	–	1.9
Profit before tax	3/4	**29.5**	**(3.4)**	**26.1**	25.5	(1.6)	23.9
Income tax	8	**(2.5)**	**0.6**	**(1.9)**	(5.6)	0.4	(5.2)
Profit for the year attributable to equity holders of the parent		**27.0**	**(2.8)**	**24.2**	19.9	(1.2)	18.7
Earnings per share							
Basic	9	**41.4p**	**(4.3)p**	**37.1p**	31.1p	(1.9)p	29.2p
Diluted	9	**40.0p**	**(4.1)p**	**35.8p**	30.0p	(1.8)p	28.2p

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

	2012 £m	2011 £m
Profit for the year	**24.2**	18.7
Exchange differences on translation of foreign operations	**(1.1)**	(0.8)
Cash flow hedges		
Group:		
Effective portion of changes in fair value during year	**–**	(0.1)
Net changes in fair value transferred to the income statement	**0.1**	0.2
Joint ventures and associates:		
Effective portion of changes in fair value (net of tax) during year	**(0.4)**	(2.8)
Net changes in fair value (net of tax) transferred to the income statement	**4.0**	–
Actuarial losses on defined benefit pension scheme	**(24.4)**	(22.1)
Tax recognised on actuarial losses recognised directly in equity	**2.7**	3.0
Other comprehensive expense for the year	**(19.1)**	(22.6)
Total comprehensive income/(expense) for the year attributable to equity holders of the parent	**5.1**	(3.9)

Company statement of comprehensive income and expense

The Company does not have any comprehensive income or expense, other than a profit for the year of £1.0 million (2011: loss of £2.5 million).

Financial statements

Consolidated statement of financial position

As at 31 December

	Notes	2012 £m	2011 £m
Assets			
Non-current assets			
Intangible assets	11	**18.7**	20.3
Property, plant and equipment	12	**9.1**	11.4
Investments in equity accounted joint ventures	13	**36.1**	21.4
Investments in equity accounted associates	13	**1.6**	1.4
Loans to equity accounted joint ventures	13	**–**	13.7
Loans to equity accounted associates	13	**2.7**	6.4
Other	14	**17.5**	16.4
Deferred tax	8	**17.4**	17.4
Total non-current assets		**103.1**	108.4
Current assets			
Inventories		**1.7**	2.3
Trade and other receivables	14	**181.5**	188.0
Cash and cash equivalents	15	**107.4**	141.7
Total current assets		**290.6**	332.0
Total assets		**393.7**	440.4
Equity			
Share capital	20	**32.8**	32.4
Share premium		**3.7**	3.3
Foreign currency translation reserve		**5.0**	6.1
Hedging reserve		**(1.2)**	(4.9)
Retained earnings		**(8.5)**	(6.1)
Total equity attributable to equity holders of the parent		**31.8**	30.8
Liabilities			
Non-current liabilities			
Retirement benefit obligations	19	**51.9**	52.9
Other payables	17	**5.0**	6.1
Provisions for other liabilities and charges	18	**1.9**	2.3
Total non-current liabilities		**58.8**	61.3
Current liabilities			
Trade and other payables	17	**297.6**	342.9
Income tax liabilities	8	**1.7**	1.7
Bank overdrafts	15	**1.7**	1.6
Provisions for other liabilities and charges	18	**2.1**	2.1
Total current liabilities		**303.1**	348.3
Total liabilities		**361.9**	409.6
Total equity and liabilities		**393.7**	440.4

The financial statements were approved by the Board of Directors on 6 March 2013 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	2012 £m	2011 £m
Assets			
Non-current assets			
Investments in subsidiaries	13	**95.2**	121.4
Total non-current assets		**95.2**	121.4
Current assets			
Trade and other receivables	14	**39.9**	8.1
Cash and cash equivalents	15	**30.0**	61.7
Total current assets		**69.9**	69.8
Total assets		**165.1**	191.2
Equity			
Share capital	20	**32.8**	32.4
Share premium		**3.7**	3.3
Other reserves		**9.3**	6.4
Retained earnings		**32.1**	38.1
Total equity attributable to equity holders of the parent		**77.9**	80.2
Liabilities			
Non-current liabilities			
Provisions for other liabilities and charges	18	**1.3**	1.3
Total non-current liabilities		**1.3**	1.3
Current liabilities			
Trade and other payables	17	**84.0**	107.5
Income tax liabilities	8	**1.7**	1.7
Provisions for other liabilities and charges	18	**0.2**	0.5
Total current liabilities		**85.9**	109.7
Total liabilities		**87.2**	111.0
Total equity and liabilities		**165.1**	191.2

The financial statements were approved by the Board of Directors on 6 March 2013 and were signed on its behalf by:

A Wyllie
Director

A O Bickerstaff
Director

Registered number: 1393773

Financial statements

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 2011	31.7	2.0	6.8	(2.2)	(0.7)	37.6
Profit for the year	–	–	–	–	18.7	18.7
Other comprehensive income/(expense)	–	–	(0.8)	(2.7)	(19.1)	(22.6)
Transfer between reserves	–	–	0.1	–	(0.1)	–
Issue of ordinary shares under employee share option plans	0.6	1.1	–	–	(0.2)	1.5
Equity-settled share-based payments	–	–	–	–	1.4	1.4
Dividends paid	0.1	0.2	–	–	(6.1)	(5.8)
At 31 December 2011	32.4	3.3	6.1	(4.9)	(6.1)	30.8
At 1 January 2012	**32.4**	**3.3**	**6.1**	**(4.9)**	**(6.1)**	**30.8**
Profit for the year	**–**	**–**	**–**	**–**	**24.2**	**24.2**
Other comprehensive income/(expense)	**–**	**–**	**(1.1)**	**3.7**	**(21.7)**	**(19.1)**
Issue of ordinary shares under employee share option plans	**0.3**	**–**	**–**	**–**	**(0.3)**	**–**
Equity-settled share-based payments	**–**	**–**	**–**	**–**	**2.1**	**2.1**
Dividends paid	**0.1**	**0.4**	**–**	**–**	**(6.7)**	**(6.2)**
At 31 December 2012	**32.8**	**3.7**	**5.0**	**(1.2)**	**(8.5)**	**31.8**

Company statement of changes in equity

	Share capital £m	Share premium £m	Other reserve £m	Retained earnings £m	Total equity £m
At 1 January 2011	31.7	2.0	4.5	46.9	85.1
Comprehensive income/(expense)	–	–	–	(2.5)	(2.5)
Issue of ordinary shares under employee share option plans	0.6	1.1	–	(0.2)	1.5
Equity-settled share-based payments granted to employees of subsidiaries	–	–	1.9	–	1.9
Dividends paid	0.1	0.2	–	(6.1)	(5.8)
At 31 December 2011	32.4	3.3	6.4	38.1	80.2
At 1 January 2012	**32.4**	**3.3**	**6.4**	**38.1**	**80.2**
Comprehensive income/(expense)	**–**	**–**	**–**	**1.0**	**1.0**
Issue of ordinary shares under employee share option plans	**0.3**	**–**	**–**	**(0.3)**	**–**
Equity-settled share-based payments granted to employees of subsidiaries	**–**	**–**	**2.9**	**–**	**2.9**
Dividends paid	**0.1**	**0.4**	**–**	**(6.7)**	**(6.2)**
At 31 December 2012	**32.8**	**3.7**	**9.3**	**32.1**	**77.9**

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

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

Group

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

Other reserve

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

Consolidated cash flow statement

Year ended 31 December

	Notes	2012 £m	2011 £m
Cash flows from operating activities			
Profit for the year		**24.2**	18.7
Adjustments for:			
Share of results of joint ventures and associates	13	**1.4**	1.3
Finance income	7	**(27.3)**	(34.1)
Finance expense	7	**29.2**	32.2
Income tax	8	**1.9**	5.2
Profit on sales of interests in joint ventures and associates	4	**(10.5)**	(0.3)
Profit on sale of non-consolidated subsidiary	4	**–**	(0.5)
Depreciation of property, plant and equipment	4	**2.3**	1.9
Amortisation of intangible assets	4	**1.8**	0.9
Employment related deferred consideration		**1.7**	0.7
Share-based payments expense	5	**2.9**	1.9
Cash from operations before changes in working capital and provisions		**27.6**	27.9
Decrease/(increase) in inventories		**0.6**	(1.0)
Decrease/(increase) in receivables		**4.1**	(10.1)
(Decrease)/increase in payables		**(48.1)**	25.0
Movement in provisions and employee benefits		**(6.5)**	(7.1)
Cash (used by)/from operations		**(22.3)**	34.7
Interest received		**1.0**	1.8
Interest paid		**(1.8)**	(1.7)
Net cash (used by)/from operating activities		**(23.1)**	34.8
Cash flows from/(used by) investing activities			
Dividends received from joint ventures and associates	13	**0.6**	1.4
Additions to property, plant and equipment	12	**(0.8)**	(2.9)
Additions to intangible assets	11	**(0.1)**	(0.1)
Proceeds of disposal of property, plant and equipment		**0.6**	0.2
Additions to loans to joint ventures and associates	13	**(5.4)**	(13.5)
Loan repayments by joint ventures and associates	13	**–**	0.4
Proceeds from sale of interest in joint venture		**–**	0.3
Proceeds from sale of subsidiary		**–**	0.5
Acquisitions of subsidiaries (net of acquired cash and cash equivalents and overdrafts)		**–**	(21.1)
Net cash used by investing activities		**(5.1)**	(34.8)
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**–**	1.5
Ordinary dividends paid		**(6.2)**	(5.8)
Net cash used by financing activities		**(6.2)**	(4.3)
Net decrease in cash, cash equivalents and overdrafts		**(34.4)**	(4.3)
Cash, cash equivalents and overdrafts at beginning of the year	15	**140.1**	144.3
Effect of foreign exchange rate changes		**–**	0.1
Cash, cash equivalents and overdrafts at end of the year	15	**105.7**	140.1

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Company cash flow statement

Year ended 31 December

	Notes	2012 £m	2011 £m
Cash flows from operating activities			
Profit/(loss) profit for the year		**1.0**	(2.5)
Adjustments for:			
Finance income		**(2.2)**	(2.3)
Finance expense		**0.3**	0.4
Income tax		**(0.1)**	(0.6)
Loss on sale of investment		**0.7**	–
Amount written off investments		**–**	3.5
Cash used by operations before changes in working capital and provisions		**(0.3)**	(1.5)
Increase in receivables		**(3.5)**	(2.3)
Decrease in payables		**(23.4)**	(10.4)
Movement in provisions		**(0.3)**	0.1
Cash used by operations		**(27.5)**	(14.1)
Interest received		**0.6**	0.3
Interest paid		**(0.3)**	(0.4)
Income tax received		**0.1**	0.6
Net cash used by operating activities		**(27.1)**	(13.6)
Cash flows from investing activities			
Dividends received		**1.6**	2.0
Net cash from investing activities		**1.6**	2.0
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**–**	1.5
Ordinary dividends paid		**(6.2)**	(5.8)
Net cash used by financing activities		**(6.2)**	(4.3)
Net decrease in cash and cash equivalents		**(31.7)**	(15.9)
Cash and cash equivalents at beginning of the year	15	**61.7**	77.6
Cash and cash equivalents at end of the year	15	**30.0**	61.7

Notes to the financial statements

1 General information

Costain Group PLC ('the Company') is a public limited company incorporated in the United Kingdom. The address of its registered office and principal place of business is disclosed on the last page of this Annual Report. The principal activities of the Company and its subsidiary undertakings (collectively referred to as 'the Group') are described in the Business review section of these financial statements.

The consolidated financial statements of the Company for the year ended 31 December 2012 comprise the Group and the Group's interests in associates, jointly controlled entities and jointly controlled 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 6 March 2013.

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 as required by IFRS. Acquisition related amortisation of acquired intangible assets and employment related deferred consideration are reported in the income statement under a separate column headed 'Other items'.

The preparation of financial statements in conformity with IFRS requires management to make judgments, 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 judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. Judgments 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 Business review section of these financial statements. 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 16.

The Group's principal business activity involves long-term contracts with a number of customers, mainly across the United Kingdom. To meet its day-to-day working capital requirements, it uses cash balances provided from shareholders' capital and retained earnings. As part of its contracting operations, it is sometimes 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, including a profit-based one, which 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 2012 but are not material to the Group:

- Amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards'
- Amendments to IFRS 2 'Share-based payment'
- IFRIC 15 'Agreements for the Construction of Real Estate'
- IFRIC 19 'Extinguishing financial liabilities with equity instruments'

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continued

2 Summary of significant accounting policies
continued

Basis of consolidation

(a) The Group's financial statements include the financial statements of the Company and subsidiaries controlled by the Company. Control exists where the Company or one of its subsidiaries has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(b) Associates are operations over which 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. If the share of losses equals the investment, no further losses are recognised, except to the extent that there are amounts receivable that may not be recoverable or further commitments to provide funding.

(c) Jointly controlled entities are those joint ventures where control is shared with another entity, established by contractual agreement. Jointly controlled entities are accounted for using the equity method from the date that the jointly controlled entity commences until the date that joint control of the entity ceases. If the share of losses equals the investment in the entity, no further losses are recognised, except to the extent that there are amounts receivable that may not be recoverable or further commitments to provide funding.

(d) The presentation in the statement of financial position in respect of investments in associates and jointly controlled entities 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) Jointly controlled operations are those joint ventures over which joint control exists, established by contractual agreement, which are not legal entities. Where a jointly controlled operation exists, then the Group entity involved records the assets it controls, the liabilities and expenses it incurs and its share of income. Such jointly controlled operations are reported in the consolidated financial statements on the same basis. Transactions between Group companies and jointly controlled 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, jointly controlled entities and jointly controlled 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, including goodwill and fair value adjustments, 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 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. 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.

2 Summary of significant accounting policies continued

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 jointly controlled operations. Most of the Group's revenue arises from long-term contracts.

(a) Long-term contracts
Revenue arises from increase in the value of work performed on construction contracts and on 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, except where this would not be representative of the stage of completion.

Variations and claims are included in revenue where it is probable that the amount, which can be measured reliably, will be recovered from the customer. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable those costs will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

Construction work in progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less amounts billed and is included in amounts due from customers for contract work. 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 the sale of goods is recognised when the significant risks and rewards of ownership of the goods 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.

Revenue from other services contracts is recognised when the service is provided.

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.

Pre-contract costs
Costs associated with bidding for contracts are written off as incurred. When it is probable that a contract will be awarded, usually when preferred bidder status is secured, costs incurred from that date to the date of financial close are carried forward in the statement of financial position and included in amounts due from customers for contract work.

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

Research and development
Costs classified as relating to research and development activities are expensed as incurred.

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.

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continued

2 Summary of significant accounting policies continued

Goodwill and other intangible assets continued
Other intangible assets comprise acquired intangible assets: customer relationships, order book and brand 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 calculated on a straight-line basis to allocate the cost of the assets over their estimated useful lives.

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)

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

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

PFI investments
The Group has interests in PFI investments held through joint ventures and associates. These arrangements, whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public services, are accounted in accordance with IFRIC 12. Under this interpretation, the infrastructure assets within the Group's investments are recognised as financial assets because the operator has an unconditional right to receive a specified amount of cash or other financial asset over the life of the agreement. The operator recognises investment income in respect of the financial asset on an effective interest basis.

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 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.

2 Summary of significant accounting policies continued

Taxation

The tax expense represents the sum of United Kingdom 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 ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax is calculated at the tax rates based on those enacted or substantially enacted at the 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.

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 the 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 United Kingdom, which provides benefits based on pensionable salary. The details are included in Note 19. 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.

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continued

2 Summary of significant accounting policies continued

Retirement benefit obligations continued
Any increase in the present value of the liabilities of the defined benefit pension scheme arising from employee service is charged to profit from operations in the period. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities arising from the passage of time are included in finance income and finance expense respectively. Actuarial gains and losses 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 available-for-sale financial assets and loans and receivables. The classification depends on the nature and purpose of the financial assets 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.

Effective interest method
The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

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.

Investments
Investments are recognised and derecognised on the trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned. Investments are measured initially at fair value plus transaction costs.

(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. The fair value of interest rate and RPI swaps is the estimated amount that would be received or paid to terminate the swap at the statement of financial position date. Valuations for forward exchange contracts and interest rate and RPI swaps are determined using valuation techniques supported by reference to market values for similar transactions.

2 Summary of significant accounting policies continued

(c) Derivative financial instruments continued

Certain derivative financial instruments are designated as 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.

Significant areas of judgment 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 judgment and estimation arise from the accounting for defined benefit pension schemes under IAS 19 Employee benefits, the accounting for long-term contracts under IAS 11 Construction contracts, assessments of the carrying value of land and the carrying value of goodwill and acquired intangible assets.

Defined benefit pension schemes require significant judgments 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 19.

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. Also, the 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 bases its judgments 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 and forecasts of the costs to complete. 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.

Alcaidesa Holding SA, one of the Group's joint ventures, operates in the Spanish real estate market and holds land and property within its current and non-current assets. The company has also developed and operates a marina under a long-term concession agreement. At 31 December 2012, a review of the net realisable value of each of its land holdings and of the carrying value of the marina assets was undertaken, including the use of external valuations, and provisions, if considered necessary, have been reflected in these financial statements.

Reviewing the carrying value of goodwill and intangible assets recognised on acquisition requires judgments, 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.

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2 Summary of significant accounting policies
continued

IFRSs not applied
The following IFRSs having been endorsed, will be applicable in the future:

- Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' – requires an entity to present the items of other comprehensive that may be recycled to profit or loss in the future if certain conditions are met, separately from those that would never be recycled to profit or loss. Consequently, as the Group presents items of other comprehensive income before related income tax effects the aggregated income tax amount would need to be allocated between those sections. It will be effective for 2013.
- IAS 19 (Revised) 'Employee Benefits' – this amendment will require the financing cost of a defined benefit scheme to be calculated on the net surplus or deficit. It will increase the net pension interest expense. It will be effective for 2013. Had it been effective for 2012, operating profit would have been reduced by £0.6 million and pension interest expense increased by £0.8 million with a corresponding increase in other comprehensive income. This change has no impact on the pension deficit or cash.
- IAS 27 (Revised) 'Separate Financial Statements' will be effective from 2014. This is not expected to have an impact on the financial statements.
- IAS 28 (Revised) 'Investments in Associates and Joint Ventures' will be effective from 2014. This is not expected to have an impact on the financial statements.
- Amendment to IAS 32 'Financial Instruments: Presentation' – Offsetting Financial Assets and Financial Liabilities' – this amendment clarifies the application of offsetting criteria in financial statements. This is not expected to have a significant impact on the financial statements. It will be effective for 2014.
- 'Amendments to IFRS 7 'Financial Instruments: Disclosures' – Offsetting Financial Assets and Financial Liabilities' – this amends the disclosure requirements in respect of financial instruments that are set-off in accordance with guidance in IAS 32. This is not expected to have a significant impact on the financial statements. It will be effective for 2013.
- IFRS 10 'Consolidated Financial Statements' – this now provides a single model establishing principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This is not expected to have a significant impact on the consolidated financial statements. It will be effective for 2014, being adopted as a 'suite of standards' (with IFRS 11 and 12).
- IFRS 11 'Joint Arrangements' – this could result in changes to the classification of certain jointly controlled operations where the Group accounts for its share of the individual assets or liabilities to being equity accounted as associates or joint ventures. It will not affect the Group's profit for the period or net assets. It will be effective for 2014, being adopted as a 'suite of standards' (with IFRS 10 and 12).
- IFRS 12 'Disclosure of Interests in Other Entities' – requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risk associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. This is not expected to have a significant impact on the financial statements. It will be effective for 2014, being adopted as a 'suite of standards' (with IFRS 10 and 11).
- IFRS 13 'Fair Value Measurement' – defines fair value with a single definition in a new standard replacing existing guidance on fair value measurement in different IFRSs, providing a framework for measuring fair values and disclosures about fair value measurements. This is not expected to have a significant impact on the financial statements. It will be effective for 2014.

The following IFRSs have not been endorsed, but may be applicable in the future:

- IFRS 9 'Financial Instruments' – classification of financial assets for measurement purposes. This is not expected to have a significant impact on the financial statements. The earliest adoption will be 1 January 2015 if adopted by the EU from this date.

3 Operating segments

Segment information is based on four business segments: Environment, Infrastructure, Energy & Process and Land Development operations in Spain. The segments are strategic business units with separate management reporting to a segment managing director 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 Business review section of these financial statements.

As discussed in the Chief Executive's review on page 17 we have announced that from 1 January 2013 we will have two main segments, Infrastructure and Natural Resources. However, the results up to 31 December 2012 were reported as set out below.

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 income tax expense. 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.

2012	Environment £m	Infrastructure £m	Energy & Process £m	Land Development £m	Central costs £m	Total £m
Segment revenue						
External revenue	148.5	562.3	137.6	–	–	848.4
Share of revenue of joint ventures and associates	84.1	–	0.1	1.9	–	86.1
Total segment revenue	232.6	562.3	137.7	1.9	–	934.5
Segment profit/(loss)						
Operating profit/(loss)	3.6	26.1	2.5	–	(7.1)	25.1
Pension liability management	–	–	–	–	(2.8)	(2.8)
Profit on sales of interests in joint ventures and associates	10.5	–	–	–	–	10.5
Share of results of joint ventures and associates	0.9	–	–	(2.3)	–	(1.4)
Profit/(loss) from operations before other items	15.0	26.1	2.5	(2.3)	(9.9)	31.4
Other items:						
Amortisation of acquired intangible assets	–	(1.6)	(0.1)	–	–	(1.7)
Employment related deferred consideration	–	(0.9)	(0.8)	–	–	(1.7)
Profit/(loss) from operations	15.0	23.6	1.6	(2.3)	(9.9)	28.0
Net finance expense						(1.9)
Profit before tax						26.1
Segment profit/(loss) is stated after charging the following:						
Depreciation	1.7	0.3	0.3	–	–	2.3
Amortisation (including acquired intangible assets)	–	1.6	0.2	–	–	1.8

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3 Operating segments continued

	Environment £m	Infrastructure £m	Energy & Process £m	Land Development £m	Central costs £m	Total £m
Segment assets						
Reportable segment assets	**56.4**	**135.6**	**40.9**	**36.0**	**–**	**268.9**
Unallocated assets:						
Deferred tax						**17.4**
Cash and cash equivalents						**107.4**
Total assets						**393.7**
Expenditure on non-current assets						
Property, plant and equipment	**0.2**	**0.5**	**0.1**	**–**	**–**	**0.8**
Intangible assets	**0.1**	**–**	**0.1**	**–**	**–**	**0.2**
Loans to joint ventures and associates	**2.2**	**–**	**–**	**3.2**	**–**	**5.4**
Segment liabilities						
Reportable segment liabilities	**94.2**	**151.0**	**50.2**	**–**	**11.2**	**306.6**
Unallocated liabilities:						
Retirement benefit obligations						**51.9**
Overdrafts						**1.7**
Income tax						**1.7**
Total liabilities						**361.9**

2011	Environment £m	Infrastructure £m	Energy & Process £m	Land Development £m	Central costs £m	Total £m
Segment revenue						
External revenue	281.8	448.5	138.2	–	–	868.5
Share of revenue of joint ventures and associates	93.6	17.5	5.2	1.5	–	117.8
Total segment revenue	375.4	466.0	143.4	1.5	–	986.3
Segment profit/(loss)						
Operating profit/(loss)	16.1	10.2	4.6	–	(6.8)	24.1
Profit on sale of non-consolidated subsidiary	0.5	–	–	–	–	0.5
Profit on sale of interest in joint venture	0.3	–	–	–	–	0.3
Share of results of joint ventures and associates	0.6	–	0.1	(2.0)	–	(1.3)
Profit/(loss) from operations before other items	17.5	10.2	4.7	(2.0)	(6.8)	23.6
Other items:						
Amortisation of acquired intangible assets	–	(0.7)	(0.2)	–	–	(0.9)
Employment related deferred consideration	–	(0.3)	(0.4)	–	–	(0.7)
Profit/(loss) from operations	17.5	9.2	4.1	(2.0)	(6.8)	22.0
Net finance income						1.9
Profit before tax						23.9
Segment profit/(loss) is stated after charging the following:						
Depreciation	0.1	1.3	0.5	–	–	1.9
Amortisation (including acquired intangible assets)	–	0.7	0.2	–	–	0.9

3 Operating segments continued

	Environment £m	Infrastructure £m	Energy & Process £m	Land Development £m	Central costs £m	Total £m
Segment assets						
Reportable segment assets	77.8	122.3	45.1	35.9	0.2	281.3
Unallocated assets:						
Deferred tax						17.4
Cash and cash equivalents						141.7
Total assets						440.4
Expenditure on non-current assets						
Property, plant and equipment	–	3.4	0.4	–	–	3.8
Intangible assets	–	16.6	4.5	–	–	21.1
Loans to joint ventures and associates	10.3	–	–	3.2	–	13.5
Segment liabilities						
Reportable segment liabilities	138.4	165.0	49.7	0.1	0.2	353.4
Unallocated liabilities:						
Retirement benefit obligations						52.9
Overdrafts						1.6
Income tax						1.7
Total liabilities						409.6

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.

	Revenue		Non-current assets	
	2012 £m	2011 £m	**2012 £m**	2011 £m
United Kingdom	**910.2**	957.9	**65.0**	68.8
Spain	**1.9**	1.5	**36.0**	37.3
Rest of the World	**22.4**	26.9	**2.1**	2.3
	934.5	986.3	**103.1**	108.4

Customers accounting for more than 10% of revenue

One customer (2011: one) in the Infrastructure segment accounted for revenue of £116.0 million (2011: £155.4 million).

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4 Other operating expenses and income

	2012 £m	2011 £m
Profit before tax is stated after charging:		
Amortisation of intangible assets (Note 11)	**1.8**	0.9
Depreciation of property, plant and equipment (Note 12)	**2.3**	1.9
Hire of plant and machinery	**26.8**	23.1
Rent of land and buildings	**4.0**	3.2
and after crediting:		
Profit on sale of non-consolidated subsidiary	**–**	0.5
Profit on sales of interests in joint ventures and associates	**10.5**	0.3
Income from rent of land and buildings	**1.1**	1.4

In February 2012, the Group transferred two PFI investments to The Costain Pension Scheme for £20.3 million. As a result of this transfer, £4.0 million of fair value adjustments on the PFI financial assets relating to cash flow hedges was recycled through the income statement, making up part of the profit of £10.5 million.

In April 2011, the Group sold its interest in its Zimbabwe based contracting business, Ceezed Construction (Private) Limited, for net proceeds of £0.5 million. In October 2011, the Group disposed of its interest in the assets of China Harbour-Costain Mexico S de RL de CV for net proceeds of £0.3 million.

Auditors' remuneration

The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011 is mandatory for periods starting on/after 1 October 2011. The comparatives in respect of the disclosures of Auditor Remuneration have been restated accordingly.

	2012 £m	2011 £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	**0.3**	0.3
– Other tax advisory services	**0.1**	0.1
– Corporate finance services	**0.3**	0.6
	0.8	1.1

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

Group	2012 £m	2011 £m
Wages and salaries	**153.7**	139.9
Social security costs	**16.1**	14.9
Pension costs (Note 19)	**8.1**	5.3
Share-based payments expense (Note 19)	**2.9**	1.9
	180.8	162.0

Average number of persons employed	2012 Number	2011 Number
Environment	**809**	1,128
Infrastructure	**2,129**	1,615
Energy & Process	**1,323**	1,394
Central	**22**	22
	4,283	4,159

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, Deferred Share Bonus Plans and share options are included in the Directors' remuneration report.

7 Net finance (expense)/income

	2012 £m	2011 £m
Interest income from bank deposits	**0.3**	0.4
Interest income on loans to related parties	**0.7**	1.4
Expected return on defined benefit pension scheme assets (Note 19)	**26.3**	32.3
Finance income	**27.3**	34.1
Interest payable on bank overdrafts and other similar charges	**(1.8)**	(1.7)
Interest cost on the present value of the defined benefit obligations (Note 19)	**(27.4)**	(30.5)
Finance expense	**(29.2)**	(32.2)
Net finance (expense)/income	**(1.9)**	1.9

Interest income on loans to related parties relates to shareholder loan interest receivable from investments in equity accounted joint ventures and associates.

8 Income tax

	2012 £m	2011 £m
On profit for the year		
United Kingdom corporation tax at 24.5% (2011: 26.5%) – Adjustment in respect of prior years	**0.1**	0.1
Current tax credit for the year	**0.1**	0.1
Deferred tax charge for current year	**(2.2)**	(5.9)
Adjustment in respect of prior years	**0.2**	0.6
Deferred tax charge for the year	**(2.0)**	(5.3)
Income tax expense in the consolidated income statement	**(1.9)**	(5.2)

	2012 £m	2011 £m
Tax reconciliation		
Profit before tax	**26.1**	23.9
Income tax at 24.5% (2011: 26.5%)	**(6.4)**	(6.3)
Share of results of joint ventures and associates at 24.5% (2011: 26.5%)	**(0.3)**	(0.3)
Disallowed provisions and expenses	**(0.2)**	(0.3)
Non-taxable gains and profits relieved by capital losses	**2.6**	0.3
Utilisation of previously unrecognised temporary differences	**1.5**	0.3
Rate adjustments relating to deferred taxation and overseas profits and losses	**0.6**	0.4
Adjustments in respect of prior years	**0.3**	0.7
Income tax expense in the consolidated income statement	**(1.9)**	(5.2)
Effective rate of tax	**7.3%**	21.8%

The income 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 £1.7 million (2011: £1.7 million) for the Group and Company represent the amount of income taxes in respect of all outstanding periods.

Accumulated tax losses carried forward, mainly in the United Kingdom, were £5.3 million (2011: £5.8 million).

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8 Income tax continued

Deferred tax asset recognised at 23.0% (2011: 25.0%)	**2012 £m**	2011 £m
Accelerated capital allowances	**1.7**	1.9
Short-term temporary differences	**3.5**	1.8
Retirement benefit obligations	**11.9**	13.2
Tax losses	**0.3**	0.5
Deferred tax asset	**17.4**	17.4

The Company had no deferred tax asset at either year end.

Analysis of deferred tax movements	**2012 £m**	2011 £m
At 1 January	**17.4**	20.9
Deferred tax relating to business combinations		
Transfer in respect of business combinations	**–**	0.8
Transfer in respect of acquired intangible assets	**–**	(1.5)
	–	(0.7)
Deferred tax in consolidated income statement		
Accelerated capital allowances	**(0.2)**	(0.4)
Short-term temporary differences	**2.2**	(4.2)
Tax losses	**(0.1)**	(0.2)
Retirement benefit obligations	**(3.9)**	(0.5)
	(2.0)	(5.3)
Deferred tax in other comprehensive income and expense statement		
Retirement benefit obligations	**2.7**	3.0
Deferred tax recognised directly in the consolidated changes in equity statement		
Short-term temporary differences	**(0.7)**	(0.5)
At 31 December	**17.4**	17.4

8 Income tax continued

Factors that may affect future tax charges

The Group and Company have potential deferred tax assets in their United Kingdom 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.

Deferred tax asset not recognised at 23.0% (2011: 25.0%)

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Accelerated capital allowances	**0.7**	0.7	**–**	–
Short-term temporary differences	**4.9**	5.7	**–**	–
Trading tax losses	**0.9**	0.7	**–**	–
Temporary differences	**6.5**	7.1	**–**	–

In addition to the above temporary differences, the following deferred tax assets are available.

Management expenses and charges incurred by parent Company	**13.1**	14.2	**13.1**	14.2
Capital losses	**63.3**	68.9	**55.4**	60.3

The current year tax effect, at 24.5%, of using the above short-term temporary differences and trading tax losses was £1.5 million (2011: £0.3 million) as detailed in the tax reconciliation above.

There are no expiry dates associated with the deferred tax assets, recognised and not recognised, and tax relief will be obtained if suitable profits arise in the future.

A further reduction to reflect the proposed tax rate of 21.0% from 1 April 2014 would reduce the deferred tax asset by £1.5 million.

9 Earnings per share

The calculation of earnings per share is based on profit of £24.2 million (2011: £18.7 million) and the number of shares set out below.

	2012 Number (millions)	2011 Number (millions)
Weighted average number of ordinary shares in issue for basic earnings per share calculation	**65.3**	64.1
Dilutive potential ordinary shares arising from employee share schemes	**2.3**	2.2
Weighted average number of ordinary shares in issue for diluted earnings per share calculation	**67.6**	66.3

At 31 December 2012, all options were included in the diluted weighted average number of ordinary shares calculation (2011: all).

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10 Dividends

	Dividend per share pence	2012 £m	2011 £m
Final dividend for the year ended 31 December 2010	6.25	**–**	3.9
Interim dividend for the year ended 31 December 2011	3.25	**–**	2.2
Final dividend for the year ended 31 December 2011	6.75	**4.4**	–
Interim dividend for the year ended 31 December 2012	3.50	**2.3**	–
Amount recognised as distributions to equity holders in the year		**6.7**	6.1
Dividends settled in shares		**(0.5)**	(0.3)
Dividends settled in cash		**6.2**	5.8

A final dividend in respect of the year ended 31 December 2012 of 7.25p per share, amounting to a dividend of £4.7 million, is to be proposed at the Annual General Meeting. If approved, the dividend is expected to be paid on 25 May 2013 to shareholders registered at the close of business on 20 April 2013 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	Software & development £m	Total £m
Cost					
At 1 January 2011	–	–	–	5.0	5.0
Acquired through business combinations	15.2	4.1	1.7	–	21.0
Other additions	–	–	–	0.1	0.1
At 31 December 2011	15.2	4.1	1.7	5.1	26.1
At 1 January 2012	**15.2**	**4.1**	**1.7**	**5.1**	**26.1**
Additions	**–**	**–**	**–**	**0.2**	**0.2**
At 31 December 2012	**15.2**	**4.1**	**1.7**	**5.3**	**26.3**
Amortisation					
At 1 January 2011	–	–	–	4.9	4.9
Provided in year	–	0.7	0.2	–	0.9
At 31 December 2011	–	0.7	0.2	4.9	5.8
At 1 January 2012	**–**	**0.7**	**0.2**	**4.9**	**5.8**
Provided in year	**–**	**1.5**	**0.2**	**0.1**	**1.8**
At 31 December 2012	**–**	**2.2**	**0.4**	**5.0**	**7.6**
Net book value					
At 31 December 2012	**15.2**	**1.9**	**1.3**	**0.3**	**18.7**
At 31 December 2011	15.2	3.4	1.5	0.2	20.3
At 1 January 2011	–	–	–	0.1	0.1

The net book value of other acquired intangible assets comprises £0.8 million relating to order book and £0.5 million relating to brand value (2011: £0.9 million and £0.6 million respectively).

Goodwill has been allocated to the applicable cash generating units identified within the Infrastructure (£11.4 million) and Energy & Process (£3.8 million) reporting segments.

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 CGU in Infrastructure was 14% and for the CGU in Energy & Process was 16%.

11 Intangible assets continued

The Group prepares cash flow forecasts derived from the most recent financial forecasts for the following two years and extrapolates those cash flows based on the following internal assessments of the annual growth rates attributable to the acquired businesses:

Growth rates	Infrastructure %	Energy & Process %
Years 3-4	2.5	2.5
Year 5	1.5	2.5
Long-term average	1.5	1.5

As at 31 December 2012, based on these internal valuations, the recoverable value of goodwill exceeded the carrying amounts by a comfortable amount.

12 Property, plant and equipment

Group	Land and buildings £m	Plant and equipment £m	Total £m
Cost			
At 1 January 2011	0.9	20.1	21.0
Additions	–	2.9	2.9
Disposals	(0.2)	(0.5)	(0.7)
Acquired through business combinations	0.2	0.7	0.9
At 31 December 2011	0.9	23.2	24.1
At 1 January 2012	**0.9**	**23.2**	**24.1**
Additions	**–**	**0.8**	**0.8**
Disposals	**–**	**(1.7)**	**(1.7)**
At 31 December 2012	**0.9**	**22.3**	**23.2**
Depreciation			
At 1 January 2011	0.6	10.7	11.3
Provided in year	0.1	1.8	1.9
Disposals	(0.1)	(0.4)	(0.5)
At 31 December 2011	0.6	12.1	12.7
At 1 January 2012	**0.6**	**12.1**	**12.7**
Provided in year	**–**	**2.3**	**2.3**
Disposals	**–**	**(0.9)**	**(0.9)**
At 31 December 2012	**0.6**	**13.5**	**14.1**

Net book value			
At 31 December 2012	**0.3**	**8.8**	**9.1**
At 31 December 2011	0.3	11.1	11.4
At 1 January 2011	0.3	9.4	9.7

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13 Investments and loans in subsidiaries, equity accounted joint ventures and associates

	Investments		Loans		
Group	Joint ventures £m	Associates £m	Joint ventures £m	Associates £m	Total £m
Cost or fair value					
At 1 January 2011	38.8	0.2	10.8	1.5	51.3
Currency realignment	(0.7)	–	(0.3)	(0.1)	(1.1)
Additions	–	–	3.2	10.3	13.5
Repayments	–	–	–	(0.4)	(0.4)
At 31 December 2011	38.1	0.2	13.7	11.3	63.3
At 1 January 2012	**38.1**	**0.2**	**13.7**	**11.3**	**63.3**
Currency realignment	**(0.8)**	**–**	**(0.5)**	**–**	**(1.3)**
Additions	**–**	**–**	**3.2**	**2.2**	**5.4**
Disposal	**–**	**–**	**–**	**(9.9)**	**(9.9)**
Transfer*	**17.6**	**–**	**(16.4)**	**–**	**1.2**
At 31 December 2012	**54.9**	**0.2**	**–**	**3.6**	**58.7**
Share of post-acquisition reserves					
At 1 January 2011	(14.3)	(0.8)			(15.1)
Currency realignment	0.2	–			0.2
Dividends	(0.8)	(0.6)			(1.4)
(Loss)/profit for the year	(1.8)	0.5			(1.3)
Cash flow hedges – change in fair value	–	(2.8)			(2.8)
At 31 December 2011	(16.7)	(3.7)			(20.4)
At 1 January 2012	**(16.7)**	**(3.7)**			**(20.4)**
Currency realignment	**0.2**	**(0.1)**			**0.1**
Dividends	**–**	**(0.6)**			**(0.6)**
(Loss)/profit for the year	**(2.3)**	**0.9**			**(1.4)**
Cash flow hedges – change in fair value	**–**	**(0.4)**			**(0.4)**
Cash flow hedges – disposals	**–**	**4.0**			**4.0**
At 31 December 2012	**(18.8)**	**0.1**			**(18.7)**
Reclassifications					
At 1 January 2011	–	2.1	–	(0.9)	1.2
Arising in the year	–	2.8	–	(4.0)	(1.2)
At 31 December 2011	–	4.9	–	(4.9)	–
At 1 January 2012	**–**	**4.9**	**–**	**(4.9)**	**–**
Arising in the year	**–**	**(3.6)**	**–**	**4.0**	**0.4**
At 31 December 2012	**–**	**1.3**	**–**	**(0.9)**	**0.4**
Net book value					
At 31 December 2012	**36.1**	**1.6**	**–**	**2.7**	**40.4**
At 31 December 2011	21.4	1.4	13.7	6.4	42.9
At 1 January 2011	24.5	1.5	10.8	0.6	37.4

* During 2012, the loan to Alcaidesa Holding SA, including outstanding interest, was converted into equity.

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

	2012				2011			
	Alcaidesa Holding SA £m	**Other joint ventures £m**	**Associates £m**	**Total £m**	Alcaidesa Holding SA £m	Other joint ventures £m	Associates £m	Total £m
Revenue	**1.9**	**52.9**	**31.3**	**86.1**	1.5	80.4	35.9	117.8
(Loss)/profit before tax	**(2.3)**	**–**	**1.3**	**(1.0)**	(2.0)	0.2	0.8	(1.0)
Income tax	**–**	**–**	**(0.4)**	**(0.4)**	–	–	(0.3)	(0.3)
(Loss)/profit for the year	**(2.3)**	**–**	**0.9**	**(1.4)**	(2.0)	0.2	0.5	(1.3)
Non-current assets	**20.0**	**–**	**0.9**	**20.9**	20.9	–	1.0	21.9
Current assets	**29.5**	**15.3**	**58.9**	**103.7**	31.2	30.3	113.6	175.1
Current liabilities	**(3.4)**	**(15.2)**	**(10.3)**	**(28.9)**	(5.3)	(30.2)	(11.3)	(46.8)
Non-current liabilities	**(10.1)**	**–**	**(47.9)**	**(58.0)**	(25.5)	–	(101.9)	(127.4)
Investments in joint ventures and associates	**36.0**	**0.1**	**1.6**	**37.7**	21.3	0.1	1.4	22.8
Financial commitments	**–**	**–**	**2.3**	**2.3**	–	–	3.6	3.6
Capital commitments	**–**	**–**	**2.2**	**2.2**	–	–	13.4	13.4

Net interest payable by joint ventures and associates in 2012 was £1.7 million (2011: £2.5 million payable). The applicable interest rates are income of 0.2% to 0.4% per annum (2011: 0.2% to 0.4%) and expense of 1.7% to 11.5% per annum (2011: 5.4% to 11.5%).

The financial commitments relate to associates involved in PFI schemes and the capital commitments relate to ongoing construction works. All figures are the Group's share.

Analysis of the total revenue, income, assets and liabilities of joint ventures and associates

	2012				2011			
	Alcaidesa Holding SA £m	**Other joint ventures £m**	**Associates £m**	**Total £m**	Alcaidesa Holding SA £m	Other joint ventures £m	Associates £m	Total £m
Revenue	**3.7**	**126.3**	**99.1**	**229.1**	3.0	176.3	119.4	298.7
(Loss)/profit before tax	**(4.6)**	**0.1**	**5.7**	**1.2**	(4.1)	0.4	3.5	(0.2)
Income tax	**–**	**–**	**(1.8)**	**(1.8)**	–	(0.1)	(0.9)	(1.0)
(Loss)/profit for the year	**(4.6)**	**0.1**	**3.9**	**(0.6)**	(4.1)	0.3	2.6	(1.2)
Non-current assets	**38.7**	**–**	**2.3**	**41.0**	42.0	–	2.4	44.4
Current assets	**59.6**	**34.9**	**178.5**	**273.0**	62.4	69.2	369.3	500.9
Current liabilities	**(6.8)**	**(34.6)**	**(32.2)**	**(73.6)**	(10.5)	(68.9)	(38.5)	(117.9)
Non-current liabilities	**(20.2)**	**–**	**(142.7)**	**(162.9)**	(50.9)	–	(328.1)	(379.0)
Equity	**71.3**	**0.3**	**5.9**	**77.5**	43.0	0.3	5.1	48.4

Details of the principal subsidiary undertakings, joint ventures, jointly controlled operations and associates are shown in Note 23.

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13 Investments and loans in subsidiaries, equity accounted joint ventures and associates continued

Company

Investments in subsidiaries	£m
Cost	
At 1 January 2011	392.2
Additions	1.9
At 31 December 2011	394.1
At 1 January 2012	**394.1**
Additions	**2.9**
Disposal	**(32.6)**
At 31 December 2012	**364.4**
Amounts written off	
At 1 January 2011	(269.2)
Provided	(3.5)
At 31 December 2011	(272.7)
At 1 January 2012	**(272.7)**
Disposal	**3.5**
At 31 December 2012	**(269.2)**

Net book value	
At 31 December 2012	**95.2**
At 31 December 2011	121.4
At 1 January 2011	123.0

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 principal subsidiaries in which the Company has an interest are set out in Note 23.

14 Trade and other receivables

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Amounts included in current assets				
Trade receivables	**73.0**	84.8	**–**	–
Other receivables	**12.8**	15.2	**–**	–
Amounts due from customers for contract work	**79.0**	74.3	**–**	–
Prepayments and accrued income	**15.9**	13.2	**0.9**	0.9
Amounts owed by joint ventures and associates	**0.8**	0.5	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**39.0**	7.2
	181.5	188.0	**39.9**	8.1
Amounts included in non-current assets				
Other	**17.5**	16.4	**–**	–

At 31 December 2012, amounts due from customers for contract work falling due within one year and other receivables falling due after more than one year included retentions of £39.8 million (2011: £40.5 million) relating to construction contracts in progress.

The directors consider that the carrying amount of trade, other receivables and amounts owed by joint ventures and associates approximates to their fair value. Based on prior experience, the directors believe that the trade receivables are recoverable and, other than as disclosed in Note 25, there is no allowance for bad or doubtful debts (2011: £Nil).

14 Trade and other receivables continued

The average credit period within trade receivables on amounts billed for construction work and on sales of goods is 33 days (2011: 31 days). The analysis of the due dates of the trade receivables was £65.3 million (2011: £61.5 million) due within 30 days, £4.6 million (2011: £19.6 million) due between 30 and 60 days and £3.1 million (2011: £3.7 million) due after 60 days.

Included in the trade receivables balance are debtors, with a carrying amount of £6.8 million (2011: £6.1 million), which are past due at the reporting date 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 aggregate amount of costs incurred plus recognised profits, less recognised losses, for all contracts in progress at the statement of financial position date was £2,753.2 million (2011: £2,789.6 million). Progress billings and advances received from customers under open construction contracts amounted to £2,707.2 million (2011: £2,762.6 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 (Note 17).

15 Cash and cash equivalents

Cash and cash equivalents are analysed below, and include the Group's share of cash held by jointly controlled operations of £29.6 million (2011: £33.6 million).

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Cash and cash equivalents	**107.4**	141.7	**30.0**	61.7
Bank overdrafts	**(1.7)**	(1.6)	**–**	–
Cash, cash equivalents and overdrafts in the cash flow statement	**105.7**	140.1	**30.0**	61.7

16 Financial instruments and risk management

The Group's centralised treasury function manages financial risk, principally arising from movements in foreign currency rates, interest rates and inflation rates and liquidity and funding risks, in accordance with policies agreed by the directors. To manage these risks, forward foreign currency sale and purchase contracts are used in respect of foreign currency requirements and interest rate swaps are used for PFI investments.

The Group does not enter into speculative transactions.

The Company does not have any forward foreign currency contracts or other derivatives.

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 Group has no long-term debt and the current capital base of the Group is driven by equity capital from shareholders and retained earnings. The Board of directors ('Board') continues to explore options to strengthen the Group by growing the business and improving profitability; the Business review 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.

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16 Financial instruments and risk management continued

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. The nature and timing of the contract cash flows causes the cash balances to vary over the month with the balance usually highest at the month end.

The average month end cash balance during the year was £103.4 million (2011: £130.4 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.

The Group has banking and bonding facilities including a £45 million Revolving Credit Facility extending to 30 September 2015. The facilities have financial covenants based on profit, interest cover and leverage measured quarterly. There were no changes in the Board's approach to capital management during the year.

Unsecured bonding facilities available

	Group and Company	
	2012 £m	2011 £m
Expiring between two and five years*	**420.0**	420.0
* Element of above facilities available for borrowings	**2.5**	2.5

Credit risk

The Group 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 United Kingdom are placed with the bank facility providers or, in jointly controlled 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 counter-parties 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 counter-party 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.

Interest rate risk

The Group has cash balances in the United Kingdom and Overseas and bank borrowings Overseas. The largest constituents are United Kingdom balances denominated in Pounds sterling. A 1% rise in interest rates would have increased the annual net interest income on cash balances by £1.0 million (2011: £1.3 million).

The only interest rate hedging currently undertaken by the Group is within PFI investments, where interest rate derivatives have been used as a means of hedging interest rate risk. The policy is to fix the interest cost on variable rate financing on specific projects by taking out floating to fixed interest rate swaps; these swaps are designated to the underlying debt obligations and are expected to be effective for cash flow hedge accounting purposes.

16 Financial instruments and risk management continued

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.

At 31 December 2012, the net monetary assets denominated in currencies other than the functional currency of the operation involved were Euro denominated net monetary assets of £Nil (2011: £16.5 million) in members of the Group with sterling as their functional currency.

A 10% strengthening in the Euro would have adversely impacted the results by £0.3 million (2011: £0.2 million).
A 10% strengthening in the UAE Dirham would have adversely impacted the results by £0.4 million (2011: £0.2 million).

Investments in joint ventures includes the Group's investment in Alcaidesa Holding SA, a company based in Spain and denominated in Euro. At the year-end, the net carrying value of the equity investment was £36.0 million (2011: £35.0 million including loans). A 10% strengthening in the Euro would have favourably impacted the statement of financial position by £4.0 million (2011: £3.9 million).

Cash flow hedges

Foreign currency contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts.

At 31 December 2012, the Group had foreign currency contracts (22 purchase contracts (2011: 26) and 4 sale contracts (2011: 11)) designated as hedges of committed future purchases. The Group held no other foreign currency sale contracts (2011: Nil).

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. These amounts were recognised as fair value derivatives. The terms of the foreign currency contracts match the terms of the commitments. There were no ineffective hedges at the year-end (2011: Nil).

The foreign currency sale and purchase contracts outstanding at 31 December 2012 are summarised below. The carrying value represents the fair value of the contract; the contractual cash flows represent the sterling commitments.

Foreign exchange contracts

	2012				2011			
	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	**(0.3)**	**(7.6)**	**(7.6)**	**–**	(0.5)	(10.7)	(6.4)	(4.3)
Sales	**0.1**	**2.6**	**2.6**	**–**	0.2	4.5	2.2	2.3
	(0.2)	**(5.0)**	**(5.0)**	**–**	(0.3)	(6.2)	(4.2)	(2.0)

The expected impact on the income statement of the foreign exchange contracts is a loss of £0.2 million in 2013.

Interest rate swaps are measured at the present value of the future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

At 31 December 2012, PFI project companies, in which the Group has an interest and records as investments in associates, had entered into the following swaps to hedge the interest rate risk of bank loans. These swaps are classified as cash flow hedges and stated at fair value based on a Level 2 valuation method. The fair value will reverse over the life of the swaps. There were no ineffective hedges at the year-end (2011: Nil).

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16 Financial instruments and risk management continued
Maturity of PFI swaps

	2012				2011			
	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
Interest rate swaps	**1.3**	**0.1**	**0.4**	**0.8**	6.0	0.3	1.2	4.5
Less tax	**(0.3)**	**–**	**(0.1)**	**(0.2)**	(1.5)	(0.1)	(0.3)	(1.1)
	1.0	**0.1**	**0.3**	**0.6**	4.5	0.2	0.9	3.4

These amounts (net of tax) were recognised as fair value derivatives within the value of the investment or, if a future commitment exists, within provisions.

Financial assets and liabilities
Currency and maturity of financial assets

	2012				2011			
	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	**106.1**	**106.1**	**–**	**–**	135.9	135.9	–	–
UAE Dirham	**1.1**	**1.1**	**–**	**–**	2.6	2.6	–	–
Euro	**–**	**–**	**–**	**–**	2.8	2.8	–	–
Other	**0.2**	**0.2**	**–**	**–**	0.4	0.4	–	–
	107.4	**107.4**	**–**	**–**	141.7	141.7	–	–
Loans to joint ventures and associates:								
Pounds sterling	**2.7**	**0.1**	**0.5**	**2.1**	6.4	0.6	2.4	3.4
Euro	**–**	**–**	**–**	**–**	13.7	–	13.7	–
	2.7	**0.1**	**0.5**	**2.1**	20.1	0.6	16.1	3.4
Trade, other receivables and amounts owed by joint ventures and associates:								
Pounds sterling	**101.8**	**84.3**	**17.5**	**–**	113.7	97.3	16.4	–
Other	**2.3**	**2.3**	**–**	**–**	3.2	3.2	–	–
	104.1	**86.6**	**17.5**	**–**	116.9	100.5	16.4	–
Total financial assets	**214.2**	**194.1**	**18.0**	**2.1**	278.7	242.8	32.5	3.4

16 Financial instruments and risk management continued

Currency and maturity of financial liabilities

	2012			2011		
	Total £m	Within one year £m	Between one and five years £m	Total £m	Within one year £m	Between one and five years £m
Bank overdrafts – UAE Dirham	**1.7**	**1.7**	**–**	1.6	1.6	–
Trade and other payables:						
Pounds sterling	**140.3**	**135.3**	**5.0**	148.4	142.3	6.1
UAE Dirham	**5.2**	**5.2**	**–**	6.4	6.4	–
	145.5	**140.5**	**5.0**	154.8	148.7	6.1
Total financial liabilities	**147.2**	**142.2**	**5.0**	156.4	150.3	6.1

The bank overdrafts are at a floating rate and are unsecured.

Reconciliation of trade and other receivables and trade and other payables to the balance sheet.

	2012		2011	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other receivables (as above)	**86.6**	**17.5**	100.5	16.4
Amounts due from customers	**79.0**	**–**	74.3	–
Prepayments and accrued income	**15.9**	**–**	13.2	–
	181.5	**17.5**	188.0	16.4

	2012		2011	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other payables (as above)	**140.5**	**5.0**	148.7	6.1
Credit balances on long-term contracts	**7.6**	**–**	22.3	–
Accruals and deferred income	**149.5**	**–**	171.9	–
	297.6	**5.0**	342.9	6.1

Effective interest rates of financial assets and liabilities

	2012	2011
Financial assets		
Cash and cash equivalents	**0.0% to 1.2%**	0.0% to 1.3%
Loans to joint ventures and associates	**10.0% to 11.5%**	10.0% to 11.5%
Financial liabilities		
Bank overdrafts	**3.3%**	5.5%

The Company's financial assets comprised cash at bank of £30.0 million (2011: £61.7 million) denominated in Pounds sterling and maturing within one year.

There are no significant differences between the carrying values of the Group's and Company's financial assets and liabilities and their fair values except the fair values of loans carrying interest rates above 10% may be higher than their carrying values of £2.7 million (2011: £6.4 million), but not by a material amount.

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17 Trade and other payables

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Current liabilities				
Trade payables	**105.1**	108.1	**–**	–
Other payables	**21.5**	23.3	**–**	–
Social security	**5.5**	4.6	**–**	–
Credit balances on long-term contracts	**7.6**	22.3	**–**	–
Accruals and deferred income	**149.5**	171.9	**–**	0.6
Amounts owed to joint ventures and associates	**8.4**	12.7	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**84.0**	106.9
	297.6	342.9	**84.0**	107.5
Non-current liabilities				
Other payables	**5.0**	6.1	**–**	–

At 31 December 2012, credit balances on long-term contracts included no advance payments from customers (2011: £13.1 million).

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.

18 Provisions for other liabilities and charges

Group	Property £m	PFI investments £m	Other £m	Total £m
Current				
At 1 January 2011	0.7	1.2	1.3	3.2
Provided	0.2	–	0.4	0.6
Utilised	(0.1)	–	–	(0.1)
Released	–	–	(0.6)	(0.6)
Transfer	0.2	(1.2)	–	(1.0)
At 31 December 2011	1.0	–	1.1	2.1
At 1 January 2012	**1.0**	**–**	**1.1**	**2.1**
Provided	**0.7**	**–**	**0.5**	**1.2**
Utilised	**(0.4)**	**–**	**–**	**(0.4)**
Released	**(0.3)**	**–**	**(0.5)**	**(0.8)**
At 31 December 2012	**1.0**	**–**	**1.1**	**2.1**

18 Provisions for other liabilities and charges continued

	Property £m	PFI investments £m	Other £m	Total £m
Non-current				
At 1 January 2011	0.4	–	2.1	2.5
Transfer	(0.2)	–	–	(0.2)
At 31 December 2011	0.2	–	2.1	2.3
At 1 January 2012	**0.2**	**–**	**2.1**	**2.3**
Provided	**–**	**–**	**0.3**	**0.3**
Utilised	**(0.1)**	**–**	**(0.6)**	**(0.7)**
At 31 December 2012	**0.1**	**–**	**1.8**	**1.9**

Company	Funding obligations £m	Other £m	Total £m
Current			
At 1 January 2011	0.2	0.1	0.3
Released	–	0.2	0.2
Utilised	(0.1)	–	(0.1)
Transfer	0.1	–	0.1
At 31 December 2011	0.2	0.3	0.5
At 1 January 2012	**0.2**	**0.3**	**0.5**
Provided	**–**	**–**	**–**
Utilised	**–**	**(0.3)**	**(0.3)**
At 31 December 2012	**0.2**	**–**	**0.2**
Non-current			
At 1 January 2011	1.4	–	1.4
Transfer	(0.1)	–	(0.1)
At 31 December 2011	1.3	–	1.3
At 1 January 2012	**1.3**	**–**	**1.3**
At 31 December 2012	**1.3**	**–**	**1.3**

Group

Property provisions relate to costs of vacant properties and will be utilised over the next three years.

PFI investment provisions relate to investments where the carrying value of the investment is negative and an obligation exists to provide further funding. The provisions are expected to reverse when the obligation to provide funding is satisfied, expected to be within one year.

Other provisions, mainly comprise a provision for staff benefits payable to the staff of an Overseas subsidiary company, which will be utilised over the next five years, and insurance claims, 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.

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19 Employee benefits

(a) Pensions

A defined benefit pension scheme is operated in the United Kingdom and a number of defined contribution pension schemes are in place in the United Kingdom and Overseas. Contributions are paid by subsidiary undertakings and employees. The total pension charge in the income statement was £9.2 million comprising £8.1 million included in operating costs and £1.1 million included in net finance expense (2011: £3.5 million, comprising £5.3 million in operating costs less £1.8 million in net finance income).

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 at 31 March 2010 and was updated to 31 December 2012 by a qualified independent actuary.

	2012 £m	2011 £m	2010 £m
Present value of defined benefit obligations	**(610.7)**	(600.8)	(576.7)
Fair value of scheme assets	**558.8**	547.9	537.1
Recognised liability for defined benefit obligations	**(51.9)**	(52.9)	(39.6)

Movements in present value of defined benefit obligations

	2012 £m	2011 £m
At 1 January	**600.8**	576.7
Interest cost	**27.4**	30.5
Amendments (Pension Increase Exchange ‘PIE’)	**(1.7)**	–
Plan Settlements (Enhanced Transfer Value ‘ETV’)	**(29.3)**	–
Actuarial losses	**40.7**	18.2
Benefits paid	**(27.2)**	(24.6)
At 31 December	**610.7**	600.8

Movements in fair value of scheme assets

	2012 £m	2011 £m
At 1 January	**547.9**	537.1
Expected return on scheme assets	**26.3**	32.3
Actuarial (losses)/gains	**16.2**	(3.9)
Contributions by employer	**28.4**	7.0
Plan Settlements (‘ETV’)	**(32.8)**	–
Benefits paid	**(27.2)**	(24.6)
At 31 December	**558.8**	547.9

19 Employee benefits continued

(a) Pensions continued

(Expense)/income recognised in the income statement

	2012 £m	2011 £m
Pension liability management (ETV and PIE, including costs of £0.9 million)	**(2.8)**	–
Expected return on scheme assets	**26.3**	32.3
Interest cost on defined benefit obligations	**(27.4)**	(30.5)
	(3.9)	1.8

Income statement classification of (expense)/income

	2012 £m	2011 £m
Pension liability management (ETV and PIE, including costs of £0.9 million)	**(2.8)**	–
Finance income	**26.3**	32.3
Finance expense	**(27.4)**	(30.5)
	(3.9)	1.8

History of the scheme for the last five years

Experience adjustments	2012	2011	2010	2009	2008
Experience gain on scheme liabilities (£m)	**–**	–	18.5	–	–
	–	0%	3%	–	–
Change in assumptions on scheme liabilities (£m)	**(40.7)**	(18.2)	(27.0)	(113.7)	94.6
	7%	3%	5%	20%	19%
Experience adjustments on scheme assets (£m)	**16.2**	(3.9)	33.1	46.3	(105.1)
	3%	1%	6%	10%	27%
Total (loss)/gain (£m)	**(24.5)**	(22.1)	24.6	(67.4)	(10.5)

The cumulative amount of actuarial gains and losses recognised in other comprehensive income and expense since 1 January 2004, the transition date to IFRS, is a loss of £84.7 million (2011: £60.2 million).

Fair value of scheme assets and the return on scheme assets

	2012 £m	2011 £m
Equities	**184.2**	173.9
High yield bonds	**46.2**	52.8
Government bonds	**195.8**	223.4
Infrastructure and property	**63.8**	43.7
Absolute return funds and cash	**68.8**	54.1
	558.8	547.9

The infrastructure holding is the portfolio of eight PFI investments transferred by the Group to The Costain Pension Scheme in 2010 and 2012.

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.

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19 Employee benefits continued

(a) Pensions continued

Principal actuarial assumptions (expressed as weighted averages)

	2012 %	2011 %	2010 %
Discount rate	**4.40**	4.80	5.40
Expected rate of return on scheme assets	**4.40**	4.95	6.11
Future pension increases	**2.85**	2.90	3.40
Inflation assumption	**2.95**	3.00	3.40

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

Weighted average life expectancy from age 65 as per mortality tables used to determine benefits at 31 December 2012 and 31 December 2011 is:

	2012		2011	
	Male (years)	Female (years)	Male (years)	Female (years)
Currently aged 65	**21.7**	**23.8**	21.5	23.7
Non-retirees	**24.5**	**25.6**	24.4	25.6

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 increases pension cost by	28.2	1.1
Decrease inflation, pension increases by 0.25%, decreases pension liability and reduces pension cost by	25.4	1.1
Increase life expectancy by one year, increases pension liability and increases pension cost by	16.7	0.7

The expected pension cost for 2013 under IAS 19 (Revised), which becomes effective for 2013 is a £0.6 million operating expense and a £2.1 million finance expense.

The Group expects to contribute an amount equal to dividends paid to shareholders and the expenses of administration to its defined benefit scheme in the next financial year.

Defined contribution schemes

Several defined contribution pensions are operated. The total expense relating to these plans was £5.3 million (2011: £5.3 million).

19 Employee benefits continued

(b) Share-based payments

The company operates a number of share based payment plans as described below.

Long-Term Incentive Plans ('LTIP')
The Company's 2002 Long-Term Incentive Plan, approved by shareholders at the 2002 AGM, reached the end of its ten-year life in 2012 and shareholders gave their approval for the introduction of a new Long-Term Incentive Plan at the 2012 AGM. The LTIP allows for conditional awards with a maximum face value of up to 100% of base salary with a performance condition based on EPS.

Deferred Share Bonus Plan ('DSBP')
Executive directors and other senior management are eligible to participate in the Company's Deferred Share Bonus Plan which promotes greater alignment with shareholders through an award of deferred shares. The DSBP allows for conditional awards with a face value of up to 50% of base salary with a performance condition based on EBIT (Earnings before interest and tax). The deferred bonus award vests on the second anniversary of the date of grant. The shares to satisfy the deferred bonus will be purchased by a trust on behalf of the Group and so the DSBP 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.

Save As You Earn Plans ('SAYE')
The Company operates a number of SAYE plans, which are open to all employees. Employees pay a fixed amount from salary into a savings account each month and may 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 income tax, for share-based payment transactions with employees was £2.9 million (2011: £1.9 million); the entire charge relates to subsidiaries.

Options outstanding at the end of the year
Outstanding awards granted prior to 2010 have been restated for the 1 to 10 share consolidation in 2010.

The outstanding LTIPs (exercise price £1 per individual grant) 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	SAYE	
	Number (m)	Number (m)	Number (m)	Weighted average exercise price (p)
Outstanding at 1 January 2011	2.9	1.2	2.0	223.4
Adjusted during the year	–	(0.2)	–	–
Forfeited during the year	(0.2)	(0.2)	(0.3)	308.8
Exercised during the year	(1.5)	–	(0.8)	196.0
Granted during the year	0.8	0.6	1.0	186.5
Outstanding at 31 December 2011	2.0	1.4	1.9	199.0
At 1 January 2012	**2.0**	**1.4**	**1.9**	**199.0**
Adjusted during the year	**–**	**0.2**	**–**	**–**
Forfeited during the year	**–**	**–**	**(0.4)**	**231.4**
Exercised during the year	**(0.6)**	**–**	**–**	**–**
Granted during the year	**0.8**	**0.6**	**–**	**–**
Outstanding at 31 December 2012	**2.2**	**2.2**	**1.5**	**190.0**
Exercisable at the end of the period	**–**	**–**	**–**	**–**

Share options outstanding at the end of the year had a weighted average remaining contractual life of 6.4 years (2011: 3.6 years).

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19 Employee benefits continued

(b) Share-based payments continued

Fair value of options granted during the year

The fair value of options granted are calculated using the Black-Scholes option pricing model. The aggregate fair value of options granted during the year was £2.7 million (2011: £3.2 million). The assumptions used in valuing the grants were:

	2012	2011
Expected volatility	**20%**	20%
Expected life (years)	**2.7 – 5.0**	2.7 – 5.0
Risk-free interest rate	**2.1%**	3.6%
Expected dividend yield	**2%**	2%

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.

20 Share capital

	2012		2011	
	Number (millions)	**Nominal value £m**	Number (millions)	Nominal value £m
Issued share capital				
Shares in issue at beginning of year – Ordinary shares of 50p each, fully paid	**64.7**	**32.4**	63.5	31.7
Issued in year (see below)	**0.8**	**0.4**	1.2	0.7
Shares in issue at end of year – Ordinary shares of 50p each, fully paid	**65.5**	**32.8**	64.7	32.4

The Company's issued share capital comprised 65,544,306 ordinary shares of 50 pence each.

On 4 April 2012, the Company issued 634,767 shares in respect of the exercise of options granted under the 2009 LTIP.

The Company announced on 24 May 2012 that shareholders had, pursuant to the Scrip Dividend Scheme, elected to receive 133,133 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 2011, and a further 65,681 ordinary shares on 26 October 2012 in lieu of cash in respect of all or part of their interim dividend for the year ended 31 December 2012.

During the year, the Company issued 3,800 shares on exercise of options granted under the 2008 3-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 19. Details of the performance conditions and the options granted to executive directors are given in the Directors' remuneration report.

21 Contingent liabilities

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Under guarantees of bank overdrafts to subsidiary companies	**–**	–	**1.7**	1.6

Group
There are contingent liabilities in respect of:

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

It is not anticipated that any material liabilities will arise from the contingent liabilities other than those provided for (Note 18).

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 United Kingdom. At 31 December 2012, the potential liability was £51.9 million (2011: £52.9 million) as disclosed in Note 19.

22 Other financial commitments
Group
Operating lease commitments

	2012		2011	
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 expiring:				
No later than one year	**4.3**	**3.6**	4.8	2.8
Between one and five years	**7.1**	**3.4**	9.5	4.3
Later than five years	**7.5**	**–**	8.3	–
	18.9	**7.0**	22.6	7.1

	Land and buildings	
Leases as lessor	**2012 £m**	2011 £m
Future aggregate minimum lease income under non-cancellable leases expiring:		
No later than one year	**0.6**	0.9
Between one and five years	**0.5**	1.0
	1.1	1.9

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 under non-cancellable operating leases.

Company
The Company does not have any other financial commitments (2011: £Nil).

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

	Activity	Percentage of equity held	Country of incorporation
Subsidiary undertakings			
ClerkMaxwell Ltd	Engineering and Design Services	100	UK
Costain Ltd	Engineering, Construction and Maintenance	100	UK
Costain Abu Dhabi Co WLL	Process Engineering	49	UAE
Costain Building & Civil Engineering Ltd	Engineering and Construction	100	UK
Costain Engineering & Construction Ltd	Holding and Service Company	100	UK
Costain Oil, Gas & Process Ltd	Process Engineering	100	UK
Promanex (Civils & Industrial Services) Ltd	Support Services	100	UK
Promanex (Construction & Maintenance Services) Ltd	Support Services	100	UK
Promanex (Total FM & Environmental Services) Ltd	Support Services	100	UK
Richard Costain Ltd	Service Company	100	UK

	Activity	Issued share capital £m	Percentage of equity held	Country of incorporation	Reporting date
Jointly controlled entities					
Alcaidesa Holding SA	Land Development	10.9	50	Spain	31 December
Brighton & Hove 4Delivery Ltd	Civil Engineering	–	49	UK	31 March
4Delivery Ltd	Civil Engineering	–	40	UK	31 March
Associates					
Severn Trent Costain Holdings Ltd	Asset Management	0.5	20	UK	31 March
Severn Trent Costain Services Ltd	Asset Management	–	20	UK	31 March
Severn Trent Costain Ltd	Asset Management	–	40	UK	31 March
Integrated Bradford LEP Ltd	Construction and Operation of Schools	–	40	UK	31 December
Lewisham Schools for the Future LEP Ltd	Construction and Operation of Schools	0.1	40	UK	31 March
Lewisham Schools for the Future SPV 3 Ltd	Construction and Operation of Schools	–	40	UK	31 March
Lewisham Schools for the Future SPV 4 Ltd	Construction and Operation of Schools	–	40	UK	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.

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.

All undertakings operate mainly in the country of incorporation, with the exception of Costain Building & Civil Engineering Ltd, which operates outside the United Kingdom.

All holdings are of ordinary shares except Richard Costain Ltd, where Costain Group PLC holds 100% of the ordinary and preference shares.

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

A full list of Group companies will be included in the Company's annual return.

	Activity	Percentage of equity held	Country of incorporation
Major jointly controlled operations			
A-one+ Integrated Highway Services – MAC 7	Engineering & Maintenance	33	UK
A-one+ Integrated Highway Services – MAC 10	Engineering & Maintenance	25	UK
A-one+ Integrated Highway Services – MAC 12	Engineering & Maintenance	33	UK
A-one+ Integrated Highway Services – MAC 14	Engineering & Maintenance	33	UK
Costain-Carillion Joint Venture – M1 Widening and A5/M1 Link	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – Bond Street station	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – Farringdon station	Civil Engineering	50	UK
Costain-Hochtief Joint Venture – Reading station	Civil Engineering	50	UK
Costain-Skanska C405 Joint Venture – Paddington – Crossrail	Civil Engineering	50	UK
Costain-Skanska C411 Joint Venture – Bond Street – Crossrail	Civil Engineering	50	UK
Educo UK Joint Venture – Bradford Schools	Construction	50	UK
Galliford-Costain-Atkins Joint Venture – United Utilities	Civil Engineering	42	UK
Lafarge Costain Joint Venture	Civil Engineering	50	UK

24 Acquisitions

There were no acquisitions during the year and there were no changes to the acquisition fair values of ClerkMaxwell Limited and Promanex Group Holdings Limited disclosed in the 2011 financial statements.

25 Related party transactions

Group

A related party relationship exists with its major shareholders, subsidiaries, joint ventures and associates, jointly controlled operations, The Costain Pension Scheme and with its directors and executive officers.

Sales of goods and services

	2012			2011		
	Joint ventures and associates £m	**Jointly controlled operations £m**	**Total £m**	Joint ventures and associates £m	Jointly controlled operations £m	Total £m
Services of Group employees	**20.6**	**61.9**	**82.5**	23.9	59.6	83.5
Construction services and materials	**41.0**	**3.2**	**44.2**	46.7	2.9	49.6
	61.6	**65.1**	**126.7**	70.6	62.5	133.1

There were no sales of goods and services to major shareholders during the year (2011: £Nil).

An amount due from a major shareholder has been fully provided against since 2006. It relates to work carried out under a subcontract. Discussions among all the parties continue but recovery is uncertain.

Balances with joint ventures and associates are disclosed in Notes 14 and 17. Balances with jointly controlled operations are eliminated on consolidation.

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25 Related party transactions continued

Major shareholders
Mohammed Abdulmohsin Al-Kharafi & Sons Co. W.L.L. and UEM Builders Berhad are regarded as related parties of the Company.

The Costain Pension Scheme
Details of transactions between the Group and The Costain Pension Scheme are included in Note 19.

Transactions with key management personnel
The directors of the Company and their immediate relatives control 383,292 ordinary shares in Costain Group PLC, which expressed as a percentage of the issued share capital is 0.6% (2011: 0.4%) 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, DSBP and SAYE plans, which are detailed in Note 19.

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

	Group	
	2012 £m	2011 £m
Directors' emoluments	**1.4**	1.6
Executive officers' emoluments	**2.1**	2.1
Post retirement benefits	**0.3**	0.4
Termination benefits	**0.2**	–
Share-based payments	**1.1**	0.9
	5.1	5.0

The above amounts are included in employee benefit expense (Note 5).

Company
The Company has no transactions with related parties other than the charge in relation to share-based payments (Note 19) (2011: none).

Five-year financial summary

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Revenue and profit					
Revenue (Group and share of joint ventures and associates)	**934.5**	986.3	1,022.5	1,061.1	996.0
Less: Share of joint ventures and associates	**(86.1)**	(117.8)	(98.0)	(67.7)	(93.4)
Group revenue	**848.4**	868.5	924.5	993.4	902.6
Group operating profit before other items	**22.3**	24.1	17.4	22.0	19.5
Other items:					
Amortisation of acquired intangible assets	**(1.7)**	(0.9)	–	–	–
Employment related deferred consideration	**(1.7)**	(0.7)	–	–	–
Group operating profit	**18.9**	22.5	17.4	22.0	19.5
Profit on sales of investments	**–**	0.5	–	–	–
Profit on sales of interests in joint ventures and associates	**10.5**	0.3	11.2	2.0	2.7
Profit on sale of land and property	**–**	–	1.3	–	–
Share of results of joint ventures and associates	**(1.4)**	(1.3)	(0.5)	(3.2)	(3.9)
Profit from operations	**28.0**	22.0	29.4	20.8	18.3
Finance income	**27.3**	34.1	30.7	26.0	34.8
Finance expense	**(29.2)**	(32.2)	(32.2)	(28.7)	(30.0)
Net finance(expense)/income	**(1.9)**	1.9	(1.5)	(2.7)	4.8
Profit before tax	**26.1**	23.9	27.9	18.1	23.1
Income tax	**(1.9)**	(5.2)	(4.8)	(3.5)	(4.9)
Profit for the year attributable to equity holders of the parent	**24.2**	18.7	23.1	14.6	18.2
Earnings per share – basic*	**37.1p**	29.2	36.4p	23.0p	29.0p
Earnings per share – diluted*	**35.8p**	28.2	35.4p	22.6p	29.0p
Dividends per ordinary share					
Final*	**7.25p**	6.75p	6.25p	5.5p	5.0p
Interim*	**3.50p**	3.25p	3.0p	2.75p	2.5p
Summarised consolidated statement of financial position					
Intangible assets	**18.7**	20.3	0.1	1.0	1.8
Property, plant and equipment	**9.1**	11.4	9.7	11.5	7.7
Investments in equity accounted joint ventures and associates	**40.4**	42.9	37.4	44.1	42.7
Other non-current assets	**34.9**	33.8	39.8	47.3	24.9
Total non-current assets	**103.1**	108.4	87.0	103.9	77.1
Current assets	**290.6**	332.0	309.3	325.1	329.2
Total assets	**393.7**	440.4	396.3	429.0	406.3
Current liabilities	**303.1**	348.3	311.4	320.5	312.1
Retirement benefit obligations	**51.9**	52.9	39.6	104.7	50.2
Other non-current liabilities	**6.9**	8.4	7.7	7.6	10.4
Total liabilities	**361.9**	409.6	358.7	432.8	372.7
Equity attributable to equity holders of the parent	**31.8**	30.8	37.6	(3.8)	33.6

* The figures for 2008 and 2009 have been restated for the 1 for 10 share consolidation in 2010.

Other information

Financial calendar and other shareholder information

Financial calendar*

Full year results	6 March 2013
Annual Report mailing	28 March 2013
Ex-dividend date for final dividend	17 April 2013
Final dividend record date	19 April 2013
Interim Management Statement	8 May 2013
Annual General Meeting	8 May 2013
Final dividend payment date (subject to shareholder approval)	24 May 2013
Half-year end	30 June 2013
Half-year results 2013	22 August 2013
Ex-dividend date for interim dividend	18 September 2013
Interim dividend record date	20 September 2013
Interim dividend payment date	25 October 2013
Interim Management Statement	October 2013
Financial year-end	31 December 2013

* The financial calendar may be updated from time to time throughout the year. Please refer to our website **www.costain.com** for up-to-date details.

Scrip dividend scheme

Subject to approval at the 2013 Annual General Meeting, 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 02 May 2013. Copies of the mandate form and the scrip dividend brochure can be downloaded from the Company's website at **www.costain.com** or obtained from Equiniti by telephoning 0871 384 2268** or +44 121 415 7173 if calling from outside the United Kingdom.

Analysis of shareholders

	Accounts	Shares	%
Institutions, companies, individuals and nominees:			
Shareholdings 100,000 and more	65	55,023,617	83.95
Shareholdings 50,000-99,999	38	2,610,553	3.98
Shareholdings 25,000-49,999	35	1,207,824	1.84
Shareholdings 5,000-24,999	316	3,237,299	4.94
Shareholdings 1-4,999	10,877	3,465,013	5.29
Totals	11,331	65,544,306	100

Secretary

Tracey Wood

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Company Number 1393773

Registrar

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

Telephone 0871 384 2250** or +44 121 415 7047 if calling from outside the United Kingdom.

Shareholder information

The Company's Registrar is Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. For enquiries regarding your shareholding, please telephone 0871 384 2250** (or +44 121 415 7047 if calling from outside the United Kingdom). You can also view up to date information about your holdings by visiting the shareholder website at **www.shareview.co.uk** (see page 123 for further details). Please ensure that you advise Equiniti promptly of a change of name or address.

** Calls to 0871 numbers cost 8p per minute plus network extras. Lines are open Monday to Friday 8.30am to 5.30pm, 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 to 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 0871 384 2250** (+44 121 415 7047 if calling from outside the United Kingdom) who will be pleased to assist you and can also be obtained via the shareholder website at **www.shareview.co.uk** (see below for further details. Alternatively, you will find one attached to the tax voucher 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 **www.shareview.com/overseas**

Shareview service

The Shareview service from our Registrar, Equiniti, gives shareholders:

- 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 tax voucher electronically. Instead of receiving the paper tax voucher, you will be notified by email with details of how to download your electronic version. Visit the website at **www.shareview.co.uk** for more details. Details of software and equipment requirements are given on the website.

**Calls to 0871 numbers cost 8p per minute plus network extras. Lines are open Monday to Friday 8.30am to 5.30pm, excluding UK bank holidays.

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 **www.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 **www.sharegift.org**. Equiniti can provide stock transfer forms on request. Donating shares to charity in this way gives rise neither to a gain nor a loss for Capital Gains Tax purposes. This service is completely free of charge.

Other information
Contact us

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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. A feedback response box has been provided on the Annual Report microsite to enable you to comment.

Website links:
www.costain.com
www.costain.com/investors
www.costain.com/responsibility
www.costain.com/annual-report-2012
www.costain.com/news

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Costain photographers: Mike Doherty, front cover and page 124 (Catherine Warbrick), pages 1, 10, 11 (Bidston Moss Viaduct), pages 49 and 124 (Tracey Wood); Phil Starling, front cover (Dave Johnson and Shuly Choudhury), pages 1 and 8 (Dave Johnson), pages 1 and 10 (Oliver O'Brien), pages 1 and 12 (Winny Oshodi), page 4 (Great Ormond Street Hospital), page 5 (Investor Relations Society Award); Ed Tyler, pages 6, 14, 44, 49, 51 (Costain Board Directors), page 124 (Graham Read); Ian Routledge, pages 48, 49, (Costain Board Directors); and Gustavo Ferrari, Pro Light Studio, page 49 (Samer G. Younis).

Additional photography: Matt Aston, pages 1, 8, 9 (Reading Station); Courtesy of Curtis Photography and Southern Water, page 26 (cleaner seas to Sussex); Darren Ruane, page 27 (M1 Junction 10-13 scheme); Brian Sherwen, www.briansherwen.co.uk page 32 (Bridges to schools event); and Tandem TV & Film, page 35 (Achieving Excellence Awards).

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This Annual Report is available at **www.costain.com**

Visit www.costain.com

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